

PADUCAH WATER WORKS

**FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2018 AND 2017**

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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, 2018 and 2017, 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 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 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, 2018 and 2017, 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.

Change in Accounting Principle

As discussed in Note 15 to the financial statements, in fiscal year 2018, Paducah Water Works adopted new accounting guidance, GASB Statement No. 75, *Accounting & Financial Reporting for Postemployment Benefits Other than Pensions*. Our opinion is not modified with respect to this matter.

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 and OPEB schedules on pages 3 through 7 and 28 through 29 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 Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated September 24, 2018, 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.

William's, Williams & Lentz, LLP

Paducah, Kentucky
September 24, 2018



WILLIAMS
WILLIAMS
& LENTZ

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, 2018. Please read it in conjunction with the financial statements, which begin on page 8.

Financial Highlights

- PWW's net position decreased by \$437 thousand (0.8%). Net operations added \$1.264 million but that was offset by the recording of Net OPEB Liability of \$1,701 million in accordance with GASB 75.
- Net income before capital contributions decreased by \$476.1 thousand to \$654 thousand.
- Operating revenues increased by \$194.9 thousand (1.8%) to \$11.153 million, due mainly to an increase in water sales revenue of approximately \$124.1 thousand.
- Operating expenses excluding depreciation increased by \$747.7 thousand (9.9%) to \$8.325 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 \$51.76 million at June 30, 2018 compared to \$52.20 at June 30, 2017, a decrease of \$437 thousand or 0.8%.

(amounts expressed in thousands)

	As of June 30,		Increase	Percent
	2018	2017	(Decrease)	Change
Current and other assets	\$ 12,347	\$ 10,894	\$ 1,453	13%
Capital assets, net	55,689	55,290	399	1%
Deferred outflows	2,997	1,393	1,604	115%
Total assets and deferred outflows	<u>71,033</u>	<u>67,577</u>	<u>3,456</u>	5%
Current liabilities	2,568	2,382	186	8%
Long-term liabilities	15,923	12,934	2,989	23%
Deferred inflows	777	59	718	1217%
Total liabilities and deferred inflows	<u>19,268</u>	<u>15,375</u>	<u>3,893</u>	25%
<u>Net assets:</u>				
Invested in capital assets	48,543	47,693	850	2%
Restricted	0	0	0	0%
Unrestricted	3,222	4,509	(1,287)	-29%
Total net position	<u>\$ 51,765</u>	<u>\$ 52,202</u>	<u>\$ (437)</u>	-1%

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 decrease in net position during the current fiscal year indicates a diminished financial position. The main reason for the decrease in net position during this fiscal year was the addition of a \$1.701 million Net OPEB Liability in accordance with GASB 75. This liability depicts an estimate of Paducah Water's share of the County Employees' Retirement System's net OPEB liability and will be adjusted annually.

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 three sources of the decrease in net position of \$437 million were income before capital contributions (formerly net revenue) of \$654 thousand, capital contributions of \$610 thousand, and the GASB 75 adjustment to net OPEB liability which was a decrease of \$1,701 million.

Condensed Statements of Revenues, Expenses and Changes in Net Position
(amounts expressed in thousands)

	Years ended June 30,		Increase	Percent
	2018	2017	(Decrease)	Change
Operating revenues	\$ 11,152	\$ 10,957	\$ 195	2%
Nonoperating revenues	181	22	159	723%
Total revenues	<u>11,333</u>	<u>10,979</u>	<u>354</u>	3%
Operating expenses	8,325	7,577	748	10%
Nonoperating expenses	<u>2,354</u>	<u>2,272</u>	<u>82</u>	4%
Total expenses	<u>10,679</u>	<u>9,849</u>	<u>830</u>	8%
Income before capital contributions (formerly net revenue)	654	1,130	(476)	-42%
Contributions	<u>610</u>	<u>625</u>	<u>(15)</u>	-2%
Increase in net position	1,264	1,755	(491)	-28%
Beginning net position	52,202	50,447	1,755	3%
Prior period adjustment	<u>(1,701)</u>	<u>0</u>	<u>(1,701)</u>	
Ending net position	<u>\$ 51,765</u>	<u>\$ 52,202</u>	<u>\$ (437)</u>	-1%

Income before capital contributions decreased by \$476 thousand from the previous year. Operating revenues increased by \$195 thousand mainly due to increased water sales revenue and total expenses increased by \$748 thousand due to pension and OPEB expense of \$855 thousand more than actual pension and OPEB contributions related to GASB 68 & 75.

Capital Assets and Long-Term Debt

PWW's net investment in plant, lines, and other facilities increased by \$399 thousand in FY 2018. Major additions included the replacement of virtually all meters larger than 1" (\$400 thousand), and the continued work on a 24" water main between 8th street and Kentucky Avenue (\$254 thousand).

During FY 2018, long-term debt increased by \$2.990 million due to the Net Pension Liability increase of \$1.085 million and the addition of Net postemployment benefits other than pension liability of \$2.360 million. These were offset by \$450 thousand in principal payments that were made on notes payable. Total long-term debt as of June 30, 2018 is \$15.923 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, KIA debt for the 24" transmission line project and Net Pension Liability and Net Postemployment Benefits Other than 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 \$11.152 million compared to a budget of \$11.121 million. Total operating expense was over the budgeted amount for the fiscal year ended by 10.7%. Actual operating expense was \$8.325 million compared to a budget of \$7.519 million. This overage was mainly caused by pension expense being \$855 thousand more than actual pension contributions related to GASB 68 & 75. Net Revenue ended \$636 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 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. While the Capital Replacement and Expansion fee has allowed PWW to begin to address aging infrastructure, experience has shown that it may be insufficient to meet future needs.

