

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

**FINANCIAL STATEMENTS  
With Independent Auditor's Report**

**YEARS ENDED JUNE 30, 2013 and 2012**

**TABLE OF CONTENTS**

	Page
<b>INDEPENDENT AUDITOR’S REPORT</b> .....	1
<b>REQUIRED SUPPLEMENTARY INFORMATION</b>	
Management Discussion and Analysis .....	3
<b>BASIC FINANCIAL STATEMENTS</b>	
Statements of Net Position .....	9
Statements of Revenues, Expenses and Changes in Net Position .....	10
Statements of Cash Flows .....	11
<b>NOTES TO FINANCIAL STATEMENTS</b> .....	13
<b>SUPPLEMENTAL INFORMATION</b>	
Statement of Revenues and Expenses, Actual to Budget – Current Year.....	22
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i> .....	23
Independent Auditor’s Report on Compliance with Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance with OMB Circular A-133 .....	25
Schedule of Expenditures of Federal Awards.....	27
Schedule of Findings and Questioned Costs .....	28
Summary Schedule of Prior Audit Findings.....	29



## INDEPENDENT AUDITOR'S REPORT

Board of Directors  
Paducah McCracken Joint Sewer Agency  
Paducah, Kentucky

### **Report on the Financial Statements**

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, 2013 and 2012, 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 opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

### ***Opinions***

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, 2013 and 2012, and the respective changes in financial position, and, where applicable, 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 the management's discussion and analysis pages 3 through 8 and budgetary comparison information on page 22 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 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 also not a required part of the financial statements.

The schedule of expenditures of federal awards 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 schedule of expenditures of federal awards 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 September 20, 2013, on our consideration of the Paducah McCracken County 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 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.

*Kempner CPA Group LLP*

Certified Public Accountants and Consultants  
Paducah, Kentucky  
September 20, 2013

**REQUIRED SUPPLEMENTARY 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, 2013.

### **Financial Highlights**

- Net position increased \$2.5 million (4.5%) as a result of FY 2013 operations
- Capital assets increased \$5.4 million (9.4%) over the prior fiscal year
- Operating revenues came in \$75 thousand ahead of budget
- Operating expenses finished \$353 thousand less than budget including \$168,000 less than budgeted depreciation
- Debt service coverage ratios remain well above the level of compliance

### **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 and expenses generated and 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)

	<u>FYE</u> <u>6/30/13</u>	<u>FYE</u> <u>6/30/12</u>	<u>Dollar</u> <u>Change</u>	<u>Percent</u> <u>Change</u>
<b>Assets</b>				
Current assets	\$ 13,071	\$ 12,461	\$ 610	4.9%
Capital assets	62,655	57,276	5,379	9.4%
Restricted funds	1,731	3,481	(1,750)	-50.3%
Deferred charges & other	<u>154</u>	<u>140</u>	<u>14</u>	10.0%
Total assets	<u>77,611</u>	<u>73,358</u>	<u>4,253</u>	5.8%
<b>Liabilities &amp; net position</b>				
Current liabilities	1,948	2,332	(384)	-16.5%
Noncurrent liabilities	<u>17,818</u>	<u>15,669</u>	<u>2,149</u>	13.7%
Total liabilities	<u>19,766</u>	<u>18,001</u>	<u>1,765</u>	9.8%
Invested in capital assets, net	44,126	40,912	3,214	7.9%
Restricted	1,731	3,481	(1,750)	-50.3%
Unrestricted	<u>11,988</u>	<u>10,964</u>	<u>1,024</u>	9.3%
Total net position	<u>\$ 57,845</u>	<u>\$ 55,357</u>	<u>\$ 2,488</u>	4.5%

### Net Position

The JSA's total net position increased by \$2.5 million in FY 2013 to \$57.8 million. The change in net assets reflects the JSA's ongoing initiative to enhance and rebuild 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.

### Capital Assets and Long-Term Debt Activity

At the close of FY 2013, the JSA had nearly \$62.7 million in undepreciated cost of total capital assets. Capital assets increased \$5.4 million during FY 2013 due to the purchase of capital assets, the completion of capital projects and the contribution of assets to the JSA by private developers. During FY 2011, the JSA began constructing a two-phase, multi-year project, named the Massac Creek Interceptor, Force Main and Pump Station Project. Phase I of this project was placed in service during December, 2012 at a total cost of \$9.1 million. To date, \$13.2 million has been expended on this project, including federal and state awards.

Total liabilities increased during FY 2013 by almost \$1.8 million or 9.8% over FY 2012. JSA secured a \$10 million loan from the Kentucky Infrastructure Authority (KIA) during FY 2011 to aid in financing the Massac Creek Project. This is a construction-type loan where the liability is recorded as money is received from KIA and interest-only is currently due on that money. Principal payments have not yet begun on that liability. During FY 2013, JSA converted a \$4.3 million loan from Kentucky Rural Water Finance Corporation (RW) to bonds purchased by United States Department of Agriculture Rural Development (RD) for the Massac Creek Project. Interest payments began January 2013 with principal payments commencing January 2014.

