

Kentucky Municipal Energy Agency

Independent Auditor's Report and Financial Statements

June 30, 2017 and 2016



Kentucky Municipal Energy Agency

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Independent Auditor's Report

Board of Directors
Kentucky Municipal Energy Agency
Louisville, Kentucky

We have audited the accompanying financial statements of Kentucky Municipal Energy Agency (the Agency), as of and for the years ended June 30, 2017 and 2016, and the related notes to the financial statements, which collectively comprise the Agency's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kentucky Municipal Energy Agency as of June 30, 2017 and 2016, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis as listed in the table of contents 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.

BKD, LLP

Lincoln, Nebraska
December 13, 2017

MANAGEMENT'S DISCUSSION AND ANALYSIS

This discussion and analysis of Kentucky Municipal Energy Agency's ("KyMEA" or the "Agency") financial performance provides an overview of the Agency's activities for the fiscal years ended June 30, 2017 and 2016. It should be read in conjunction with the basic financial statements and the accompanying notes.

Background

KyMEA is a joint agency organized under the Interlocal Cooperation Act of the State of Kentucky. KyMEA was created to allow its Members to collaborate effectively to do all things necessary or convenient to serve the current and future electric power and energy requirements of the Members and to provide assistance to the Members related to their electric power and energy utility systems. The Agency's Members currently consist of the following Kentucky municipalities: Barbourville, Bardwell, Benham, Berea, Corbin, Falmouth, Frankfort, Madisonville, Owensboro, Paris, and Providence (the "Members").

KyMEA was created in 2015 and will begin to supply power to Members beginning on May 1, 2019. During 2017 and 2016, the Agency incurred costs for administration, which were billed to the Members.

Summary of the Financial Statements

The financial statements, related notes to the financial statements and management's discussion and analysis provide information about KyMEA's financial position and activities.

Management's Discussion and Analysis – provides an objective and easily readable analysis of the financial activities of KyMEA based on currently known facts, decisions or conditions.

Balance Sheets – provide a summary of the assets, liabilities and net position of KyMEA, as of the Agency's fiscal year end.

Statements of Revenues, Expenses and Changes in Net Position – present the operating results of KyMEA into various categories of operating revenues and expenses, and non-operating revenues and expenses.

Statements of Cash Flows – report the cash provided by and used for operating activities, as well as other cash sources such as interest income.

Notes to the Financial Statements – provide additional disclosures and information that is essential to a full understanding of the data provided in the statements.

Financial Analysis

The following comparative condensed financial information summarizes the Agency's financial position and operating results for the years ended June 30, 2017 and 2016.

Condensed Balance Sheets

	2017	2016
Assets		
Current assets	\$ 564,113	\$ 418,724
Other noncurrent assets	<u>259,746</u>	<u>50,000</u>
Total assets	<u><u>\$ 823,859</u></u>	<u><u>\$ 468,724</u></u>
Liabilities and Net Position		
Current liabilities	\$ 720,985	\$ 408,826
Net position		
Restricted	259,746	50,000
Unrestricted	<u>(156,872)</u>	<u>9,898</u>
Total net position	<u>102,874</u>	<u>59,898</u>
Total liabilities and net position	<u><u>\$ 823,859</u></u>	<u><u>\$ 468,724</u></u>

Condensed Statements of Revenues, Expenses and Changes in Net Position

	2017	2016
Operating revenues	\$ 1,690,811	\$ 1,013,672
Operating expenses	<u>1,647,967</u>	<u>953,774</u>
Operating income	<u>42,844</u>	<u>59,898</u>
Nonoperating revenues	<u>132</u>	<u>-</u>
Change in net position	<u>42,976</u>	<u>59,898</u>
Net position - Beginning of Year	<u>59,898</u>	<u>-</u>
Net position - End of Year	<u><u>\$ 102,874</u></u>	<u><u>\$ 59,898</u></u>

General Trends and Significant Events

KyMEA will continue to search for additional power and energy resources for its Members, which may include purchased power agreements, investments in power projects and other sources. KyMEA's goal is to establish a portfolio with renewable, coal and natural gas resources to provide more flexibility in response to market changes and future regulations.

Contact Information

This financial report is designed to provide a general overview of KyMEA's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to Heather Overby, Interim Chief Financial Officer, 1500 Broadway, Paducah, KY 42001, (270) 408-5020.