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, 2018
(amounts expressed in thousands)

	Actual	Budget	Increase (Decrease)	Percent Difference
Operating revenue	\$ 11,152	\$ 11,121	\$ 31	0%
Operating expenses				
Pumping & purification	2,767	2,599	168	6%
Distribution & engineering	2,332	1,935	397	21%
Office & administrative	2,283	1,990	293	15%
Other	943	995	(52)	-5%
Total expenses	<u>8,325</u>	<u>7,519</u>	<u>806</u>	11%
Net operating income	<u>2,827</u>	<u>3,602</u>	<u>(775)</u>	-22%
Other income (expenses)				
Interest income	38	21	17	81%
Other	143	0	143	0%
Depreciation	(2,244)	(2,220)	(24)	1%
Interest on funded debt	(110)	(113)	3	-3%
	<u>(2,173)</u>	<u>(2,312)</u>	<u>139</u>	-6%
Net Revenue	<u>\$ 654</u>	<u>\$ 1,290</u>	<u>\$ (636)</u>	-49%

BASIC FINANCIAL STATEMENTS

PADUCAH WATER WORKS
STATEMENTS OF NET POSITION
JUNE 30

ASSETS

	<u>2018</u>	<u>2017</u>
Current Assets:		
Cash and cash equivalents	\$ 1,059,995	\$ 1,204,121
Accounts receivable	628,643	581,914
Material and supplies inventory	813,914	794,806
Accrued unbilled revenue	1,165,042	1,163,546
Other current assets	<u>1,229,973</u>	<u>962,335</u>
Total current assets	<u>4,897,567</u>	<u>4,706,722</u>
Capital Assets:		
Utility plant in service	93,962,959	88,314,371
Construction in progress	<u>1,471,143</u>	<u>4,809,862</u>
Totals	95,434,102	93,124,233
Less accumulated depreciation	<u>39,744,448</u>	<u>37,834,026</u>
Total capital assets	<u>55,689,654</u>	<u>55,290,207</u>
Other Assets:		
KIA replacement reserve	142,450	112,500
Cash, designated	7,043,148	5,812,281
Certificates of deposit, designated	<u>263,748</u>	<u>262,441</u>
Total other assets	<u>7,449,346</u>	<u>6,187,222</u>
Total assets	<u>68,036,567</u>	<u>66,184,151</u>

DEFERRED OUTFLOWS OF RESOURCES

Deferred pension plan outflows	1,891,262	994,338
Deferred pension plan contributions	425,015	398,738
Deferred postemployment benefits other than pensions outflows	513,539	-
Deferred postemployment benefits other than pensions contributions	<u>166,798</u>	<u>-</u>
Total deferred outflows of resources	<u>2,996,614</u>	<u>1,393,076</u>

LIABILITIES

Current Liabilities:		
Notes payable, KIA	455,532	450,271
Accounts payable, trade	625,899	657,085
Other accrued expenses and current liabilities	<u>1,486,278</u>	<u>1,274,898</u>
Total current liabilities	<u>2,567,709</u>	<u>2,382,254</u>
Long-Term Debt:		
Notes payable, KIA	6,691,526	7,147,038
Net pension liability	6,871,607	5,786,673
Net postemployment benefits other than pensions liability	<u>2,360,081</u>	<u>-</u>
Total long-term debt	<u>15,923,214</u>	<u>12,933,711</u>
Total liabilities	<u>18,490,923</u>	<u>15,315,965</u>

DEFERRED INFLOWS OF RESOURCES

Deferred pension plan inflows	653,693	59,312
Deferred postemployment benefits other than pensions inflows	<u>123,567</u>	<u>-</u>
Total deferred inflows of resources	<u>777,260</u>	<u>59,312</u>

NET POSITION

Net investment in capital assets	48,542,596	47,692,898
Unrestricted	<u>3,222,402</u>	<u>4,509,052</u>
TOTAL NET POSITION	<u>\$51,764,998</u>	<u>\$52,201,950</u>

See notes to financial statements.

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

	2018	2017
Operating Revenues:		
Metered water sales	\$ 7,805,035	\$ 7,680,914
Fire protection fees	149,455	143,493
Municipal water sales	45,068	44,690
Collection fees and late payment charges	398,201	400,294
Capital replacement fee	2,455,084	2,419,607
Miscellaneous	299,445	268,437
	<hr/>	<hr/>
Total operating revenues	11,152,288	10,957,435
	<hr/>	<hr/>
Operating Expenses:		
Pumping and purification	2,767,163	2,656,547
Transmission and distribution	2,332,368	1,906,376
Office and administrative	2,282,413	2,075,748
Other	943,018	938,588
	<hr/>	<hr/>
Total operating expenses	8,324,962	7,577,259
	<hr/>	<hr/>
Operating income	2,827,326	3,380,176
	<hr/>	<hr/>
Nonoperating Revenues (Expenses):		
Interest income	38,410	21,596
Other interest	(110,288)	(96,872)
Depreciation	(2,244,001)	(2,179,062)
Gain on disposal of capital asset	120,711	(3,441)
Other	21,604	7,505
	<hr/>	<hr/>
Net nonoperating revenues (expenses)	(2,173,564)	(2,250,274)
	<hr/>	<hr/>
Income before capital contributions	653,762	1,129,902
	<hr/>	<hr/>
Capital Contributions:		
Connection fees	268,321	336,964
Donated surplus	342,134	288,526
	<hr/>	<hr/>
Total capital contributions	610,455	625,490
	<hr/>	<hr/>
Change in net position	1,264,217	1,755,392
	<hr/>	<hr/>
Net position - beginning	52,201,950	50,446,558
Prior period adjustment	(1,701,169)	-
	<hr/>	<hr/>
Net position, beginning, as restated	50,500,781	50,446,558
	<hr/>	<hr/>
NET POSITION, ENDING	<u>\$51,764,998</u>	<u>\$52,201,950</u>

See notes to financial statements.

