

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

**FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2016 AND 2015**

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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, 2016 and 2015, 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, 2016 and 2015, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Changes in Accounting Principles

As discussed in Note J to the financial statements, in fiscal year 2015, the Agency adopted new accounting guidance, GASB Statement No. 68, *Accounting & Financial Reporting for Pensions*. In addition, adjustments were made to restate the 2015 financial statements as discussed in Note P. Our opinion is not modified with respect to these matters.

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 9 and schedules of employer's proportionate share of the net pension liability and employer contributions information on pages 26 and 27 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 revenues, expenses, and changes in net assets - budget and actual on page 28 is presented for the purpose of additional analysis and is not a required part of the basic financial statements. The schedule of revenues, expenses, and changes in net assets - budget and actual 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 revenues, expenses, and changes in net assets - budget and actual is fairly stated in all material respects in relation to the financial statements as a whole.

Prior period adjustments

As part of our audit of the financial statements, we also audited adjustments described in Note P that were applied to restate the 2015 financial statements. In our opinion, such adjustments are appropriate and have been properly applied.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 25, 2016, 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 25, 2016

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, 2016.

Financial Highlights

- Total net position increased \$376 thousand during the year
- Total revenues up \$561 thousand (7.8%) over FY 2015
- Capital contributions of \$208 thousand received during the year
- Debt service coverage ratio above level of compliance at 2.55 for FY 2016

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 6/30/16	FYE 6/30/15	Dollar Change	Percent Change
Assets				
Current assets	\$ 13,993	\$ 13,346	\$ 647	4.8%
Capital assets	65,443	65,880	(437)	-0.7%
Restricted funds	1,150	1,260	(110)	-8.7%
Deferred charges & other	814	1,022	(208)	-20.4%
Total assets	<u>81,400</u>	<u>81,508</u>	<u>(108)</u>	-0.1%
Deferred Outflows of Resources	<u>503</u>	<u>189</u>	<u>314</u>	166.1%
Liabilities & net position				
Current liabilities	2,581	2,137	444	20.8%
Noncurrent liabilities	<u>23,854</u>	<u>24,270</u>	<u>(416)</u>	-1.71%
Total liabilities	<u>26,435</u>	<u>26,407</u>	<u>28</u>	0.1%
Deferred Inflows of Resources	<u>36</u>	<u>234</u>	<u>(198)</u>	-84.6%
Invested in capital assets, net	43,233	43,869	(636)	-1.4%
Restricted	1,150	1,260	(110)	-8.7%
Unrestricted	<u>11,048</u>	<u>9,927</u>	<u>1,121</u>	11.3%
Total net position	<u>\$ 55,431</u>	<u>\$ 55,056</u>	<u>\$ 375</u>	0.7%

Capital Assets and Long-Term Debt Activity

Net capital assets decreased by \$437 thousand during FY 2016. This was due to net accumulated depreciation for the year being greater than the increase in total capital assets for the year. 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 Wallace Park Sewer Separation Project into service during the beginning of FY 2016 for \$4 million. The Agency also completed the Cook Street Overflow Tank for a total of \$729 thousand. Three additional overflow storage tanks were either in the planning stages or under construction as of June 30, 2016. 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 JSA recorded \$1.1 million in draws against a current Kentucky Infrastructure Authority (KIA) loan during the fiscal year. 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 increased during FY 2016 by \$28 thousand or 0.1% over FY 2015. The largest contributing factor to this increase is a \$621 thousand escalation in the net pension liability. Because the JSA participates in the County Employees Retirement System (CERS), administered by the Kentucky Retirement Systems, the Agency became subject to new reporting requirements under the Governmental Accounting Standards Board (GASB) beginning in FY 2015. JSA recorded \$2.7 million as its proportionate share of the CERS net pension liability under these new standards.

The JSA's total net position increased by \$375 thousand during FY 2016. Unrestricted assets increased by \$1.1 million or 11.3% over last year.

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

	<u>FYE</u> <u>6/30/16</u>	<u>FYE</u> <u>6/30/15</u>	<u>Dollar</u> <u>Change</u>	<u>Percent</u> <u>Change</u>
Revenues				
Operating revenues	\$ 7,408	\$ 6,921	\$ 487	7.0%
Non-operating revenues	<u>376</u>	<u>302</u>	<u>74</u>	24.5%
Total revenues	<u>7,784</u>	<u>7,223</u>	<u>561</u>	7.8%
Expenses				
Depreciation	2,705	2,558	147	5.7%
Operating expenses	4,447	4,564	(117)	-2.6%
Non-operating expenses	<u>465</u>	<u>486</u>	<u>(21)</u>	-4.3%
Total expenses	<u>7,617</u>	<u>7,608</u>	<u>9</u>	0.1%
Contributions	<u>208</u>	<u>612</u>	<u>(404)</u>	-66.0%
Change in net position	375	227	148	65.2%
Beginning net position, restated	<u>55,056</u>	<u>54,829</u>	<u>227</u>	0.4%
Ending net position	\$ 55,431	\$ 55,056	\$ 375	0.7%

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 2016 finished \$487 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 \$582 thousand more than budget for FY 2016. This was due to a rate increase that became effective March 1, 2016, which was not budgeted. Operating expenses came in under budget for the fiscal year finishing \$94 thousand below estimate.

JSA received \$208 thousand in capital contributions during the fiscal year. These contributions came in the forms of grant revenue of \$4.5 thousand, developer cash contributions of \$59 thousand and developer non-cash contributions of \$144 thousand.

