

PADUCAH WATER WORKS

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

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J. DAVID BAILEY, III
C. SUZETTE CRONCH
ROGER G. HARRIS
MICHAEL F. KARNES
MARK A. THOMAS
ASHLEY C. GROOMS
KELLY D. SCRUGGS
BENJAMIN D. TEER

WILLIAMS, WILLIAMS & LENTZ, LLP
CERTIFIED PUBLIC ACCOUNTANTS
~Established 1953~

P.O. Box 2500
PADUCAH, KY 42002-2500
www.wwlcpa.com

601 JEFFERSON
PADUCAH, KY 42001
TELEPHONE: 270-443-3643
FAX: 270-444-0652

1104 PARIS RD, SUITE 100
MAYFIELD, KY 42066
TELEPHONE: 270-247-2124
FAX: 270-247-2028

Independent Auditor's Report

The Board of Directors
Paducah Water Works
Paducah, Kentucky

We have audited the accompanying financial statements of the business-type activities of Paducah Water Works, a component unit of the City of Paducah, Kentucky, as of and for the years ended June 30, 2016 and 2015, and the related notes to the financial statements, which collectively comprise Paducah Water Works' 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 audit. We conducted our audit in accordance with auditing standards general accepted in the United States of America and the standards applicable to financial audits contained in *Governmental 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 upon 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 opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of Paducah Water Works, as of June 30, 2016 and 2015, and the respective 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.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and pension schedules on pages 3 through 7 and 20 through 21 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Government 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 Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated September 19, 2016, on our consideration of Paducah Water Works' internal control over financial reporting and 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 Water Works' internal control over financial reporting and compliance.



Paducah, Kentucky
September 19, 2016

REQUIRED SUPPLEMENTARY INFORMATION

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's discussion and analysis of Paducah Water's financial performance provides an overview of the financial activities for the fiscal year ended June 30, 2016. Please read it in conjunction with the financial statements, which begin on page 8.

Financial Highlights

- PWW's net position increased by \$2,178 million (4.5%) as a result of this year's operations.
- Net income before capital contributions decreased by \$895.9 thousand to \$1.136 million.
- Operating revenues increased by \$155.4 thousand (1.5%) to \$10.862 million, due mainly to an increase in water sales revenue of approximately \$47.5 thousand and an increase in Capital Replacement Fee revenue of \$52.3 thousand.
- Operating expenses excluding depreciation increased by \$609.2 thousand (9.1%) to \$7.288 million.

Using This Annual Report

This annual report consists of a series of financial statements: The Statement of Net Position, The Statements of Revenues, Expenses, and Changes in Net Position and The Statement of Cash Flows. These statements provide information about the activities of PWW and present a long-term view of the finances.

The Statement of Net Position

The Statement of Net Position includes all of PWW's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to creditors (liabilities). The difference between assets and liabilities is reported as net position. Over time increases or decreases in net position may serve as a useful indicator of whether the financial position of PWW is improving or deteriorating.

The Statements of Revenues, Expenses, and Changes in Net Position

The Statements of Revenues, Expenses, and Changes in Net Position identifies the revenues generated, expenses incurred and net position change during the period reported. This statement measures the success of PWW's operations over the reporting period and can be used to determine whether PWW has successfully recovered all its costs through its water rates and other charges.

The Statement of Cash Flows

The Statement of Cash Flows provides information relating to PWW's cash receipts and cash disbursements during the fiscal year. The statement reports net changes in cash resulting from operations, investing and financing activities, and helps the user assess where cash came from, what cash was used for, and what changes occurred in cash balances during the reporting period.

Financial Analysis

Net Position

Net position may serve over time as a useful indicator of PWW's financial position. Net position was \$50.45 million at June 30, 2016 compared to \$48.27 at June 30, 2015, an increase of \$2.178 million or 4.5%.

Condensed Statements of Net Position (amounts expressed in thousands)

	As of June 30,		Increase	Percent
	2016	2015	(Decrease)	Change
Current and other assets	\$ 10,471	\$ 9,578	\$ 893	9%
Capital assets, net	51,581	50,476	1,105	2%
Deferred outflows	915	338	577	171%
Total assets and deferred outflows	<u>62,967</u>	<u>60,392</u>	<u>2,575</u>	4%
Current liabilities	2,304	2,302	2	0%
Long-term liabilities	10,119	9,398	721	8%
Deferred inflows	98	423	(325)	-77%
Total liabilities and deferred inflows	<u>12,521</u>	<u>12,123</u>	<u>398</u>	3%
<u>Net assets:</u>				
Invested in capital assets	45,977	44,528	1,449	3%
Restricted	-	-	-	0%
Unrestricted	4,469	3,741	728	19%
Total net position	<u>\$ 50,446</u>	<u>\$ 48,269</u>	<u>\$ 2,177</u>	5%

By far, the largest portion of PWW's net position reflects its investment in capital assets (i.e., utility plant), less any related debt used to acquire those assets that is still outstanding. Although PWW's investment in its capital assets is reported net of related debt, it should be noted that the resources to repay this debt must be provided from other sources, since the capital assets themselves are not intended to be used to liquidate these liabilities.

