

***OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM
&
WATER WORKS SYSTEM
FINANCIAL STATEMENTS
& SUPPLEMENTARY INFORMATION
Years Ended May 31, 2020 and 2019***

(With Independent Auditor's Report Thereon)

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INDEPENDENT AUDITOR'S REPORT

City Utility Commission
City of Owensboro, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the Owensboro Municipal Utilities Electric Light and Power System (Electric System), a component unit of the City of Owensboro, Kentucky, as of and for the years ended May 31, 2020 and 2019, and the related notes to the 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 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 the Owensboro Municipal Utilities Electric Light and Power System of the City of Owensboro, Kentucky, as of May 31, 2020 and 2019, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 6 and the Pension and Other Postemployment Benefits (OPEB) Schedules on pages 38 through 42, be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the 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 financial statements, and other knowledge we obtained during our audit of the 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 Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The Schedule of Revenues and Expenses is presented for purposes of additional analysis and is not a required part of the financial statements.

The Schedule of Revenues and Expenses is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of revenues and expenses is fairly stated in all material respects, in relation to the financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 23, 2020, on our consideration of Electric System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely 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 effectiveness of the Electric System's 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 the Electric System's internal control over financial reporting and compliance.

Owensboro, Kentucky
September 23, 2020

Ringel Hancock CPA's PSC

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of the Owensboro Municipal Utilities Electric Light and Power System (Electric System) financial performance provides an overview of the Electric System's financial activities for the fiscal year ended May 31, 2020. Please read it in conjunction with the Electric System's financial statements, which begin on page 7.

Overview of the Financial Statements

This annual report consists of three parts: Management's Discussion and Analysis, Financial Statements, and Supplementary Information.

Management's Discussion and Analysis (MD&A) serves as an introduction to the basic financial statements and supplementary information. The MD&A represents management's examination and analysis of the Electric System's financial condition and performance.

The financial statements report information using accounting methods similar to those used by private sector companies. The financial statements include a Statement of Net Position; a Statement of Revenues, Expenses, and Changes in Fund Net Position; a Statement of Cash Flows; and Notes to the Financial Statements.

The Statement of Net Position presents the financial position of the Electric System and thus provides information about the nature and amount of resources and obligations at year-end.

The Statement of Revenues, Expenses, and Changes in Net Position presents the results of the business activities over the course of the fiscal year and information as to how the net position changed during the year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flow.

The Statement of Cash Flows presents changes in cash and cash equivalents resulting from operational, financing and investing activities. This statement presents cash receipts and cash disbursements information, without consideration of the earnings event or when an obligation arises.

The Notes to the Financial Statements provide required disclosures and other information that are essential to a full understanding of material data provided in the statements. The notes present information about the Electric System's accounting policies, significant account balances and activities, material risks, obligations, commitments, contingencies and subsequent events, if any.

MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED

Financial Summary

The following table summarizes the financial condition and operations of the Electric System for 2020 and 2019.

Assets and Deferred Outflows of Resources	2020	2019
Utility plant, net	\$ 144,403,195	\$ 153,690,633
Restricted assets	57,605,012	90,171,827
Current assets	72,233,239	68,119,541
Other noncurrent assets	19,881,111	14,701,392
Deferred outflows of resources	59,929,304	56,464,945
	<u>\$ 354,051,861</u>	<u>\$ 383,148,338</u>

Liabilities, Deferred Inflows of Resources, and Net Position

Net position		
Net investment in capital assets	\$ 31,356,119	\$ 9,971,619
Restricted	38,602,465	59,457,106
Unrestricted	72,355,305	68,178,200
Total net position	142,313,889	137,606,925
Long-term debt	111,081,991	143,252,879
Current liabilities	33,919,239	40,524,043
Other noncurrent liabilities	60,863,962	55,972,702
Deferred revenues	1,080,450	431,961
Deferred inflows of resources	4,792,330	5,359,828
	<u>\$ 354,051,861</u>	<u>\$ 383,148,338</u>

Revenues, Expenses and Changes in Net Position

Operating revenues	\$ 122,627,803	\$ 155,207,207
Operating expenses	105,107,398	132,966,126
Operating income	17,520,405	22,241,081
Interest, debt expense and defeasance	(5,814,348)	(8,542,856)
Interest and other income	2,612,709	3,298,041
Net nonoperating expenses	(3,201,639)	(5,244,815)
Income before transfers	14,318,766	16,996,266
Transfers out - dividends to City of Owensboro	(9,611,802)	(9,387,288)
Change in net position	<u>\$ 4,706,964</u>	<u>\$ 7,608,978</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED

FINANCIAL HIGHLIGHTS

- Total net position increased \$4.7 million in 2020, or 3.4%, versus an increase of \$7.6 million in 2019 as the result of changes in operating revenues, operating expenses, nonoperating revenues/expenses and transfers, as discussed below.
- Operating revenues decreased 32.6 million, or 21.0%, in 2020 when compared to 2019. The decrease in 2020 is due primarily to wholesale revenues decreasing \$38.5 million, or 69.7%, in 2020 from decreased wholesale energy sales volumes due to decreased Elmer Smith Generating Station (ESGS) power generation. In 2020, there was essentially no generation by ESGS's generating Unit 1. In 2019, there were no planned maintenance outages and fewer generation curtailments during periods of projected low wholesale prices, which led to increased ESGS surplus generation being sold into the energy market. Partially offsetting the wholesale revenue decrease was an increase in retail electric revenues of \$5.9 million in 2020, or 6.5%, versus 2019. This increase was primarily due to increased recovery of energy costs from retail customers through the energy cost adjustment. The adjustment provides for the Electric System to adjust charges to its retail customers for fluctuations in energy costs. The primary cause of the retail energy cost increase was a decline in wholesale energy sales volumes in 2020, as discussed above, resulting in a reduction in energy cost recovery from wholesale customers and increasing the recovery requirement from retail customers. Finally, in 2020, telecommunication revenues were up \$454,425, or 22.9%, due to increases in commercial telecommunication services, as well as additional residential services through the expanding Fiber-to-the-Home program.
- Operating expenses in 2020 decreased \$27.9 million, or 21.0%, versus 2019, largely the result of an overall decrease in power production cost of \$26.3 million, or 29.1%. Fuel cost decreased \$22.3 million, or 37.0%, as less fuel was required due to decreased power generation discussed above. Other production costs decreased \$3.5 million, or 17.4%, as maintenance costs decreased \$4.1 million, or 69.9%, due to no power generated in 2020 by the ESGS's generating Unit 1.
- Nonoperating expenses decreased by \$2.0 million, or 39.0%, in 2020 when compared to 2019. Interest expense decreased by \$2.7 million, or 31.5%, primarily the result of debt refunded in connection with the 2019 Series bond issuance, as discussed below, as well as final maturity of the 1991-B and 2002-A Series bonds. Interest income also decreased by \$686,622, or 21.0%, primarily due to lower bank and investment balances, as well as lower rates received on those balances.
- Dividend transfers to the City of Owensboro increased by \$224,514 in 2020, or 2.4%, due primarily to an increase in actual cash transfers to the City.

MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of 2020, the Electric System had \$144.4 million invested in a broad range of assets, including power plant facilities and equipment, substation facilities and equipment, transformers, poles, wiring, street lighting, traffic signal equipment, communication equipment, fiber optic cable and equipment, buildings and other equipment. This represents a decrease of \$9.3 million over 2019 due to depreciation that exceeded capital asset additions. In addition to other routine capital additions during 2020, the Electric System incurred \$2.7 million on the Fiber-to-the-Home program to deliver high-speed internet service to residential customers. The Electric System also incurred \$2.2 million on a transmission interconnect project required due to the shutdown of ESGS and the increased need to transmit power from external sources, \$958,000 on routine distribution pole change-outs, \$704,000 on street and park lighting, and \$567,000 for the back-up control center and relay house. The following table summarizes capital assets, net of accumulated depreciation, at the end of 2020 and 2019:

	<u>2020</u>	<u>2019</u>
Production plant	\$ 61,136,316	\$ 75,390,040
Transmission plant	11,325,226	11,938,286
Distribution plant	47,606,200	36,932,335
General plant	6,550,857	7,274,900
Unclassified plant and construction in progress	17,784,596	22,155,072
	<u>\$ 144,403,195</u>	<u>\$ 153,690,633</u>

Debt

At the end of 2020, the Electric System had \$113.5 million in bonds outstanding versus \$156.3 million in 2019, for a decrease of \$42.8 million, or 27.4%. Scheduled debt repayments along with the 2019 Series bond refunding of existing debt resulted in the overall decline in outstanding debt. In addition to refinancing a portion of existing debt to reduce interest cost, the Electric System utilized \$15 million of its cash reserves to lower outstanding debt in connection with the 2019 Bonds. The Electric System bonds carry ratings of "A" (stable outlook) and "A3" (stable outlook) as assigned by S&P Global Ratings and Moody's Investors Services, Inc., respectively.

Outlook

We expect the 2021 net operating results to decline somewhat from 2020 results, with lower revenue anticipated to outpace overall cost reductions. Retail revenues are expected to be lower due to both lower expected sales volumes and lower rates. Wholesale revenues are expected to diminish with the shutdown of ESGS and cessation of energy sales to the wholesale power market. In regard to operating expenses, overall power costs are expected to decline as a result of lower purchased power cost from external sources versus self-generation. Additionally, interest expense should continue to decline because of the 2019 Series bond refunding discussed above. Finally, in 2021, Telecom residential revenue is expected to continue growing with the ongoing expansion of the Fiber-to-the-Home system.

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**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

STATEMENTS OF NET POSITION

May 31, 2020 and 2019

**ASSETS AND DEFERRED OUTFLOWS OF
RESOURCES**

	<u>2020</u>	<u>2019</u>
Utility plant, net	\$ 144,403,195	\$ 153,690,633
Restricted assets	<u>57,605,012</u>	<u>90,171,827</u>
Current assets:		
Cash and cash equivalents	29,163,473	20,862,250
Investments	24,000,367	28,921,563
Receivables:		
Retail accounts receivable, less allowance for doubtful accounts of \$95,984 for 2020 and \$47,205 for 2019	9,533,890	10,081,011
Wholesale accounts receivable	1,401,643	2,582,444
City of Owensboro	127,505	185,264
Other	2,441,741	636,153
Materials and supplies inventories	5,137,982	4,227,617
Prepayments	425,884	345,849
Other	<u>754</u>	<u>277,390</u>
Total current assets	<u>72,233,239</u>	<u>68,119,541</u>
Other noncurrent assets:		
Unamortized debt expense	735,276	875,414
Energy cost to be recovered	19,140,835	13,819,774
Other noncurrent assets	<u>5,000</u>	<u>6,204</u>
Total other noncurrent assets	<u>19,881,111</u>	<u>14,701,392</u>
Total assets	<u>294,122,557</u>	<u>326,683,393</u>
Deferred outflows of resources:		
Accumulated decrease in fair value of hedging derivatives	-	71,464
Deferred asset retirement outflow	285,523	-
Deferred pension outflows	8,438,711	9,431,044
Deferred other postemployment benefit outflows	3,818,353	3,054,090
Deferred pension obligation	35,835,162	31,322,536
Deferred postemployment benefit obligation	10,219,173	10,043,223
Deferred asset retirement obligation	-	144,100
Unamortized loss on debt refunding	1,332,382	2,191,684
Net unrealized loss on investments	<u>-</u>	<u>206,804</u>
Total deferred outflows of resources	<u>59,929,304</u>	<u>56,464,945</u>
Total assets and deferred outflows of resources	<u><u>\$ 354,051,861</u></u>	<u><u>\$ 383,148,338</u></u>

