

# **Kentucky Municipal Energy Agency**

Independent Auditor's Report and Financial Statements

June 30, 2018 and 2017



# Kentucky Municipal Energy Agency

## June 30, 2018 and 2017

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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, 2018 and 2017, 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, 2018 and 2017, and the changes in financial position and 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  
August 31, 2018

## 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, 2018, 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 2018, 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, operating results and cash flows for the years ended June 30, 2018, 2017 and 2016.

### Condensed Balance Sheets

	2018	2017	2016
<b>Assets</b>			
Current assets	\$ 410,198	\$ 564,113	\$ 418,724
Other noncurrent assets	-	259,746	50,000
Capital assets	406,037	-	-
Total assets	<u>\$ 816,235</u>	<u>\$ 823,859</u>	<u>\$ 468,724</u>
<b>Liabilities and Net Position</b>			
Current liabilities	\$ 640,561	\$ 720,985	\$ 408,826
Noncurrent liabilities	392,005	-	-
Total liabilities	<u>1,032,566</u>	<u>720,985</u>	<u>408,826</u>
Net position			
Net investment in capital assets	54,487	-	-
Restricted	-	259,746	50,000
Unrestricted	(270,818)	(156,872)	9,898
Total net position	<u>(216,331)</u>	<u>102,874</u>	<u>59,898</u>
Total liabilities and net position	<u>\$ 816,235</u>	<u>\$ 823,859</u>	<u>\$ 468,724</u>

### Condensed Statements of Revenues, Expenses and Changes in Net Position

	2018	2017	2016
Operating revenues	\$ 2,195,330	\$ 1,690,811	\$ 1,013,672
Operating expenses	<u>2,514,447</u>	<u>1,647,967</u>	<u>953,774</u>
Operating income (loss)	<u>(319,117)</u>	<u>42,844</u>	<u>59,898</u>
Net nonoperating revenues (expenses)	<u>(88)</u>	<u>132</u>	<u>-</u>
Change in net position	<u>(319,205)</u>	<u>42,976</u>	<u>59,898</u>
Net position - Beginning of Year	<u>102,874</u>	<u>59,898</u>	<u>-</u>
Net position - End of Year	<u>\$ (216,331)</u>	<u>\$ 102,874</u>	<u>\$ 59,898</u>

## ***Financing***

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. The amount outstanding under this line of credit was \$392,005 as of June 30, 2018.

## ***Capital Assets***

The agency's investment in capital assets as of June 30, 2018 totaled \$406,037 (net of accumulated depreciation). This investment includes transportation equipment and construction work in process.

## ***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, Vice President of Finance and Accounting / Chief Financial Officer, 1700 Eastpoint Business Center, Louisville, KY 40223, (502) 640-1304.

# Kentucky Municipal Energy Agency

## Balance Sheets

June 30, 2018 and 2017

	2018	2017
<b>Assets</b>		
<b>Current Assets</b>		
Cash	\$ 61,442	\$ 342,612
Accounts receivable	340,305	214,023
Prepaid expenses	8,451	7,478
Total current assets	410,198	564,113
<b>MISO Collateral Deposit</b>	-	259,746
<b>Capital Assets, Net of Accumulated Depreciation</b>	406,037	-
Total assets	\$ 816,235	\$ 823,859
<b>Liabilities and Net Position</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 612,847	\$ 720,985
Accrued liabilities	26,423	-
Accrued interest payable	1,291	-
Total current liabilities	640,561	720,985
<b>Line of Credit</b>	392,005	-
Total liabilities	1,032,566	720,985
<b>Net Position</b>		
Net investment in capital assets	54,487	-
Restricted	-	259,746
Unrestricted	(270,818)	(156,872)
Total net position	(216,331)	102,874
Total liabilities and net position	\$ 816,235	\$ 823,859



**Kentucky Municipal Energy Agency**  
**Statements of Revenues, Expenses and Changes in Net Position**  
**Years Ended June 30, 2018 and 2017**

	<u>2018</u>	<u>2017</u>
<b>Operating Revenues</b>		
Billings to members	\$ 2,195,330	\$ 1,690,811
Total operating revenues	<u>2,195,330</u>	<u>1,690,811</u>
<b>Operating Expenses</b>		
Transmission	420,596	121,091
Depreciation	2,123	-
Other operating expenses	<u>2,091,728</u>	<u>1,526,876</u>
Total operating expenses	<u>2,514,447</u>	<u>1,647,967</u>
<b>Operating Income (Loss)</b>	<u>(319,117)</u>	<u>42,844</u>
<b>Nonoperating Revenues (Expenses)</b>		
Interest expense	(255)	-
Interest income	<u>167</u>	<u>132</u>
Total nonoperating revenues (expenses)	<u>(88)</u>	<u>132</u>
<b>Change in Net Position</b>	<u>(319,205)</u>	<u>42,976</u>
<b>Net Position, Beginning of Year</b>	<u>102,874</u>	<u>59,898</u>
<b>Net Position, End of Year</b>	<u><u>\$ (216,331)</u></u>	<u><u>\$ 102,874</u></u>