The remaining balance of net position represents unrestricted net position and may be used to meet PWW's ongoing obligations to creditors.

The increase in net position during the current fiscal year indicates an improved financial position.

Change in Net Position

While the statements of net position show the make-up of PWW's assets, liabilities and net position at year-end, the statements of revenues, expenses and changes in net position provide information on the source of the change during the year. The two sources of the increase in net position of \$2.178 million were income before capital contributions (formerly net revenue) of \$1.136 million and capital contributions of \$1.042 million.

Condensed Statements of Revenues, Expenses and Changes in Net Position

(amounts expressed in thousands)

	Years ended June 30, 2016	2015	Increase (Decrease)	Percent Change
Operating revenues	\$ 10,862	\$ 10,707	\$ 155	1%
Nonoperating revenues	14	15	(1)	-7%
Total revenues	<u>10,876</u>	<u>10,722</u>	<u>154</u>	1%
Operating expenses	7,288	6,679	609	9%
Nonoperating expenses	<u>2,452</u>	<u>2,011</u>	<u>441</u>	22%
Total expenses	<u>9,740</u>	<u>8,690</u>	<u>1,050</u>	12%
Income before capital contributions (formerly net revenue)	1,136	2,032	(896)	-44%
Contributions	<u>1,041</u>	<u>914</u>	<u>127</u>	14%
Increase in net position	2,177	2,946	(769)	-26%
Beginning net position	48,269	49,367	(1,098)	-2%
GASB 68 adjustment	<u>-</u>	<u>(4,044)</u>	<u>4,044</u>	
Ending net position	<u>\$ 50,446</u>	<u>\$ 48,269</u>	<u>\$ 2,177</u>	5%

Income before capital contributions decreased by \$896 thousand from the previous year mainly due to increase in operating expenses of \$609 thousand and increased loss on disposal of capital assets of \$291 mainly to the disposal of a tank. The increase in operating expenses was due mainly to increased chemical and other water treatment plant costs, increased pension expense and increased insurance costs.

Capital Assets and Long-Term Debt

PWW's net investment in plant, lines, and other facilities increased by \$1.105 million in FY 2016. Major additions included phase two of a main extension project on Lovelaceville Road (\$249 thousand), a dead end main elimination project in Hendron area (\$231 thousand) and a main extension project on Clinton Road (\$124 thousand).

During FY 2016, long-term debt increased by \$724 thousand due to the Net Pension Liability increase of \$1.069 million which was offset by \$345 thousand in principal payments that were made on notes payable. Total long-term debt as of June 30, 2016 is \$10.119 million. This consists of KIA debt that was assumed in order to connect the Paducah system with the Reidland system as well as improvements to the Reidland area system and Net Pension Liability of the County Employees Retirement System.

Budgetary Controls

PWW operates its general activities in accordance with a budget adopted by its Board. As demonstrated by the statements included in the financial section of this report, PWW continues to meet its responsibility for sound financial management.

Total operating revenues for the period were \$10.862 million compared to a budget of \$11.036 million. Total operating expense was over the budgeted amount for the fiscal year ended by 1.6%. Actual operating expense was \$7.288 million compared to a budget of \$7.175 million. Net Revenue ended \$626 thousand under budget for the period.

Currently Known Facts, Decisions or Conditions

This section discusses currently known facts, decisions or conditions as of the date of the auditor's report that are expected to have a significant effect on PWW's financial position (net position) or results of operations (revenues, expenses, and other changes in net position).

PWW has a significant percentage of water mains that are aging. Over the next twenty-five years, these water mains will need to begin to be replaced at what will be a significant expense to the rate payers. Management estimates that nearly \$100 million will need to be spent over the next fifty to sixty years replacing aging water mains. In FY2010, a Capital Replacement and Expansion fee was instituted for all customers based on meter size that will add additional revenue of approximately \$2 million per year. This fee partnered with other operating revenue has begun to allow Paducah Water to address this issue.