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

	<b>FYE</b> <b>6/30/13</b>	<b>FYE</b> <b>6/30/12</b>	<b>Dollar</b> <b>Change</b>	<b>Percent</b> <b>Change</b>
<b>Revenues</b>				
Operating revenues	\$ 6,971	\$ 6,807	\$ 164	2.4%
Non-operating revenues	<u>405</u>	<u>293</u>	<u>112</u>	38.2%
Total revenues	<u>7,376</u>	<u>7,100</u>	<u>276</u>	3.9%
<b>Expenses</b>				
Depreciation	2,299	2,100	199	9.5%
Operating expenses	4,189	4,114	75	1.8%
Non-operating expenses	<u>192</u>	<u>176</u>	<u>16</u>	9.1%
Total expenses	<u>6,680</u>	<u>6,390</u>	<u>290</u>	4.5%
<b>Contributions</b>	<u>1,793</u>	<u>1,037</u>	<u>756</u>	72.9%
<b>Change in net position</b>	<b>2,489</b>	<b>1,748</b>	<b>741</b>	<b>42.4%</b>
Beginning net position	<u>55,356</u>	<u>53,608</u>	<u>1,748</u>	3.3%
<b>Ending net position</b>	<b>\$ 57,845</b>	<b>\$ 55,356</b>	<b>\$ 2,489</b>	<b>4.5%</b>

### 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 finished \$75 thousand ahead of budget for FY 2013. Sewer charges comprise the bulk of operating revenues and are billed based on customer water consumption. These charges came in \$68 thousand over budget, while the remainder of operating revenues came in \$7 thousand over budget. Operating expenses came in under budget for the fiscal year finishing \$353 thousand below estimate. Net non-operating revenue for FY 2013 was more than the budgeted amount mainly due to construction period interest being capitalized rather than expensed during the fiscal year. JSA finished the fiscal year with a \$695 thousand increase in net position before capital contributions.

### Results of Operations

Overall revenues totaled \$7.4 million for FY 2013, an increase of \$276 thousand or 3.9% from FY 2012. Total expenses increased \$290 thousand over FY 2012 to nearly \$6.7 million. The largest contributing factor to the increase in expenses was depreciation resulting from the capitalization of large projects during the fiscal year and the capitalization of interest to those projects.

EXHIBIT 3: Detail of Operating Expenses

<b>Operating Expenses (in thousands)</b>	<b>FYE 6/30/13</b>	<b>FYE 6/30/12</b>	<b>Dollar Change</b>	<b>Percent Change</b>
Salaries and benefits	\$ 2,179	\$ 2,107	\$ 72	3.4%
Chemicals, testing & solids disposal	309	293	16	5.5%
Utilities	653	587	66	11.2%
Material, supplies and repairs	435	537	(102)	-19.0%
Fleet expense	127	139	(12)	-8.6%
Professional fees	153	115	38	33.0%
Billing, collection and bad debts	143	139	4	2.9%
All other	190	197	(7)	-3.6%
<b>Total</b>	<b>\$ 4,189</b>	<b>\$ 4,114</b>	<b>\$ 75</b>	<b>1.8%</b>

**Salaries and Benefits**

Salaries and benefits comprise the bulk of operating expenses. Benefits total 51% of actual wages, with health insurance comprising 40% of the benefits cost. While pension funding has risen over the past several years, it remained steady during FY 2013 costing the Agency \$271 thousand, or 37% of total benefits. Employees received annual wage increases during FY 2013 and 2012.

**Other Operating Expenses**

Chemicals, testing and solids disposal showed a \$16 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.

The largest component of utilities expense is electricity costs. The budget for electricity was \$496 thousand with actual costs totaling \$523 thousand. Electricity costs vary from year to year based on flows received and pumped. Other factors can have a large impact on electricity usage, such as the methane burning engine in use at the Paducah Wastewater Treatment Plant. When this large engine is offline, more electricity is consumed. Most utility rates have been impacted by rate increases over the last few years, and will most likely continue to do so, making the budgeting process difficult.

Materials, supplies and repairs are ordinary and necessary costs incurred to keep the sewer utility process in good working order. The FY 2013 budget for materials, supplies and repairs was \$530 thousand resulting in a positive variance of \$95 thousand. This is due to successful preventive maintenance programs as well as a reduction of higher-cost dig and repairs.

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. Repairs were made as follows:

EXHIBIT 4: Repairs by Department (in thousands)

<b>Department</b>	<b>FYE 2013</b>	<b>FYE 2012</b>	<b>Dollar Change</b>	<b>Percent Change</b>
Collection System (pipes)	\$ 159	\$ 224	\$ (65)	-29.0%
Lift Stations (pipes & pumps)	54	80	(26)	-32.5%
Treatment Plants (pipes, pumps & motors)	43	39	4	10.3%
<b>Total</b>	<b>\$ 256</b>	<b>\$ 343</b>	<b>\$ (87)</b>	<b>-25.4%</b>

Fleet expense declined \$12 thousand, or 8.6%, over the prior fiscal year. The JSA maintains a vehicle replacement program to cull the aging fleet and attempt to minimize extensive repair costs. Fleet expense finished \$23 thousand less than budget for the current fiscal year.

FY 2013 professional fees were \$38 thousand higher than in FY 2012. This is due to litigation with a developer that arose during the fiscal year. The budget for professional fees was \$89 thousand for FY 2013.

Paducah Water provides billing and collection services. Bad debt write offs finished better than expected at 0.60% of sewer charges.

All other expenses totaled \$190 thousand for FY 2013 and included costs for insurance, office, safety, training and miscellaneous expenses. The budget for all other expenses was \$211 thousand. While most expenses included in this category finished near budget, safety came in almost \$6 thousand less than budget, and miscellaneous expense finished \$17 thousand under budget. A portion of the safety expense is paid to a third party provider and fluctuates based on the working environment and safety conditions encountered. Miscellaneous expense can vary widely due to insurance claims, grant fees, legal advertising and certain travel expenses.

### **Debt Service Coverage**

Debt service coverage ratio is an indicator of the JSA's ability to meet its debt obligations. The JSA Board strives to maintain a minimum debt service coverage ratio of 1.3 times the required debt service payments. For purposes of this calculation, gross revenues include investment income, grant revenues and connection fees, but exclude the deduction for depreciation expense. The JSA is exceeding the minimum level of net revenue equal to 1.3 times of the required debt service payments. The JSA's debt service coverage ratio was 3.82 in 2013 and 2.95 in 2012.

### **Relevant Current Economic Factors and Other Significant Matters**

Regional economic trends that affect the financial condition of the JSA have remained sluggish throughout this fiscal year. New home construction was slow which is representative of the current U.S. market.