Beginning net position has been restated for two purposes: 1) the JSA should have recorded a liability for its \$72 thousand proportionate share of the CERS insurance fund liability in the prior year, and 2) the JSA had unrecorded liabilities of \$83 thousand in FY 2014 and \$313 in FY 2015 for the cost of projects to be given to the City of Paducah and the Kentucky Transportation Cabinet.

Results of Operations

Total revenues of \$7.8 million, showed an increase of \$561 thousand or 7.8% from FY 2015. The March rate increase was responsible for this growth in revenue. Total expenses increased \$9 thousand or 0.1% from FY 2015.

EXHIBIT 3: Detail of Operating Expenses (Excluding Depreciation)

Operating Expenses (in thousands)	FYE 6/30/16	FYE 6/30/15	Dollar Change	Percent Change
Salaries, wages and benefits	\$ 2,305	\$ 2,134	\$ 171	8.0%
Chemicals, testing & solids disposal	354	329	25	7.6%
Utilities	777	723	54	7.5%
Material, supplies and repairs	475	479	(4)	-0.8%
Fleet expense	76	91	(15)	-16.5%
Professional fees	67	109	(42)	-38.5%
Billing, collection and bad debts	178	171	7	4.1%
All other	215	528	(313)	-59.3%
Total	\$ 4,447	\$ 4,564	\$ (117)	-2.6%

Salaries, Wages and Benefits

Salaries, wages and benefits comprise the bulk of operating expenses. These expenses increased 8.0% over FY 2015. The JSA recorded a \$124 thousand increase in pension expense over the prior year due to the new pension and insurance reporting requirements mandated by GASB. Health insurance expense also increased \$70 thousand from FY 2015 due to these same reporting requirements. Employees received annual wage increases during FY 2016 and 2015.

Other Operating Expenses

Chemicals, testing and solids disposal showed a \$25 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 \$665 thousand with actual costs totaling \$684 thousand. Electricity costs vary from year to year based on flows received and pumped. However, both of JSA’s primary electrical providers, Paducah Power and Jackson Purchase Electric, have had significant rate increases within the past two years.

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 \$4 thousand decrease from the prior fiscal year. The FY 2016 budget for materials, supplies and repairs was \$500 thousand resulting in a positive variance of \$26 thousand. Repairs and maintenance, buildings and grounds expense and equipment rent all came in slightly under budget contributing to this variance.

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)

<u>Department</u>	<u>FYE 2016</u>	<u>FYE 2015</u>	<u>Dollar Change</u>	<u>Percent Change</u>
Collection System (pipes)	\$ 216	\$ 169	\$ 47	27.8%
Lift Stations (pipes & pumps)	47	55	(8)	-14.5%
Treatment Plants (pipes, pumps & motors)	38	42	(4)	-9.5%
Total	\$ 301	\$ 266	\$ 35	13.2%

Collection system expenses saw an increase over FY 2015, mostly due to a sewer system smoke testing contract that took place during FY 2016 for \$69 thousand.

Fleet expense declined \$15 thousand, or -16.8%, 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 \$24 thousand less than budget for the current fiscal year.

FY 2016 professional fees were \$42 thousand less than in FY 2015. This account consists of legal and accounting fees, as well as contractual services, containing certain engineering fees and software contractual services. Legal fees accounted for \$26 thousand of this decrease due to \$21 thousand of bond costs being paid in FY 2015 to refinance bonds. Contractual services made up the remaining \$16 thousand. This was engineering fees expensed (not capitalized to projects) in FY 2015 compared to \$0 in FY 2016. The budget for professional fees was \$109 thousand for FY 2016.

Paducah Water provides billing and collection services for the JSA. Bad debt write offs finished slightly lower than expected at 0.74% of sewer charges.

All other expenses totaled \$216 thousand for FY 2016 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 \$219 thousand. Each expense included in this category finished at or near budget during the current fiscal year.

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 2.55 in 2016 and 1.47 in 2015.

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. Commercial development within the JSA service area has remained consistent with FY 2015.

Investment returns have continued to remain flat. JSA has begun to see a very 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, with another revision approved for July 1, 2017. 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

	2016	2015
Current Assets:		
Cash and cash equivalents	\$ 5,722,531	\$ 6,055,956
Investments and accrued interest	6,754,519	5,778,338
Customer accounts receivable	494,863	501,747
Grants and other receivables	29,993	135,182
Accrued unbilled revenue	650,000	562,000
Inventories and prepaid expenses	340,680	313,192
	<hr/>	<hr/>
Total current assets	13,992,586	13,346,415
Noncurrent Assets:		
Capital assets, net	65,443,109	65,880,195
Restricted assets and investments	1,149,796	1,260,054
Bond discount, net	53,039	59,320
Other noncurrent assets	761,664	962,281
	<hr/>	<hr/>
Total noncurrent assets	67,407,608	68,161,850
	<hr/>	<hr/>
TOTAL ASSETS	81,400,194	81,508,265

DEFERRED OUTFLOWS OF RESOURCES

Deferred pension plan outflows	<hr/> 503,015	<hr/> 188,741
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LIABILITIES

Current Liabilities:		
Notes and bonds payable	1,073,797	798,557
Accounts payable	500,830	1,104,563
Salaries and benefits payable	86,523	87,463
Other current liabilities	920,198	146,686
	<hr/>	<hr/>
Total current liabilities	2,581,348	2,137,269
Noncurrent Liabilities:		
Notes and bonds payable	21,136,109	21,212,348
Net pension liability	2,717,993	2,096,632
Other noncurrent liabilities	-	961,381
	<hr/>	<hr/>
Total noncurrent liabilities	23,854,102	24,270,361
	<hr/>	<hr/>
TOTAL LIABILITIES	26,435,450	26,407,630