Kentucky Municipal Energy Agency

Balance Sheets

June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Assets		
Current Assets		
Cash	\$ 342,612	\$ 412,782
Accounts receivable	214,023	-
Prepaid expenses	7,478	5,942
Total current assets	<u>564,113</u>	<u>418,724</u>
MISO Collateral Deposit	<u>259,746</u>	<u>50,000</u>
Total assets	<u>\$ 823,859</u>	<u>\$ 468,724</u>
 Liabilities and Net Position		
Current Liabilities		
Accounts payable	<u>\$ 720,985</u>	<u>\$ 408,826</u>
Net Position		
Restricted	259,746	50,000
Unrestricted	(156,872)	9,898
Total net position	<u>102,874</u>	<u>59,898</u>
Total liabilities and net position	<u>\$ 823,859</u>	<u>\$ 468,724</u>

Kentucky Municipal Energy Agency
Statements of Revenues, Expenses and Changes in Net Position
Years Ended June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Operating Revenues		
Billings to members	\$ 1,690,811	\$ 1,013,672
Total operating revenues	<u>1,690,811</u>	<u>1,013,672</u>
Operating Expenses		
Transmission	121,091	65,000
Other operating expenses	<u>1,526,876</u>	<u>888,774</u>
Total operating expenses	<u>1,647,967</u>	<u>953,774</u>
Operating Income	<u>42,844</u>	<u>59,898</u>
Nonoperating Revenues		
Interest income	<u>132</u>	<u>-</u>
Total nonoperating revenues	<u>132</u>	<u>-</u>
Change in Net Position	<u>42,976</u>	<u>59,898</u>
Net Position, Beginning of Year	<u>59,898</u>	<u>-</u>
Net Position, End of Year	<u><u>\$ 102,874</u></u>	<u><u>\$ 59,898</u></u>

Kentucky Municipal Energy Agency
Statements of Cash Flows
Years Ended June 30, 2017 and 2016

	2017	2016
Operating Activities		
Receipts from members	\$ 1,476,788	\$ 1,013,672
Payments to service providers and others	(1,337,344)	(550,890)
MISO collateral remittances	(209,746)	(50,000)
	<u>(70,302)</u>	<u>412,782</u>
Net cash provided by (used in) operating activities		
Investing Activities		
Interest income	<u>132</u>	<u>-</u>
Net cash provided by investing activities	<u>132</u>	<u>-</u>
Net Increase (Decrease) in Cash	(70,170)	412,782
Cash, Beginning of Year	<u>412,782</u>	<u>-</u>
Cash, End of Year	<u><u>\$ 342,612</u></u>	<u><u>\$ 412,782</u></u>
Reconciliation of Operating Income to Net Cash Provided by (Used in) Operating Activities		
Operating income	\$ 42,844	\$ 59,898
Changes in operating assets and liabilities		
Accounts receivable	(214,023)	-
Prepaid expenses	(1,536)	(5,942)
MISO collateral deposit	(209,746)	(50,000)
Accounts payable	<u>312,159</u>	<u>408,826</u>
Net cash provided by (used in) operating activities	<u><u>\$ (70,302)</u></u>	<u><u>\$ 412,782</u></u>

Kentucky Municipal Energy Agency

Notes to Financial Statements

June 30, 2017 and 2016

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Kentucky Municipal Energy Agency (“KyMEA” or the “Agency”) is a joint agency organized under the Interlocal Cooperation Act of the State of Kentucky. KyMEA was formed in 2015 to allow its Members to collaborate effectively to do all things necessary or convenient to serve the current and future electric power and energy requirements of the Members and to provide assistance to the Members related to their electric power and energy utility systems. The Agency’s Members currently consist of the following Kentucky municipalities: Barbourville, Bardwell, Benham, Berea, Corbin, Falmouth, Frankfort, Madisonville, Owensboro, Paris, and Providence (the “Members”).

Eight of the eleven Members have entered into All Requirements Power Sales Contracts (“Contracts”). Under the Contracts, these eight members will purchase all power and energy needed to meet their respective retail requirements, beginning May 1, 2019, and the Contracts also obligate these members to provide revenue sufficient to allow the Agency to meet its obligations, including those related to power purchases, administration and prospective debt issuance.

KyMEA’s Board of Directors (the “Board”) is comprised of representatives from each of the Members. The Board directs and makes all significant decisions relating to the operations of the Agency. During 2017 and 2016, the Agency had no employees.

Reporting Entity

In evaluating how to define the Agency for financial reporting purposes, management has considered all potential component units for which financial accountability may exist. The determination of financial accountability includes consideration of a number of criteria, including: (1) the Agency’s ability to appoint a voting majority of another entity’s governing body and to impose its will on that entity, (2) the potential for that entity to provide specific financial benefits to or impose specific financial burdens on the Agency and (3) the entity’s fiscal dependency on the Agency. Based upon the above criteria, KyMEA has determined that it has no reportable component units.