Investment returns have continued to show significant declines. These returns will fluctuate with adjustments in interest rates, due to the nature of our investments.

The Paducah McCracken Joint Sewer Agency entered into a Consent Judgment with the Kentucky Environmental and Public Protection Cabinet in September 2007 to bring combined and sanitary sewer overflows into compliance with Federal and State guidelines. The Agency will be bound by this Judgment for many years to come and will incur costs to bring the system into compliance that can only be determined as solutions to the issues are proposed and approved by the Cabinet as outlined in the Consent Judgment. The total cost of complying with this Consent Judgment has not been determined, but will be significant. As a result, future rate increases may be necessary to achieve compliance. 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 continues to pursue alternative means of funding in the form of grants and low-interest loans to aid in the funding of JSA's capital expenditures. The JSA has been successful in securing \$10.2 million in grants from the Kentucky Infrastructure Authority (KIA) and the United States Department of Agriculture (USDA) Rural Development since FY 2005. JSA was also awarded a \$100 thousand grant from Delta Regional Authority and expended \$100 thousand of those funds during FY 2013. 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, 2013 and 2012**

	<b>2013</b>	<b>2012</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 4,311,660	\$ 3,884,724
Investments and accrued interest	6,845,778	6,664,947
Customer accounts receivable	385,096	337,842
Grants and other receivables	659,439	691,700
Accrued unbilled revenue	544,000	566,000
Inventories and prepaid expenses	324,669	315,483
<b>Total Current Assets</b>	13,070,642	12,460,696
<b>NON-CURRENT ASSETS</b>		
Utility Plant and Capital assets, net	62,654,717	57,276,509
Restricted assets, investments and accrued interest	1,731,224	3,481,096
Bond discount - net	149,605	130,799
Notes receivable	4,755	8,918
<b>Total Noncurrent Assets</b>	64,540,301	60,897,322
<b>TOTAL ASSETS</b>	77,610,943	73,358,018
<b>LIABILITIES</b>		
<b>CURRENT LIABILITIES</b>		
Notes and bonds payable	711,288	695,319
Accounts payable	1,050,266	1,156,137
Salaries and benefits payable	102,320	74,909
Other current liabilities	84,127	405,685
<b>Total Current Liabilities</b>	1,948,001	2,332,050
Non-Current Liabilities		
Notes and bonds payable	17,818,151	15,669,545
<b>Total Noncurrent Liabilities</b>	17,818,151	15,669,545
<b>TOTAL LIABILITIES</b>	19,766,152	18,001,595
<b>NET POSITION</b>		
Invested in capital assets, net of related debt	44,125,276	40,911,646
Restricted for:		
Debt service	1,731,224	2,075,365
Capital Projects	-	1,405,730
Unrestricted - net assets	11,988,291	10,963,682
<b>TOTAL NET POSITION</b>	\$ 57,844,791	\$ 55,356,423

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**  
**For the Years ended June 30, 2013 and 2012**

	<b>2013</b>	<b>2012</b>
<b>Operating Revenues</b>		
Charges for service	\$ 6,971,035	\$ 6,807,438
<b>Operating Expenses</b>		
Salaries, wages and benefits	2,179,431	2,107,174
Chemicals, testing and solid disposal	309,472	293,386
Utilities	653,216	587,107
Materials, supplies and repairs	434,821	536,854
Fleet expense	126,952	138,960
Liability insurance	104,406	104,197
Training, safety and dues	42,173	40,403
Professional fees	152,963	115,017
Office expense	15,753	13,601
Public education	750	3,289
Billing and collections	101,345	94,079
Bad debts	41,310	44,863
Board of directors expense	16,800	16,800
Miscellaneous	10,098	18,450
Depreciation	2,299,209	2,099,806
	6,488,699	6,213,986
<b>Operating Income (Loss)</b>	482,336	593,452
<b>Non-operating Revenues (Expenses)</b>		
Investment income	34,398	52,590
Interest expense	(163,235)	(145,660)
Amortization	(12,120)	(11,153)
Gain (loss) on sale of assets	(16,186)	(19,216)
Tap-on and assessment fees	335,696	203,140
Other, net	34,479	37,566
Total non-operating revenue (expenses), net	213,032	117,267
Change in net position before capital contributions	695,368	710,719
<b>Capital Contributions</b>		
Grant revenue	1,144,980	745,443
Contributions from developers	648,020	291,840
	1,793,000	1,037,283
<b>Change in Net Position</b>	2,488,368	1,748,002
<b>Net Position, Beginning</b>	55,356,423	53,608,421
<b>NET POSITION, ENDING</b>	\$ 57,844,791	\$ 55,356,423

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

**PADUCAH McCracken Joint Sewer Agency**  
**Statements of Cash Flows**  
For the Years ended June 30, 2013 and 2012

	<b>2013</b>	<b>2012</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Collections from customers	\$ 6,904,471	\$ 6,726,111
Cash paid to suppliers	(2,373,103)	(2,057,080)
Cash paid to employees	(2,152,020)	(2,154,586)
<b>NET CASH PROVIDED BY (USED IN)</b>		
<b>OPERATING ACTIVITIES</b>	2,379,348	2,514,445
 <b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Contributed capital	1,144,980	745,443
Tap-on fees and assessments	335,696	203,141
Acquisition of capital assets	(6,719,558)	(7,074,098)
Proceeds from the sale of fixed assets	2,862	16,202
Transfers from restricted funds	36,426	1,097,482
Proceeds from debt issues	7,183,894	608,637
Principal payments on long term debt	(5,019,318)	(731,237)
Interest payments on long term debt	(475,936)	(574,645)
Other, net	(30,254)	37,569
<b>NET CASH PROVIDED BY (USED IN) CAPITAL</b>		
<b>AND RELATED FINANCING ACTIVITIES</b>	(3,541,208)	(5,671,506)
 <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from sales and maturities of investments	10,714,972	12,653,773
Purchases of investments	(9,168,582)	(8,380,091)
Investment earnings	42,406	58,368
<b>NET CASH PROVIDED BY (USED IN)</b>		
<b>INVESTING ACTIVITIES</b>	1,588,796	4,332,050
 <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	426,936	1,174,989
 <b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	3,884,724	2,709,735
 <b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	\$ 4,311,660	\$ 3,884,724