**LIABILITIES, DEFERRED INFLOWS OF
RESOURCES, AND NET POSITION**

	<u>2020</u>	<u>2019</u>
Net position:		
Net investment in capital assets	\$ 31,356,119	\$ 9,971,619
Restricted for capital projects, net of related debt	6,885,749	5,924,053
Restricted for debt service	6,434,427	16,862,799
Restricted for other purposes	25,282,289	36,670,254
Unrestricted	<u>72,355,305</u>	<u>68,178,200</u>
Total net position	<u>142,313,889</u>	<u>137,606,925</u>
Long-term debt	<u>111,081,991</u>	<u>143,252,879</u>
Current liabilities (payable from restricted assets):		
Current maturities of long-term debt	13,390,000	18,661,838
Accrued interest payable	2,313,838	2,653,886
Accounts payable	<u>399,012</u>	<u>5,815,189</u>
	<u>16,102,850</u>	<u>27,130,913</u>
Current liabilities (payable from current assets):		
Accounts payable	5,616,704	5,229,366
Other	<u>12,199,685</u>	<u>8,163,764</u>
	<u>17,816,389</u>	<u>13,393,130</u>
Total current liabilities	<u>33,919,239</u>	<u>40,524,043</u>
Other noncurrent liabilities:		
Net pension liability	43,315,494	37,759,911
Net other postemployment benefit liability	10,356,480	11,007,791
Asset retirement obligation	<u>7,191,988</u>	<u>7,205,000</u>
Total other noncurrent liabilities	<u>60,863,962</u>	<u>55,972,702</u>
Commitments and contingencies (Note 9)		
Deferred revenues	<u>1,080,450</u>	<u>431,961</u>
Total liabilities	<u>206,945,642</u>	<u>240,181,585</u>
Deferred inflows of resources:		
Accumulated increase in fair value of hedging derivatives	-	276,636
Deferred pension inflows	958,379	2,993,670
Deferred other postemployment benefit inflows	3,681,046	2,089,522
Net unrealized gains on investments	<u>152,905</u>	<u>-</u>
Total deferred inflows of resources	<u>4,792,330</u>	<u>5,359,828</u>
Total liabilities, deferred inflows of resources, and net position	\$ <u>354,051,861</u>	\$ <u>383,148,338</u>

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

Years Ended May 31, 2020 and 2019

	<u>2020</u>	<u>2019</u>
Operating revenues:		
Charges for services:		
Residential	\$ 33,974,239	\$ 31,704,076
Commercial	9,173,504	7,668,602
Industrial	55,351,826	52,775,883
Water Works System	1,192,960	1,177,066
City of Owensboro and Schools	3,436,495	3,150,770
Supplemental power	1,124,848	1,621,059
Other wholesale	16,697,010	55,178,896
Build America Bond subsidy	276,741	542,764
Other	1,400,180	1,388,091
Total operating revenues	<u>122,627,803</u>	<u>155,207,207</u>
Operating expenses:		
Production:		
Fuel for electric generation	37,951,248	60,250,869
Purchased power	9,761,292	10,301,425
Other	16,573,476	20,069,853
Transmission and distribution	10,549,046	10,298,808
Customer service and information	2,066,091	1,964,320
General and administrative	7,381,448	8,231,723
Telecommunications	1,053,280	1,038,967
Depreciation	19,771,517	20,810,161
Total operating expenses	<u>105,107,398</u>	<u>132,966,126</u>
Operating income	<u>17,520,405</u>	<u>22,241,081</u>
Nonoperating revenues (expenses):		
Interest and debt expense	(5,814,348)	(8,483,737)
Loss on debt defeasance	-	(59,119)
Interest income on investments	2,584,889	3,271,511
Other, net	27,820	26,530
Net increase (decrease) in fair value of investments	359,709	898,675
Deferred net change in fair value of investments	(359,709)	(898,675)
Total nonoperating revenues (expenses)	<u>(3,201,639)</u>	<u>(5,244,815)</u>
Income before transfers	14,318,766	16,996,266
Transfers out - dividends to City of Owensboro	<u>(9,611,802)</u>	<u>(9,387,288)</u>
Change in net position	<u>4,706,964</u>	<u>7,608,978</u>
Net position, beginning of year, before restatement	137,606,925	136,914,747
Cumulative effect of a change in accounting principle	<u>-</u>	<u>(6,916,800)</u>
Net position, beginning of year, as restated	<u>137,606,925</u>	<u>129,997,947</u>
Net position, end of year	<u>\$ 142,313,889</u>	<u>\$ 137,606,925</u>

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

STATEMENTS OF CASH FLOWS

Years Ended May 31, 2020 and 2019

	<u>2020</u>	<u>2019</u>
Cash flows from operating activities:		
Receipts from customers, including collections as agent for third parties	\$ 146,693,308	\$ 187,854,644
Customer remittances to third parties	(27,588,177)	(29,284,689)
Payments to suppliers	(67,694,217)	(92,067,391)
Payments to employees	(15,554,479)	(14,703,112)
Net cash provided by operating activities	<u>35,856,435</u>	<u>51,799,452</u>
Cash flows from noncapital financing activities:		
Transfers out - dividends to City of Owensboro	<u>(9,611,802)</u>	<u>(9,387,288)</u>
Cash flows from capital and related financing activities:		
Capital expenditures	(10,298,459)	(8,740,510)
Payments on long-term debt	(19,275,000)	(19,405,000)
Interest paid on long-term debt	(4,345,550)	(6,787,737)
Proceeds from bond issuance	71,486,827	-
Payment to refunded bond agent	(90,305,755)	(3,100,749)
Debt issuance cost	<u>(302,055)</u>	<u>-</u>
Net cash used in capital and related financing activities	<u>(53,039,992)</u>	<u>(38,033,996)</u>
Cash flows from investing activities:		
Purchase of investments	(28,501,425)	(32,183,554)
Proceeds from sale and maturities of investments	68,552,767	34,094,000
Interest on investments	<u>2,984,854</u>	<u>3,247,534</u>
Net cash provided by investing activities	<u>43,036,196</u>	<u>5,157,980</u>
Net increase in cash and cash equivalents	16,240,837	9,536,148
Cash and cash equivalents, beginning of year	<u>59,145,209</u>	<u>49,609,061</u>
Cash and cash equivalents, end of year	<u><u>\$ 75,386,046</u></u>	<u><u>\$ 59,145,209</u></u>
Included in the following Statements of Net Position captions:		
Restricted assets	\$ 46,222,573	\$ 38,282,959
Cash and cash equivalents	<u>29,163,473</u>	<u>20,862,250</u>
	<u><u>\$ 75,386,046</u></u>	<u><u>\$ 59,145,209</u></u>

See Notes to Financial Statements

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

STATEMENTS OF CASH FLOWS, Concluded

Years Ended May 31, 2020 and 2019

	<u>2020</u>	<u>2019</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 17,520,405	\$ 22,241,081
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	20,048,657	21,081,212
Other revenues	6,086	8,898
Change in assets and liabilities:		
Decrease (increase) in assets and deferred outflows of resources:		
Restricted assets:		
Fuel inventory	4,289,245	2,392,556
Other	998,823	(137,128)
Receivables	1,424,969	1,907,845
Materials and supplies	(910,365)	(18,032)
Prepayments	(80,035)	25,007
Other noncurrent assets	(5,319,857)	4,895,868
Deferred outflows of resources	144,100	144,100
Increase (decrease) in liabilities and deferred inflows of resources:		
Accounts payable	(7,021,467)	(1,434,699)
Other current liabilities	4,107,385	927,749
Deferred revenues	648,489	(235,005)
Net cash provided by operating activities	\$ <u>35,856,435</u>	\$ <u>51,799,452</u>
Noncash investing, capital and financing activities:		
Accretion of interest expense on long-term debt	\$ <u>613,162</u>	\$ <u>1,611,139</u>
Amortization of debt premium and expense and deferred loss on debt defeasance	\$ <u>(432,909)</u>	\$ <u>431,459</u>
Deferred gain on hedging derivatives	\$ <u>-</u>	\$ <u>205,172</u>

OWENSBORO MUNICIPAL UTILITIES ELECTRIC LIGHT AND POWER SYSTEM

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

1. Organization and Summary of Significant Accounting Policies

General Information

In 1940, the City of Owensboro, Kentucky (City), established the City Utility Commission to manage, control and operate Owensboro Municipal Utilities (OMU). City officials appoint the five individuals who comprise the City Utility Commission. OMU consists of the Electric Light and Power System (Electric System) and the Water Works System (Water System), which are component units of the City. Accordingly, the Electric System and the Water System are part of the financial reporting entity of the City. The accompanying financial statements present only the Electric System and are not intended to present fairly the financial position of the City and the changes in its financial position or, where applicable, its cash flows, in conformity with accounting principles generally accepted in the United States of America. The Electric System is subject to regulation by the City, including approval of rates charged for utility services, as set forth in applicable City ordinances.

The Electric System provides electric power to approximately 26,000 residential, commercial and industrial customers in Owensboro, Kentucky. The Electric System also sells electric power into regional wholesale power markets and to other wholesale customers.

The Electric System consists of the original generating station, the transmission and distribution plant and the Elmer Smith Generating Station (ESGS). ESGS is operated, including subsequent additions, as a separate division.

System of Accounts and Basis of Accounting

The Electric System's accounts are maintained substantially in accordance with the Uniform System of Accounts of the Federal Energy Regulatory Commission and in conformity with accounting principles generally accepted in the United States of America using the economic resources measurement focus and the accrual basis of accounting.

The financial statements are prepared in accordance with generally accepted accounting principles and follow accounting guidance provided by the Governmental Accounting Standards Board (GASB) in the regulated operations provisions of GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which permit certain entities with cost-based rates to defer certain costs or income that would otherwise be recognized when incurred to the extent that the rate-regulated entity is recovering or expects to recover such amounts in future rates charged to its customers. Regulatory assets are the deferral of costs expected to be recovered in future customer rates and regulatory liabilities represent current recovery of expected future costs.

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

1. Organization and Summary of Significant Accounting Policies, Continued

System of Accounts and Basis of Accounting, Continued

The Electric System considers electric and telecommunications revenues and costs that are directly related to generation, purchase, transmission, and distribution of electricity and telecommunications services to be operating revenues and expenses. Revenues and expenses related to financing and other activities are reflected as nonoperating.

The Electric System accrues revenues as services are rendered to utility customers. In addition, the Electric System's present electric rate ordinance provides for an energy cost adjustment and environmental control cost adjustment to be made to customer bills, except bills rendered to the City, to reflect changes in the price of fuel and maintenance costs and environmental compliance costs to generate electricity. The Electric System estimates and records amounts to be billed or refunded under the energy cost adjustment on a monthly basis.

Change in Accounting Principles

In 2020, the Electric System adopted the provisions of GASB Statement No. 83, *Certain Asset Retirement Obligations*, as it relates to the shutdown of Elmer Smith Generating Station (ESGS) and the requirement for OMU to record an asset obligation (ARO) for the portion of ESGS decommissioning costs that is legally enforceable and a reasonable estimated cost is available. The Federal Environmental Protection Agency's (EPA) rule for coal combustion residuals under the Resource Conservation and Recovery Act, requires OMU to close the ESGS ash ponds, resulting in a legally enforceable obligation in the estimated amount of \$7,205,000. The cumulative effect of this change resulted in a restatement of beginning net position of \$6,916,800, a corresponding increase to the asset retirement obligation of \$7,205,000 and an increase in deferred asset retirement obligation of \$144,100 for the year ended May 31, 2019. In addition, \$144,100 was restated as an additional outflow of resources for 2019 and is included in other production expense.

Additionally, in 2020, the Electric System adopted the provisions of GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB AICPA Pronouncements*, (GASB 62) as it relates to the shutdown of ESGS and the costs for removal of the coal stockpile, removal of the smoke stacks, removal of asbestos, other environmental maintenance expenses, and for other structures such as fencing. These expenses are not legally enforceable by the EPA or required by the City of Owensboro, and since there are no contracts that have been awarded and signed for the decommissioning, they are not legally enforceable obligations. Therefore, OMU is applying the provisions of GASB Statement No. 62 to defer these expenses and recognize them over a five-year period, as they will be recovered from retail customers through the Energy Cost Adjustment (ECA)

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

1. Organization and Summary of Significant Accounting Policies, Continued

Change in Accounting Principles, Continued

over that same period. The adjustment allows the Electric System to adjust charges to its retail customers for fluctuations in energy costs. Accordingly, \$285,523 is included in deferred asset retirement outflow at May 31, 2020. There was no restatements required as a result of this change.