PADUCAH WATER WORKS
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30

	<u>2018</u>	<u>2017</u>
Cash Flows from Operating Activities:		
Receipts from customers	\$11,104,063	\$11,051,909
Payments to suppliers	(4,549,130)	(4,405,881)
Payments to employees	(3,053,450)	(2,924,998)
	<u>3,501,483</u>	<u>3,721,030</u>
Cash Flows from Capital and Related Financing Activities:		
Capital contributions	268,321	336,964
Acquisitions of capital assets	(2,351,059)	(5,640,765)
Proceeds from sale of assets	192,060	44,979
Loan proceeds received	-	2,341,776
Principal paid on capital debt	(450,251)	(348,054)
Interest paid on capital debt	(110,916)	(93,054)
	<u>(2,451,845)</u>	<u>(3,358,154)</u>
Cash Flows from Investing Activities:		
Purchase of investments	(1,307)	(1,178)
Interest on investments	38,410	21,596
	<u>37,103</u>	<u>20,418</u>
Net increase in cash and cash equivalents	1,086,741	383,294
Cash and cash equivalents, beginning of year	<u>7,016,402</u>	<u>6,633,108</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u><u>\$ 8,103,143</u></u>	<u><u>\$ 7,016,402</u></u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 2,827,326	\$ 3,380,176
Adjustments to reconcile operating income to net cash provided by operating activities:		
Changes in assets and liabilities:		
(Increase) decrease in accounts receivable	(46,729)	87,855
(Increase) decrease in accrued unbilled revenue	(1,496)	6,619
(Increase) decrease in inventory	(19,108)	(75,391)
(Increase) decrease in other current assets	(267,638)	(39,791)
(Increase) decrease in deferred outflows of resources	(1,603,538)	(477,727)
Increase (decrease) in accounts payable	(31,186)	(79,231)
Increase (decrease) in accrued payroll	11,707	8,804
Increase (decrease) in other current liabilities	170,350	25,351
Increase (decrease) in deferred inflows of resources	717,948	(39,280)
Increase (decrease) in net pension liability	1,084,935	923,645
Increase (decrease) in net OPEB liability	658,912	-
	<u>3,501,483</u>	<u>3,721,030</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u><u>\$ 3,501,483</u></u>	<u><u>\$ 3,721,030</u></u>

See notes to financial statements.

PADUCAH WATER WORKS
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2018 AND 2017

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 14,900 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.

(Continued)

PADUCAH WATER WORKS
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2018 AND 2017

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

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

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.

(Continued)

PADUCAH WATER WORKS
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2018 AND 2017

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

Pensions and Postemployment Benefits Other Than Pensions

For purposes of measuring the net pension liability, the net postemployment benefits other than pensions (OPEB) liability, deferred outflows of resources and deferred inflows of resources related to pensions and OPEB, pension expense, and OPEB expense information about the fiduciary net position of the County Employees' Retirement System (CERS) and additions to/deductions from the plans' fiduciary net position has been determined on the same basis as they are reported by the plans. 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.

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 \$32,603 and \$32,259 in bad debts during the years ended June 30, 2018 and 2017, 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 24, 2018, 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, 2018 and 2017, Paducah Water Works' financial institution balances were fully collateralized as required by State statute.

Deposits consist of a money market and checking accounts and a fixed rate certificate of deposit with a maturity of eighteen months. The money market and certificate of deposit accounts are reported at cost which represents fair market value. The financial institution balances of Paducah Water Works' deposits were \$8,518,931 for the year ended June 30, 2018. The book balance was \$8,366,891. Of the various financial institution balances at June 30, 2018, \$763,748 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 \$7,755,183 was uninsured and collateralized with securities held by the pledging bank's agent not in Paducah Water Works' name.

(Continued)

PADUCAH WATER WORKS
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2018 AND 2017

Note 2 - Deposits (Continued):

Custodial credit risk for deposits is the risk that in the event of a bank failure, the utility's deposits may not be returned or Paducah Water Works will not be able to recover collateral securities in the possession of an outside party. Paducah Water Works' policy requires all investments be made in accordance with applicable legal requirements with consideration of the safety of its investments. Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations.

Note 3 - Reserve Fund:

As required by the Note Agreement with the Kentucky Infrastructure Authority for the Reidland Interchange Project, Paducah Water Works is required on December 1st each year beginning December 1, 2011 to transfer \$18,750 into replacement reserve until the account balance reaches \$187,500. At June 30, 2018 and 2017, \$131,250 and \$112,500 had been transferred into a replacement reserve account.

As required by the Note Agreement with the Kentucky Infrastructure Authority for the 24" Water Main Project, Paducah Water Works is required on December 1st each year beginning December 1, 2017 to transfer \$11,200 into replacement reserve until the account balance reaches \$112,000. At June 30, 2018, \$11,200 had been transferred into a replacement reserve account.

Note 4 - Capital Assets:

A summary of capital asset activity for the year ended June 30, 2018, is as follows:

	<u>Balance</u> <u>June 30, 2017</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u> <u>June 30, 2018</u>
Capital assets	\$ 93,124,233	\$ 2,693,193	\$ (383,324)	\$ 95,434,102
Accumulated depreciation	<u>(37,834,026)</u>	<u>(2,244,001)</u>	<u>333,579</u>	<u>(39,744,448)</u>
CAPITAL ASSETS, NET	<u>\$ 55,290,207</u>	<u>\$ 449,192</u>	<u>\$ (49,745)</u>	<u>\$ 55,689,654</u>

A summary of capital asset activity for the year ended June 30, 2017, is as follows:

	<u>Balance</u> <u>June 30, 2016</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u> <u>June 30, 2017</u>
Capital assets	\$ 89,543,911	\$ 5,929,291	\$(2,348,969)	\$ 93,124,233
Accumulated depreciation	<u>(37,963,019)</u>	<u>(2,179,062)</u>	<u>2,308,055</u>	<u>(37,834,026)</u>
CAPITAL ASSETS, NET	<u>\$ 51,580,892</u>	<u>\$ 3,750,229</u>	<u>\$ (40,914)</u>	<u>\$ 55,290,207</u>

Note 5 - Notes Payable, KIA:

Notes payable, KIA represents financing from the Kentucky Infrastructure Authority. For the Reidland Interchange note, the interest rate is 1.00% with a .25% annual service fee. The 24" Water Main note has an interest rate of 1.75% with a .25% annual service fee.