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

**PADUCAH McCRACKEN JOINT SEWER AGENCY**  
**STATEMENTS OF CASH FLOWS (CONTINUED)**  
**For the Years ended June 30, 2013 and 2012**

	<b>2013</b>	<b>2012</b>
<b>RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES</b>		
Operating income	\$ 482,336	\$ 593,452
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	2,299,209	2,099,806
Change in assets and liabilities:		
Accounts receivable	(14,993)	(11,464)
Accrued unbilled revenue	22,000	(25,000)
Inventory and prepaid expenses	(9,186)	(180,737)
Accounts payable	(105,871)	65,443
Salaries and benefits payable	27,411	(47,412)
Other current liabilities	(321,558)	20,357
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>\$ 2,379,348</b>	<b>\$ 2,514,445</b>

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

**PADUCAH McCracken JOINT SEWER AGENCY  
NOTES TO FINANCIAL STATEMENTS**

**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 the 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 Paducah McCracken Joint Sewer Agency maintains its books and these financial statements are presented on the accrual basis of accounting. Proprietary funds are accounted for 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 present 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 in which the liability is incurred.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and delivering goods in connection with a proprietary fund’s ongoing operations. The principal operating revenues of the Agency are charges for sewer service. Operating expenses for proprietary funds 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. 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**

The Agency adopted formal deposit and investment policies in 1999. These policies apply to all Agency funds not contained in public trusts.

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.

**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.

**PADUCAH McCRACKEN JOINT SEWER AGENCY  
NOTES TO FINANCIAL STATEMENTS**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Notes Receivable**

Notes receivable represent balances due from customers in developed areas/subdivisions that have elected to pay their sewer service tap-on fee in installments. The Agency charges new customers an initial fee to connect to the system. That fee is paid upon connection, or the customer in developed areas/subdivisions may elect to spread the payment over ten years. The monthly installments include six percent interest. The Agency obtains a lien against the property until the tap-on fee is satisfied.

**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 developers, when they construct and pay for sewer lines and then donate these additions to the Agency, and 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.

**Reclassifications**

Certain accounts in the prior-year financial statements have been reclassified for comparative purposes to conform to presentation in the current-year financial statements.

**NOTE B - RESTRICTED FUNDS**

Restricted funds consist of certificates of deposit and other securities, which have been set aside for the repayment of bonds and notes or 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.

**PADUCAH McCracken JOINT SEWER AGENCY  
NOTES TO FINANCIAL STATEMENTS**

**NOTE B - RESTRICTED FUNDS (Continued)**

At June 30, 2013, these restricted funds were comprised of the following investments:

	<u>2013</u>	<u>2012</u>
Certificates of deposit – various financial institutions	\$ 1,201,171	\$ 1,430,288
U.S. Government money market funds	-	482,473
U.S. Government treasury obligations	<u>530,053</u>	<u>1,568,335</u>
<b>TOTAL</b>	<u>\$ 1,731,224</u>	<u>\$ 3,481,096</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**

**Deposits**

**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. Deposits are 100% secured with collateral valued at market or par, whichever is lower. 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 year ended June 30, 2013 and 2012, the Agency’s investments include U.S. government money market funds, short-term treasury obligations, demand deposits and certificates of deposit. The carrying amount, including restricted cash, was \$12,888,662 and \$14,030,766, respectively. The bank balance was \$12,348,426 and \$12,671,462, respectively. As of June 30, 2013 and 2012, the Agency’s bank balance was as follows:

	<u>2013</u>	<u>2012</u>
Balance covered by FDIC insurance	\$ 6,885,011	\$ 7,167,868
Uninsured and collateral held by pledging bank or bank trust department or agent but not in the Agency’s name	5,463,415	5,503,594
Uninsured and uncollateralized	<u>-</u>	<u>-</u>
	<u>\$ 12,348,426</u>	<u>\$ 12,671,462</u>

**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.

**PADUCAH McCRACKEN JOINT SEWER AGENCY  
NOTES TO FINANCIAL STATEMENTS**

**NOTE D - CONSTRUCTION IN PROGRESS**

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

	<u>2013</u>	<u>2012</u>
Blandville West Estates Rehabilitation	\$ 792	\$ -
Bridge Street Sewer Separation	-	256,443
Chickadee Lift Station Elimination Project	144	-
Cook Street Overflow Tank	144	-
Gatewood Lift Station Elimination Project	144	-
Handrails at PWWTP	51,395	-
Friendship Road Phase II Sewer Extension	-	-
Long Term Control Plan	805,578	804,159
Massac Creek Interceptor		
Pump Station and Force Main Phase I	-	8,700,893
Pump Station and Force Main Phase II	4,136,109	405,872
Milton Pump Station Control Panel Upgrad	12,118	-
Rehab and Manhole Contract CY '11	-	2,008,019
Rehab and Manhole Contract CY '12	1,266,779	37,739
Rehab and Manhole Contract CY '13	20,229	-
Rural Development Bond Pre-Closing Costs	-	12,658
Fieldmont Pump Station Refurbishments	-	12,750
N. Friendship/Hwy 62 Sewer Extension	-	10,700
Homewood/Milliken Pump Station Refurbishment	405,253	93,704
James Marine Sewer Extension	774	-
Old Hwy 60 Extension	4,250	4,250
Storage Building	-	8,568
Wallace Park Sewer Separation	560,513	52,104
Waukeshaw Engine Rebuild	-	720
WIN 911 System and Pump Stations/WWTP	1,760	-
Woodlawn WWTP Wet Weather Upgrades	-	39,806
Video & Cleaning Contract #9	48,528	-
Capitalized Interest	144,322	322,387
McCracken County Board of Education	-	120,000
	<hr/>	<hr/>
TOTALS	<u>\$ 7,458,832</u>	<u>\$ 12,890,772</u>

Construction in progress related invoices of \$614,631 and \$549,327 were included in accounts payable at June 30, 2013 and 2012, respectively.