# Kentucky Municipal Energy Agency

## Statements of Cash Flows

### Years Ended June 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
<b>Operating Activities</b>		
Receipts from members	\$ 2,069,048	\$ 1,476,788
Payments to service providers and others	(2,602,358)	(1,337,344)
MISO collateral receipts (remittances)	<u>259,746</u>	<u>(209,746)</u>
Net cash used in operating activities	<u>(273,564)</u>	<u>(70,302)</u>
<b>Noncapital Financing Activities</b>		
Advances from line of credit	147,801	-
Payments on line of credit	<u>(100,000)</u>	<u>-</u>
Net cash provided by noncapital financing activities	<u>47,801</u>	<u>-</u>
<b>Capital and Related Financing Activities</b>		
Advances from line of credit	344,204	-
Purchase of capital assets	(400,814)	-
Interest payments	<u>1,036</u>	<u>-</u>
Net cash used in investing activities	<u>(55,574)</u>	<u>-</u>
<b>Investing Activities</b>		
Interest income	<u>167</u>	<u>132</u>
Net cash provided by investing activities	<u>167</u>	<u>132</u>
<b>Net Decrease in Cash</b>	(281,170)	(70,170)
<b>Cash, Beginning of Year</b>	<u>342,612</u>	<u>412,782</u>
<b>Cash, End of Year</b>	<u><u>\$ 61,442</u></u>	<u><u>\$ 342,612</u></u>
<b>Reconciliation of Operating Income (Loss) to Net Cash Used in Operating Activities</b>		
Operating income (loss)	\$ (319,117)	\$ 42,844
Depreciation	2,123	-
Changes in operating assets and liabilities		
Accounts receivable	(126,282)	(214,023)
Prepaid expenses	(973)	(1,536)
MISO collateral deposit	259,746	(209,746)
Accounts payable	(115,484)	312,159
Accrued expenses	<u>26,423</u>	<u>-</u>
Net cash used in operating activities	<u><u>\$ (273,564)</u></u>	<u><u>\$ (70,302)</u></u>
<b>Supplemental Noncash Activities</b>		
Capital asset acquisitions included in accounts payable	\$ 7,346	\$ -

# **Kentucky Municipal Energy Agency**

## **Notes to Financial Statements**

### **June 30, 2018 and 2017**

#### **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.

##### ***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 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, 2018 and 2017**

**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, 2018 and 2017.

***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.

***Property and Equipment***

Property and equipment acquisitions are stated at cost less accumulated depreciation. Depreciation is charged to expense on the straight-line basis over the estimated useful life of each asset. The Agency is using an estimated useful life for transportation equipment of 7 years.

At June 30, 2018, construction work in progress consists primarily of leasehold improvements and other related assets for the Agency's office space.

***Compensated Absences***

Agency policies permit employees to accumulate vacation, personal time and sick leave benefits that may be realized as paid time off or as a cash payment upon retirement. Expense and the related liability are recognized as benefits are earned whether the employee is expected to realize the benefit as time off or in cash. Compensated absence liabilities are computed using the regular pay rates in effect at the balance sheet date plus an additional amount for compensation-related payments such as social security and Medicare taxes computed using rates in effect at that date.

# Kentucky Municipal Energy Agency

## Notes to Financial Statements

June 30, 2018 and 2017

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

#### ***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.

***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.

***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.

# Kentucky Municipal Energy Agency

## Notes to Financial Statements

June 30, 2018 and 2017

### 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, 2018 and 2017, the carrying amounts of the Agency's deposits were \$61,442 and \$342,612, respectively, and the bank balances were \$152,716 and \$638,720, respectively, which were covered by federal depository insurance up to \$250,000 and then by collateral held by the bank's agent in the Agency's name, for amounts in excess of federally insured limits.

### Note 3: Capital Assets

Capital asset activity for the year ended June 30, 2018 was as follows:

	July 1, 2017	Increase	Decrease	Transfers	June 30, 2018
Construction work in progress	\$ -	\$ 372,498	\$ -	\$ -	\$ 372,498
Equipment	-	35,662	-	-	35,662
Less: accumulated depreciation	-	(2,123)	-	-	(2,123)
Totals	\$ -	\$ 406,037	\$ -	\$ -	\$ 406,037

### Note 4: Line of Credit

In October 2017, the Agency executed 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. The amount outstanding under this line of credit was \$392,005 as of June 30, 2018.

**Kentucky Municipal Energy Agency**  
**Notes to Financial Statements**  
**June 30, 2018 and 2017**

**Note 5: Operating Leases**

The Agency has entered into a noncancellable operating lease for office space expiring in fiscal year 2024. The lease contains two renewal options for 60 months each. The Agency had not taken occupancy of the office space as of June 30, 2018, as such no rent expense was recorded for the fiscal year ending June 30, 2018.

Future minimum lease payments at June 30, 2018 were:

2019	\$ 139,376
2020	155,580
2021	162,183
2022	162,754
2023	162,754
2024	<u>13,563</u>
	<u>\$ 796,210</u>

**Note 6: Retirement Plans**

The Agency offers all employees a deferred compensation plan, created in accordance with Internal Revenue Code Section 457 ("457 Plan"). The 457 Plan permits employees to defer a portion of their salary until termination, retirement or death.

The Agency also sponsors a defined contribution retirement savings plan, created in accordance with Internal Revenue Code Section 401(a). All full-time employees are eligible to participate in this plan. The Agency contributes 10% of base wages to eligible employees. Eligible employees are those that contribute a minimum of 3% to the 457 Plan. Employer contributions of \$14,286 were made for the fiscal year ended June 30, 2018.

Assets and liabilities of the retirement plans are not included in the Agency's financial statements as all assets are held and managed by a third-party administrator.

**Kentucky Municipal Energy Agency**  
**Notes to Financial Statements**  
**June 30, 2018 and 2017**

**Note 7: 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 8: 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.