Finally, in 2020, the Electric System adopted the provisions of GASB Statement No. 41, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, as it related to impairment of ESGS assets due to the shutdown of ESGS. The Electric System is applying GASB 62, as it relates to rate-regulated entities, to defer the impairment loss associated with the shutdown. ESGS was permanently shut down on May 31, 2020, which was prior to the end of the normal economic life cycle of many ESGS assets, resulting in an impairment in the net book value of those assets. The remaining net book value of ESGS assets at May 31, 2020, was \$68.6 million. In lieu of immediate recognition of the associated impairment loss, the Electric System is deferring that loss and continuing to depreciate those ESGS assets over the remaining life of the corresponding ESGS long-term debt. That debt will continue to be serviced through January 1, 2026, with funds recovered through existing rates from retail customers, thus corresponding to the remaining depreciation on those assets. There were no restatements as a result of this change.

Utility Plant and Depreciation

Utility plant is stated at original cost, which includes the cost of contracted services, materials, labor, and labor-related expenditures, administrative and general costs, and an allowance for borrowed funds used during construction.

Replacements of depreciable property units, except minor replacements, are charged to utility plant. Property units replaced or retired, including cost of removal net of any salvage value received, are charged to accumulated depreciation. Routine maintenance, repairs and minor replacement costs are charged to expense as incurred.

Allowance for borrowed funds used during construction includes capitalized interest during the construction period less any interest income on construction fund investments from bond proceeds during such period. Capitalization of interest is discontinued when the project is completed and the related utility plant is placed in service.

Depreciation of utility plant and unclassified plant in service is provided using the straight-line composite rate method over the estimated service lives of the depreciable assets of the

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

1. Organization and Summary of Significant Accounting Policies, Continued

Utility Plant and Depreciation, Continued

Electric System, excluding ESGS, and on the sinking fund method for ESGS depreciable assets. Estimated service lives of assets depreciated using the composite method range from 5 to 60 years. The sinking fund method was adopted for ESGS as a result of the terms of a power sale contract. Depreciation expense during 2020 and 2019 was approximately 4.3% and 4.5%, respectively, of the average original cost of depreciable utility plant in service.

Restricted Assets

The City ordinances that authorized the Electric Light and Power Revenue Bonds require that certain amounts from bond proceeds and payments by customers for services provided be deposited into designated funds and be used only for the specified purposes of the funds. The Electric System's policy is to first apply restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

Cash and Investments

Cash deposits are reported at carrying amounts. Long-term repurchase agreements are reported at cost. The Electric System categorizes the fair value measurements of its investments based on the hierarchy established by generally accepted accounting principles. U.S. treasury and agency securities and negotiable certificates of deposit are stated at fair values based upon externally developed models that use rates and prices of similar securities.

The Electric System considers all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash equivalents. Unrestricted investments with initial maturities exceeding three months, consisting of U.S. treasury and agency securities, negotiable certificates of deposit, and repurchase agreements, are classified as temporary investments.

Inventories

Inventories consisting of materials and supplies and fuel inventory (included in restricted assets) are valued at the lower of weighted average cost or net realizable value. Fuel for electric generation is charged to expense as used.

Bond Issuance Costs

Premiums and discounts arising from various bond issues are deferred and amortized using the straight-line method over the lives of the bond issues.

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

1. Organization and Summary of Significant Accounting Policies, Continued

Bond Issuance Costs, Continued

The Electric System's rate making methodology allows for future recovery of debt costs, including bond issuance costs, in its rate making process. Accordingly, under GASBS No. 62, debt issuance costs are deferred and amortized using the straight-line method over the lives of the bond issues.

The difference between the reacquisition price and the net carrying amount of defeased bond issues has been deferred and is being amortized using the straight-line method over the lives of the refunding bond issues.

Pension and Other Postemployment Benefits

For purposes of measuring the net liabilities, the deferred outflows of resources and deferred inflows of resources and expense related to pensions and other postemployment benefits (OPEB), information about the fiduciary net position of the pension/OPEB plans, and additions to/deductions from the pension/OPEB plans' fiduciary net position have been determined on the same basis as they are reported by the pension/OPEB plans. For this purpose, revenues are recognized when earned. Contributions are recognized when due, pursuant to legal (or statutory) requirements. Benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Plan investments are reported at fair value.

The Electric System's rate making methodology allows for future recovery of certain pension and other postemployment benefit costs in its rate making process. Accordingly, under GASBS No. 62, pension and other postemployment benefit costs in excess of required contributions are deferred.

Income Taxes

The Electric System is exempt from federal and state income taxes and, accordingly, the financial statements include no provision for such taxes.

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.

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

1. Organization and Summary of Significant Accounting Policies, Continued

Hedging Derivative Instruments

The Electric System has adopted GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments* (GASBS No. 53). GASBS No. 53 requires that hedging derivative instruments (Hedging Transactions) be recorded at fair value and establishes certain requirements for revenue recognition, measurement and disclosure related to Hedging Transactions. The Electric System's Hedging Transactions have been tested for effectiveness under the guidelines prescribed by GASBS No. 53. The Electric System utilized one of the three quantitative methods required by GASBS No. 53, the synthetic instrument method. This method evaluates the effectiveness of a hedge transaction by comparing the relationship of the variable cash flows of the potential hedging item and the hedgeable item. The effectiveness testing of the Electric System's Hedging Transactions demonstrated that the hedges are effective as defined by GASBS No. 53.

2. Utility Plant

Electric utility plant activity for the year ended May 31, 2020, was as follows:

	Beginning Balance	Additions	Retirements	Ending Balance
Utility plant:				
Production plant	\$ 324,212,376	\$ -	\$ -	\$ 324,212,376
Transmission plant	32,397,753	393,650	(41,988)	32,749,415
Distribution plant	89,215,720	14,249,101	(1,507,350)	101,957,471
General plant	22,493,057	485,353	(154,959)	22,823,451
Unclassified plant in service	16,472,379	(5,521,031)	-	10,951,348
Total, at original cost	484,791,285	9,607,073	(1,704,297)	492,694,061
Accumulated depreciation:				
Production plant	(248,822,336)	(14,253,724)	-	(263,076,060)
Transmission plant	(20,459,467)	(1,006,710)	41,988	(21,424,189)
Distribution plant	(52,283,385)	(3,633,463)	1,565,577	(54,351,271)
General plant	(15,218,157)	(1,154,760)	100,323	(16,272,594)
Total accumulated depreciation	(336,783,345)	(20,048,657)	1,707,888	(355,124,114)
Construction in progress	5,682,693	1,150,555	-	6,833,248
Utility plant, net	\$ 153,690,633	\$ (9,291,029)	\$ 3,591	\$ 144,403,195

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

2. Utility Plant, Continued

Depreciation expense for the years ended May 31 was as follows:

	<u>2020</u>	<u>2019</u>
Electric utility plant	\$ 19,095,369	\$ 20,496,195
Telecommunications	<u>676,148</u>	<u>313,966</u>
	19,771,517	20,810,161
Transportation and stores depreciation charged to construction activities or other operating expenses	<u>277,140</u>	<u>271,051</u>
	<u>\$ 20,048,657</u>	<u>\$ 21,081,212</u>

It is the Electric System's policy to capitalize interest on funds borrowed to finance the construction of utility plant. For the years ended May 31, 2020 and 2019, total interest cost incurred was \$5,958,198 and \$8,730,337, respectively. In 2020, \$143,850 of interest was capitalized in connection with construction in progress, while \$246,600 of interest was capitalized in 2019.

3. Restricted Assets

Restricted assets at May 31 consists of the following:

	<u>2020</u>	<u>2019</u>
Cash and cash equivalents	\$ 46,222,573	\$ 38,282,959
Investments	8,423,088	43,191,108
Accrued interest receivable	51,607	501,948
Fuel and other inventories, at cost	2,899,448	7,188,693
Other	<u>8,296</u>	<u>1,007,119</u>
	<u>\$ 57,605,012</u>	<u>\$ 90,171,827</u>

The above balances are contained in the following funds:

	<u>2020</u>	<u>2019</u>
Operation and Maintenance Fund	\$ 16,186,089	\$ 8,321,298
Construction Fund	1,226,178	3,673,480
Depreciation Fund	5,711,846	5,323,522
Sinking Funds	17,332,863	31,499,107
Facility Charge Fund	363,063	8,200,903
Reserve and Contingency Fund	<u>16,784,973</u>	<u>33,153,517</u>
	<u>\$ 57,605,012</u>	<u>\$ 90,171,827</u>

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

3. Restricted Assets, Continued

The terms of the City ordinances authorizing the Electric System's Electric Light and Power Revenue Bonds require all investment income to be credited to the various restricted asset funds.

OMU follows GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investments Pools* (GASBS No. 31), which requires certain investments to be carried at fair value in the statements of net position and changes in the fair value of investments to be reported in the statements of revenues, expenses and changes in net position. In accordance with GASBS No. 31, OMU recorded unrealized gains of \$359,709 and \$898,675 for the years ended May 31, 2020 and 2019, respectively. OMU's rate making methodology does not consider unrealized gains or losses on marketable securities in its rate making process. Accordingly, the unrealized gains for the years ended May 31, 2020 and 2019, have been deferred.

The net increase in the fair value of investments consists of the following:

	<u>2020</u>	<u>2019</u>
Net unrealized gains on investments	\$ <u>359,709</u>	\$ <u>898,675</u>

The calculation of realized gains or losses on sales of investments is independent of the calculation of the net change in the fair value of investments. Realized gains or losses on investments that were held in more than one fiscal year and sold in the current year were included as a net change in the fair value of investments reported in prior years and the current year.

4. Cash Deposits and Investments

At May 31, the carrying amounts of the Electric System's deposits in financial institutions and investments other than deposits were:

	<u>2020</u>	<u>2019</u>
Deposits in financial institutions	\$ 78,413,470	\$ 65,621,003
Investments other than deposits	<u>29,396,031</u>	<u>65,636,877</u>
	\$ <u>107,809,501</u>	\$ <u>131,257,880</u>

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

4. Cash Deposits and Investments, Continued

These amounts are reflected in the statements of net position as:

	<u>2020</u>	<u>2019</u>
Cash and cash equivalents	\$ 29,163,473	\$ 20,862,250
Temporary investments	24,000,367	28,921,563
Restricted assets:		
Cash and cash equivalents	46,222,573	38,282,959
Investments	<u>8,423,088</u>	<u>43,191,108</u>
	<u>\$ 107,809,501</u>	<u>\$ 130,627,880</u>

Deposit and Investment Policy. The Electric System's deposit and investment policy prescribes to the prudent-person rule: Investments shall be made with applicable law and under prevailing circumstances which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital, as well as the probable income to be derived.

Custodial Credit Risk. Custodial credit risk is the risk that, in the event of a bank failure, the Electric System's deposits may not be returned to it. The Electric System's deposit and investment policy permits uncollateralized deposits only if issued by institutions ranked in one of the three highest categories by a nationally recognized rating agency. As of May 31, 2020, \$75,663,932 of the Electric System's bank balance of \$78,866,887 was exposed to custodial credit risk as follows:

Uninsured with collateral held by pledging bank's agent	\$ <u>75,663,932</u>
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Investments are measured at fair value on a recurring basis. Recurring fair value measurements are those that Governmental Accounting Standards Board (GASB) Statements require or permit in the statement of net position at the end of each reporting period. Fair value measurements are categorized based on the valuation inputs used to measure an asset's fair value: Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs. The Electric System's investments include U.S. treasury and agency securities and negotiable certificates of deposit, which utilize Level 2 inputs for fair value measurements. Fair value is based upon externally developed models that use rates and prices of similar securities, due to the limited market activity of the securities.