**PADUCAH McCracken Joint Sewer Agency  
Notes to Financial Statements**

**NOTE E - UTILITY PLANT**

Utility plant consists of the following at June 30:

	<b>2013</b>			
	<u>Balance as of June 30, 2012</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance as of June 30, 2013</u>
<b><u>Capital assets, not being depreciated:</u></b>				
Land	\$ 542,149	\$ 203,160	\$ -	\$ 745,309
Construction in progress	<u>12,890,772</u>	<u>7,178,991</u>	<u>12,610,931</u>	<u>7,458,832</u>
Total capital assets, not being depreciated:	<u>13,432,921</u>	<u>7,382,151</u>	<u>12,610,931</u>	<u>8,204,141</u>
<b><u>Capital assets, being depreciated:</u></b>				
Utility assets (pipes, pumps, plants, structures)	65,719,127	12,907,027	38,834	78,587,320
Vehicles	1,361,584	8,752	46,472	1,323,864
General plant and office furniture	<u>2,359,669</u>	<u>9,466</u>	<u>12,470</u>	<u>2,356,665</u>
Totals at historical cost	<u>69,440,380</u>	<u>12,925,245</u>	<u>97,776</u>	<u>82,267,849</u>
Less: accumulated depreciation				
Utility assets	23,294,970	1,956,256	25,948	25,225,278
General plant and office furniture	1,377,787	176,139	8,391	1,545,535
Vehicles	<u>924,035</u>	<u>166,814</u>	<u>44,389</u>	<u>1,046,460</u>
Total accumulated depreciation	<u>25,596,792</u>	<u>2,299,209</u>	<u>78,728</u>	<u>27,817,273</u>
Total capital assets, being depreciated, net:	<u>43,843,588</u>	<u>10,626,036</u>	<u>19,048</u>	<u>54,450,576</u>
<b>Total System capital assets – net:</b>	<u>\$ 57,276,509</u>	<u>\$ 18,008,187</u>	<u>\$ 12,629,979</u>	<u>\$ 62,654,717</u>

  

	<b>2012</b>			
	<u>Balance as of June 30, 2011</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance as of June 30, 2012</u>
<b><u>Capital assets, not being depreciated:</u></b>				
Land	\$ 504,906	\$ 37,243	\$ -	\$ 542,149
Construction in progress	<u>7,736,949</u>	<u>7,044,760</u>	<u>1,890,937</u>	<u>12,890,772</u>
Total capital assets, not being depreciated:	<u>8,241,855</u>	<u>7,082,003</u>	<u>1,890,937</u>	<u>13,432,921</u>
<b><u>Capital assets, being depreciated:</u></b>				
Utility assets (pipes, pumps, plants, structures)	63,567,214	2,228,542	76,629	65,719,127
Vehicles	1,301,671	122,838	62,925	1,361,584
General plant and office furniture	<u>2,527,827</u>	<u>123,625</u>	<u>291,783</u>	<u>2,359,669</u>
Totals at historical cost	<u>67,396,712</u>	<u>2,475,005</u>	<u>431,337</u>	<u>69,440,380</u>
Less: accumulated depreciation				
Utility assets	21,594,726	1,763,472	63,228	23,294,970
General plant and office furniture	1,469,475	178,076	269,764	1,377,787
Vehicles	<u>828,702</u>	<u>158,258</u>	<u>62,925</u>	<u>924,035</u>
Total accumulated depreciation	<u>23,892,903</u>	<u>2,099,806</u>	<u>395,917</u>	<u>25,596,792</u>
Total capital assets, being depreciated, net:	<u>43,503,809</u>	<u>375,199</u>	<u>35,420</u>	<u>43,843,588</u>
<b>Total System capital assets – net:</b>	<u>\$ 51,745,664</u>	<u>\$ 7,457,202</u>	<u>\$ 1,926,357</u>	<u>\$ 57,276,509</u>

**PADUCAH McCracken JOINT SEWER AGENCY  
NOTES TO FINANCIAL STATEMENTS**

**NOTE F – LONG-TERM DEBT**

Notes and bond payable consists of the following:

	<b>2013</b>	<b>2012</b>
Notes Payable		
Kentucky Infrastructure Agency	\$ 9,605,439	\$ 7,240,864
Rural Water	-	4,324,000
Bonds Payable		
Sewer Revenue Bonds, Series 2011	4,324,000	-
2010 Revenue Bonds	4,600,000	4,800,000
	18,529,439	16,364,864
Less current maturities	711,288	695,319
	<b>\$ 17,818,151</b>	<b>\$ 15,669,545</b>

Debt service requirements on notes payable and bonds payable at June 30, 2013, are as follows:

<b>Years Ending June 30,</b>	<b>Principal</b>	<b>Interest</b>	<b>Service Fee</b>	<b>R&amp;M Reserves</b>	<b>Total</b>
2014	\$ 711,288	\$ 416,071	\$ 9,089	\$ 43,930	\$ 1,180,378
2015	726,822	401,201	8,181	14,830	1,151,034
2016	743,092	384,308	7,255	-	1,134,655
2017	754,605	366,553	6,310	-	1,127,468
2018	776,868	347,338	5,346	-	1,129,552
2019 – 2023	3,009,789	1,475,636	16,037	-	4,501,462
2024 – 2028	2,569,838	1,036,795	4,231	-	3,640,864
2029 – 2033	1,599,319	531,458	132	-	2,100,909
2034 – 2038	599,500	337,865	-	-	937,365
2039 – 2043	703,500	249,920	-	-	953,420
Thereafter	6,334,818	177,691	-	-	6,512,509
	<b>\$ 18,529,439</b>	<b>\$ 5,724,836</b>	<b>\$ 56,581</b>	<b>\$ 58,760</b>	<b>\$ 24,369,616</b>

Notes payable are secured by capital assets and restricted funds. At June 30, 2013, the above notes are payable to the Kentucky Infrastructure Authority and are payable in semi-annual installments, including interest ranging from 1% to 3.7%. These agreements provide capital project funding utilizing a combination of both long-term borrowing and federal stimulus grants funds from the American Recovery and Reinvestment Act.