Requests for Additional Information

This financial report is designed to provide a general overview of PWW's finances for all those with an interest in PWW's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to:

Controller
Paducah Water
P.O. Box 2377
Paducah, KY 42002-2377

Statement of Income and Expense
For the twelve months ended June 30, 2016
(amounts expressed in thousands)

	Actual	Budget	Increase (Decrease)	Percent Difference
Operating revenue	\$ 10,862	\$ 11,036	\$ (174)	-2%
Operating expenses				
Pumping & purification	2,659	2,419	240	10%
Distribution & engineering	1,826	1,990	(164)	-8%
Office & administrative	1,894	1,902	(8)	0%
Other	909	865	44	5%
Total expenses	<u>7,288</u>	<u>7,176</u>	<u>112</u>	2%
Net operating income	<u>3,574</u>	<u>3,860</u>	<u>(286)</u>	-7%
Other income (expenses)				
Interest income	14	14	-	0%
Other	(263)	-	(263)	0%
Depreciation	(2,116)	(2,040)	(76)	4%
Interest on funded debt	(73)	(73)	-	0%
	<u>(2,438)</u>	<u>(2,099)</u>	<u>(339)</u>	16%
Net Revenue	<u>\$ 1,136</u>	<u>\$ 1,761</u>	<u>\$ (625)</u>	-35%

BASIC FINANCIAL STATEMENTS

PADUCAH WATER WORKS
STATEMENTS OF NET POSITION
JUNE 30

ASSETS

	2016	2015
Current Assets:		
Cash and cash equivalents	\$ 963,676	\$ 1,414,719
Accounts receivable	669,769	577,722
Material and supplies inventory	719,415	645,471
Accrued unbilled revenue	1,170,165	1,113,567
Other current assets	922,544	797,634
Total current assets	4,445,569	4,549,113
Capital Assets:		
Utility plant in service	87,917,041	86,180,280
Construction in progress	1,626,870	531,621
Totals	89,543,911	86,711,901
Less accumulated depreciation	37,963,019	36,235,553
Total capital assets	51,580,892	50,476,348
Other Assets:		
KIA replacement reserve	93,750	75,000
Cash, designated	5,669,432	3,646,493
Certificates of deposit, designated	261,263	1,307,400
Total other assets	6,024,445	5,028,893
Total assets	62,050,906	60,054,354

DEFERRED OUTFLOWS OF RESOURCES

Deferred pension plan outflows	574,389	-
Deferred pension plan contributions	340,960	338,078
Total deferred outflows of resources	915,349	338,078

LIABILITIES

Current Liabilities:		
Notes payable, KIA	348,054	344,600
Accounts payable, trade	736,316	747,648
Other accrued expenses and current liabilities	1,218,174	1,210,137
Total current liabilities	2,302,544	2,302,385
Long-Term Debt:		
Notes payable, KIA	5,255,533	5,603,587
Net pension liability	4,863,028	3,794,000
Total long-term debt	10,118,561	9,397,587
Total liabilities	12,421,105	11,699,972

DEFERRED INFLOWS OF RESOURCES

Deferred pension plan inflows	98,592	423,460
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NET POSITION

Net investment in capital assets	45,977,305	44,528,161
Unrestricted	4,469,253	3,740,839
TOTAL NET POSITION	\$50,446,558	\$48,269,000

See notes to financial statements.

PADUCAH WATER WORKS
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
YEARS ENDED JUNE 30

	<u>2016</u>	<u>2015</u>
Operating Revenues:		
Metered water sales	\$ 7,580,888	\$ 7,533,438
Fire protection fees	141,254	138,007
Municipal water sales	43,163	42,085
Collection fees and late payment charges	376,197	362,482
Capital replacement fee	2,376,465	2,324,125
Miscellaneous	344,516	306,945
	<u>10,862,483</u>	<u>10,707,082</u>
Operating Expenses:		
Pumping and purification	2,659,028	2,269,224
Transmission and distribution	1,826,475	1,780,214
Office and administrative	1,893,957	1,803,186
Other	909,009	826,607
	<u>7,288,469</u>	<u>6,679,231</u>
Operating income	<u>3,574,014</u>	<u>4,027,851</u>
Nonoperating Revenues (Expenses):		
Interest income	14,225	15,185
Other interest	(72,787)	(77,027)
Depreciation	(2,115,895)	(1,983,290)
Gain (loss) on disposal of capital asset	(266,376)	24,776
Other	2,945	24,485
	<u>(2,437,888)</u>	<u>(1,995,871)</u>
Net nonoperating revenues (expenses)	<u>(2,437,888)</u>	<u>(1,995,871)</u>
Income before capital contributions	<u>1,136,126</u>	<u>2,031,980</u>
Capital Contributions:		
Connection fees	289,623	225,592
Donated surplus	751,809	688,620
	<u>1,041,432</u>	<u>914,212</u>
Total capital contributions	<u>1,041,432</u>	<u>914,212</u>
Change in net position	2,177,558	2,946,192
Net position - beginning	48,269,000	49,367,233
Prior period adjustment	-	(4,044,425)
	<u>48,269,000</u>	<u>45,322,808</u>
Net position, beginning, as restated	<u>48,269,000</u>	<u>45,322,808</u>
NET POSITION, ENDING	<u><u>\$ 50,446,558</u></u>	<u><u>\$ 48,269,000</u></u>

See notes to financial statements.