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

4. Cash Deposits and Investments, Continued

As of May 31, 2020, the Electric System had the following investments:

<u>Investments</u>	<u>Maturities</u>	
Federal Farm Credit Bank – Callable	04/07/2021 thru 03/25/2030	\$ 12,467,263
Federal Home Loan Bank – Callable	11/27/2020 thru 09/30/2026	13,922,500
Federal Home Loan Mtg Corp - Callable	05/19/2024	3,006,267
Negotiable Certificates of Deposit	08/28/2020 thru 05/24/2022	<u>3,027,425</u>
		<u>\$ 32,423,455</u>

Interest Rate Risk. As a means of limiting its exposure to fair value losses arising from rising interest rates, the Electric System's deposit and investment policy limits investment maturities based upon provisions of bond ordinances. The bond ordinances limit investments contained in the Operation and Maintenance Fund to five years and limit investments in the Depreciation Fund, Sinking Funds, and Facility Charge Fund to ten years.

Credit Risk. The Electric System's deposit and investment policy authorizes the investment of funds in any manner permitted by bond ordinances and the Kentucky Revised Statutes and does not further limit its investment choices.

Concentration of Credit Risk. Other than the prudent-person rule, the Electric System's deposit and investment policy places no limit on the amount the Electric System may invest in any one issuer. The Electric System's investments, other than deposits, are in U.S. agency securities and treasury coupon securities at May 31, 2020.

5. Hedging Transactions

The Electric System is exposed to market price fluctuations on its sale of surplus electricity. To protect itself from wholesale electricity price fluctuations, the Electric System periodically enters into electricity price and futures contracts (hedging transactions). Hedging transactions are measured at fair value on a recurring basis. The Electric System utilizes Level 2 inputs (see investment footnote for definition of fair value inputs) for fair value measurements of hedging transactions.

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

5. Hedging Transactions, Continued

The Electric System enters into electricity hedging transactions at various fixed prices and notional amounts. Each electricity short hedging transaction provides for the Electric System to pay a floating price and for the contract counterparty to pay a fixed price. Furthermore, the Electric System from time to time will remove an electricity short hedge position by entering into a long hedging transaction to pay a fixed price, and for the contract counterparty to pay a floating price for a like notional amount as the original hedging transaction. The notional amount of each electricity hedging transaction is measured in megawatt hours (MWh), with the floating price based on a specific published index (spot price) for the relevant contract month.

The Electric System entered into electricity hedging transactions with notional amounts totaling 121,000 and 1,207,032 MWh in 2020 and 2019, respectively. Hedging transactions with notional amounts totaling 323,495 and 2,197,432 MWh were settled in 2020 and 2019, respectively, with a resulting gain (loss) of \$472,294 and \$(688,548) in 2020 and 2019, respectively, which are reflected in other wholesale revenue. At May 31, 2020, the Electric System had no outstanding electricity hedging swap transactions.

The electricity hedging transactions are settled by cash payments that are equal to the difference between the contract price and the settlement price (financially settled). These financially settled hedging transactions are hedging derivative instruments as defined by GASBS No. 53. Accordingly, the Electric System's unrealized gains and losses on its outstanding hedging transactions are reported at fair value in other current assets, other noncurrent assets, other current liabilities and other noncurrent liabilities in its May 31, 2019, statement of net position. The fair market value for each of the Electric System's hedging transactions have been determined by computing the difference between the contractual forward price and the published forward price at the respective market's settlement point at market closing as of May 31, 2019. The Electric System's electricity hedging transactions settle and are valued at the AEP-Dayton Hub, the PJM West Hub and the Indiana Hub, which are settlement hubs in the PJM and MISO energy markets, respectively. The outstanding electricity hedging transactions had a fair value of \$205,172 at May 31, 2019.

Credit Risk: The Electric System is exposed to credit risk on hedging transactions that are in an asset position. To minimize the Electric System's exposure to loss related to credit risk, the Electric System requires certain counterparties to post collateral equal to all or a portion of the fair value of hedging transactions in asset positions (net of the effect of applicable netting arrangements) should the fair value of the netted contracts exceed contractually agreed upon parameters or if the credit rating of a certain counterparty or, an affiliated guarantor of the counterparty, is at, or falls below, contractually agreed-upon levels. Collateral posted is in the form of a letter of credit or US dollars held by the Electric System. At May 31, 2020, the Electric System had no hedges and thus no counterparties.

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

5. Hedging Transactions, Continued

It is the Electric System's practice to enter into netting arrangements whenever it has entered into more than one financially settled forward swap contract transaction with a counterparty. If one party becomes insolvent or defaults on its obligations, closeout netting provisions permit the non-defaulting party to accelerate and terminate all outstanding transactions and net the transactions' fair values so that a single sum will be owed to, or owed by, the non-defaulting party. There were no outstanding hedging transactions at May 31, 2020.

Basis Risk: The Electric System is exposed to basis risk on its hedging transactions because the price of the expected physical commodity sale being hedged will be priced at pricing points (South Import PJM Interface or LG&E MISO Interface), which are different than the pricing points at which the hedging transactions will settle (AEP-Dayton Hub, PJM West Hub or Indiana Hub). Management believes this risk is not material based on quantitative analysis.

Termination Risk: The Electric System is exposed to termination risk on its hedging transactions because a counterparty may fail to perform under the terms of one or more contracts resulting in the termination of the aggregate contracts with that counterparty. To minimize the Electric System's exposure to loss related to termination risk, the Electric System requires counterparties to post collateral equal to the fair value of hedging transactions in asset positions (net of the effect of applicable netting arrangements) should the fair value of the netted contracts exceed contractually agreed upon parameters or if the credit rating of a certain counterparty, or an affiliated guarantor of the counterparty, is at, or falls below, contractually agreed-upon levels. If at the time of termination the net position of financially settled power contracts with a terminating party is in an aggregate liability position, the Electric System would be liable to the counterparty for a payment equal to the aggregate liability position, subject to netting arrangements.

Commitments: Hedging transactions provide that the Electric System post collateral in the event that 1) OMU's credit profile falls below contractually agreed-upon parameters or 2) the fair value of the Electric System's hedging transactions are in a liability position (net of the effect of applicable netting arrangements) should the fair value of the netted contracts exceed contractually agreed-upon parameters. When collateral is posted, it is in US dollars in the amount of the fair value of the hedging derivative instruments in liability positions (net of the effect of applicable netting arrangements). If the Electric System does not post collateral, the aggregate outstanding hedging transactions may be terminated by the counterparty. If the collateral posting requirements related to OMU's credit profile had been triggered at May 31, 2020, the Electric System would not have been required to post collateral with its counterparties.

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

6. Long-Term Debt

Long-term debt activity for the year ended May 31, 2020, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Bonds payable:					
Series of 1991-B	\$ 15,111,838	\$ 613,162	\$ (15,725,000)	\$ -	\$ -
Series of 2002-A	3,550,000	-	(3,550,000)	-	-
Series of 2010-A	7,070,000	-	(7,070,000)	-	-
Series of 2010-B	31,425,000	-	(31,425,000)	-	-
Series of 2013-A	8,875,000	-	(8,875,000)	-	-
Series of 2013-B	40,940,000	-	(40,940,000)	-	-
Series of 2017	49,345,000	-	-	49,345,000	3,205,000
Series of 2019	-	64,155,000	-	64,155,000	10,185,000
	156,316,838	64,768,162	(107,585,000)	113,500,000	13,390,000
Add unamortized debt premium	5,597,879	7,529,516	(2,155,404)	10,971,991	-
Total long-term debt	\$ 161,914,717	\$ 72,297,678	\$ (109,740,404)	\$ 124,471,991	\$ 13,390,000

Long-term debt at May 31 consists of the following Electric Light and Power Revenue Bonds:

	2020	2019
Series of 1991-B:		
Deferred interest bonds including interest compounded semi-annually at 6.70% to 6.95%, principal and interest due in 2020	\$ -	\$ 15,111,838
Series of 2002-A:		
6.34% due 2020, subject to annual pro rata sinking fund redemption in 2020	-	3,550,000
Series of 2010-A:		
Current interest bonds, 4.88% to 5.03%, due from 2021 to 2022	-	7,070,000
Series of 2010-B:		
Current interest bonds, 4.88% to 5.58%, due from 2021 to 2025	-	31,425,000
Series of 2013-A:		
Current interest bonds, 3.40% to 3.65%, due from 2021 to 2022	-	8,875,000
Series of 2013-B:		
Current interest bonds, 3.00% to 5.00%, due from 2022 to 2027	-	40,940,000

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

6. Long-Term Debt, Continued

	<u>2020</u>	<u>2019</u>
Series of 2017:		
Current interest bonds, 4.00%, due from 2022 to 2037	49,345,000	49,345,000
Series of 2019:		
Current interest bonds, 4.00% to 5.00%, due from 2021 to 2027	<u>64,155,000</u>	<u>-</u>
Total long-term debt	113,500,000	156,316,838
Less current maturities	(13,390,000)	(18,661,838)
Add unamortized debt premium	<u>10,971,991</u>	<u>5,597,879</u>
	<u>\$111,081,991</u>	<u>\$143,252,879</u>

Sinking fund requirements and scheduled aggregate maturities of long-term debt are as follows:

<u>Year Ending May 31:</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2021	\$ 13,390,000	\$ 5,234,705	\$ 18,624,705
2022	14,255,000	4,369,750	18,624,750
2023	14,930,000	3,696,750	18,626,750
2024	15,525,000	3,099,550	18,624,550
2025	16,235,000	2,391,800	18,626,800
2026 – 2030	35,595,000	3,272,450	38,867,450
2031 – 2035	2,385,000	535,200	2,920,200
2036 – 2040	<u>1,185,000</u>	<u>71,800</u>	<u>1,256,800</u>
	<u>\$ 113,500,000</u>	<u>\$ 22,672,005</u>	<u>\$ 136,172,005</u>

The Electric System is subject to certain debt covenants, compliance with which is required by the ordinances authorizing its bond issues. Such ordinances require revenue to be first applied to the Sinking Funds, second to the Operations and Maintenance Fund, third to the Additions and Replacements Fund, fourth to the Depreciation Fund, fifth to the Reserve and Contingency Fund, and lastly to the Facility Charge Fund.

On December 6, 1991, the City issued \$62,474,359 of Electric Light and Power System Revenue Bonds, 1991-B series, dated December 6, 1991. These deferred interest bonds bear interest at rates ranging from 6.70% to 6.95% which, when compounded semi-annually and added to the original principal amount, will result in compounded amounts at scheduled maturities in 2005 to 2020 of \$25,000 per bond.

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

6. Long-Term Debt, Continued

The 1991-B Bonds were issued to provide construction funds for certain pollution control facilities and equipment, certain solid waste disposal facilities and equipment and related purposes.

The 1991-B series was not subject to redemption prior to maturity.

On February 27, 2002, the City issued \$34,905,000 of Electric Light and Power System Revenue Bonds, Taxable 2002-A Series and \$12,205,000 of Electric Light and Power System Revenue Bonds, Tax-Exempt 2002-B Series, each dated February 1, 2002.

The 2002-A and B Bonds were issued to provide construction funds for certain pollution control facilities and equipment.

The 2002-A series was subject to scheduled redemption prior to maturity based upon annual pro rata sinking fund redemptions. In addition, the 2002-A series was subject to early redemption, in whole or in part, at any time, at terms specified in the 2002 Official Statement.

On November 18, 2010, the City issued \$10,070,000 of Electric Light and Power System Revenue Bonds, Taxable 2010-A Series, \$31,425,000 of Electric Light and Power System Revenue Bonds, Taxable 2010-B Series (Build America Bonds) and \$8,935,000 of Electric Light and Power System Refunding Revenue Bonds, Tax-Exempt 2010-C Series, each dated November 4, 2010. The 2010 Bonds were issued to fund various capital improvement expenditures for the Electric System and to refund the 2002-B series bonds. The in-substance defeasance of the 2002-B Bonds was accomplished by placing approximately \$9,274,976 in proceeds from the 2010-C Bonds and \$170,826 in funds from the 2002-B Bond Sinking Fund in an irrevocable escrow fund to be used solely for satisfying scheduled debt service payments of the 2002-B Bonds. Accordingly, the 2002-B Bonds in the amount of \$9,230,000, as well as accrued interest payable of \$164,248 and net of unamortized discount and issuance costs of \$123,543, were extinguished resulting in the accounting recognition of a loss from defeasance of \$175,097, reported in the accompanying financial statements as a deferred outflow of resources. The City advance refunded the 2002-B bonds to extend the repayment period of the bond, reduce its near term annual debt payments and reduce the effective rate on the debt. The advance refunding resulted in an economic gain (difference between the present value of the debt service payment on the old and new debt) of \$558,382. On May 15, 2019, \$3,000,000 of the 2010-A Bonds were defeased. The partial defeasance of the 2010-A Bonds was accomplished by placing \$3,128,498.35 in an irrevocable escrow fund to be used solely for satisfying scheduled debt service payments of the 2010-A Bonds. Accordingly, the partial defeasance of the 2010-A Bonds in the amount of \$3,000,000, as well as accrued interest payable of \$54,900 and prorated unamortized issuance costs of \$13,271, were extinguished resulting in the accounting recognition of a loss from defeasance of \$59,119, which is included in nonoperating expenses.