DEFERRED INFLOWS OF RESOURCES

Deferred pension plan inflows	<hr/> 36,299	<hr/> 234,035
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NET POSITION

Invested in capital assets, net of related debt	43,233,203	43,869,290
Restricted for debt service	1,149,796	1,260,054
Unrestricted net assets	11,048,461	9,925,997
	<hr/>	<hr/>
TOTAL NET POSITION	\$ 55,431,460	\$ 55,055,341

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>2016</u>	<u>2015</u>
Operating Revenues:		
Charges for services	<u>\$ 7,407,866</u>	<u>\$ 6,921,452</u>
Operating Expenses:		
Salaries, wages and benefits	2,305,320	2,134,477
Chemicals, testing, and solids disposal	353,945	328,761
Utilities	776,503	722,744
Materials, supplies, and repairs	474,784	478,986
Fleet expense	75,715	91,049
Liability insurance	127,671	118,100
Training, safety, and dues	36,252	34,109
Professional fees	66,762	109,065
Office expense	13,442	16,353
Public education	750	3,190
Billing and collections	123,458	122,076
Bad debts	54,705	48,868
Board of directors expense	16,800	16,800
Miscellaneous	20,763	339,590
Depreciation	<u>2,704,898</u>	<u>2,557,652</u>
Total operating expenses	<u>7,151,768</u>	<u>7,121,820</u>
Operating income (loss)	<u>256,098</u>	<u>(200,368)</u>
Non-operating Revenues (Expenses):		
Investment revenue	33,760	33,831
Interest expense	(439,887)	(410,705)
Amortization	(6,281)	(6,177)
Gain on sale of assets	15,475	11,446
Loss on bond refinancing	-	(52,424)
Tap-on and assessment fees	327,125	256,193
Other, net	<u>(18,700)</u>	<u>(16,336)</u>
Total non-operating revenues (expenses), net	<u>(88,508)</u>	<u>(184,172)</u>
Change in net position before capital contributions	<u>167,590</u>	<u>(384,540)</u>
Capital Contributions:		
Grant revenue	4,500	320,868
Contributions from developers	<u>203,122</u>	<u>290,856</u>
Total capital contributions	<u>207,622</u>	<u>611,724</u>
Change in net position	375,212	227,184
Net position, beginning	55,056,248	57,146,640
Adjustment to net position, see note P	<u>-</u>	<u>(2,317,576)</u>
Net position, beginning, as restated	<u>55,056,248</u>	<u>54,829,064</u>
NET POSITION, ENDING	<u><u>\$ 55,431,460</u></u>	<u><u>\$ 55,056,248</u></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>2016</u>	<u>2015</u>
Cash Flows from Operating Activities:		
Collections from customers	\$ 7,273,065	\$ 6,796,125
Cash paid to suppliers	(2,016,531)	(1,927,091)
Cash paid to employees	(2,196,165)	(2,223,815)
	<u>3,060,369</u>	<u>2,645,219</u>
Cash Flows from Capital and Related Financing Activities:		
Grants and contributed capital	19,530	6,000
Tap-on fees and assessments	327,125	256,193
Acquisition of capital assets	(2,439,739)	(4,926,594)
Proceeds from the sale of fixed assets	15,475	19,078
Proceeds from debt issues	1,104,899	6,458,977
Principal payments on long-term debt	(905,898)	(5,830,202)
Interest payments on long-term debt	(469,423)	(589,186)
(Increase)/decrease in other noncurrent assets	(194,900)	12,089
Other, net	(18,700)	(16,336)
	<u>(2,561,631)</u>	<u>(4,609,981)</u>
Cash Flows from Investing Activities:		
Proceeds from sales and maturities of investments	2,831,299	4,333,306
Purchases of investments	(3,694,729)	(1,580,625)
Investment earnings	31,267	33,126
	<u>(832,163)</u>	<u>2,785,807</u>
Net increase/(decrease) in cash and cash equivalents	(333,425)	821,045
Cash and cash equivalents, beginning of year	<u>6,055,956</u>	<u>5,234,911</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u><u>\$ 5,722,531</u></u>	<u><u>\$ 6,055,956</u></u>
Reconciliation of Operating Income (Loss) to Net Cash Provided by Operating Activities:		
Operating income (loss)	\$ 256,098	\$ (200,368)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Depreciation	2,704,898	2,557,652
Changes in operating assets and liabilities:		
Accounts receivable	8,648	(59,946)
Accrued unbilled revenue	(88,000)	(8,000)
Inventory and prepaid expenses	(27,488)	5,129
Deferred outflows of resources	(314,274)	(260,355)
Accounts payable	(117,778)	130,215
Salaries and benefits payable	(940)	1,168
Other current liabilities	215,580	311,913
Net pension liability	621,361	(66,224)
Deferred inflows of resources	(197,736)	234,035
	<u>\$ 3,060,369</u>	<u>\$ 2,645,219</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, 2016 AND 2015

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, 2016 AND 2015

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, 2016 AND 2015

Note B - Restricted Assets and Investments (Continued):

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

	<u>2016</u>	<u>2015</u>
Certificates of deposit - various financial institutions	\$ 639,000	\$ 749,000
U.S. Government money market funds	<u>510,796</u>	<u>511,054</u>
TOTALS	<u>\$1,149,796</u>	<u>\$1,260,054</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, 2016 and 2015, 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 \$12,839,239 and \$13,106,397, respectively, at June 30, 2016 and 2015, 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, 2016 AND 2015

