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Board of Directors and Management
Kentucky Municipal Energy Agency
Louisville, Kentucky

As part of our audit of the financial statements of Kentucky Municipal Energy Agency (the "Agency") as of and for the year ended June 30, 2020, we wish to communicate the following to you.

AUDIT SCOPE AND RESULTS

<u>Auditor's Responsibility Under Auditing Standards Generally Accepted in the United States of America</u>

An audit performed in accordance with auditing standards generally accepted in the United States of America is designed to obtain reasonable, rather than absolute, assurance about the financial statements. In performing auditing procedures, we establish scopes of audit tests in relation to the financial statements taken as a whole. Our engagement does not include a detailed audit of every transaction. Our engagement letter more specifically describes our responsibilities.

These standards require communication of significant matters related to the financial statement audit that are relevant to the responsibilities of those charged with governance in overseeing the financial reporting process. Such matters are communicated in the remainder of this letter or have previously been communicated during other phases of the audit. The standards do not require the auditor to design procedures for the purpose of identifying other matters to be communicated with those charged with governance.

An audit of the financial statements does not relieve management or those charged with governance of their responsibilities. Our engagement letter more specifically describes your responsibilities.

<u>Qualitative Aspects of Significant Accounting Policies and Practices</u>

<u>Significant Accounting Policies</u>

The Agency's significant accounting policies are described in Note 1 of the audited financial statements.

<u>Alternative Accounting Treatments</u>

We had discussions with management regarding alternative accounting treatments within accounting principles generally accepted in the United States of America for policies and practices for material items, including recognition, measurement and disclosure considerations related to the accounting for specific transactions as well as general accounting policies, as follows:

- Proper accounting treatment in accordance with the regulated operations provisions of Governmental Accounting Standards Board (GASB) Statement No. 62

Management Judgments and Accounting Estimates

Accounting estimates are an integral part of financial statement preparation by management, based on its judgments. The following areas involve significant estimates for which we are prepared to discuss management's estimation process and our procedures for testing the reasonableness of those estimates:

- Derivative instruments

Financial Statement Disclosures

The following areas involve particularly sensitive financial statement disclosures for which we are prepared to discuss the issues involved and related judgments made in formulating those disclosures:

- Commitments
- Derivative instruments

Audit Adjustments

During the course of any audit, an auditor may propose adjustments to financial statement amounts. Management evaluates our proposals and records those adjustments which, in its judgment, are required to prevent the financial statements from being materially misstated. A misstatement is a difference between the amount, classification, presentation or disclosure of a reported financial statement item and that which is required for the item to be presented fairly in accordance with the applicable financial reporting framework. No audit adjustments were proposed as a result of the fiscal year 2020 audit engagement.

Auditor's Judgments About the Quality of the Entity's Accounting Principles

During the course of the audit, we made the following observations regarding the Agency's application of accounting principles. The Agency implemented the following Governmental Accounting Standards Board (GASB) Statements for its fiscal year ended June 30, 2020:

- GASB Statement No. 84, *Fiduciary Activities*
- GASB Statement No. 97, *Certain Component Unit Criteria, and Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*

Other Material Communication

Listed below is another material communication between management and us related to the audit:

- Management representation letter (attached)

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit of the financial statements of Kentucky Municipal Energy Agency (the "Agency") as of and for the year ended June 30, 2020, in accordance with auditing standards generally accepted in the United States of America, we considered the Agency's internal control over financial reporting (internal control) as a basis for designing our audit procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Agency's internal control. Accordingly, we do not express an opinion on the effectiveness of the Agency's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified.

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 Agency's financial statements will not be prevented or detected and corrected on a timely basis.

A significant deficiency is a deficiency, or 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.

We observed the following matter that we consider to be a deficiency.

Deficiency

Segregation of Duties

We noted the Vice President of Finance and Accounting/CFO has incompatible duties within the cash outflows transaction cycle. Proper internal control would have the preparation of checks, authorization of wire transfers, and reconciliation of accounting records performed by different individuals, with these abilities being limited for any individuals with review and approval responsibilities. With the limited number of staff employed by the Agency, complete segregation of duties is challenging, however the Agency does employ mitigating controls to address some of these segregation of duties issues. We acknowledge that the Agency is currently in the process of hiring an accountant/financial analyst to further segregate duties.

OTHER MATTERS

Although not considered material weaknesses, significant deficiencies or deficiencies in internal control over financial reporting, we observed the following matters and offer these comments and suggestions with respect to matters which came to our attention during the course of the audit of the financial statements. Our audit procedures are designed primarily to enable us to form an opinion on the financial statements and, therefore, may not bring to light all weaknesses in policies and procedures that may exist. However, these matters are offered as constructive suggestions for the consideration of management as part of the ongoing process of modifying and improving financial and administrative practices and procedures. We can discuss these matters further at your convenience and may provide implementation assistance for changes or improvements.