(Continued)

**PADUCAH WATER WORKS
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2018 AND 2017**

Note 5 - Notes Payable, KIA (Continued):

The annual requirements to amortize the outstanding debt as of June 30, 2018, are as follows:

<u>Year Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>.25% Service Fee</u>	<u>R & M Reserve</u>	<u>Total</u>
2019	\$ 455,532	\$ 86,971	\$ 17,584	\$29,950	\$ 590,037
2020	460,856	81,646	16,442	29,950	588,894
2021	466,250	76,252	15,287	29,950	587,739
2022	471,709	70,793	14,117	11,200	567,819
2023	477,236	65,266	12,934	11,200	566,636
2024-2028	2,471,573	240,937	46,437	44,800	2,803,747
2029-2033	1,808,096	97,967	16,234	-	1,922,297
2034-2037	<u>535,806</u>	<u>21,312</u>	<u>3,046</u>	-	<u>560,164</u>
TOTALS	<u>\$7,147,058</u>	<u>\$741,144</u>	<u>\$142,081</u>	<u>\$157,050</u>	<u>\$8,187,333</u>

Note 6 - Change in Long-Term Liability:

	<u>Balance June 30, 2017</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2018</u>
Notes payable, KIA				
Reidland Interchange	\$5,255,533	\$ -	\$351,543	\$4,903,990
24" Water Main	<u>2,341,776</u>	-	<u>98,708</u>	<u>2,243,068</u>
TOTALS	<u>\$7,597,309</u>	<u>\$ -</u>	<u>\$450,251</u>	<u>\$7,147,058</u>
	<u>Balance June 30, 2016</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2017</u>
Notes payable, KIA				
Reidland Interchange	\$5,603,587	\$ -	\$348,054	\$5,255,533
24" Water Main	-	<u>2,341,776</u>	-	<u>2,341,776</u>
TOTALS	<u>\$5,603,587</u>	<u>\$2,341,776</u>	<u>\$348,054</u>	<u>\$7,597,309</u>

Note 7 - Employee Benefits:

County Employees' Retirement System Pension and Insurance Funds

Plan Descriptions and benefits provided. 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 (KRS). The plan covers all regular full-time members employed in non-hazardous and hazardous duty positions of any state department, board, agency, county, city, school board, and any other eligible local agencies electing to participate. Paducah Water Works does not have any employees participating in hazardous duty positions. CERS provides 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 amendments are authorized by the State legislature.

(Continued)

PADUCAH WATER WORKS
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2018 AND 2017

Note 7 - Employee Benefits (Continued):

County Employees' Retirement System Pension and Insurance Funds

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. The amount of contribution paid by the insurance fund is based upon years of service. 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.

The Kentucky Retirement Systems issues a publicly available financial report that includes financial statements and required supplementary information for the plans. 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.

Contributions. Contribution rates are established by the Kentucky Revised Statutes. Non-hazardous plan members who began participating prior to September 1, 2008 are required to contribute 5% of their annual creditable compensation. Plan members who began participating on or after September 1, 2008 are required to contribute an additional 1% for retirement health insurance coverage. Plan members who began participating on or after January 1, 2014 are required to contribute to the Cash Balance Plan which is a hybrid plan with characteristics of both a defined benefit plan and a defined contribution plan. Members in the Cash Balance Plan are required to contribute at the same rates as plan members who began participating on or after September 1, 2008. The employer contribution plan rate for non-hazardous plan members was 19.18% for the year ended June 30, 2018. The required contribution rates for fiscal years ending June 30, 2017 and 2016 were 18.68% and 17.06%, respectively. The required contribution rates are made up of a portion that is attributed to the insurance fund and a portion attributed to the pension fund. For fiscal year ended June 30, 2018, the pension plan portion and the insurance fund portions were 14.48% and 4.70%. These percentages were 13.95% and 4.73% for fiscal year ended June 30, 2017 and 12.42% and 4.64% for fiscal year ended June 30, 2016. The pension contributions for fiscal years ended June 30, 2018, 2017, and 2016 were \$425,015, \$398,739 and \$340,960, respectively. The insurance contributions (excluding the implicit subsidy) for fiscal years ended June 30, 2018, 2017, and 2016 were \$137,954, \$135,199, and \$127,701, respectively. The actuarially determined contribution requirements of plan members and Paducah Water Works are established and may be amended by the KRS Board of Trustees.

County Employees' Retirement System Pension Fund

Pension liabilities, pension expense, and deferred outflows of resources and deferred inflows of resources related to pensions. At June 30, 2018 and 2017, Paducah Water Works reported a liability of \$6,871,607 and \$5,786,673, respectively, for its proportionate share of the net pension liability. The net pension liability at June 30, 2018 and 2017 was measured as of June 30, 2017 and 2016, respectively, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2016. For the June 30, 2017 measurement, the total pension liability was rolled-forward from the actuarial valuation date of June 30, 2016 to the plan's fiscal year ending June 30, 2017 using generally accepted actuarial principles. 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, actuarially determined. At June 30, 2018 and 2017, Paducah Water Works' proportion was 0.117397% and 0.11753%.

(Continued)

PADUCAH WATER WORKS
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2018 AND 2017

Note 7 - Employee Benefits (Continued):

County Employees' Retirement System Pension Fund

As a result of its requirement to contribute to CERS pension fund, Paducah Water Works recognized pension expenses of \$1,181,129 and \$798,328 for the years ended June 30, 2018 and 2017, respectively. At June 30, 2018, 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:

	<u>Deferred Outflows Of Resources</u>	<u>Deferred Inflows Of Resources</u>
Net differences between projected and actual earnings on pension plan investments	\$ 544,223	\$459,229
Difference between expected and actual experience	8,523	174,431
Changes of assumptions	1,267,998	-
Change in proportion and differences between employer contributions and proportionate share of contributions	70,518	20,033
Contributions subsequent to the measurement date	<u>425,015</u>	<u>-</u>
TOTALS	<u>\$2,316,277</u>	<u>\$653,693</u>

At June 30, 2017, 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:

	<u>Deferred Outflows Of Resources</u>	<u>Deferred Inflows Of Resources</u>
Net differences between projected and actual earnings on pension plan investments	\$ 544,006	\$ -
Difference between expected and actual experience	25,263	-
Changes of assumptions	306,547	-
Change in proportion and differences between employer contributions and proportionate share of contributions	118,521	59,312
Contributions subsequent to the measurement date	<u>398,739</u>	<u>-</u>
TOTALS	<u>\$1,393,076</u>	<u>\$ 59,312</u>

Deferred outflows of resources in the amount of \$425,015 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, 2019. 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>	
2019	\$554,845
2020	540,208
2021	230,752
2022	(88,236)

(Continued)

PADUCAH WATER WORKS
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2018 AND 2017

Note 7 - Employee Benefits (Continued):

County Employees' Retirement System Pension Fund

The net pension liability as of June 30, 2018, is based on the June 30, 2016, actuarial valuation as rolled forward to the plan's fiscal year end of June 30, 2017 using generally accepted actuarial principles. The net pension liability as of June 30, 2017, is based on the June 30, 2016 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, changes of assumptions, and changes in proportion and differences between employer contributions and proportionate share of contributions are amortized over a period that represents the weighted average of the remaining service life of active and inactive members of the plan (3.50 years and 3.41 years for June 30, 2017 and June 30, 2016, respectively).