Note D - Construction in Progress:

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

	<u>2016</u>	<u>2015</u>
Anita Drive Pump Station Capacity Evaluation	\$ 12,085	\$ 12,085
Blandville West Subdivision Rehabilitation	-	1,675
Chickadee Lift Station Elimination Project	11,368	5,710
Cook Street Overflow Tank	-	89,798
Dewatering Building Roof Replacement	69	-
Harrison Street Storage Tank	36,421	-
Homewood Overflow Tank	180,870	25,224
Kentucky Avenue Sewer Rehabilitation	-	44,996
Long Term Control Plan	1,023,798	969,759
Massac Creek Phase III Study	19,500	19,500
Old Highway 60 Extension	4,250	4,250
Olivet Church Road/Rebecca Lane Extension	52,696	3,350
Rate Study	-	25,569
Rehab Contract CY '15	315,341	755
Rehab Contract CY '16	19,189	-
Reidland Above Ground Storage Tank	23,024	-
Video and Cleaning Contract 2016	16,993	-
Wallace Park Sewer Separation	-	3,999,642
Wexford Pump Station Valve Vault Replacement	4,130	-
Capitalized Interest	<u>3,413</u>	<u>91,720</u>
TOTALS	<u>\$1,723,147</u>	<u>\$5,294,033</u>

Construction in progress related invoices of \$279,121 and \$765,076 were included in accounts payable at June 30, 2016 and 2015, respectively.

Note E - Capital Assets:

Capital assets consists of the following at June 30:

	<u>2016</u>			
	<u>Balance as of</u>			<u>Balance as of</u>
	<u>June 30, 2015</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2016</u>
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>

(Continued)

PADUCAH MCCRACKEN JOINT SEWER AGENCY
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2016 AND 2015

Note E - Capital Assets (Continued):

	2016			Balance as of June 30, 2016
	Balance as of June 30, 2015	Increases	Decreases	
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>
	2015			
	Balance as of June 30, 2014	Increases	Decreases	Balance as of June 30, 2015
Capital assets, not being depreciated:				
Land	\$ 868,102	\$ 17,955	\$ -	\$ 886,057
Construction in progress	<u>1,717,300</u>	<u>5,338,629</u>	<u>2,157,732</u>	<u>4,898,197</u>
Total capital assets not being depreciated	<u>2,585,402</u>	<u>5,356,584</u>	<u>2,157,732</u>	<u>5,784,254</u>
Capital assets, being depreciated:				
Utility assets (pipes, pumps, plants, structures)	86,672,489	2,010,186	7,500	88,675,175
Vehicles	1,348,234	404,445	391,295	1,361,384
General plant and office furniture	<u>2,421,509</u>	<u>90,964</u>	<u>1,508</u>	<u>2,510,965</u>
Totals at historical cost	<u>90,442,232</u>	<u>2,505,595</u>	<u>400,303</u>	<u>92,547,524</u>
Less accumulated depreciation:				
Utility assets	27,392,769	2,292,097	4,107	29,680,759
General plant and office furniture	1,701,993	159,907	1,508	1,860,392
Vehicles	<u>1,191,840</u>	<u>105,648</u>	<u>387,056</u>	<u>910,432</u>
Total accumulated depreciation	<u>30,286,602</u>	<u>2,557,652</u>	<u>392,671</u>	<u>32,451,583</u>
Total capital assets, being depreciated, net	<u>60,155,630</u>	<u>(52,057)</u>	<u>7,632</u>	<u>60,095,941</u>
TOTAL SYSTEM CAPITAL ASSETS - NET	<u>\$ 62,741,032</u>	<u>\$ 5,304,527</u>	<u>\$ 2,165,364</u>	<u>\$ 65,880,195</u>

(Continued)

PADUCAH MCCRACKEN JOINT SEWER AGENCY
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2016 AND 2015

Note F - Notes and Bonds Payable:

Notes and bonds payable consists of the following:

	2016	2015
Notes Payable:		
Kentucky Infrastructure Authority	\$14,069,406	\$13,587,405
Bonds Payable:		
Sewer Revenue Bonds, Series 2011	4,140,500	4,203,500
Sewer Revenue Refunding Bonds, Series 2014	4,000,000	4,220,000
	22,209,906	22,010,905
Less current maturities	1,073,797	798,557
	\$21,136,109	\$21,212,348

Debt service requirements on notes and bonds payable at June 30, 2016, are as follows:

Years Ending June 30	Principal	Interest	Service Fee	Total
2017	\$ 1,073,797	\$ 467,923	\$ 27,751	\$ 1,569,471
2018	1,099,364	449,123	26,187	1,574,674
2019	1,114,668	429,163	24,596	1,568,427
2020	1,130,714	408,906	22,979	1,562,599
2021	1,151,505	388,235	21,335	1,561,075
2022-2026	5,858,466	1,608,779	81,433	7,548,678
2027-2031	5,546,660	998,823	42,733	6,588,216
2032-2036	2,893,732	468,866	9,954	3,372,552
2037-2041	659,500	286,784	-	946,284
2042-2046	775,000	189,956	-	964,956
Thereafter	906,500	76,230	-	982,730
TOTALS	\$22,209,906	\$5,772,788	\$256,968	\$28,239,662

Notes payable are secured by capital assets and restricted funds. At June 30, 2016, the above notes are payable to Kentucky Infrastructure Authority and are payable in semi-annual installments, including interest ranging from 1% to 2%. 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 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 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.