New Accounting Standards

Governmental Accounting Standards Board Statement No. 87

The Governmental Accounting Standards Board has issued Statement No. 87, *Leases* (GASB 87). GASB 87 provides a new framework for accounting for leases under the principle that leases are financings. No longer will leases be classified between capital and operating. Lessees will recognize an intangible asset and a corresponding liability. The liability will be based on the payments expected to be paid over the lease term, which includes an evaluation of the likelihood of exercising renewal or termination options in the lease. Lessors will recognize a lease receivable and related deferred inflow of resources. Lessors will not derecognize the underlying asset. An exception to the general model is provided for short-term leases that cannot last more than 12 months. Contracts that contain lease and nonlease components will need to be separated so each component is accounted for accordingly.

This statement will be effective for the Agency's fiscal year ending June 30, 2022.

Governmental Accounting Standards Board Statement No. 89

The Governmental Accounting Standards Board has issued Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period* (GASB 89). GASB 89 requires that interest costs incurred before the end of a construction period be recognized as expenses in the period in which the costs are incurred. As a result, the interest cost incurred before the end of a construction period will not be included in the historical cost of a capital asset reported on the Balance Sheet.

This statement will be effective for the Agency's fiscal year ending June 30, 2022.

Governmental Accounting Standards Board Statement No. 96

The Governmental Accounting Standards Board has issued Statement No. 96, *Subscription-Based Information Technology Arrangements* (GASB 96). GASB 96 provides guidance on the accounting and financial reporting for subscription-based information technology arrangements (SBITAs) for government end users. This Statement (1) defines a SBITA; (2) establishes that a SBITA results in a right-to-use subscription asset – an intangible asset – and a corresponding subscription liability; (3) provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA; and (4) requires not disclosures regarding a SBITA.

This statement will be effective for the Agency's fiscal year ending June 30, 2023.

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This communication is intended solely for the information and use of management, the Board of Directors, others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

BKD, LLP

September 11, 2020

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September 11, 2020

BKD, LLP
Certified Public Accountants
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We are providing this letter in connection with your audits of our financial statements as of and for the years ended June 30, 2020 and 2019. We confirm that we are responsible for the fair presentation of the financial statements in conformity with accounting principles generally accepted in the United States of America. We are also responsible for adopting sound accounting policies, establishing and maintaining effective internal control over financial reporting, operations and compliance, and preventing and detecting fraud.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, the following:

1. We have fulfilled our responsibilities, as set out in the terms of our engagement letter dated July 27, 2020, for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America.

2. We acknowledge our responsibility for 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.

3. We acknowledge our responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud.

4. We have reviewed and approved a draft of the financial statements and related notes

referred to above, which you prepared in connection with your audit of our financial statements. We acknowledge that we are responsible for the fair presentation of the financial statements and related notes.

5. We have provided you with:

   (a) Access to all information of which we are aware that is relevant to the preparation and fair presentation of the financial statements such as records, documentation and other matters.

   (b) Additional information that you have requested from us for the purpose of the audit.

   (c) Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.

   (d) All minutes of meetings of the governing body held through the date of this letter.

   (e) All significant contracts and grants.

6. All transactions have been recorded in the accounting records and are reflected in the financial statements.

7. We have informed you of all current risks of a material amount that are not adequately prevented or detected by entity procedures with respect to:

   (a) Misappropriation of assets.

   (b) Misrepresented or misstated assets, liabilities or net position.

8. We have no knowledge of any known or suspected:

   (a) Fraudulent financial reporting or misappropriation of assets involving management or employees who have significant roles in internal control.

   (b) Fraudulent financial reporting or misappropriation of assets involving others that could have a material effect on the financial statements.

9. We have no knowledge of any allegations of fraud or suspected fraud affecting the Agency received in communications from employees, customers, regulators, suppliers or others.

10. We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.

11. We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware. Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with accounting principles generally accepted in the United States of America. We understand that the term related party refers to an affiliate; management, and members of their immediate families, component units; and any other party with which the entity may deal if it can significantly influence, or be influenced by, the management or operating policies of the other. The term affiliate refers to a party that directly or indirectly controls, or is controlled by, or is under common control with us.

12. Except as reflected in the financial statements, there are no:

    (a) Plans or intentions that may materially affect carrying values or classifications of assets and liabilities.

    (b) Material transactions omitted or improperly recorded in the financial statements.

    (c) Material gain/loss contingencies requiring accrual or disclosure, including those arising from environmental remediation obligations.

    (d) Events occurring subsequent to the balance sheet date through the date of this letter requiring adjustment or disclosure in the financial statements.