Basis of Presentation

KyMEA’s activities are accounted for on the flow of economic resources measurement focus and use the accrual basis of accounting. KyMEA’s accounting records are maintained in accordance with accounting principles generally accepted in the United States of America for regulated utilities and generally follow the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission (FERC). KyMEA prepares its financial statements as a business-type activity in conformity with applicable pronouncements of the Governmental Accounting Standards Board (GASB).

Kentucky Municipal Energy Agency

Notes to Financial Statements

June 30, 2017 and 2016

Note 1: Nature of Operations and Summary of Significant Accounting Policies - Continued

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Accounts Receivable

Accounts receivable are stated at the amount billed to the Members. Accounts receivable are due immediately upon issuance of the invoice, which is ordinarily 20 days after the end of the prior month. Management does not believe an allowance for doubtful accounts is necessary at June 30, 2017 and 2016.

Midcontinent Independent System Operator (MISO) Collateral Deposit

KyMEA is a transmission dependent utility of the Midcontinent Independent System Operator, a regional transmission organization whose purpose is to ensure the reliability of its respective integrated, regional electrical transmission systems, to facilitate a regional wholesale marketplace, to provide non-discriminatory access to the transmission system and to maintain and improve electric system reliability.

The collateral deposit represents funds remitted to MISO as a form of financial assurance to secure the Agency's performance under the terms and conditions of the MISO Tariff related to the purchase of transmission service, market services, ancillary services, and related products or services.

Net Position Classification

Net position is required to be classified into three components – net investment in capital assets; restricted; and unrestricted. These classifications are defined as follows:

Net investment in capital assets- This component of net position consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. There are no components of net position at June 30, 2017 and 2016 that meet the “net investment in capital assets” definition.

Restricted - This component of net position consists of constraints placed on net position use through external constraints imposed by creditors (such as through debt covenants), contributors, or law or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

Kentucky Municipal Energy Agency

Notes to Financial Statements

June 30, 2017 and 2016

Note 1: Nature of Operations and Summary of Significant Accounting Policies - Continued

Net Position Classification - Continued

Unrestricted - This component of net position consists of the net amount of assets and liabilities that do not meet the definition of “restricted” or “net investment in capital assets.”

Classification of Revenues and Expenses

Operating revenues and expenses are defined as revenues and expenses directly related to, or incurred in support of, the future procurement and distribution of power and energy to KyMEA’s Members. Operating revenues currently include billings to Members to cover Agency administration costs. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Income Taxes

KyMEA, as a unit of local government of the State of Kentucky, is exempt from federal and state income taxes.

Note 2: Deposits

Custodial credit risk is the risk that in the event of a bank failure, a government’s deposit may not be returned to it. The Agency’s deposit policy for custodial credit risk requires compliance with the provisions of state law.

State law requires collateralization of all deposits with federal depository insurance, bonds and other obligations of the U.S. Treasury, U.S. agencies or instrumentalities of the State of Kentucky, bonds of any city, county, school district or special road district of the State of Kentucky or a surety bond having an aggregate value at least equal to the amount of the deposits. State law also allows uncollateralized deposits issued by any bank rated in one of the three highest categories by a nationally recognized rating agency.

At June 30, 2017 and 2016, the carrying amounts of the Agency’s deposits were \$342,612 and \$412,782, respectively, and the bank balances were \$638,720 and \$426,905, respectively, which were covered by collateral held by the bank’s agent in the Agency’s name.

Kentucky Municipal Energy Agency

Notes to Financial Statements

June 30, 2017 and 2016

Note 3: Commitments

Purchased Power Agreements

KyMEA expects to supply nearly all of its power requirements through a portfolio of purchased power agreements. The Agency currently has three purchased power agreements in effect, with varying terms, to supply its power requirements beginning May 1, 2019.

The first agreement is a 10 year arrangement with Big Rivers Electric Corporation (BREC) for 100 megawatts (MW) of firm base load capacity from BREC's portfolio of owned resources. The second agreement is a three year contract with Illinois Power Marketing Company (IPMC) for 100 MW of capacity from IPMC's 500MW Joppa Power Station, which consists of three coal-fired generating units. The final agreement provides for an initial nomination of 90 MW of peaking capacity from Paducah Power System.

Note 4: Risk Management

KyMEA is exposed to various risks of loss related to torts, theft of, damage to, and destruction of assets; errors and omissions, injuries to agents and others; and natural disasters. The Agency carries commercial insurance, subject to certain limits and deductibles, to reduce the financial impact for claims arising from such matters. Claims have not exceeded this commercial coverage in any of the three preceding years.

Note 5: Subsequent Events

Line of Credit

In July 2017, the Board approved the Agency to execute a revolving line of credit agreement, expiring October 19, 2019, for advances up to \$5,000,000. Advances under this agreement bear interest at two percent (2%) above One Month LIBOR, and interest is payable semi-annually.