(Continued)

PADUCAH MCCRACKEN JOINT SEWER AGENCY
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2016 AND 2015

Note F - Notes and Bonds Payable (Continued):

Notes and bonds payable activity for the year ended June 30, 2016, 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	\$ 8,423,500	\$ -	\$ 283,000	\$ 8,140,500	\$ 295,000
Notes payable	<u>13,587,405</u>	<u>1,104,899</u>	<u>622,898</u>	<u>14,069,406</u>	<u>778,797</u>
TOTAL LONG-TERM LIABILITIES	<u>\$ 22,010,905</u>	<u>\$ 1,104,899</u>	<u>\$ 905,898</u>	<u>\$ 22,209,906</u>	<u>\$ 1,073,797</u>

Note G - Contributed Capital:

For the years ended June 30, 2016 and 2015, the Agency accepted \$144,045 and \$290,856, 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>2016</u>	<u>2015</u>
Non-cash investing and financing transactions received during the years ended June 30 as follows:		
Developer contributions	\$ 203,122	\$ 290,856
Undepreciated costs of assets disposed	-	7,632

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.

(Continued)

PADUCAH MCCRACKEN JOINT SEWER AGENCY
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2016 AND 2015

Note J - Employee Retirement System:

Plan description. Employees of Paducah McCracken Joint Sewer Agency participate in the County Employees' Retirement System (CERS), a cost-sharing, multiple-employer, defined benefit pension plan, which is administered by the Kentucky Retirement Systems. The plan covers all eligible full-time employees and provides for retirement and death benefits to plan members as well as disability to members other than those in the third tier. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost of living adjustments (COLA) are provided at the discretion of the State legislature. Under the provisions of Kentucky Revised Section 61.645, the Board of Trustees of Kentucky Retirement Systems provides for the establishment of the system and benefit amendments are authorized by the State legislature. The Kentucky Retirement Systems issues a publicly available financial report that includes financial statements and required supplementary information for the plan. The report may be obtained by writing or calling the plan:

Kentucky Retirement Systems
Perimeter Park West
1260 Louisville Road
Frankfort, KY 40601-6124
(502) 564-4646

The CERS also provides other post-employment benefits through the Kentucky Retirement Systems Insurance Fund (Insurance Fund), which was established to provide hospital and medical insurance for members receiving benefits from CERS. The Insurance Fund is a cost-sharing multiple-employer defined benefit postemployment healthcare plan administered by the Kentucky Retirement Systems. The Insurance Fund pays a prescribed contribution for whole or partial payment of required premiums to purchase hospital and medical insurance. All participants enrolled in CERS are automatically enrolled in both the Insurance Fund and the pension plan. Information regarding the Insurance Fund is contained in the financial statements of the Kentucky Retirement Systems.

Funding policy. Contribution rates are established by the Kentucky Revised Statutes. Non-hazardous plan members of CERS are required to contribute 5.00% of their annual covered salary, and Paducah McCracken Joint Sewer Agency provides a contribution of 17.06% of that salary during the fiscal year ended June 30, 2016. The required contribution rates for fiscal years ending June 30, 2015 was 17.67%. The contribution rate is a combined rate for both the pension plan and the Insurance Fund. For the fiscal year ended June 30, 2016, the pension plan portion was 12.42% and the Insurance Fund portion was 4.64%. These percentages were 12.75% and 4.92% for the fiscal year ended June 30, 2015. For employees hired on September 1, 2008, or thereafter, an additional 1% must be contributed by employees to a health insurance account. The employer pension contributions for fiscal years ended June 30, 2016 and 2015 were \$181,983 and \$188,741, respectively. The employer insurance contributions for fiscal years ended June 30, 2016 and 2015 were \$67,987 and \$71,614, respectively. The actuarially determined contribution requirements of plan members and the Agency are established and may be amended by the KRS Board of Trustees.

Pension liabilities, pension expense, and deferred outflows of resources and deferred inflows of resources related to pensions. The Agency reported a liability of \$2,717,993 and \$2,096,632 at June 30, 2016 and 2015, respectively, for its proportionate share of the net pension liability. The net pension liability at June 30, 2016 and 2015 was measured as of June 30, 2015 and 2014, respectively, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Agency's proportion of the net pension liability was based on a projection of the Agency's share of contributions to the pension plan relative to the total contributions of all participating employers, actuarially determined. At June 30, 2016 and 2015, the Agency's proportions were 0.06322% and 0.06460%, respectively.

(Continued)

PADUCAH MCCRACKEN JOINT SEWER AGENCY
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2016 AND 2015

Note J - Employee Retirement System (Continued):

As a result of its requirement to contribute to CERS, the Agency recognized pension expenses of \$291,334 and \$167,811, for the years ended June 30, 2016 and 2015, respectively. At June 30, 2016, the Agency reported deferred outflows of resources and deferred inflows of resources from the following sources as a result of its requirements to contribute to CERS:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Net difference between projected and actual earnings on plan investments	\$ 24,365	\$ -
Difference between expected and actual experience	22,587	-
Change in assumptions	274,080	-
Change in proportion and differences between employer contributions and proportionate share of contributions	-	36,299
Contributions subsequent to the measurement date	<u>181,983</u>	<u>-</u>
TOTALS	<u>\$ 503,015</u>	<u>\$ 36,299</u>

At June 30, 2015, the Agency reported deferred outflows of resources and deferred inflows of resources from the following sources as a result of its requirements to contribute to CERS:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Net differences between projected and actual earnings on pension plan investments	\$ -	\$ 234,035
Contributions subsequent to the measurement date	<u>260,355</u>	<u>-</u>
TOTALS	<u>\$ 260,355</u>	<u>\$ 234,035</u>

Deferred outflows of resources in the amount of \$181,983 related to pensions contributions made subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

<u>Year Ended June 30</u>	
2017	\$95,515
2018	95,515
2019	44,686
2020	49,017

The net pension liability as of June 30, 2016, is based on the June 30, 2015, actuarial valuation. Deferred outflows and inflows related to the net difference between projected and actual earnings on plan investments are netted and amortized over a closed five year period. Deferred outflows and inflows related to differences between expected and actual experience and change in assumptions are amortized over a period of 3.51 years.