Actuarial assumptions. The total pension liability, net pension liability, and sensitivity information for the actuarial valuation as of June 30, 2017 was based on an actuarial valuation date of June 30, 2016. The total pension liability was rolled-forward from the valuation date (June 30, 2016) to the plan's fiscal year ending June 30, 2017, using generally accepted actuarial principles. An actuarial experience study was conducted for the five-year period July 1, 2008 to June 30, 2013. Subsequent to the actuarial valuation date (June 30, 2016), but prior to the measurement date the KRS Board of Trustees reviewed investment trends, inflation, and payroll growth historical trends. Based on this review, the Board adopted the following updated actuarial assumptions which were used in performing the actuarial valuation as of June 30, 2017 (a complete list of actuarial assumptions is listed in the Required Supplementary Information section of this report):

Inflation - 2.30%

Salary increases - 3.05%, average including inflation

Investment rate of return - 6.25%, net of pension plan investment expense including inflation

Payroll growth rate - 2.00%

The total pension liability in the June 30, 2016 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 preceding mortality tables were used in both the June 30, 2017 and 2016 actuarial calculations.

(Continued)

PADUCAH WATER WORKS
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2018 AND 2017

Note 7 - Employee Benefits (Continued):

County Employees' Retirement System Pension Fund

The long-term expected rate of return on plan assets was determined by using a building block method in which best-estimate ranges of expected future real rate of returns are developed for each asset class. The ranges are combined by weighting the expected future real rate of return by the target asset allocation percentage. For the June 30, 2017 actuarial calculation, 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>
US Equity	17.50%	5.97%
International Equity	17.50%	7.85%
Global Bonds	4.00%	2.63%
Global Credit	2.00%	3.63%
High Yield	7.00%	5.75%
Emerging Market Debt	5.00%	5.50%
Private Credit	10.00%	8.75%
Real Estate	5.00%	7.63%
Absolute Return	10.00%	5.63%
Real Return	10.00%	6.13%
Private Equity	10.00%	8.25%
Cash Equivalent	<u>2.00%</u>	1.88%
Total	<u>100.00%</u>	

For the June 30, 2016 actuarial calculation, 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	44.00%	5.40%
Combined Fixed Income	19.00%	1.50%
Real Return (Diversified Inflation Strategies)	10.00%	3.50%
Real Estate	5.00%	4.50%
Absolute Return (Diversified Hedge Funds)	10.00%	4.25%
Private Equity	10.00%	8.50%
Cash Equivalent	<u>2.00%</u>	(.25)%
Total	<u>100.00%</u>	

Discount rate. The discount rate used to measure the total pension liability was 6.25% and 7.50% at June 30, 2017 and 2016, respectively. The discount rate determination does not use a municipal bond rate. 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 26 year amortization period of the unfunded actuarial accrued liability. Once the unfunded actuarial accrued liability is fully amortized, the employer will only contribute the normal cost rate and the administrative expense rate on the close payroll for existing members.

(Continued)

PADUCAH WATER WORKS
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2018 AND 2017

Note 7 - Employee Benefits (Continued):

County Employees' Retirement System Pension Fund

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 6.25%, 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 (5.25%) or 1-percentage-point higher (7.25%) than the current rate:

	<u>1%</u> <u>Decrease</u>	<u>Current</u> <u>Discount</u>	<u>1%</u> <u>Increase</u>
	<u>5.25%</u>	<u>6.25%</u>	<u>7.25%</u>
Paducah Water Works' proportionate share of the net pension liability	\$8,666,582	\$6,871,607	\$5,370,124

Pension plan fiduciary net position. Detailed information about the pension plan's fiduciary net position is available in the separately issued Kentucky Retirement Systems financial report.

Payables to the pension plan. At June 30, 2018 and 2017, the financial statements include no payables to CERS. These are legally required contributions to the plan. These amounts are not accounted for in the net pension liability.

County Employees' Retirement System Insurance Fund - Postemployment Benefits Other Than Pensions (OPEB)

OPEB liabilities, OPEB expense, and deferred outflows of resources and deferred inflows of resources related to OPEB. At June 30, 2018, Paducah Water Works reported a liability of \$2,360,081 for its proportionate share of the net OPEB liability. The total OPEB liability was rolled-forward from the actuarial valuation date of June 30, 2016 to the plan's fiscal year ending, June 30, 2017, using generally accepted actuarial principles. Paducah Water Works' proportion of the net OPEB liability was based on a projection of Paducah Water Works' share of contributions to the OPEB plan relative to the total contributions of all participating employers, actuarially determined. At June 30, 2018, Paducah Water Works' proportion was 0.11740%.

The fully-insured premiums KRS pays for the Kentucky Employees' Health Plan are blended rates based on the combined experience of active and retired members. Because the average cost of providing health care benefits to retirees under age 65 is higher than the average cost of providing health care benefits to active employees, there is an implicit employer subsidy for the non-Medicare eligible retirees. GASB 75 requires that the liability associated with this implicit subsidy be included in the calculation of the total OPEB liability.