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

6. Long-Term Debt, Continued

The 2010-B Series bonds (Build America Bonds – Direct Payment) were issued in connection with the American Recovery and Reinvestment Act of 2009 (Act). Under the Act, state and local governments were authorized to issue taxable bonds to finance capital expenditures for which they could otherwise issue tax-exempt bonds, and receive from the IRS a direct interest subsidy totaling 35% of the total coupon interest paid to investors. Due to federal budget sequestration, the direct interest subsidy was reduced to 33% of the total coupon interest. Interest subsidy received for fiscal years 2020 and 2019 was \$276,741 and \$542,764, respectively. The interest subsidy ended when the 2010-B Series bonds were refunded.

The 2010-A and B series were subject to redemption prior to maturity in whole or in part on any date on or after January 1, 2020, at the redemption price (expressed as a percentage of principal amount to be redeemed) of 100%, plus accrued interest to the redemption date. Furthermore, the 2010-B series (Build America Bonds) may be subject to redemption prior to maturity in whole or in part upon the occurrence of an Extraordinary Event, as defined in the Official Statement. As discussed above, Build America Bonds involve a payment to the issuer from the United States Treasury for a portion of the interest payable on such bonds. If the associated payment from the United States Treasury is reduced or eliminated through no fault of the issuer (Extraordinary Event), the bonds will become redeemable, at the option of the issuer, at a potentially reduced redemption price, as defined in the Official Statement.

On June 25, 2013, the City issued \$8,875,000 of Electric Light and Power System Revenue Bonds, Taxable 2013-A Series and \$77,100,000 of Electric Light and Power System Revenue Bonds, Tax-Exempt 2013-B Series, each dated June 25, 2013. The 2013 Bonds were issued to fund various capital improvement expenditures for the Electric System and to refund certain 1991-B series bonds. The in-substance defeasance of the 1991-B Bonds was accomplished by placing \$40,325,905 in proceeds from the 2013-B Bonds and \$6,552,083 in funds from the 1991-B Bond Sinking Fund in an irrevocable escrow fund to be used solely for satisfying scheduled debt service payments of the 1991-B Bonds. Accordingly, the 1991-B Bonds in the amount of \$42,597,295, net of unamortized discount and issuance costs of \$211,974, were extinguished resulting in the accounting recognition of a loss from defeasance of \$4,492,667, reported in the accompanying financial statements as a deferred outflow of resources. The City advance refunded the 1991-B bonds to extend the repayment period of the bond and reduce its near term annual debt payments. The advance refunding resulted in an economic loss (difference between the present value of the debt service payment on the old and new debt) of \$2,993,589.

The 2013-A and B series were subject to redemption prior to maturity in whole or in part on any date on or after January 1, 2020, at the redemption price (expressed as a percentage of principal amount to be redeemed) of 100%, plus accrued interest to the redemption date.

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

6. Long-Term Debt, Continued

On August 9, 2017, the City issued \$49,685,000 of Electric Light and Power System Revenue Bonds, 2017 Series, each dated August 9, 2017. The 2017 Bonds were issued to fund construction of a residential fiber optic distribution network with the ability to provide ultrahigh speed internet access to approximately 6,500 dwellings and to refund the 2010-C series bonds and certain 2013-B series bonds. The in-substance defeasance of the 2010-C and 2013-B bonds was accomplished by placing \$48,325,931 in proceeds from the 2017 Bonds and \$456,210 in funds from the 2010-C and 2013-B Bond Sinking Funds in an irrevocable escrow fund to be used solely for satisfying scheduled debt service payments of the 2010-C and 2013-B Bonds. Accordingly, the 2010-C Bonds in the amount of \$8,935,000, and certain 2013-B Bonds in the amount of \$36,160,000, as well as accrued interest payable of \$347,104 and unamortized discount and issuance costs of \$1,152,596, were extinguished resulting in the accounting recognition of a loss from defeasance of \$2,187,441, reported in the accompanying financial statements as a deferred outflow of resources. The City advance refunded the 2010-C and 2013-B bonds to reduce the effective rate on the debt. The advance refunding resulted in an economic savings (difference between the present value of the debt service payment on the old and new debt) of \$3,128,648.

The 2017 series bonds maturing on or after January 1, 2028, are subject to redemption prior to maturity in whole or in part on any date on or after January 1, 2027, at the redemption price (expressed as a percentage of principal amount to be redeemed) of 100%, plus accrued interest to the redemption date.

On December 4, 2019, the City issued \$64,155,000 of Electric Light and Power System Refunding Revenue Bonds, 2019 Series, each dated December 4, 2019. The 2019 Bonds were issued for the purpose of refunding certain outstanding revenue bonds which include the 2010-A Series, 2010-B Series, 2013-A Series and 2013-B Series. The in-substance defeasance of the 2010 and 2013 Series bonds was accomplished by placing \$71,178,711 in proceeds from the 2019 Bonds, \$3,895,548 of sinking funds and \$15,231,495 of other restricted funds in an irrevocable escrow fund to be used solely for satisfying scheduled debt service payments of the 2010 and 2013 Series Bonds. Accordingly, the 2010 Series Bonds in the amount of \$38,495,000, the 2013 Series Bonds in the amount of \$49,815,000, as well as accrued interest payable of \$1,772,444 and unamortized discount and issuance costs of \$449,846, were extinguished resulting in the accounting recognition of a gain from defeasance of \$226,536, reported in the accompanying financial statements as a deferred outflow of resources. The City advance refunded these bonds to reduce its total outstanding debt and reduce the effective rate on the debt. The advance refunding resulted in an economic savings (difference between the present value of the debt service payment on the old and new debt) of \$7,441,846.

All bonds are secured by a pledge of, and are payable from, the gross revenues derived from the operation of the Electric System and are secured by a statutory mortgage lien as provided and authorized by the Kentucky Revised Statutes.

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

6. Long-Term Debt, Continued

For all bonds, in the event of default, any Bondholder may proceed to protect and enforce its rights and the rights of the holders of the Bonds under the Ordinance forthwith by a suit or suits in equity or at law.

7. Dividends - City of Owensboro

Under the terms of City ordinances authorizing the Electric System bonds, whenever all specified or required transfers and payments have been set aside and paid into the restricted asset funds and there is a balance in excess of the amount to be set aside and paid into the restricted asset funds during the next succeeding two months (approximately \$15,758,000 at May 31, 2020), the City Utility Commission may withdraw and transfer from such excess to the general fund of the City in any fiscal year an amount not to exceed 10% of the value of the City's ownership (net assets) exclusive of interest accumulated on deposits in the Reserve and Contingency Fund (\$6,050,155 at May 31, 2020) and amounts reserved for asset retirement (\$1,176,446 at May 31, 2020) as shown on the Electric System's books on the first day of the fiscal year. The Ordinance also allows for the transfer to the City of a sum equal to the dollar value of services purchased by the City from the Electric System in the fiscal year, not to exceed, however, \$700,000 for the fiscal year ended June 30, 1985, and thereafter increasing at a compound rate of 5% per annum. Transfers to the City under this ordinance and agreement were \$9,611,802 and \$9,387,288 for 2020 and 2019, respectively.

8. Pension and Other Postemployment Benefits – CERS

Plan Description

The Electric System contributes to the County Employees Retirement System (CERS), which is a cost-sharing multiple-employer defined benefit pension/OPEB plan administered by Kentucky Retirement Systems (KRS) that covers members employed in positions of each participating county, city, and school board, and any additional eligible local agencies electing to participate in CERS. Kentucky Revised Statute Section 61.645 assigns the authority to establish and amend benefit provisions to the Board of Trustees of Kentucky Retirement Systems (Board). KRS issues a publicly available financial report that can be obtained at www.kyret.ky.gov.

Benefits Provided

CERS provides for retirement, disability, and death benefits to system members through its Pension Fund, as well as other postemployment benefits (OPEB) for hospital and medical insurance through its Insurance Fund.

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

8. Pension and Other Postemployment Benefits – CERS, Continued

Benefits Provided, Continued

Retirement benefits may be extended to beneficiaries of members under certain circumstances. Retirement benefits are determined using a formula which considers the member's final compensation; benefit factors set by statute which vary depending upon the type/amount of service, participation date, and retirement date; and years of service. Plan members with a participation date prior to September 1, 2008, are eligible to retire with full benefits at any time with 27 or more years of service credit, or at age 65 with at least 4 years of service credit. Plan members with a participation date on or after September 1, 2008, are eligible to retire with full benefits at age 57 if the member's age and years of service equal 87, or at age 65 with at least 5 years of service credit.

Other postemployment benefits provided by CERS consist of prescribed contributions for whole or partial payments of required premiums to purchase hospital and medical insurance.

Contributions

State statute requires active members to contribute 5% of creditable compensation. For members participating on or after September 1, 2008, an additional 1% of creditable compensation is required. This amount is credited to the Insurance Fund and is non-refundable to the member. Employers contribute at the rate determined by the KRS Board to be necessary for the actuarial soundness of the systems, as required by KRS 61.565 and KRS 61.752.

The Electric System's actuarially determined contribution rates and contribution amounts, based on annual creditable compensation, for the year ended May 31, 2020, were as follows:

	<u>Contribution Rates</u>	<u>Contributions</u>
Pension	19.30%	\$ 2,913,660
OPEB	4.76	718,602
Total	24.06%	\$ 3,632,262

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

8. Pension and Other Postemployment Benefits – CERS, Continued

Pension Liabilities, Pension Expense, Deferred Outflows of Resources, and Deferred Inflows of Resources Related to Pensions

The net pension and OPEB liabilities reported as of May 31, 2020, were measured as of June 30, 2019, and the total pension and OPEB liabilities used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2018. The Electric System's proportion of the liabilities was based on a projection of the Electric System's long-term share of contributions to the plan relative to the projected contributions of all participating entities, actuarially determined. Changes in the Electric System's pension and OPEB proportions as of the measurement date were as follows:

	<u>Pension</u>	<u>OPEB</u>
June 30, 2018	0.620000%	0.620000%
Decrease	(0.004115)	(0.004115)
June 30, 2019	0.615885%	0.615885%

The Electric System's pension and OPEB liabilities and expense as of and for the year ended May 31, 2020, were as follows:

	<u>Pension</u>	<u>OPEB</u>
Net Liability	\$ 43,315,494	\$ 10,356,480
Expense	\$ 2,913,660	\$ 718,602

At May 31, 2020, the Electric System reported deferred outflows of resources and deferred inflows of resources related to pensions and OPEB from the following sources:

	<u>Pension</u>		<u>OPEB</u>	
	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual experience	\$ 1,105,975	\$ 183,019	\$ -	\$ 3,124,790
Changes of assumptions	4,384,020	-	3,064,579	20,493
Net difference between projected and actual earnings on plan investments	-	698,263	-	459,990
Changes in proportion and differences between contributions and proportionate share of contributions	226,090	77,097	82,287	75,773
Contributions subsequent to the measurement date	<u>2,722,626</u>	<u>-</u>	<u>671,487</u>	<u>-</u>
Total	\$ <u>8,438,711</u>	\$ <u>958,379</u>	\$ <u>3,818,353</u>	\$ <u>3,681,046</u>

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

8. Pension and Other Postemployment Benefits – CERS, Continued

Pension Liabilities, Pension Expense, Deferred Outflows of Resources, and Deferred Inflows of Resources Related to Pensions, Continued

The \$2,722,626 and \$671,487 of deferred outflows of resources resulting from the Electric System's pension and OPEB contributions subsequent to the measurement date will be recognized as a reduction of the net pension and OPEB liabilities in the year ending May 31, 2021. Other amounts reported as deferred outflows of resources and deferred inflows of resources will be recognized as follows:

Year ending May 31,	<u>Pension</u>	<u>OPEB</u>
2021	\$ 3,104,393	\$ (74,329)
2022	1,162,693	(74,329)
2023	441,078	71,921
2024	49,542	(208,253)
2025	-	(210,293)
Thereafter	-	(38,897)
	<u>\$ 4,757,706</u>	<u>\$ (534,180)</u>

Actuarial Assumptions

The total pension/OPEB liabilities in the June 30, 2018, actuarial valuation were determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	2.30%
Healthcare payroll growth rate	2.00%
Salary increases	3.30% to 10.30%, varies by service
Net investment rate of return	6.25%
Healthcare cost trend rates (OPEB)	Pre-65: Initial trend starting at 7.0% at January 2020, and gradually decreasing to an ultimate trend rate of 4.05% over a period of 12 years. Post-65: Initial trend starting at 5.0% at January 1, 2020, and gradually decreasing to an ultimate trend rate of 4.05% over a period of 10 years.