(Continued)

PADUCAH MCCRACKEN JOINT SEWER AGENCY
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2016 AND 2015

Note J - Employee Retirement System (Continued):

Actuarial assumptions. The total pension liability in the June 30, 2015 actuarial valuation was determined using the following actuarial assumptions, applied to all prior periods included in the measurement:

Inflation - 3.25%

Salary increases - 4.0%, average including inflation

Investment rate of return - 7.5%, net of pension plan investment expense including inflation

The mortality table used for active members is RP-2000 Combined Mortality Table projected with Scale BB to 2013 (multiplied by 50% for males and 30% for females). For healthy retired members and beneficiaries, the mortality table used is the RP-2000 Combined Mortality Table projected with Scale BB to 2013 (set back for one year for females). For disabled members, the RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (set back four years for males) is used for the period after disability retirement. There is some margin in the current mortality tables for possible future improvement in mortality rates and that margin will be reviewed again when the next experience investigation is conducted. The long-term expected return on plan assets is reviewed as part of the regular experience studies prepared every five years for KRS. The most recent analysis, performed for the period covering fiscal years 2008 through 2013, is outlined in a report dated April 30, 2014. Several factors are considered in evaluating the long-term rate of return assumption including long-term historical data, estimates inherent in current market data, and a distribution analysis in which best estimate ranges of expected future real rates of return (expected return, net of investment expense, and inflation) were developed by the investment consultant for each major asset class. These ranges were combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and then adding expected inflation.

The capital market assumptions developed by the investment consultant are intended for use over a 10-year horizon and may not be useful in setting the long-term rate of return for funding pension plans which covers a longer time frame. The assumption is intended to be a long-term assumption and is not expected to change absent a significant change in the asset allocation, a change in the inflation assumption, or a fundamental change in the market that alters expected returns in future years.

Discount rate. The discount rate determination does not use a municipal bond rate. Projected future benefit payments for all current plan members were projected through 2117. The target allocation and best estimates of arithmetic nominal rates of return for each major asset class are summarized in the following table:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-Term Expected Real Rate of Return</u>
Combined Equity	44%	5.40%
Combined Fixed Income	19%	1.50%
Real Return (Diversified Inflation Strategies)	10%	3.50%
Real Estate	5%	4.50%
Absolute Return (Diversified Hedge Funds)	10%	4.25%
Private Equity	10%	8.50%
Cash	<u>2%</u>	(.25)%
Total	<u>100%</u>	

The actuarial assumptions used in the June 30, 2015 valuation were based on the results of an actuarial experience study for the period July 1, 2008 to June 30, 2013. The discount rate used to measure the total pension liability was 7.5%. The projection of cash flows used to determine the discount rate assumed that contributions from plan members and employers will be made at the actuarially determined contribution rate of projected compensation over the remaining 28 year amortization period of the unfunded actuarial accrued liability.

(Continued)

PADUCAH MCCRACKEN JOINT SEWER AGENCY
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2016 AND 2015

Note J - Employee Retirement System (Continued):

Sensitivity of the Agency's proportionate share of the net pension liability to changes in the discount rate. The following presents the Agency's proportionate share of the net pension liability calculated using the discount rate of 7.5%, as well as what the Agency's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.5%) or 1-percentage-point higher (8.5%) than the current rate:

	1% Decrease 6.5%	Current Discount Rate 7.5%	1% Increase 8.5%
The Agency's proportionate share of the net pension liability	\$3,469,849	\$2,717,993	\$2,074,085

Note K - 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 \$18,000.

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 through December 31, 2014. Beginning January 1, 2015, the Kentucky Public Employees Deferred Comp Plan stopped accepting employer contribution. At that time, the Agency elected to continue to make the 5.36% discretionary contribution to a new plan with Nationwide Financial Services. Participants are immediately vested in the employer contribution. Employer contributions for the years ended June 30, 2016 and 2015, were \$78,918 and \$79,120, respectively.

Note L - 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. The total cost of complying with this Consent Decree is estimated at \$102 million and is expected to be completed over the next 22 years.

The following significant contracts in progress represent future construction contractual obligations on executed construction contracts as of June 30, 2016:

	Contract Total	Contract Cost-to-Date	Future Commitment
Dewatering Building Roof Replacement	\$ 31,724	\$ -	\$ 31,724
Waste Water Treatment Plant Digester Study	12,000	-	12,000
Harrison Street Storage Tank	2,847	-	2,847
Homewood Overflow Tank	865,000	-	865,000
Long-term Control Plan, Sanitary Sewer Overflow Response Plan	1,076,844	960,595	116,249
Old Highway 60 Sewer Extension	7,500	3,750	3,750
Rehab Contact CY '16	878,119	-	878,119
Reidland Tank	254,930	6,444	248,486
Smoke Testing	26,400	-	26,400
Video and Cleaning Contract	120,615	-	120,615
	<u>\$3,275,979</u>	<u>\$970,789</u>	<u>\$2,305,190</u>

(Continued)

PADUCAH MCCRACKEN JOINT SEWER AGENCY
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2016 AND 2015

Note L - Commitments and Contingencies (Continued):

The Agency has entered into an agreement with the City of Paducah to donate a portion of the Wallace Park Sewer Separation project to the City upon completion of the project. This portion of the project was \$759,545 at June 30, 2016 and is recorded in other current assets. Due to the fact that this will be donated upon completion, a liability is recorded in other current liabilities for the same amount. The project was completed during the year ended June 30, 2016 and is expected to be transferred to the City of Paducah in the first part of fiscal year 2017.