PADUCAH WATER WORKS
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30

	<u>2016</u>	<u>2015</u>
Cash Flows from Operating Activities:		
Receipts from customers	\$ 10,713,838	\$ 10,706,621
Payments to suppliers	(4,418,889)	(3,957,758)
Payments to employees	(2,929,447)	(2,784,874)
	<u>3,365,502</u>	<u>3,963,989</u>
Cash Flows from Capital and Related Financing Activities:		
Capital contributions	289,623	225,592
Acquisitions of capital assets	(2,736,006)	(3,227,234)
Proceeds from sale of assets	3,945	49,261
Principal paid on capital debt	(344,600)	(341,179)
Interest paid on capital debt	(67,131)	(77,027)
	<u>(2,854,169)</u>	<u>(3,370,587)</u>
Cash Flows from Investing Activities:		
Purchase of investments	(3,143)	(4,540)
Sale of investments	1,049,280	38,791
Interest on investments	14,426	15,012
	<u>1,060,563</u>	<u>49,263</u>
Net increase in cash and cash equivalents	1,571,896	642,665
Cash and cash equivalents, beginning of year	5,061,212	4,418,547
CASH AND CASH EQUIVALENTS, END OF YEAR	<u><u>\$ 6,633,108</u></u>	<u><u>\$ 5,061,212</u></u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 3,574,014	\$ 4,027,851
Adjustments to reconcile operating income to net cash provided by operating activities:		
Changes in assets and liabilities:		
(Increase) decrease in accounts receivable	(92,047)	13,905
(Increase) decrease in accrued unbilled revenue	(56,598)	(14,366)
(Increase) decrease in inventory	(73,944)	(14,748)
(Increase) decrease in other current assets	(125,111)	180,023
(Increase) decrease in deferred outflows of resources	(577,271)	(468,678)
Increase (decrease) in accounts payable	(11,332)	266
Increase (decrease) in accrued payroll	(41,267)	12,462
Increase (decrease) in other current liabilities	24,898	(76,361)
Increase (decrease) in deferred inflows of resources	(324,868)	423,460
Increase (decrease) in net pension liability	1,069,028	(119,825)
	<u>1,069,028</u>	<u>(119,825)</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u><u>\$ 3,365,502</u></u>	<u><u>\$ 3,963,989</u></u>

See notes to financial statements.

PADUCAH WATER WORKS
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2016 AND 2015

Note 1 - Summary of Significant Accounting Policies:

Reporting Entity

Paducah Water Works is a municipal utility, purchased by the City of Paducah in 1930. The area served is virtually all of McCracken County, including a separate water district, as well as a small portion of Marshall County and Graves County. Effective July 18, 2012, the Hendron Water District merged with Paducah Water Works. Paducah Water Works assumed control of Hendron Water District on August 1, 2012.

Paducah Water Works serves 27,000 customers with 14,800 of these in the City of Paducah and the remainder in the areas previously described.

Basis of Accounting

Paducah Water Works' financial statements are prepared in accordance with generally accepted accounting principles (GAAP) as applied to governmental units. This requires the accrual basis of accounting for proprietary entities. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Paducah Water Works is a single fund government and a component unit of the City of Paducah with the Board of Directors appointed by the Mayor. Paducah Water Works has no oversight responsibility for any other entity since control or dependence is determined on the basis of budget adoption, taxing authority, funding, and appointment of the respective governing board.

Basic Financial Statements

Paducah Water Works' basic financial statements include the Statements of Net Position; the Statements of Revenues, Expenses, and Changes in Net Position; and the Statements of Cash Flows. Paducah Water Works has only one fund that uses a set of self-balancing accounts comprised of its assets, deferred outflows, liabilities, deferred inflows, net position, revenues, and expenses.

The statements are prepared on a full accrual, economic resource basis, which recognizes all long-term assets and receivables as well as long-term debt and obligations.

Cash and Cash Equivalents

For purposes of reporting cash flows, Paducah Water Works does not consider certificates of deposit, regardless of maturity, as cash equivalents.