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

8. Pension and Other Postemployment Benefits – CERS, Continued

Actuarial Assumptions, Continued

The mortality table used for active members was a Pub-2010 General Mortality table, projected with the ultimate rates from the MP-2014 mortality improvement scale using a base year of 2010. The mortality table used for healthy retired members was a system-specific mortality table based on mortality experience from 2013-2018, projected with the ultimate rates from MP-2014 mortality improvement scale using a base year of 2019. The mortality table used for the disabled members was PUB-2010 Disabled Mortality table, with a 4-year set-forward for both male and female rates, projected with the ultimate rates from the MP-2014 mortality improvement scale using a base year of 2010.

The actuarial assumptions used in the June 30, 2018, valuation were based on the results of an actuarial experience study for the five-year period ended June 30, 2018.

The long-term expected rate of return 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 real rate of return for each major asset class are summarized in the tables below.

	Target Allocation	Long-Term Expected Real Rate of Return
US equity:		
US equity	18.75%	4.30%
Non US equity	18.75	4.80%
Private equity	10.00	6.65%
Specialty credit/high yield	15.00	2.60%
Liquidity:		
Core bonds	13.50	1.35%
Cash	1.00	.20%
Diversifying strategies:		
Real estate	5.00	4.85%
Opportunistic	3.00	2.97%
Real return	15.00	4.10%
Total	<u>100.00%</u>	

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

8. Pension and Other Postemployment Benefits – CERS, Continued

Discount Rate

The discount rates used to measure the total pension / OPEB liabilities at the measurement dates and changes since the prior year were as follows:

	Pension	OPEB
Discount rate, June 30, 2018	6.25%	5.85%
Increase (decrease)	-	(0.17)
Discount rate, June 30, 2019	6.25%	5.68%

The discount rate of 6.25% used to measure the total pension liability was based on the expected rate of return on pension plan investments. The discount rate of 5.68% used to measure the total OPEB liability was based on the expected rate of return of 6.25% and a municipal bond rate of 3.13%, as reported in Fidelity Index's "20-Year Municipal GO AA Index" as of June 30, 2019.

The projections of cash flows used to determine the pension discount rate assumed that the funds would receive employer contributions in each future year, as determined by the current funding policy established in Statue last amended by House Bill 362 (passed in 2018). The projection of cash flows used to determine the OPEB discount rate assumed that employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 24 years (closed) amortization period of the unfunded actuarial accrued liability.

Sensitivity of the Electric System's Proportionate Share of the Liabilities to Changes in the Discount Rate

The following presents the Electric System's proportionate share of the net pension/OPEB liabilities, as well as what the Electric System's proportionate share of the net pension/OPEB liabilities would be if they were calculated using a discount rate that is 1-percentage-point lower or 1-percentage-point higher than the current rate:

	Electric System's Proportionate Share			
	Discount Rate	Net pension Liability	Discount Rate	Net OPEB Liability
1% decrease	5.25%	\$ 54,175,397	4.68%	\$ 13,873,423
Current discount rate	6.25%	\$ 43,315,494	5.68%	\$ 10,356,480
1% increase	7.25%	\$ 34,263,870	6.68%	\$ 7,458,753

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

8. Pension and Other Postemployment Benefits – CERS, Continued

Sensitivity of the Electric System's Proportionate Share of the Net OPEB Liability to Changes in the Healthcare Cost Trend Rates

The following presents the Electric System's proportionate share of the net OPEB liability, as well as what the Electric System's 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 rate:

	Healthcare Cost Trend Rate		Electric System's Proportionate Share of Net OPEB Liability
1% decrease	6.0% Pre-65 or 4.0% Post-65	\$	7,702,167
Current healthcare cost trend rate	7.0% Pre-65 or 5.0% Post-65	\$	10,356,480
1% increase	8.0% Pre-65 or 6.0% Post-65	\$	13,575,149

Plan Fiduciary Net Position

Detailed information about the CERS fiduciary net position is available in the separately issued Kentucky Retirement Systems Comprehensive Annual Financial Report.

Payables to the Pension/OPEB Plans

The Electric System reported the following payables for the outstanding amount of pension/OPEB contributions due to CERS for the year ended May 31, 2020.

Pension	OPEB
\$ <u>209,039</u>	\$ <u>51,556</u>

9. Commitments and Contingencies

The Electric System has entered into contracts to purchase fuel and related products for electric generation. Although contracts have termination provisions, minimum future payments on these contracts for the year ending May 31, 2020, are estimated to be \$0.

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

9. Commitments and Contingencies, Continued

OMU is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. OMU manages its risks through coverages provided by private insurance carriers for various risks of losses to which it is exposed, including directors and officers, employee dishonesty, boiler and machinery, workers' compensation, and other property risks. The boiler and machinery policy contains a deductible of \$500,000 and excludes acts of terrorism from its coverage. For the last three years, settled claims have not exceeded private insurance coverage, nor has there been any reduction in insurance coverage.

OMU is self-insured for group health and limits its risks of loss by purchasing reinsurance coverage. A third-party administrator administers claims. The estimated liability for unpaid health claims at May 31, 2020, has been included in other current liabilities. The following reconciles health claims payable for the three years ended May 31:

<u>Fiscal Year Ended May 31,</u>	<u>Claims Payable June 1</u>	<u>Claims and Changes in Estimates</u>	<u>Claims Paid</u>	<u>Claims Payable May 31</u>
2020	\$ 880,458	\$ 3,339,938	\$ 3,816,321	\$ 404,076
2019	\$ 329,773	\$ 3,608,350	\$ 3,057,665	\$ 880,458
2018	\$ 304,513	\$ 3,844,869	\$ 3,819,609	\$ 329,773

OMU has been identified by the United States Environmental Protection Agency as one of numerous parties that may be liable for damages under federal law with respect to a superfund hazardous waste site. Through May 31, 2019, OMU has paid \$57,500, plus legal costs, related to this matter. Based upon the opinion of its outside legal counsel, management does not anticipate additional costs to be material; however, the ultimate resolution of this matter and the related financial impact on OMU, if any, cannot be determined at this time.

There are a number of other pending legal actions involving OMU. Management believes that the outcome of such legal actions and claims will not have a material effect on OMU's financial position or results of operations.

10. Asset Retirement Obligation and Deferred Asset Retirement Outflow

The Electric System accounts for certain costs associated with the dismantling and removal of the Elmer Smith Generating System (ESGS) in accordance with GASB Statement No. 83, Certain Asset Retirement Obligations. Under Statement No. 83, the Electric System has recognized a liability of \$7,205,000 which equals the estimated cost of activities that are legally required by the Environmental Protection Agency to perform retirement of the ash ponds. As of May 31, 2020, the Electric System had expended \$13,012 in costs for retirement leaving an obligation of \$7,191,988.

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

10. Asset Retirement Obligation and Deferred Asset Retirement Outflow, Continued

The Electric System accounts for other not legally enforceable costs associated with the dismantling and removal of the ESGS in accordance with GASB statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB AICPA Pronouncements. These costs are for removal of the coal stockpile, removal of the smoke stacks, removal of asbestos, other environmental maintenance expenses, and for other structures, such as fencing. As of May 31, 2020, the Electric System had expended \$285,523 for these costs.

11. COVID-19 Considerations

In December 2019, a novel strain of coronavirus, known as COVID-19, was reported in Wuhan, China and has since extensively impacted the global health and economic environment. In March 2020, the World Health Organization characterized COVID-19 as a pandemic, and the President declared the COVID-19 outbreak in the United States as a national emergency.

During the COVID-19 pandemic, our services have generally been considered essential in nature and have not been materially interrupted. As the situation continues to evolve, we are closely monitoring the impact of the COVID-19 pandemic on all aspects of our business, including how it impacts our customers, subcontractors, suppliers, vendors and employees, in addition to how the COVID-19 pandemic impacts our ability to provide services to our customers. We believe the ultimate impact of the COVID-19 pandemic on our operating results, cash flows and financial condition is likely to be determined by factors which are uncertain, unpredictable and outside of our control. The situation surrounding COVID-19 remains fluid, and if disruptions do arise, they could materially adversely impact our business.

During the period from March through May 31, 2020, we have not written off any past due customer receivables and have allowed our reserves to increase for the economic disruption caused by COVID-19, which is reflected in our bad debt expense in 2020. This increase was primarily, but not exclusively, due to concern over collectability of receivables from customers more directly impacted by COVID-19.

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

**SCHEDULE OF PROPORTIONATE SHARE OF THE NET PENSION LIABILITY
COUNTY EMPLOYEES RETIREMENT SYSTEM**

Last 10 Fiscal Years *

	<u>2020</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Electric System's proportion of the net pension liability	0.615885%	0.620000%	0.611400%	0.626738%	0.610636%	0.632508%
Electric System's proportionate share of the net pension liability	\$ 43,315,494	\$ 37,759,911	\$ 35,787,099	\$ 30,858,179	\$ 26,254,442	\$ 20,520,943
Electric System's covered payroll	\$ 15,475,990	\$ 14,991,261	\$ 14,942,435	\$ 15,035,975	\$ 14,221,628	\$ 14,612,052
Electric System's proportionate share of the net pension liability as a percentage of its covered payroll	279.89%	251.88%	239.50%	205.23%	184.61%	140.44%
Plan fiduciary net position as a percentage of the total pension liability	50.45%	53.54%	53.32%	55.50%	59.97%	66.80%

* Presented for those years for which the information is available.

OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM

SCHEDULE OF PENSION CONTRIBUTIONS
COUNTY EMPLOYEES RETIREMENT SYSTEM

Last 10 Fiscal Years

	<u>2020</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Contractually required contributions	\$ 2,913,660	\$ 2,497,758	\$ 2,148,899	\$ 2,062,855	\$ 1,908,105	\$ 1,820,510
Contributions in relation to the contractually required contributions	<u>(2,913,660)</u>	<u>(2,497,758)</u>	<u>(2,148,899)</u>	<u>(2,062,855)</u>	<u>(1,908,105)</u>	<u>(1,820,510)</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Electric System's covered payroll	\$ 15,221,323	\$ 15,527,315	\$ 14,873,999	\$ 14,889,969	\$ 15,097,888	\$ 14,199,426
Contributions as a percentage of covered payroll	19.14%	16.09%	14.45%	13.85%	12.64%	12.82%

* Presented for those years for which the information is available.

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

**SCHEDULE OF PROPORTIONATE SHARE OF THE NET OPEB LIABILITY
COUNTY EMPLOYEES RETIREMENT SYSTEM**

Last 10 Fiscal Years *

	<u>2020</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>
Electric System's proportion of the net OPEB liability	0.615885%	0.620000%	0.611400%	0.626738%
Electric System's proportionate share of the net OPEB liability	\$ 10,356,480	\$ 11,007,791	\$ 12,291,225	\$ 9,663,041
Electric System's covered payroll	\$ 15,475,990	\$ 14,991,261	\$ 14,942,435	\$ 15,035,975
Electric System's proportionate share of the net OPEB liability as a percentage of its covered payroll	66.92%	73.43%	82.26%	64.27%
Plan fiduciary net position as a percentage of the total OPEB liability	60.44%	57.62%	52.39%	55.24%

* Presented for those years for which the information is available.