    (e) Agreements to purchase assets previously sold.

    (f) Restrictions on cash balances or compensating balance agreements.

    (g) Guarantees, whether written or oral, under which the Agency is contingently liable.

13. We have disclosed to you all known instances of noncompliance or suspected noncompliance with laws and regulations whose effects should be considered when preparing financial statements.

14. We have no reason to believe the Agency owes any penalties or payments under the Employer Shared Responsibility Provisions of the Patient Protection and Affordable Care Act nor have we received any correspondence from the IRS or other agencies indicating such payments may be due.

15. We are not aware of any pending or threatened litigation or claims whose effects should be considered when preparing the financial statements. We have not sought or received attorney's services related to pending or threatened litigation or claims

during or subsequent to the audit period. Also, we are not aware of any litigation or claims, pending or threatened, for which legal counsel should be sought.

16. Adequate provisions and allowances have been accrued for any material losses from:

    (a) Uncollectible receivables.

    (b) Sales commitments, including those unable to be fulfilled.

    (c) Purchase commitments in excess of normal requirements or above prevailing market prices.

17. Except as disclosed in the financial statements, we have:

    (a) Satisfactory title to all recorded assets, and they are not subject to any liens, pledges or other encumbrances.

    (b) Complied with all aspects of contractual and grant agreements, for which noncompliance would materially affect the financial statements.

18. We have not been designated as a potentially responsible party (PRP or equivalent status) by the Environmental Protection Agency (EPA) or other cognizant regulatory agency with authority to enforce environmental laws and regulations.

19. With regard to deposit and investment activities:

    (a) All deposit and investment transactions have been made in accordance with legal and contractual requirements.

    (b) Disclosures of deposit and investment balances and risks in the financial statements are consistent with our understanding of the applicable laws regarding enforceability of any pledges of collateral.

    (c) We understand that your audit does not represent an opinion regarding the enforceability of any collateral pledges.

20. With respect to any nonattest services you have provided us during the year, including assistance with drafting of the financial statements and related notes:

    (a) We have designated a qualified management-level individual to be responsible and accountable for overseeing the nonattest services.

    (b) We have established and monitored the performance of the nonattest services to ensure that they meet our objectives.

(c) We have made any and all decisions involving management functions with respect to the nonattest services and accept full responsibility for such decisions.

(d) We have evaluated the adequacy of the services performed and any findings that resulted.

21. The financial statements disclose all significant estimates and material concentrations known to us. Significant estimates are estimates at the balance sheet date which could change materially within the next year. Concentrations refer to volumes of business, revenues, available sources of supply, or markets for which events <u>could</u> occur which would significantly disrupt normal finances within the next year. Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.

22. The fair values of financial and nonfinancial assets and liabilities, if any, recognized in the financial statements or disclosed in the notes thereto are reasonable estimates based on the methods and assumptions used. The methods and significant assumptions used result in measurements of fair value appropriate for financial statement recognition and disclosure purposes and have been applied consistently from period to period, taking into account any changes in circumstances. The significant assumptions appropriately reflect market participant assumptions.

23. The supplementary information required by the Governmental Accounting Standards Board, consisting of management's discussion and analysis, has been prepared and is measured and presented in conformity with the applicable GASB pronouncements, and we acknowledge our responsibility for the information. The information contained therein is based on all facts, decisions and conditions currently known to us and is measured using the same methods and assumptions as were used in the preparation of the financial statements. We believe the significant assumptions underlying the measurement and/or presentation of the information are reasonable and appropriate. There has been no change from the preceding period in the methods of measurement and presentation.

24. We believe the commodity swaps are effective in hedging the risk of market price fluctuations and should be considered qualifying hedging derivative instruments, as defined by GASB Codification Section D40, for financial statement presentation purposes.

25. We acknowledge the current protracted economic decline presents difficult circumstances and challenges for the governmental industry. Governmental entities are facing declines in the fair values of investments and other assets, declines in the volume of business, constraints on liquidity and difficulty obtaining financing. We understand the values of the assets and liabilities recorded in the

financial statements could change rapidly, resulting in material future adjustments to asset values, allowances for accounts and notes receivable, etc. that could negatively impact the Agency's ability to meet debt covenants or maintain sufficient liquidity. We acknowledge that you have no responsibility for future changes caused by the current economic environment and the resulting impact on the Agency's financial statements. Further, management and the Board are solely responsible for all aspects of managing the Agency, including questioning the quality and valuation of investments, other assets, reviewing allowances for uncollectible amounts and evaluating capital needs and liquidity plans.

Doug Buresh
Doug Buresh, President and CEO

Heather Overby
Heather Overby, Vice President of Finance & Accounting / CFO