Materials and Supplies Inventory

Materials and supplies inventory is valued at weighted average cost.

Depreciation

Depreciation is computed on the straight-line basis over the estimated useful lives of various classes of assets. It is Paducah Water Works' policy to include amortization expense on assets acquired under capital leases with depreciation expense on owned assets.

Distribution mains, service lines, standpipes, and tanks	60 years
Booster station, raw water intake, and treatment plant equipment	40 years
Meters	25 years
Hydrants	40 years
Buildings	40-60 years
Other equipment	5-15 years

(Continued)

PADUCAH WATER WORKS
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2016 AND 2015

Note 1 - Summary of Significant Accounting Policies (Continued):

Net Position

Net position is displayed in three components:

- a. Investment in capital assets - Consists of capital assets including restricted capital assets, net of accumulated depreciation, and unpaid debt financing.
- b. Restricted net position - Consists of net position with constraints placed on the use either by (1) external groups such as creditors, grantors, contributors, or laws or regulations of other governments; or (2) law through constitutional provisions or enabling legislation.
- c. Unrestricted net position - All other net position that does not meet the definition of "restricted" or "investment in capital assets."

Capital Contributions

Capital contributions are derived from three main sources: 1) customers, in the form of tap fees; 2) developers, when they construct and pay for water lines and then donate these additions to Paducah Water Works; and 3) other governments, in the form of grant contributions for capital assets. Developer contributions are recorded at the developer's cost and are depreciated over their estimated useful lives using the straight-line method.

Employee Compensated Absences

Employees of Paducah Water Works are entitled to paid vacations and sick days depending on job classification, length of service, and other factors and, accordingly, Paducah Water Works has recorded the accrual in the accompanying financial statements.

Deferred Outflows and Deferred Inflows

Deferred outflow of resources represents a consumption of net position by Paducah Water Works that is applicable to a future reporting period and will not be recognized as an outflow of resources (expenditure/expense) until that time. Deferred inflow of resources represents an acquisition of net position by Paducah Water Works that is applicable to a future reporting period and will not be recognized as an inflow of resources (revenue) until that time.

Paducah Water Works reports deferred inflows and outflows of resources with respect to their participation in the County Employee Retirement System as discussed further in note 7.

Pensions

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the County Employee's Retirement System (CERS) and additions to/deductions from the plan's fiduciary net position has been determined on the same basis as they are reported by the plan. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

(Continued)

PADUCAH WATER WORKS
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2016 AND 2015

Note 1 - Summary of Significant Accounting Policies (Continued):

Operating Revenues and Expenses

Operating revenues consist primarily of charges to customers for the sale of water. Operating expenses consist of the cost of providing water, including administrative expenses. All other revenues and expenses are classified as non-operating.

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

Bad Debts

The Company uses the direct write-off method in recognizing bad debts expense. Generally accepted accounting principles require that the allowance method be used to reflect bad debts. However, the effect of the use of the direct write-off method is not materially different from the results that would have been obtained had the allowance method been followed. The Company expensed \$37,528 and \$30,695 in bad debts during the years ended June 30, 2016 and 2015, respectively.

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 amounts and disclosures. Accordingly, actual results could differ from those estimates.

Subsequent Events

Subsequent events were evaluated through September 19, 2016, which is the date the financial statements were available to be issued.

Note 2 - Deposits:

The investment policies of Paducah Water Works are governed by the State statute. In general, this requires that all deposits and investments, not covered by FDIC insurance, are to be collateralized. For the years ended June 30, 2016 and 2015, Paducah Water Works' financial institution balances were fully collateralized as required by State statute.

Deposits consist of savings and checking accounts and certificates of deposit that mature in twelve months or less. The financial institution balances of Paducah Water Works' deposits were \$6,972,545 for the year ended June 30, 2016. The book balance was \$6,894,371. Of the various financial institution balances at June 30, 2016, \$500,000 was insured by federal depository insurance, and the remaining balance was subject to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the Utility's deposits may not be returned to it. The remaining balance of \$6,472,545 was uninsured and collateralized with securities held by the pledging bank's agent not in Paducah Water Works' name.

Note 3 - Reserve Fund:

As required by the Note Agreement with the Kentucky Infrastructure Authority, Paducah Water Works is required on December 1 each year beginning December 1, 2011 to transfer \$18,750 into replacement reserve until the account balance reaches \$187,500. At June 30, 2016, \$93,750 had been transferred into a replacement reserve account.