Note M - Board Designated Funds:

It is the policy of the current Board of Directors to designate up to \$135,000 annually for high dollar capital equipment purchases, for emergencies, or for rate stabilization in the event of a loss of a 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, but are subject to change. Board designated funds amounted to \$3 million as of June 30, 2016 and 2015, respectively, and are included as part of the unrestricted net assets on the statements of net position.

Note N - Interest Expense:

For the years ended June 30, 2016 and 2015, interest expense before adjustment for capitalized construction period interest was \$461,810 and \$535,914, respectively. For the years ended June 30, 2016 and 2015, interest expense of \$21,923 and \$125,209, respectively, was capitalized to the Agency's capital assets accounts.

Note O - Subsequent Events:

Management has evaluated subsequent events through October 25, 2016, the date which the financial statements were available to be issued. On October 10, 2016, the Agency received approval of the Long Term Control Plan, discussed in Note L above, from the Kentucky Department of Environmental Protection.

Note P - Correction of Error and Restatement of Beginning Net Position:

In June 2012, the Governmental Accounting Standards Board (GASB) issued Statement No. 68, *Accounting and Financial Reporting for Pensions*, which amends GASB Statement No. 27. The new standard addresses several issues regarding public pension plans, including the liabilities reported pertaining to unfunded portions and the disclosure requirements of those plans. The standard was effective for the Agency for the fiscal year beginning July 1, 2014. The new standard requires the Agency to report its proportionate share of the total net pension liability of the County Employee Retirement System Plan as a liability on the statement of net position and on the statement of revenues, expenses, and changes in net position. The standard also requires the deferral of changes in the net pension liability and amortization of those changes over set periods.

According to GASB Statement No. 68, the Agency's proportionate share of the County Employee Retirement System's total net pension liability must be reported by the Agency as well as deferral and amortization of changes in the net pension liability. The Agency's proportionate share of the net pension liability and deferred outflows at July 1, 2014 was \$2,442,913 and \$280,057, respectively. The information provided by the Kentucky Retirement System in the initial year of implementation included total contributions the Agency made to the plan. These total contributions consisted of a portion for the pension plan and a portion for the Insurance Fund, another post employee benefit plan. The amounts provided for the actuarial valuation dated June 30, 2015 include only the pension plan portion. In fiscal year 2015, the Agency reported \$71,614 paid to CERS for other post-employment benefits as contributions to the CERS pension plan subsequent to the measurement date on the statement of net position. This amount represented the insurance fund portion of the total contributions paid which should have been reported as a current year expense on the statement of activities for the year ended June 30, 2015.

(Continued)

PADUCAH MCCRACKEN JOINT SEWER AGENCY
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2016 AND 2015

Note P - Correction of Error and Restatement of Beginning Net Position (Continued):

The effect of this restatement on Paducah McCracken Joint Sewer Agency's net position is as follows:

Net position July 1, 2014, as previously stated		\$57,146,640
Proportionate share of net pension liability	\$(2,442,913)	
Deferred outflows:		
Contributions made after the measurement date	280,057	
Adjustment for insurance portion	<u>(71,614)</u>	
Adjustments to net position		<u>(2,234,470)</u>
NET POSITION JULY 1, 2014, AS RESTATED		<u>\$54,912,170</u>

During the year ended June 30, 2013, the Agency began the Wallace Park Separation Project. As part of the project, the Agency has agreed to donate portions of the project to the City of Paducah and to the Kentucky Transportation Cabinet upon completion. Expenses were incurred during the years ended June 30, 2014 and 2015 and no liability was recorded for the portion of the project to be donated. The following adjustments were made to reflect this liability:

Net position July 1, 2014, as previously restated		\$54,912,170
Adjustments to recognize 2014 expenses		<u>(83,106)</u>
NET POSITION JULY 1, 2014, AS RESTATED		54,829,064
Change in net position, as previously stated		539,914
Adjustment to record project expenses during the year ended June 30, 2015		<u>(312,730)</u>
NET POSITION JULY 1, 2015, AS RESTATED		<u>\$55,056,248</u>

Project expenses of \$312,730 were incurred during the year ended June 30, 2015. An adjustment was made to increase the liability by this amount with the offsetting entry being to miscellaneous expense.

REQUIRED SUPPLEMENTAL INFORMATION

**PADUCAH MCCRACKEN JOINT SEWER AGENCY
SCHEDULE OF EMPLOYER'S PROPORTIONATE SHARE OF THE
NET PENSION LIABILITY
COUNTY EMPLOYEE'S RETIREMENT SYSTEM (CERS)
LAST TWO FISCAL YEARS***

	<u>2016</u>	<u>2015</u>
Employer's proportion of the net pension liability (asset)	0.06322%	0.06460%
Employer's proportionate share of the net pension liability (asset)	\$ 2,717,993	\$ 2,096,632
Employer's covered payroll	\$ 1,473,428	\$ 1,482,568
Employer's proportionate share of the net pension liability (asset) as a percentage of its covered payroll	184.47%	141.42%
Plan fiduciary net position as a percentage of the total pension liability	59.97%	66.80%

* The amounts presented for each fiscal year were determined as of June 30. Until a full 10-year trend is compiled, governments will present information only for those years for which information is available.