During the year ended June 30, 2011, the Agency issued Series 2010 (Build America Bonds) Taxable Sewer Revenue Bonds, in the amount of \$4,995,000, to finance the acquisition, construction, development and equipping of improvements and renovations to address combined sewer overflows and eliminate sanitary sewer overflows. These taxable bonds were created as part of the Recovery Act of 2009 to finance municipal agency's capital expenditures for which the US Treasury Department pays a direct subsidy of 35 percent of the interest cost to the issuer. During the fiscal year ended June 30, 2013, the Agency received an 8.7 percent reduction in the interest subsidy received due to the Federal Government Sequestration. There is a possibility of additional reductions in future interest subsidies relative to Build America Bonds.

During the year ended June 30, 2013, the Agency formally issued Sewer Revenue Bonds, Series 2011, 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 Development note.

**PADUCAH McCracken JOINT SEWER AGENCY  
NOTES TO FINANCIAL STATEMENTS**

**NOTE G – CHANGES IN LONG-TERM LIABILITIES**

Long-term liability activity for the year ended June 30, 2013, 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	\$ 4,800,000	\$ 4,324,000	\$ (200,000)	\$ 8,924,000	\$ 259,500
Notes payable	<u>11,564,863</u>	<u>2,859,894</u>	<u>(4,819,318)</u>	<u>9,605,439</u>	<u>451,788</u>
Total long-term liabilities	<u>\$ 16,364,863</u>	<u>\$ 7,183,894</u>	<u>\$ (5,019,318)</u>	<u>\$ 18,529,439</u>	<u>\$ 711,288</u>

**NOTE H - CONTRIBUTED CAPITAL**

For the years ended June 30, 2013 and 2012, the Agency accepted sewer line extensions valued \$648,020 and \$291,840 for extensions put into service during the year by developers in McCracken County, Kentucky.

**NOTE I – DISCLOSURES REGARDING STATEMENTS OF CASH FLOWS**

**Non-cash Investing and Financing**

	<u>2013</u>	<u>2012</u>
Non-cash contributions of property received during the years ended June 30 as follows:		
Developer contributions	\$ 648,020	\$ 291,840
Loss on abandonment of construction in progress	\$ 56,121	\$ -

**NOTE J - 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.

**NOTE K - EMPLOYEE RETIREMENT SYSTEM**

The Paducah McCracken Joint Sewer Agency employees participate in the County Employees Retirement System (CERS), a cost-sharing, multi-employer public employee retirement system that provides retirement, disability, and death benefits to members of the plan. Benefits and contribution rates are established by state statute. Under the provisions of Kentucky Revised Statute 61.645, the Board of Trustees of Kentucky Retirement Systems administers the CERS. Kentucky Retirement Systems issues a publicly available financial report that includes financial statements and required supplementary information for CERS. Requests for a copy of the report should be made in writing and submitted to Kentucky Retirement Systems, Perimeter Park West, 1260 Louisville Road, Frankfort, Kentucky 40601.

CERS participants have a fully vested interest after completion of sixty (60) months of service, twelve (12) months of which are current service. At a minimum, terminated employees are refunded their contributions with credited interest at 3 percent compounded annually through June 30, 1981, 6 percent thereafter through June 30, 1986, and 4 percent thereafter. Benefits and contribution rates are established by State statute.

**PADUCAH McCracken Joint Sewer Agency  
Notes to Financial Statements**

**NOTE K - EMPLOYEE RETIREMENT SYSTEM (Continued)**

CERS covered non-hazardous employees are required to contribute an amount equal to 5.00% of their annual covered salary and 6.00% for all new members hired after August 31, 2009. For the years ended June 30, 2013, 2012 and 2011, the System contributed 19.55%, 18.96%, and 16.93%, respectively, of each non-hazardous employee's creditable compensation. These actuarially determined rates are set by the Board of Trustees of Kentucky Retirement Systems. Total contributions made for the years ended June 30, 2013, 2012 and 2011 were \$342,943, \$344,320 and \$299,464, of which \$271,263, \$270,111 and \$229,672 were made by the employer and \$71,680, \$74,209 and \$69,792 were made by employees, respectively, equal to the required contributions for each year.

**NOTE L - DEFERRED COMPENSATION**

The Agency participates in the Kentucky Public Employees' Deferred Compensation Plan, a self-directed multi-employer 401(k) and 457(b) plan. Under the plan, employees may defer up to 25% of eligible compensation, not to exceed the statutory limits, currently \$16,500.

The Agency made discretionary contributions to the 401(k) plan on behalf of the employees in an amount equal to 5.36% of eligible compensation. Participants are immediately vested in the employer contribution. Employer contributions for the years ended June 30, 2013 and 2012, were \$74,549 and \$76,488, respectively.

**NOTE M - COMMITMENTS AND CONTINGENCIES**

The Agency has entered into a Consent Decree with the Kentucky Environmental and Public Protection Cabinet. The Agency is required to bring combined and sanitary sewer overflows into compliance with Federal and State guidelines. The Agency is bound by the Decree for many years to come and will incur significant costs to bring the system into compliance that can only be determined as solutions to the issues are proposed and approved by the Cabinet as outlined in the Consent Decree. The total cost of complying with this Consent Decree has not been determined, but will be significant.