(Continued)

PADUCAH WATER WORKS
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2016 AND 2015

Note 4 - Capital Assets:

A summary of capital asset activity for the year ended June 30, 2016, is as follows:

	<u>Balance</u> <u>June 30, 2015</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u> <u>June 30, 2016</u>
Capital assets	\$ 86,711,901	\$ 3,487,815	\$ (655,805)	\$ 89,543,911
Accumulated depreciation	<u>(36,235,553)</u>	<u>(2,115,895)</u>	<u>388,429</u>	<u>(37,963,019)</u>
CAPITAL ASSETS, NET	<u>\$ 50,476,348</u>	<u>\$ 1,371,920</u>	<u>\$ (267,376)</u>	<u>\$ 51,580,892</u>

Note 5 - Notes Payable, KIA:

Notes payable, KIA represents financing from the Kentucky Infrastructure Authority. Interest rate is 1.00% with a .25% annual service fee.

The annual requirements to amortize the outstanding debt as of June 30, 2016, are as follows:

<u>Year Ending</u> <u>June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>.25%</u> <u>Service</u> <u>Fee</u>	<u>R & M</u> <u>Reserve</u>	<u>Total</u>
2017	\$ 348,054	\$ 55,168	\$ 13,792	\$18,750	\$ 435,764
2018	351,543	51,679	12,920	18,750	434,892
2019	355,068	48,155	12,039	18,750	434,012
2020	358,627	44,595	11,149	18,750	433,121
2021	342,222	41,000	10,250	18,750	412,222
2022-2026	1,886,314	149,795	37,449	-	2,073,558
2027-2031	<u>1,961,759</u>	<u>54,352</u>	<u>13,587</u>	-	<u>2,029,698</u>
TOTALS	<u>\$5,603,587</u>	<u>\$444,744</u>	<u>\$111,186</u>	<u>\$93,750</u>	<u>\$6,253,267</u>

Note 6 - Change in Long-Term Liability:

	<u>Balance</u> <u>June 30, 2015</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u> <u>June 30, 2016</u>
Notes payable, KIA				
Reidland Interchange	<u>\$5,948,187</u>	<u>\$ -</u>	<u>\$344,600</u>	<u>\$5,603,587</u>
TOTALS	<u>\$5,948,187</u>	<u>\$ -</u>	<u>\$344,600</u>	<u>\$5,603,587</u>

Note 7 - Employee Benefits:

Plan Descriptions. Employees of Paducah Water Works 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 (COLA) adjustments 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

(Continued)

PADUCAH WATER WORKS
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2016 AND 2015

Note 7 - Employee Benefits (Continued):

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 fund. Information regarding the Insurance Fund is contained in the financial statements of the Kentucky Retirement Systems.

Funding policies. Contribution rates are established by the Kentucky Revised Statutes. Non-hazardous plan members of CERS are required to contribute 5.000% of their annual covered salary, and Paducah Water Works provides a contribution of 17.06% of that salary. The required contribution rates for fiscal years ending June 30, 2015 and 2014 was 17.67% and 18.89%, respectively. The contribution rate is a combined rate for both the pension plan and the Insurance Fund. For fiscal year ended June 30, 2016, the pension plan portion and the Insurance Fund portions were 12.42% and 4.64%. These percentages were 12.75% and 4.92% for fiscal year ended June 30, 2015 and 13.74% and 5.15% for fiscal year ended June 30, 2014. For employees hired on September 1, 2008, or thereafter, an additional 1% must be contributed by employees to a health insurance account. The pension contributions for fiscal years ended June 30, 2016, 2015, and 2014 were \$340,960, \$338,078, and \$368,614, respectively. The insurance contributions for fiscal years ended June 30, 2016, 2015, and 2014 were \$127,701, \$130,600, and \$138,163, respectively.

Pension liabilities, pension expense, and deferred outflows of resources and deferred inflows of resources related to pensions. At June 30, 2016, Paducah Water Works reported a liability of \$4,863,028 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. Paducah Water Works' proportion of the net pension liability was based on a projection of Paducah Water Works' share of contributions to the pension plan relative to the total contributions of all participating employers. At June 30, 2015, Paducah Water Works' proportion was .11311%.