As a result of its requirement to contribute to the CERS insurance fund, Paducah Water Works recognized OPEB expenses of \$268,940 for the year ended June 30, 2018. At June 30, 2018, Paducah Water Works reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources:

	<u>Deferred Outflows</u> <u>Of Resources</u>	<u>Deferred Inflows</u> <u>Of Resources</u>
Net differences between projected and actual earnings on OPEB plan investments	\$ -	\$111,536
Difference between expected and actual experience	-	6,555
Changes of assumptions	513,539	-
Change in proportion and differences between employer contributions and proportionate share of contributions	-	5,476
Contributions subsequent to the measurement date	<u>166,798</u>	<u>-</u>
TOTALS	<u>\$ 680,337</u>	<u>\$123,567</u>

(Continued)

PADUCAH WATER WORKS
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2018 AND 2017

Note 7 - Employee Benefits (Continued):

County Employees' Retirement System Insurance Fund - Postemployment Benefits Other Than Pensions (OPEB)

Deferred outflows of resources related to OPEB, in the amount of \$166,798 related to OPEB resulting from Paducah Water Works' contributions subsequent to the measurement date and before the end of the fiscal year will be recognized as a reduction of the net OPEB liability in the year ended June 30, 2019. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to OPEB will be recognized in OPEB expense as follows:

Year Ended	
<u>June 30</u>	
2019	\$67,099
2020	67,099
2021	67,099
2022	67,099
2023	94,982
Thereafter	26,594

The net OPEB liability as of June 30, 2018, is based on the June 30, 2016, actuarial valuation as rolled forward to the plan's fiscal year end of June 30, 2017 using generally accepted actuarial principles. 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, changes of assumptions, and changes in proportion and differences between employer contributions and proportionate share of contributions are amortized over a period that represents the weighted average of the remaining service life of active and inactive members of the plan (6.28 years for June 30, 2017).

Actuarial assumptions. The total OPEB liability, net OPEB liability, and sensitivity information for the actuarial valuation as of June 30, 2017 was based on an actuarial valuation date of June 30, 2016. The total OPEB liability was rolled-forward from the valuation date (June 30, 2016) to the plan's fiscal year ending June 30, 2017, using generally accepted actuarial principles. An actuarial experience study was conducted for the five-year period July 1, 2008 to June 30, 2013. Subsequent to the actuarial valuation date (June 30, 2016), but prior to the measurement date the KRS Board of Trustees reviewed investment trends, inflation, and payroll growth historical trends. Based on this review, the Board adopted the following updated actuarial assumptions which were used in performing the actuarial valuation as of June 30, 2017 (a complete list of actuarial assumptions is listed in the Required Supplementary Information section of this report):

Inflation	2.30%
Salary increases, average, including inflation	3.05%
Investment rate of return, net of OPEB plan investment expense, including inflation	6.25%
Payroll growth rate	2.00%
Municipal bond index rate	
Prior measurement date	2.92%
Measurement date	3.56%
Single equivalent interest rate(discount rate), net of OPEB plan investment expense, including inflation	
Prior measurement date	6.89%
Measurement date	5.84%

Healthcare cost trend rates - Initial trend starting at 7.25% at January 1, 2019, and gradually decreasing to an ultimate trend rate of 4.05% over a period of 13 years (Pre-65). Initial trend rate starting at 5.10% at January 1, 2019, and gradually decreasing to an ultimate trend rate of 4.05% over a period of 11 years (Post-65).

(Continued)

PADUCAH WATER WORKS
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2018 AND 2017

Note 7 - Employee Benefits (Continued):

County Employees' Retirement System Insurance Fund - Postemployment Benefits Other Than Pensions (OPEB)

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 rate of return on plan assets was determined by using a building block method in which best-estimate ranges of expected future real rate of returns are developed for each asset class. The ranges are combined by weighting the expected future real rate of return by the target asset allocation percentage. 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>
US Equity	17.50%	5.97%
International Equity	17.50%	7.85%
Global Bonds	4.00%	2.63%
Global Credit	2.00%	3.63%
High Yield	7.00%	5.75%
Emerging Market Debt	5.00%	5.50%
Private Credit	10.00%	8.75%
Real Estate	5.00%	7.63%
Absolute Return	10.00%	5.63%
Real Return	10.00%	6.13%
Private Equity	10.00%	8.25%
Cash Equivalent	<u>2.00%</u>	1.88%
Total	<u>100.00%</u>	

Discount rate. The discount rate used to measure the total OPEB liability was 5.84%. 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 26 year amortization period of the unfunded actuarial accrued liability. The cost associated with the implicit employer subsidy was not included in the calculation of the KRS's actuarial determined contributions, and any cost associated with the implicit subsidy will not be paid out of the KRS's trusts. Therefore, the municipal bond rate was applied to future expected benefit payments associated with the implicit subsidy. Based on those assumptions, the OPEB plan's fiduciary net position was projected to be available to make all projected future benefit payments from the retirement system, as a result, the Municipal Bond Index Rate was used in the determination of the single equivalent interest rate. There was a change in the Municipal Bond Index Rate from the prior measurement date to the measurement date, so as required under GASB 75, the single equivalent interest rate at the measurement date of 5.84% was calculated using the Municipal Bond Index Rate as of the measurement date of 3.56%, as reported in Fidelity Index's "20-Year Municipal GO AA Index" as of June 30, 2017. This change in the discount rate is considered a change in actuarial assumptions or other inputs under GASB 75.

(Continued)

PADUCAH WATER WORKS
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2018 AND 2017

Note 7 - Employee Benefits (Continued):

County Employees' Retirement System Insurance Fund - Postemployment Benefits Other Than Pensions (OPEB)

Sensitivity of the Paducah Water Works' proportionate share of the net OPEB liability to changes in the discount rate. The following presents Paducah Water Works' proportionate share of the net OPEB liability calculated using the discount rate of 5.84%, as well as what Paducah Water Works' proportionate share of the net OPEB liability would be if it were calculated using a discount rate that is 1-percentage-point lower (4.84%) or 1-percentage-point higher (6.84%) than the current discount rate:

	1% Decrease 4.84%	Current Discount 5.84%	1% Increase 6.84%
Paducah Water Works' proportionate share of the net OPEB liability	\$3,003,073	\$2,360,081	\$1,825,011

Sensitivity of the Paducah Water Works' proportionate share of the net OPEB liability to changes in the healthcare cost trend rates. The following presents Paducah Water Works' proportionate share of the net OPEB liability, as well as what Paducah Water Works' proportionate share of the net OPEB liability would be if it were calculated using healthcare cost trend rates that are 1-percentage-point lower or 1-percentage-point higher than the current healthcare cost trend rates:

	1% Decrease	Current Trend Rate	1% Increase
Paducah Water Works' proportionate share of the net OPEB liability	\$1,810,304	\$2,360,081	\$3,074,760

OPEB plan fiduciary net position

Detailed information about the OPEB plan's fiduciary net position is available in the separately issued Kentucky Retirement Systems financial report.