The following significant contracts in progress represent future construction contractual obligations on executed construction contracts as of June 30, 2013.

	<u>Contract Total</u>	<u>Contract Cost-to-date</u>	<u>Future Commitment</u>
Wallace Park Combined Sewer Separation Project	\$ 607,280	\$ 359,128	\$ 248,152
Long Term Control Plan	781,024	757,195	23,829
Massac Creek Interceptor Pump Station and Force Main Phase II	4,300,212	3,667,088	633,125
Homewood/Milliken Pump Station Refurbishment	955,106	218,690	736,416
Old Hwy 60 Sewer Extension Sewer System	7,500	3,750	3,750
Rehabilitation Contract '13 WIN-911 System at Pump Stations and WWTP	899,682	19,875	879,807
	<u>2,112</u>	<u>1,320</u>	<u>792</u>
	<u>\$ 7,552,917</u>	<u>\$ 5,027,046</u>	<u>\$ 2,525,871</u>

The Agency is a party to litigation with a developer concerning public dedication and connection fees. The Agency's counsel has indicated the case is in discovery phase with the outcome presently undeterminable. Management believes the Agency will prevail in this case and, accordingly, no liability has been accrued as of June 30, 2013 applicable to this matter.

**PADUCAH McCracken Joint Sewer Agency  
Notes to Financial Statements**

**NOTE N – BOARD DESIGNATED FUNDS**

It is the policy of the current Board of Directors to designate \$135,000 annually for high dollar capital equipment purchases, emergencies or rate stabilization in the event of a loss of substantial revenue stream. The Board’s intent is to establish a maximum funding level of \$3 million and a minimum level of \$750 thousand in this fund. Designations of amounts represent tentative management plans and are subject to change. Unrestricted net assets at June 30, 2013 and 2012, consist of the following:

	<b>2013</b>	<b>2012</b>
Designations – high dollar capital equipment emergencies and rate stabilization	\$ 3,000,000	\$ 3,000,000
Undesignated	8,988,289	7,963,682
	\$ 11,988,289	\$ 10,963,682

**NOTE O – INTEREST EXPENSE**

For the years ended June 30, 2013 and 2012, interest expense before adjustment for capitalized construction period interest was \$475,935 and \$468,047, respectively. For the years ended June 30, 2013 and 2012, interest expense of \$312,701 and \$322,387, respectively, was capitalized as part of construction in progress.

**NOTE P – RECENTLY ISSUED ACCOUNTING STANDARDS**

During the year ended June 30, 2012, the Governmental Accounting Standards Board (GASB) issued two new pronouncements that will have a future impact on the Agency. These statements relate to the recognition of Other Post-Employments Benefits earned by employees whose governmental agency participates in multi-employer, cost-sharing pension plan. The new statements are Statement No. 67, Financial Reporting for Pension Plans, effective for years beginning after June 30, 2013, and Statement No. 68, Accounting and Financial Reporting for Pensions, effective for years beginning after June 30, 2014. These GASB statements require the cost-sharing governments to report a net pension liability, pension expense and pension-related deferred inflows and outflows of resources based on their proportionate share of the collective amounts for all the governments in the plan. These amounts are not being calculated for the year ended June 30, 2013, but will likely have a significant impact in the year of implementation.

**NOTE Q – SUBSEQUENT EVENTS**

Management has evaluated subsequent events through September 20, 2013, the data which the financial statements were available to be issued.

**PADUCAH McCracken Joint Sewer Agency**  
**STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS**  
**ACTUAL TO BUDGET**  
**For the Year Ended June 30, 2013**

	<b>Original Budget Amounts</b>	<b>Actual Amounts</b>	<b>Variance Favorable (Unfavorable)</b>
<b>Operating Revenues</b>			
Charges for service	\$ 6,896,000	\$ 6,971,035	\$ 75,035
<b>Operating Expenses</b>			
Salaries and wages	2,280,945	2,179,431	101,514
Chemicals, testing and solid disposal	332,000	309,472	22,528
Utilities	621,880	653,216	(31,336)
Materials, supplies and repairs	529,500	434,821	94,679
Fleet expense	150,000	126,952	23,048
Liability insurance	104,500	104,406	94
Training, safety and dues	43,575	42,173	1,402
Professional fees	88,500	152,963	(64,463)
Office expense	14,500	15,753	(1,253)
Public education	4,500	750	3,750
Billing and collections	103,000	101,345	1,655
Bad debts	58,400	41,310	17,090
Board of directors expense	16,800	16,800	-
Miscellaneous	27,000	10,098	16,902
Depreciation	2,467,000	2,299,209	167,791
	<u>6,842,100</u>	<u>6,488,699</u>	<u>353,401</u>
<b>Operating Income (Loss)</b>	<u>53,900</u>	<u>482,336</u>	<u>428,436</u>
<b>Non-operating Revenues (Expenses)</b>			
Investment income	35,500	34,398	(1,102)
Interest expense	(605,000)	(163,235)	441,765
Amortization	(11,100)	(12,120)	(1,020)
Gain (loss) on sale of assets	(25,000)	(16,186)	8,814
Tap-on and assessment fees	200,000	335,696	135,696
Other, net	32,500	34,479	1,979
Total non-operating revenue (expenses), net	<u>(373,100)</u>	<u>213,032</u>	<u>586,132</u>
Change in net position before capital contributions	(319,200)	695,368	1,014,568
<b>Capital Contributions</b>			
Grant revenue	-	1,144,980	1,144,980
Contributed capital	-	648,020	648,020
	<u>-</u>	<u>1,793,000</u>	<u>1,793,000</u>
<b>Increase (decrease) in net assets</b>	<u>\$ (319,200)</u>	<u>\$ 2,488,368</u>	<u>\$ 2,807,568</u>

See Independent Auditor's Report

**SUPPLEMENTAL INFORMATION**



**INDEPENDENT AUDITOR'S 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 Directors  
Paducah McCracken Joint Sewer Agency  
Paducah, Kentucky

We have audited 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, the financial statements of the business-type activities of Paducah McCracken Joint Sewer Agency as of and for the years ended June 30, 2013 and 2012, and the related notes to the financial statements, which collectively comprise Paducah McCracken County Joint Sewer Agency's basic financial statements, and have issued our report thereon dated September 20, 2013.