As a result of its requirement to contribute to CERS, Paducah Water Works recognized pension expenses of \$507,849 for the year ended June 30, 2016. At June 30, 2016, Paducah Water Works reported deferred outflows of resources and deferred inflows of resources from the following sources as a result of its requirements to contribute to CERS:

	Deferred Outflows Of Resources	Deferred Inflows Of Resources
Net differences between projected and actual earnings on pension plan investments	\$ 43,593	\$ -
Difference between expected and actual experience	40,413	-
Change in assumptions	490,383	-
Change in proportion and differences between employer Contributions and proportionate share of contributions	-	98,592
Contributions subsequent to the measurement date	340,960	-
TOTALS	\$ 915,349	\$ 98,592

(Continued)

PADUCAH WATER WORKS
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2016 AND 2015

Note 7 - Employee Benefits (Continued):

Deferred outflows of resources in the amount of \$340,960 related to pensions resulting from Paducah Water Works' contributions 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:

Year Ended	
<u>June 30</u>	
2017	\$156,625
2018	156,625
2019	72,250
2020	90,297

The net pension liability as of June 30, 2016, is based on the June 30, 2015, actuarial valuation. Deferred outflows and inflows related to differences 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.

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 morality 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.

(Continued)

PADUCAH WATER WORKS
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2016 AND 2015

Note 7 - Employee Benefits (Continued):

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.

Sensitivity of the Paducah Water Works' proportionate share of the net pension liability to changes in the discount rate. The following presents Paducah Water Works' proportionate share of the net pension liability calculated using the discount rate of 7.5%, as well as what Paducah Water Works' 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:

	<u>1% 6.5%</u>	<u>Current 7.5%</u>	<u>1% 8.5%</u>
Paducah Water Works' proportionate share of the net pension liability	\$6,208,470	\$4,863,028	\$3,711,083

Payables to the pension plan. At June 30, 2016, the financial statements include \$0 in payables to CERS. These are legally required contributions to the plan. These amounts are not accounted for in the net pension liability.

Health Insurance

Paducah Water Works no longer has a self-insured health plan but rather a traditional health insurance plan through Anthem. A majority of the cost of the plan is borne by Paducah Water Works. Health insurance expense was \$676,835 and \$621,143 for years ended June 30, 2016 and 2015, respectively.

Note 8 - Disclosures Regarding the Statement of Cash Flows:

For purposes of the Statement of Cash Flows, the composition of cash and cash equivalents at June 30, 2016 and 2015, is as follows:

	<u>2016</u>	<u>2015</u>
Cash and cash equivalents	\$ 963,676	\$1,414,719
Cash, designated	<u>5,669,432</u>	<u>3,646,493</u>
TOTAL CASH AND CASH EQUIVALENTS	<u>\$6,633,108</u>	<u>\$5,061,212</u>
Noncash capital and related financing activities:		
NONCASH CAPITAL CONTRIBUTIONS	<u>\$ 751,809</u>	<u>\$ 688,620</u>

(Continued)

PADUCAH WATER WORKS
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2016 AND 2015

Note 9 - Other Current Assets:

Other Current Assets consisted of the following:

	<u>2016</u>	<u>2015</u>
Miscellaneous receivable	\$ 645,556	\$ 586,225
Accrued interest receivable	-	201
Prepaid insurance	78,730	67,437
Health insurance premium receivable	133,279	89,016
Flex advance receivable	14,276	17,547
Other	<u>50,703</u>	<u>37,208</u>
TOTAL OTHER CURRENT ASSETS	<u>\$ 922,544</u>	<u>\$ 797,634</u>

Note 10 - Other Accrued Expenses and Current Liabilities:

Other accrued expenses and current liabilities consisted of the following:

	<u>2016</u>	<u>2015</u>
Accrued payroll and payroll withholdings	\$ 60,825	\$ 93,418
Accrued sales tax	25,334	23,539
City refuse and dumpster payable	167,117	165,962
Sewer service collections payable	496,114	496,056
Deposit collections payable	56,618	60,958
Accrued sick and vacation time	236,631	211,796
Customer advances	38,828	38,828
Replacement reserve	93,750	75,000
Other	<u>42,957</u>	<u>44,580</u>
TOTAL ACCRUED EXPENSES AND CURRENT LIABILITIES	<u>\$1,218,174</u>	<u>\$1,210,137</u>

Note 11 - Miscellaneous Revenues:

Miscellaneous revenues consisted of the following:

	<u>2016</u>	<u>2015</u>
Returned checks	\$ 9,030	\$ 7,562
Re-established service	189,023	125,529
Meter replacement	9,871	7,620
Service calls	4,950	15,030
New service	127,977	123,624
Miscellaneous fees	<u>3,665</u>	<u>27,580</u>
TOTAL MISCELLANEOUS REVENUE	<u>\$ 344,516</u>	<u>\$ 306,945</u>

Note 12 - Other Operating Expenses:

Other operating expenses consisted of the following:

	<u>2016</u>	<u>2015</u>
Legal and professional expenses	\$ 34,327	\$ 25,384
Insurance expense	874,682	797,567
Wellness Program	<u>-</u>	<u>3,656</u>
TOTAL OTHER OPERATING EXPENSES	<u>\$ 909,009</u>	<u>\$ 826,607</u>