Payables to the OPEB plan

At June 30, 2018, 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 OPEB 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 \$715,634 and \$677,353 for years ended June 30, 2018 and 2017, 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, 2018 and 2017, is as follows:

	2018	2017
Cash and cash equivalents	\$1,059,995	\$1,204,121
Cash, designated	7,043,148	5,812,281
TOTAL CASH AND CASH EQUIVALENTS	\$8,103,143	\$7,016,402
Noncash capital and related financing activities:		
NONCASH CAPITAL CONTRIBUTIONS	\$ 342,134	\$ 288,526

(Continued)

PADUCAH WATER WORKS
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2018 AND 2017

Note 9 - Other Current Assets:

Other Current Assets consisted of the following:

	<u>2018</u>	<u>2017</u>
Miscellaneous receivable	\$ 748,616	\$ 645,126
Prepaid insurance	122,625	115,979
Health insurance premium receivable	98,605	127,445
Flex advance receivable	13,358	14,856
Other	<u>246,769</u>	<u>58,928</u>
 TOTAL OTHER CURRENT ASSETS	 <u>\$1,229,973</u>	 <u>\$ 962,335</u>

Note 10 - Other Accrued Expenses and Current Liabilities:

Other accrued expenses and current liabilities consisted of the following:

	<u>2018</u>	<u>2017</u>
Accrued payroll and payroll withholdings	\$ 70,754	\$ 58,906
Accrued sales tax	28,142	23,712
City refuse and dumpster payable	175,851	168,322
Sewer service collections payable	641,457	508,049
Deposit collections payable	67,875	55,388
Accrued sick and vacation time	276,380	254,344
Customer advances	38,828	38,828
Replacement reserve	142,450	112,500
Other	<u>44,541</u>	<u>54,849</u>
 TOTAL ACCRUED EXPENSES AND CURRENT LIABILITIES	 <u>\$1,486,278</u>	 <u>\$1,274,898</u>

Note 11 - Miscellaneous Revenues:

Miscellaneous revenues consisted of the following:

	<u>2018</u>	<u>2017</u>
Returned checks	\$ 7,601	\$ 7,575
Re-established service	129,802	109,986
Meter replacement	17,190	12,317
Service calls	10,680	6,430
New service	128,570	122,704
Miscellaneous fees	<u>5,602</u>	<u>9,424</u>
 TOTAL MISCELLANEOUS REVENUE	 <u>\$ 299,445</u>	 <u>\$ 268,437</u>

Note 12 - Other Operating Expenses:

Other operating expenses consisted of the following:

	<u>2018</u>	<u>2017</u>
Legal and professional expenses	\$ 27,135	\$ 35,594
Insurance expense	<u>915,883</u>	<u>902,992</u>
 TOTAL OTHER OPERATING EXPENSES	 <u>\$ 943,018</u>	 <u>\$ 938,588</u>

(Continued)

PADUCAH WATER WORKS
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2018 AND 2017

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

Gain (loss) on Disposal of Capital Asset as of June 30, 2018 consisted of:

Sold 5400 Old Mayfield Rd	\$ 170,455
Disposal of Hendron Tanks & Pump Station	(35,978)
Write off of Hendron Land	<u>(13,766)</u>
 TOTAL GAIN ON DISPOSAL OF CAPITAL ASSET	 <u>\$ 120,711</u>

Gain (loss) on Disposal of Capital Asset as of June 30, 2017 consisted of:

Sold Unit 117	\$ 14,010
Sale of other miscellaneous assets	7,964
Disposal of Chlorine Dioxide Generator	<u>(25,415)</u>
 TOTAL LOSS ON DISPOSAL OF CAPITAL ASSET	 <u>\$ (3,441)</u>

Note 14 - Contingencies:

Paducah Water Works received a claim on July 25, 2016 from an individual stating the individual fell into a meter box. As of June 30, 2018 a settlement amount of \$490,000 was agreed to by Paducah Water's insurance company, but the settlement is not finalized. Paducah Water's insurance company will pay the settlement directly to the individual. Therefore, there is no accrual on the books of Paducah Water Works. Another alleged fall related to a meter box occurred on August 2, 2017, and Paducah Water was not notified until July 20, 2018. It is not known at this time the possible outcome or amount of any potential liability.

Note 15 - Change in Accounting Principles and Restatement of Beginning Net Position:

In June 2015, the *Governmental Accounting Standards Board (GASB)* issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions*, which replaces GASB Statement No. 45. The new standard addresses several issues regarding postemployment benefits other than pensions, 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, 2017. The new standard requires Paducah Water Works to report its proportionate share of the total net other postemployment benefit (OPEB) liability which consists of the insurance portion of the County Employee Retirement System Plan as a liability on the statement of net position and to recognize the appropriate expense on the statement of revenues, expenses, and changes in net position. The standard also requires the deferral of changes in the net OPEB liability and amortization of those changes over set periods.

Paducah Water Works' proportionate share of the net OPEB liability and deferred outflows at July 1, 2017 was \$1,851,177 and \$150,008, respectively. Beginning net position at July 1, 2017 has been adjusted to reflect this.

Net position July 1, 2017, as previously stated	\$52,201,950
 Proportionate share of net OPEB liabilities	 \$(1,851,177)
Deferred outflows	
Contributions made after the measurement date	<u>150,008</u>
Adjustments to net position	<u>(1,701,169)</u>
 NET POSITION JULY 1, 2017, AS RESTATED	 <u>\$50,500,781</u>

The net position at June 30, 2016 and related deferred outflows and inflows could not be determined in a practical manner. Therefore, net position at June 30, 2016 has not been restated and is presented based on previous guidance under GASB Statement No. 45.