**Internal Control Over Financial Reporting**

In planning and performing our audits of the financial statements, we considered Paducah McCracken Joint Sewer Agency's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Paducah McCracken Joint Sewer Agency's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Paducah McCracken Joint Sewer Agency'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 combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of Paducah McCracken Joint Sewer Agency's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control 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 material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

**Compliance and Other Matters**

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

### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Kempel CPA Group LLP*

Certified Public Accountants and Consultants  
Paducah, Kentucky  
September 20, 2013



**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM  
AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133**

Board of Directors  
Paducah McCracken Joint Sewer Agency  
Paducah, Kentucky

**Report on Compliance for Each Major Federal Program**

We have audited Paducah McCracken Joint Sewer Agency's compliance with the types of compliance requirements described in the U. S. Office of Management and Budget (OMB) Circular A-133 *Compliance Supplement* that could have a direct and material effect on each of Paducah McCracken Joint Sewer Agency's major federal programs for the years then ended June 30, 2013. Paducah McCracken Joint Sewer Agency's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

***Management's Responsibility***

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs.

***Auditor's Responsibility***

Our responsibility is to express an opinion on compliance for each of Paducah McCracken Joint Sewer Agency's major federal programs based on our audit of the types of compliance requirements referred to above. 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 the 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 Paducah McCracken Joint Sewer Agency'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 on compliance for each major federal program. However, our audit does not provide a legal determination of Paducah McCracken Joint Sewer Agency's compliance.

***Opinion on Each Major Federal Program***

In our opinion, the Agency, complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2013.

**Report on Internal Control Over Compliance**

Management of the Paducah McCracken Joint Sewer Agency, is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit, we considered Paducah McCracken Joint Sewer Agency's internal control over compliance with the requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Paducah McCracken Joint Sewer Agency's internal control over compliance.

*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance 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 compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

*Kempner CPA Group LLP*

Certified Public Accountants and Consultants  
Paducah, Kentucky  
September 20, 2013

**PADUCAH McCracken County Joint Sewer Agency  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2013**

	<u>Federal CFDA Number</u>	<u>Pass Through Grantor's Number</u>	<u>Federal Expenditures</u>
<b>US Environmental Protection Agency</b>			
Passed through Kentucky Infrastructure Authority:			
Capitalization Grants for Clean Water State Revolving Funds	66.458	A09-02	\$ 914,139
Capitalization Grants for Clean Water State Revolving Funds	66.458	A12-08	<u>900,897</u>
Total US Environmental Protection Agency			<u>1,815,036</u>
<b>US Department of Agriculture</b>			
Passed through Kentucky Department of Agriculture:			
USDA Rural Utilities Services – ARRA	10.781	KY20100629- 1170	691,913
<b>Delta Regional Authority</b>			
Delta Area Economic Development	90.201		<u>100,000</u>
<b>Total Federal Awards</b>			<u>\$ 2,606,949</u>

**NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2013**

**NOTE A – BASIS OF PRESENTATION**

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Paducah McCracken Joint Sewer Agency and is presented on the accrual method of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

**NOTE B – RECONCILIATION TO FINANCIAL STATEMENTS**

Total federal award expenditures above	\$ 2,606,949
Less: Federal award expenditures above applicable to loan program	<u>(1,467,969)</u>
	1,138,980
Other grants	<u>6,000</u>
Total grant revenue per Statement of Revenues, Expenses and Changes in Net Position	<u>\$ 1,144,980</u>

See Independent Auditor's Report

**PADUCAH McCracken County Joint Sewer Agency  
 SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
 FOR THE YEAR ENDED JUNE 30, 2013**

**Section I – Summary of Auditor’s Results**

1. The auditor’s report expresses an unqualified opinion on the financial statements of the Paducah McCracken County Joint Sewer Agency.
2. No significant deficiencies were disclosed relating to the audit of the financial statements. No material weaknesses are reported.
3. No instances of noncompliance material to the financial statements of the Paducah McCracken County Joint Sewer Agency were disclosed during the audit.
4. No instances of significant deficiencies were disclosed during the audit of internal control over major federal award programs. No material weaknesses are reported.
5. The auditor’s report on compliance for the major federal award programs for the Paducah McCracken County Joint Sewer Agency expresses an unqualified opinion.
6. There were no audit findings that required reporting in accordance with Section 510(a) of OMB Circular A-133 is reported in this schedule.
7. The programs tested as major program include:

<u>Name</u>	<u>CFDA</u>
Capitalization Grants for Clean Water State Revolving Funds	66.458
USDA Rural Utilities Service – ARRA	10.781

8. The threshold used for distinguishing Types A and B programs was \$300,000.
9. The Paducah McCracken County Joint Sewer Agency was determined to be a high-risk auditee.

**Section II – Findings – Financial Statements Audit**

There were no findings in the current year required to be reported.

**Section III – Findings and Questioned Costs – Major Federal Awards Programs**

There were no findings in the current year required to be reported.

**PADUCAH McCracken County Joint Sewer Agency  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2012**

**Section II – Findings – Financial Statements Audit**

There were no findings in reported.

**Section III – Findings and Questioned Costs – Major Federal Awards Programs**

None.