Notes to Schedule

The total pension liability was determined by applying procedures to the actuarial valuation as of June 30, 2015. The financial reporting actuarial valuation used the following actuarial methods and assumptions, applied to all prior periods included in the measurement.

Valuation date	June 30, 2015
Experience study	July 1, 2008 - June 30, 2013
Actuarial cost method	Entry age normal
Amortization method	Level percentage of payroll, closed
Remaining amortization period	28 years
Asset valuation method	5-year smoothed market
Inflation	3.25%
Salary increase	4.0%, average, including inflation
Investment rate of return	7.5%, net of pension plan investment expense, including inflation

Retirement age In the 2015 actuarial valuation, expected retirement ages of general employees were adjusted to more closely reflect actual experience.

Mortality In the 2015 actuarial valuation, assumed life expectancies were adjusted as a result of adopting the RP-2000 Healthy Annuitant Mortality Table. In prior years, those assumptions were based on the 1983 Group Annuity Mortality Table.

Other Information Salary increases and investment rate of return have decreased as a result of the experience study performed for the period covering fiscal years 2008 through 2013 which include adjustments for inflation.

NOTE: This schedule is based on the last measurement date of the net pension liability.

**PADUCAH MCCRACKEN JOINT SEWER AGENCY
SCHEDULE OF EMPLOYER CONTRIBUTIONS
COUNTY EMPLOYEE'S RETIREMENT SYSTEM (CERS)
LAST THREE FISCAL YEARS***

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Contractually required contribution	\$ 181,983	\$ 188,741	\$ 203,705
Contributions in relation to the contractually required contribution	<u>181,983</u>	<u>188,741</u>	<u>203,705</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Employer's covered payroll	\$ 1,465,240	\$ 1,473,428	\$ 1,482,568
Contributions as a percentage of covered payroll	12.42%	12.75%	13.74%

* The amounts presented for each fiscal year were determined as of June 30. Until a full 10-year trend is compiled, governments will present information only for those years for which information is available.

NOTE: This schedule is determined as of the employer's most recent fiscal year-end.

SUPPLEMENTAL INFORMATION

PADUCAH MCCRACKEN JOINT SEWER AGENCY
SCHEDULE OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS -
BUDGET AND ACTUAL
FOR THE YEAR ENDED JUNE 30, 2016

	Original and Final Budget Amounts	Actual Amounts	Variance Favorable (Unfavorable)
Operating Revenues:			
Charges for services	<u>\$6,826,250</u>	<u>\$7,407,866</u>	<u>\$ 581,616</u>
Operating Expenses:			
Salaries, wages, and benefits	2,308,822	2,305,320	(3,502)
Chemicals, testing, and solids disposal	341,300	353,945	12,645
Utilities	780,850	776,503	(4,347)
Materials, supplies, and repairs	500,400	474,784	(25,616)
Fleet expense	99,800	75,715	(24,085)
Liability insurance	125,500	127,671	2,171
Training, safety, and dues	37,450	36,252	(1,198)
Professional fees	108,500	66,762	(41,738)
Office expense	15,400	13,442	(1,958)
Public education	3,500	750	(2,750)
Billing and collections	125,500	123,458	(2,042)
Bad debts	60,300	54,705	(5,595)
Board of Directors expense	16,800	16,800	-
Miscellaneous	20,000	20,763	763
Depreciation	<u>2,701,300</u>	<u>2,704,898</u>	<u>3,598</u>
Total operating expenses	<u>7,245,422</u>	<u>7,151,768</u>	<u>(93,654)</u>
Operating income (loss)	<u>(419,172)</u>	<u>256,098</u>	<u>675,270</u>
Non-operating Revenues (Expenses):			
Investment revenue	35,000	33,760	(1,240)
Interest expense	(497,000)	(439,887)	57,113
Amortization	(11,500)	(6,281)	5,219
Gain (loss) on sale of assets	(20,000)	15,475	35,475
Tap-on and assessment fees	177,000	327,125	150,125
Other, net	<u>(66,900)</u>	<u>(18,700)</u>	<u>48,200</u>
Total non-operating revenues (expenses), net	<u>(383,400)</u>	<u>(88,508)</u>	<u>294,892</u>
Change in net position before capital contributions	<u>(802,572)</u>	<u>167,590</u>	<u>970,162</u>
Capital Contributions:			
Grant revenue	-	4,500	4,500
Contributed capital	<u>-</u>	<u>203,122</u>	<u>203,122</u>
Total capital contributions	<u>(802,572)</u>	<u>207,622</u>	<u>207,622</u>
INCREASE (DECREASE) IN NET ASSETS	<u><u>\$ (802,572)</u></u>	<u><u>\$ 375,212</u></u>	<u><u>\$ 1,177,784</u></u>

See independent auditor's report.

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**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***

The Board of Directors
Paducah McCracken Joint Sewer Agency
Paducah, Kentucky

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to the 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, 2016 and 2015, and the related notes to the financial statements, which collectively comprise Paducah McCracken Joint Sewer Agency's basic financial statements, and have issued our report thereon dated October 25, 2016.

Internal Control Over Financial Reporting

In planning and performing our audit 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. Accordingly, we do not express an opinion on the effectiveness of Paducah McCracken Joint Sewer Agency's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. 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 was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control 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 of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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.

Williams, William & Lutz, LLP

Paducah, Kentucky
October 25, 2016