REQUIRED SUPPLEMENTARY INFORMATION

PADUCAH WATER WORKS
SCHEDULE OF EMPLOYER'S PROPORTIONATE SHARE OF THE
NET PENSION LIABILITY
COUNTY EMPLOYEES' RETIREMENT SYSTEM (CERS)
LAST FOUR FISCAL YEARS*

	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Employer's proportion of the net pension liability (asset)	0.11740%	0.11753%	0.11311%	0.11693%
Employer's proportionate share of the net pension liability (asset)	\$ 6,871,607	\$ 5,786,673	\$ 4,863,028	\$ 3,794,000
Employer's covered payroll	\$ 2,858,333	\$ 2,739,805	\$ 2,634,729	\$ 2,698,560
Employer's proportionate share of the net pension liability (asset) as a percentage of its covered payroll	240.41%	211.21%	184.57%	140.59%
Plan fiduciary net position as a percentage of the total pension liability	53.30%	55.50%	59.97%	66.80%

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

Notes to Schedule

The total pension liability and net pension liability as of June 30, 2018, is based on the June 30, 2016 actuarial valuation as rolled forward to the plan's fiscal year end of June 30, 2017 using generally accepted actuarial principles. 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, 2016
Experience study:	July 1, 2008 - June 30, 2013
Actuarial cost method:	Entry age normal
Amortization method:	Level percentage of payroll
Remaining amortization period:	26 years
Asset valuation method:	20% of the difference between the market value of assets and the expected actuarial value of assets is recognized each year
Inflation:	2.30%
Payroll Growth:	2.00%
Salary increase:	3.05%, average
Investment rate of return:	6.25%, net of pension plan investment expense, including inflation
Mortality:	For active members: 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: RP 2000 Combined Mortality Table projected with Scale BB to 2013 (female mortality rates are set back one year). For disabled members: RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (male mortality rates are set back four years).
Changes of benefit terms:	None.
Changes of assumptions:	The investment rate of return was decreased from 7.50% to 6.25%. The price inflation assumption was decreased from 3.25% to 2.30% The payroll growth rate assumption was decreased from 4.00% to 2.00%. The salary increase assumption decreased from 4.00% to 3.05%, average. The assumed rates of retirement, withdrawal, and disability were updated to more accurately reflect experience.

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

PADUCAH WATER WORKS
SCHEDULE OF EMPLOYER CONTRIBUTIONS
COUNTY EMPLOYEES' RETIREMENT SYSTEM (CERS)
LAST FIVE FISCAL YEARS*

	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
Contractually required contribution	\$ 425,015	\$ 398,739	\$ 340,284	\$ 335,928	\$ 370,782
Contributions in relation to the contractually required contribution	<u>425,015</u>	<u>398,739</u>	<u>340,960</u>	<u>337,696</u>	<u>370,782</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (676)</u>	<u>\$ (1,768)</u>	<u>\$ -</u>
Employer's covered payroll	\$ 2,935,190	\$ 2,858,333	\$ 2,739,805	\$ 2,634,729	\$ 2,698,560
Contributions as a percentage of covered payroll	14.48%	13.95%	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.

See accompanying notes to the basic financial statements.
No assurance is provided on these financial statements.

PADUCAH WATER WORKS
SCHEDULE OF EMPLOYER'S PROPORTIONATE SHARE OF THE
NET POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS (OPEB) LIABILITY
COUNTY EMPLOYEES' RETIREMENT SYSTEM (CERS) INSURANCE FUND
FISCAL YEAR ENDED JUNE 30, 2018*

	2018
Employer's proportion of the net OPEB liability (asset)	0.11740%
Employer's proportionate share of the net OPEB liability (asset)	\$ 2,360,081
Employer's covered-employee payroll	\$ 2,858,333
Employer's proportionate share of the net OPEB liability (asset) as a percentage of its covered-employee payroll	82.57%
Plan fiduciary net position as a percentage of the total OPEB liability	52.40%

* 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 OPEB liability and net OPEB liability as of June 30, 2018, is based on the June 30, 2016 actuarial valuation as rolled forward to the plan's fiscal year end of June 30, 2017 using generally accepted actuarial principles. 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, 2016
Experience study:	July 1, 2008 - June 30, 2013
Actuarial cost method:	Entry age normal
Amortization method:	Level percentage of payroll
Remaining amortization period:	26 years
Asset valuation method:	20% of the difference between the market value of assets and the expected actuarial value of assets is recognized each year
Inflation:	2.30%
Payroll Growth:	2.00%
Salary increase:	3.05%, average
Investment rate of return:	6.25%, net of OPEB plan investment expense, including inflation
Mortality:	For active members: 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: RP 2000 Combined Mortality Table projected with Scale BB to 2013 (female mortality rates are set back one year). For disabled members: RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (male mortality rates are set back four years).
Healthcare trend rates:	Initial trend starting at 7.25% at January 1, 2019 and gradually decreasing to an ultimate trend rate of 4.05% over a period of 13 years (Pre-65). Initial trend starting at 5.10% at January 1, 2019 and gradually decreasing to an ultimate trend rate of 4.05% over a period of 11 years (Post-65).
Changes of benefit terms:	None.
Changes of assumptions:	The investment rate of return was decreased from 7.50% to 6.25%. The price inflation assumption was decreased from 3.25% to 2.30%. The payroll growth rate assumption was decreased from 4.00% to 2.00%. The salary increase assumption decreased from 4.00% to 3.05%, average. The single discount rate for non-hazardous changed from 6.89% to 5.84%. The municipal bond rate increased from 2.92% to 3.56%. Healthcare trend rates were changed as noted above. The assumed rates of retirement, withdrawal, disability, and medical cost inflation were updated to more accurately reflect experience.

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

PADUCAH WATER WORKS
SCHEDULE OF EMPLOYER CONTRIBUTIONS
NET POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS (OPEB) LIABILITY
COUNTY EMPLOYEES' RETIREMENT SYSTEM (CERS) INSURANCE FUND
LAST TWO FISCAL YEARS*

	<u>2018</u>	<u>2017</u>
Contractually required contribution	\$ 137,954	\$ 135,199
Contributions in relation to the contractually required contribution	<u>137,954</u>	<u>135,199</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>
Employer's covered-employee payroll	\$ 2,935,190	\$ 2,858,333
Contributions as a percentage of covered-employee payroll	4.70%	4.73%

* 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. Contractually required contributions do not include the expected implicit subsidy included in the calculation of the net OPEB liability.

See accompanying notes to the basic financial statements.
No assurance is provided on these financial statements.



WILLIAMS WILLIAMS & LENTZ
CERTIFIED PUBLIC ACCOUNTANTS

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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 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, 2018 and 2017, 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 24, 2018.

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.

Williams, Williams, & Lentz, LLP

Paducah, Kentucky
September 24, 2018



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& LENTZ