(Continued)

PADUCAH WATER WORKS
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2016 AND 2015

Note 13 - Gain (Loss) on Disposal of Capital Asset:

Gain (loss) on Disposal of Capital Asset as of June 30, 2016 consisted of:

Disposal of Hendron water tank and buildings	\$(254,660)
Sale of two trucks, excavator and backhoe	<u>(11,716)</u>
TOTAL LOSS ON DISPOSAL OF CAPITAL ASSET	<u>\$(266,376)</u>

Gain (loss) on Disposal of Capital Asset as of June 30, 2015 consisted of:

Sale of two trucks	<u>\$24,776</u>
TOTAL GAIN ON DISPOSAL OF CAPITAL ASSET	<u>\$24,776</u>

Note 14 - Contingencies:

Paducah Water Works received a claim from an individual stating the individual fell into a meter box. This claim was settled on July 5, 2016 for \$75,000. Paducah Water's insurance company paid the settlement directly to the individual. Therefore, there is no accrual on the books of Paducah Water Works.

Note 15 - 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 addressed 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 Paducah Water Works for the fiscal year beginning July 1, 2014. 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 is effective for Paducah Water Works for the fiscal year beginning July 1, 2014. The new standard requires Paducah Water Works 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, Paducah Water Works' proportionate share of the County Employee Retirement System's total net pension liability must be reported by Paducah Water Works as well as deferral and amortization of changes in the net pension liability. Paducah Water Works' proportionate share of the net pension liability and deferred outflows at July 1, 2014 was \$4,423,583 and \$509,758, respectively. The information provided by the Kentucky Retirement System in the initial year of implementation, included total contributions Paducah Water Works made to the plan. These total contributions consist of a portion for the pension plan and a portion for the Insurance Fund, an other 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 Paducah Water Works reported \$130,600 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. The effect of this restatement on Paducah Water Works' net position is as follows:

Net position July 1, 2014, as previously stated	\$49,367,233
Proportionate share of net pension liability	\$(4,423,583)
Deferred outflows:	
Contributions made after the measurement date	509,758
Adjustment for insurance portion	<u>(130,600)</u>
Adjustments to net position	<u>(4,044,425)</u>
NET POSITION JULY 1, 2014, AS RESTATED	<u>\$45,322,808</u>

REQUIRED SUPPLEMENTARY INFORMATION

PADUCAH WATER WORKS
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)	0.11311%	0.11693%
Employer's proportionate share of the net pension liability (asset)	\$ 4,863,028	\$ 3,794,000
Employer's covered payroll	\$ 2,634,729	\$ 2,698,560
Employer's proportionate share of the net pension liability (asset) as a percentage of its covered payroll	184.57%	140.59%
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 WATER WORKS
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	\$ 340,284	\$ 335,928	\$ 370,782
Contributions in relation to the contractually required contribution	<u>340,960</u>	<u>337,696</u>	<u>370,782</u>
Contribution deficiency (excess)	<u>\$ (676)</u>	<u>\$ (1,768)</u>	<u>\$ -</u>
Employer's covered payroll	\$ 2,739,805	\$ 2,634,729	\$ 2,698,560
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.

J. DAVID BAILEY, III
C. SUZETTE CRONCH
ROGER G. HARRIS
MICHAEL F. KARNES
MARK A. THOMAS
ASHLEY C. GROOMS
KELLY D. SCRUGGS
BENJAMIN D. TEER

WILLIAMS, WILLIAMS & LENTZ, LLP
CERTIFIED PUBLIC ACCOUNTANTS
~Established 1953~

P.O. Box 2500
PADUCAH, KY 42002-2500
www.wwlcpa.com

601 JEFFERSON
PADUCAH, KY 42001
TELEPHONE: 270-443-3643
FAX: 270-444-0652

1104 PARIS RD, SUITE 100
MAYFIELD, KY 42066
TELEPHONE: 270-247-2124
FAX: 270-247-2028

**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 Water Works
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 Water Works as of and for the years ended June 30, 2016 and 2015, and the related notes to the financial statements, which collectively comprise Paducah Water Works' basic financial statements, and have issued our report thereon dated September 19, 2016.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Paducah Water Works' 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 Water Works' internal control. Accordingly, we do not express an opinion on the effectiveness of Paducah Water Works' 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 Water Works' 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.

A handwritten signature in black ink that reads "Williams, William F. Zengler". The signature is written in a cursive style with a large, stylized "Z" at the end.

Paducah, Kentucky
September 19, 2016