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

**SCHEDULE OF OPEB CONTRIBUTIONS
COUNTY EMPLOYEES RETIREMENT SYSTEM**

Last 10 Fiscal Years

	<u>2020</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Contractually required contributions	\$ 718,602	\$ 810,000	\$ 697,502	\$ 699,448	\$ 712,851	\$ 698,185
Contributions in relation to the contractually required contributions	<u>(718,602)</u>	<u>(810,000)</u>	<u>(697,502)</u>	<u>(699,448)</u>	<u>(712,851)</u>	<u>(698,185)</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Electric System's covered payroll	\$ 15,221,323	\$ 15,527,315	\$ 14,873,999	\$ 14,889,969	\$ 15,097,888	\$ 14,199,426
Contributions as a percentage of covered payroll	4.72%	5.22%	4.69%	4.70%	4.72%	4.92%

* Presented for those years for which the information is available.

**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

**NOTES TO REQUIRED SUPPLEMENTARY INFORMATION
COUNTY EMPLOYEES RETIREMENT SYSTEM**

Year Ended May 31, 2020

Changes of Benefit Terms

2020	None
2019	None
2018	None
2017	None
2016	None

Changes of Assumptions

2020 Pension and OPEB:

The salary increases assumption was changed from 3.05% to 3.30% - 10.30%.

OPEB:

The single discount rate changed from 5.85% to 5.68%.

2019 Pension and OPEB:

The salary increases assumption was changed from 2.00% to 3.05%.

OPEB:

The single discount rate changed from 5.84% to 5.85%.

2018 Pension and OPEB:

The assumed investment return was changed from 7.50% to 6.25%.

The price inflation assumption was changed from 3.25% to 2.30%, which also resulted in a 0.95% decrease in the salary increase assumption at all years of service.

The payroll growth assumption (applicable for the amortization of unfunded actuarial accrued liabilities) was changed from 4.00% to 2.00%.

OPEB:

The single discount rate changed from 6.89% to 5.84%.

2017 None

2016 Pension:

The assumed investment rate of return was decreased from 7.75% to 7.50%.

The assumed rate of inflation was reduced from 3.50% to 3.25%.

The assumed rate of wage inflation was reduced from 1.00% to 0.75%.

Payroll growth assumption was reduced from 4.50% to 4.00%.

The assumed rates of Retirement, Withdrawal and Disability were updated to more accurately reflect experience.

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**OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM**

SCHEDULE OF REVENUES AND EXPENSES

Year Ended May 31, 2020 (with comparative totals for 2019)

	<u>Retail Electric System</u>	<u>Wholesale Power Marketing</u>
Operating revenues:		
Charges for services:		
Residential	\$ 33,243,218	\$ -
Commercial	7,757,037	-
Industrial	55,351,826	-
Water Works System	1,172,254	-
City of Owensboro and Schools	3,368,608	-
Supplemental power	-	1,124,848
Other wholesale	-	16,697,010
Electric Light and Power System	-	-
Build America Bond subsidy	202,724	-
Other	1,529,260	-
	<hr/>	<hr/>
Total operating revenues	102,624,927	17,821,858
	<hr/>	<hr/>
Operating expenses:		
Production:		
Fuel for electric generation	-	-
Purchased power	53,578,483	33,898,305
Other	144,100	-
Transmission and distribution	6,083,940	4,147,313
Customer service and information	1,926,723	-
General and administrative	2,851,695	484,695
Telecommunications	-	-
Depreciation	4,277,827	-
	<hr/>	<hr/>
Total operating expenses	68,862,768	38,530,313
	<hr/>	<hr/>
Operating income (loss)	33,762,159	(20,708,455)
	<hr/>	<hr/>
Nonoperating revenues (expenses):		
Interest and debt expense	(1,406,458)	-
Loss on debt defeasance	-	-
Interest income on investments	1,750,784	23,330
Interest income on Elmer Smith Generating Station investments allocated to:		
Electric System	777,754	-
Other, net	23,300	-
Net increase (decrease) in fair value of investments	271,076	-
Deferred net change in fair value of investments	(271,076)	-
	<hr/>	<hr/>
Total nonoperating revenues (expenses)	1,145,380	23,330
	<hr/>	<hr/>
Income before transfers	34,907,539	(20,685,125)
	<hr/>	<hr/>
Transfers out - dividends to City of Owensboro	(9,543,915)	-
	<hr/>	<hr/>
Change in net position	<u>\$ 25,363,624</u>	<u>\$ (20,685,125)</u>

Elmer Smith Generating Station	Telecommunications	Eliminations	Total	2019 Total
\$ -	\$ 731,021	\$ -	\$ 33,974,239	\$ 31,704,076
-	1,416,467	-	9,173,504	7,668,602
-	-	-	55,351,826	52,775,883
-	20,706	-	1,192,960	1,177,066
-	67,887	-	3,436,495	3,150,770
-	-	-	1,124,848	1,621,059
-	-	-	16,697,010	55,178,896
77,940,977	202,390	(78,143,367)	-	-
74,017	-	-	276,741	542,764
-	-	(129,080)	1,400,180	1,388,091
<u>78,014,994</u>	<u>2,438,471</u>	<u>(78,272,447)</u>	<u>122,627,803</u>	<u>155,207,207</u>
37,951,248	-	-	37,951,248	60,250,869
225,481	-	(77,940,977)	9,761,292	10,301,425
16,438,136	-	(8,760)	16,573,476	20,069,853
359,987	-	(42,194)	10,549,046	10,298,808
-	139,368	-	2,066,091	1,964,320
3,931,257	253,683	(139,882)	7,381,448	8,231,723
-	1,193,914	(140,634)	1,053,280	1,038,967
14,817,542	676,148	-	19,771,517	20,810,161
<u>73,723,651</u>	<u>2,263,113</u>	<u>(78,272,447)</u>	<u>105,107,398</u>	<u>132,966,126</u>
<u>4,291,343</u>	<u>175,358</u>	<u>-</u>	<u>17,520,405</u>	<u>22,241,081</u>
(4,326,563)	(92,366)	11,039	(5,814,348)	(8,483,737)
-	-	-	-	(59,119)
806,888	14,926	(11,039)	2,584,889	3,271,511
(777,754)	-	-	-	-
6,086	(1,566)	-	27,820	26,530
88,633	-	-	359,709	898,675
(88,633)	-	-	(359,709)	(898,675)
<u>(4,291,343)</u>	<u>(79,006)</u>	<u>-</u>	<u>(3,201,639)</u>	<u>(5,244,815)</u>
-	96,352	-	14,318,766	16,996,266
-	(67,887)	-	(9,611,802)	(9,387,288)
<u>\$ -</u>	<u>\$ 28,465</u>	<u>\$ -</u>	<u>\$ 4,706,964</u>	<u>\$ 7,608,978</u>



Riney Hancock CPAs
PSC

**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**

City Utility Commission
City of Owensboro, Kentucky

We have audited, in accordance with the 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, the financial statements of the Owensboro Municipal Utilities Electric Light and Power System (Electric System) of the City of Owensboro, Kentucky as of and for the year ended May 31, 2020, and the related notes to the financial statements, and have issued our report thereon dated September 23, 2020.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Electric System's internal control over financial reporting (internal control) as a basis for designing 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 the Electric System's internal control. Accordingly, we do not express an opinion on the effectiveness of the Electric System's 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 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 the Electric System's financial statements are free from 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 financial statements. 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 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.

Owensboro, Kentucky
September 23, 2020

Ring Hansen & Co. PSC



INDEPENDENT AUDITOR'S REPORT

City Utility Commission
City of Owensboro, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the Owensboro Municipal Utilities Water Works System (Water System) a component unit of the City of Owensboro, Kentucky, as of and for the years ended May 31, 2020 and 2019, and the related notes to the 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 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 the Owensboro Municipal Utilities Water Works System of the City of Owensboro, Kentucky, as of May 31, 2020 and 2019, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 49 through 52 and the Pension and Other Postemployment Benefits (OPEB) Schedules on pages 78 through 82, be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the 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 financial statements, and other knowledge we obtained during our audit of the 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 23, 2020, on our consideration of the Water System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely 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 effectiveness of the Water System's 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 the Water System's internal control over financial reporting and compliance.

Owensboro, Kentucky
September 23, 2020

Ringham & Co. PSC

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of the Owensboro Municipal Utilities Water Works System (Water System) financial performance provides an overview of the Water System's financial activities for the fiscal year ended May 31, 2020. Please read it in conjunction with the Water System's financial statements, which begin on page 53.

Overview of the Financial Statements

This annual report consists of two parts: Management's Discussion and Analysis and the Financial Statements.

Management's Discussion and Analysis (MD&A) serves as an introduction to the basic financial statements. The MD&A represents management's examination and analysis of the Water System's financial condition and performance.

The financial statements report information using accounting methods similar to those used by private sector companies. The financial statements include a Statement of Net Position; a Statement of Revenues, Expenses, and Changes in Fund Net Position; a Statement of Cash Flows; and Notes to the Financial Statements.

The Statement of Net Position presents the financial position of the Water System and thus provides information about the nature and amount of resources and obligations at year-end.

The Statement of Revenues, Expenses, and Changes in Net Position presents the results of the business activities over the course of the fiscal year and information as to how the net position changed during the year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flow.

The Statement of Cash Flows presents changes in cash and cash equivalents resulting from operational, financing and investing activities. This statement presents cash receipts and cash disbursements information, without consideration of the earnings event or when an obligation arises.

The Notes to the Financial Statements provide required disclosures and other information that are essential to a full understanding of material data provided in the statements. The notes present information about the Water System's accounting policies, significant account balances and activities, material risks, obligations, commitments, contingencies and subsequent events, if any.

MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED

Financial Summary

The following table summarizes the financial condition and operations of the Water System for 2020 and 2019.

Assets and Deferred Outflows of Resources	2020	2019
Utility plant, net	\$ 77,448,664	\$ 50,611,288
Restricted assets	31,233,781	57,122,206
Current assets	8,094,624	6,832,146
Other noncurrent assets	1,284,402	1,373,046
Deferred outflow of resources	12,974,921	11,811,786
	<u>\$ 131,036,392</u>	<u>\$ 127,750,472</u>
Liabilities, Deferred Inflows of Resources, and Net Position		
Net position		
Net investment in capital assets	\$ 21,405,311	\$ 21,211,219
Restricted	4,789,442	2,932,280
Unrestricted	6,307,138	6,220,928
Total net position	32,501,891	30,364,427
Long-term debt	80,567,640	82,183,216
Current liabilities	5,644,033	4,109,179
Other noncurrent liabilities	11,256,127	9,986,886
Deferred inflows of resources	1,066,701	1,106,764
	<u>\$ 131,036,392</u>	<u>\$ 127,750,472</u>
Revenues, Expenses and Changes in Net Position		
Operating revenues	\$ 15,212,463	\$ 12,896,075
Operating expenses	10,644,111	10,349,953
Operating income	4,568,352	2,546,122
Interest expense	(3,145,859)	(2,599,333)
Interest and other income	972,265	1,162,714
Net nonoperating expenses	(2,173,594)	(1,436,619)
Income (loss) before contributions and transfers	2,394,758	1,109,503
Capital contributions	63,976	305,122
Transfers out - dividends to City of Owensboro	(321,270)	(317,102)
Change in net position	<u>\$ 2,137,464</u>	<u>\$ 1,097,523</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED

FINANCIAL HIGHLIGHTS

- Net position increased \$2,137,464 in 2020, and the income before contributions and transfers was \$2,394,758 in 2020 versus \$1,109,503 in 2019, as a result of changes in operating revenues, operating expenses and interest as discussed below.
- Operating revenues increased by \$2,316,388 in 2020 when compared to 2019, or 18.0%. The increase in revenues in 2020 is primarily attributable to an increase in residential and commercial revenues, which increased \$1,633,480, or 18.1%, due to the second phase of water rate adjustments that was effective June 1, 2019, which was anticipated to increase annual revenues by approximately 12%. The first phase was effective October 1, 2018, and was anticipated to increase annual revenues by 20%. These rate adjustments were enacted primarily to repay the bonds and other costs incurred to expand the Cavin Water Treatment Plant (Cavin Plant) to treat an additional 20 million gallons of water per day. The Water System's Cavin Plant is being expanded to allow for abandonment of its treatment Plant "A" as a result of foundation settlement issues at the aging facility. Wholesale revenues also increased by \$544,988 in 2020 in comparison to 2019, or 21.0%, due to amendments to contracts with three rural water districts, necessary for establishing a proportionate allocated share of the fixed cost for the expanded Cavin Plant.
- Operating expenses increased \$294,158 in 2020 when compared to 2019, or 2.8%. Production and purification expenses increased \$172,386 in 2020, or 4.6%, due to increased treatment expense. Depreciation increased \$145,809 in 2020, or 4.9%, primarily due to capital asset additions, as discussed below. Partially offsetting that increase was a decrease in customer service and information expense of \$74,577 in 2020, or 9.8%, due primarily to decreased records & collection costs.
- Interest expense increased by \$546,526 in 2020, or 21.0%, due primarily to bonds issued for expansion of the Cavin Plant, as discussed above. Interest income also decreased \$190,449, or 16.4%, primarily due to less interest being earned on the Cavin Plant construction funds since these funds were used for the expansion of the Cavin Plant, as well as lower rates received on bank and investment balances.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of 2020, the Water System had \$77.4 million invested in a broad range of assets, including wells, treatment facilities and equipment, storage tanks, buildings and water mains. This amount represents an increase of \$26.8 million from 2019 due to capital asset additions which exceeded current depreciation expense. The following table summarizes capital assets, net of accumulated depreciation, at the end of 2020 and 2019.

	2020	2019
Source of supply plant	\$ 2,456,441	\$ 2,643,070
Pumping plant	326,105	356,787
Water treatment plant	11,940,080	12,841,719
Transmission and distribution plant	29,894,591	21,267,041
General plant	1,301,569	1,372,171
Unclassified plant and construction in progress	31,529,878	12,130,500
	<u>\$ 77,448,664</u>	<u>\$ 50,611,288</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED

CAPITAL ASSET AND DEBT ADMINISTRATION, Continued

Capital Assets, Continued

In addition to the Water System's routine additions and replacement of distribution plant, the Water System incurred \$607,000 for new wells and well field development, \$515,000 for design and construction services related to expansion of the Water System's Cavin Plant, and \$26.9 million for the actual construction of the Cavin Plant expansion.

Debt

At the end of 2020, the Water System had \$82.1 million in bonds outstanding versus \$83.7 million in 2019, for a decrease of \$1.6 million, or 1.9%. As there was no new debt issued during 2020, this decrease is due to scheduled bond payments. The Water System bonds carry ratings of "AA" (stable outlook) and "A1" (upper medium grade) as assigned by S&P Global Ratings and Moody's Investors Services, Inc., respectively.

Outlook

We expect the 2021 results to be lower than in 2020, as the water treatment chemicals for disinfection and softening at the Cavin Plant are being changed and will result in additional expenses. In addition, purchased power costs will be higher as a result of additional downtime during the completion of construction and startup of the Cavin plant.

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**OWENSBORO MUNICIPAL UTILITIES
WATER WORKS SYSTEM**

STATEMENT OF NET POSITION

May 31, 2020 and 2019

**ASSETS AND DEFERRED OUTFLOWS OF
RESOURCES**

	<u>2020</u>	<u>2019</u>
Utility plant, net	\$ 77,448,664	\$ 50,611,288
Restricted assets	<u>31,233,781</u>	<u>57,122,206</u>
Current assets:		
Cash and cash equivalents	4,154,327	1,831,723
Investments	149,637	1,954,493
Accounts receivable, less allowance for doubtful accounts of \$11,860 for 2020 and \$3,899 for 2019	3,151,740	2,307,766
Materials and supplies inventories	635,480	589,244
Prepayments	<u>3,440</u>	<u>148,920</u>
Total current assets	<u>8,094,624</u>	<u>6,832,146</u>
Other noncurrent assets	<u>1,284,402</u>	<u>1,373,046</u>
Total assets	<u>118,061,471</u>	<u>115,938,686</u>
Deferred outflows of resources:		
Deferred pension outflow	1,851,193	1,971,643
Deferred other postemployment benefit outflows	819,446	638,508
Deferred pension obligation	7,397,703	6,324,181
Deferred postemployment benefit obligation	2,113,019	2,027,589
Unamortized loss on debt refunding	<u>793,560</u>	<u>849,865</u>
Total deferred outflows of resources	<u>12,974,921</u>	<u>11,811,786</u>
Total assets and deferred outflows of resources	\$ <u>131,036,392</u>	\$ <u>127,750,472</u>

See Notes to Financial Statements

**LIABILITIES, DEFERRED INFLOWS OF
RESOURCES, AND NET POSITION**

	<u>2020</u>	<u>2019</u>
Net position:		
Net investment in capital assets	\$ 21,405,311	\$ 21,211,219
Restricted for capital projects, net of related debt	3,076,104	1,483,590
Restricted for debt service	1,713,338	1,448,690
Unrestricted	<u>6,307,138</u>	<u>6,220,928</u>
Total net position	<u>32,501,891</u>	<u>30,364,427</u>
Long-term debt	<u>80,567,640</u>	<u>82,183,216</u>
Current liabilities (payable from restricted assets):		
Current maturities of long-term debt	1,560,000	1,500,000
Accrued interest payable	639,697	651,822
Accounts payable	<u>2,675,111</u>	<u>1,338,647</u>
	<u>4,874,808</u>	<u>3,490,469</u>
Current liabilities (payable from current assets):		
Accounts payable	<u>769,225</u>	<u>618,710</u>
Total current liabilities	<u>5,644,033</u>	<u>4,109,179</u>
Other noncurrent liabilities:		
Net pension liability	9,048,688	7,686,431
Net other postemployment benefit liability	2,163,488	2,240,753
Customers' advances for construction	<u>43,951</u>	<u>59,702</u>
Total other noncurrent liabilities	<u>11,256,127</u>	<u>9,986,886</u>
Total liabilities	<u>97,467,800</u>	<u>96,279,281</u>
Deferred inflows of resources:		
Deferred pension inflows	200,208	609,393
Deferred other postemployment benefit inflows	768,977	425,344
Net unrealized gain on investments	<u>97,516</u>	<u>72,027</u>
	<u>1,066,701</u>	<u>1,106,764</u>
Total liabilities, deferred inflows of resources, and net position	<u><u>\$ 131,036,392</u></u>	<u><u>\$ 127,750,472</u></u>

See Notes to Financial Statements

**OWENSBORO MUNICIPAL UTILITIES
WATER WORKS SYSTEM**

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

Years Ended May 31, 2020 and 2019

	<u>2020</u>	<u>2019</u>
Operating revenues:		
Charges for services:		
Residential	\$ 5,549,311	\$ 4,532,740
Commercial	5,121,554	4,504,645
Water districts	3,139,796	2,594,808
Fire protection	360,162	300,642
City of Owensboro	320,976	317,102
Electric Light and Power System	389,845	356,845
Service revenues	<u>330,819</u>	<u>289,293</u>
Total operating revenues	<u>15,212,463</u>	<u>12,896,075</u>
Operating expenses:		
Production and purification	3,906,920	3,734,534
Transmission and distribution	1,469,923	1,380,566
Customer service and information	686,324	760,901
General and administrative	1,429,644	1,468,461
Depreciation	<u>3,151,300</u>	<u>3,005,491</u>
Total operating expenses	<u>10,644,111</u>	<u>10,349,953</u>
Operating income	<u>4,568,352</u>	<u>2,546,122</u>
Nonoperating revenues (expenses):		
Interest and debt expense	(3,145,859)	(2,599,333)
Interest income on investments	972,265	1,162,714
Gain on sale of utility plant	-	-
Net increase (decrease) in fair value of investments	25,489	219,793
Deferred net change in fair value of investments	<u>(25,489)</u>	<u>(219,793)</u>
Total nonoperating revenues (expenses)	<u>(2,173,594)</u>	<u>(1,436,619)</u>
Income (loss) before contributions and transfers	2,394,758	1,109,503
Capital contributions	63,976	305,122
Transfers out - dividends to City of Owensboro	<u>(321,270)</u>	<u>(317,102)</u>
Change in net position	<u>2,137,464</u>	<u>1,097,523</u>
Net position, beginning of year	<u>30,364,427</u>	<u>29,266,904</u>
Net position, end of year	<u>\$ 32,501,891</u>	<u>\$ 30,364,427</u>

**OWENSBORO MUNICIPAL UTILITIES
WATER WORKS SYSTEM**

STATEMENTS OF CASH FLOWS

Years Ended May 31, 2020 and 2019

	<u>2020</u>	<u>2019</u>
Cash flows from operating activities:		
Receipts from customers	\$ 14,339,623	\$ 12,474,505
Payments to suppliers	(4,174,611)	(4,642,444)
Payments to employees	(2,909,107)	(2,841,232)
Net cash provided by operating activities	<u>7,255,905</u>	<u>4,990,829</u>
Cash flows from noncapital financing activities:		
Transfers out - dividends to City of Owensboro	<u>(328,170)</u>	<u>(315,641)</u>
Cash flows from capital and related financing activities:		
Capital expenditures	(28,699,714)	(6,587,234)
Payments on long-term debt	(1,500,000)	(890,000)
Interest paid on long-term debt	(3,099,646)	(2,131,575)
Proceeds from bond issuance	-	64,075,925
Payment to refunded bond agent	-	(12,811,687)
Reimbursements of customers' advances	(4,273)	(4,948)
Debt issuance cost	<u>-</u>	<u>(245,839)</u>
Net cash used in capital and related financing activities	<u>(33,303,633)</u>	<u>41,404,642</u>
Cash flows from investing activities:		
Purchase of investments	-	(28,795,236)
Proceeds from sale and maturities of investments	10,540,898	16,870,000
Interest on investments	<u>943,020</u>	<u>1,037,251</u>
Net cash used in investing activities	<u>11,483,918</u>	<u>(10,887,985)</u>
Net decrease in cash and cash equivalents	(14,891,980)	35,191,845
Cash and cash equivalents, beginning of year	<u>42,221,266</u>	<u>7,029,421</u>
Cash and cash equivalents, end of year	<u>\$ 27,329,286</u>	<u>\$ 42,221,266</u>
Included in the following Statements of Net Position captions:		
Cash and cash equivalents, unrestricted	\$ 4,154,327	\$ 1,831,723
Cash and cash equivalents, restricted	<u>23,174,959</u>	<u>40,389,543</u>
	<u>\$ 27,329,286</u>	<u>\$ 42,221,266</u>

See Notes to Financial Statements

**OWENSBORO MUNICIPAL UTILITIES
WATER WORKS SYSTEM**

STATEMENTS OF CASH FLOWS, Concluded

Years Ended May 31, 2020 and 2019

	<u>2020</u>	<u>2019</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 4,568,353	\$ 2,546,122
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	3,251,300	3,095,491
Change in assets and liabilities:		
Decrease (increase) in assets:		
Accounts receivable	(851,441)	(319,864)
Materials and supplies	(46,236)	(129,622)
Prepayments	145,480	(1,112)
Other noncurrent assets	31,035	(26,803)
Increase (decrease) in liabilities:		
Accounts payable	157,414	(90,500)
Deferred revenues	-	(82,883)
Net cash provided by operating activities	<u>\$ 7,255,905</u>	<u>\$ 4,990,829</u>
Noncash investing, capital and financing activities:		
Noncash contributions in aid of construction	<u>\$ 52,498</u>	<u>\$ 278,530</u>
Unrefunded customers' advances credited to contributions in aid of construction	<u>\$ 11,478</u>	<u>\$ 26,592</u>
Amortization of debt discount and expense and deferred loss on debt defeasance	<u>\$ 58,339</u>	<u>\$ 65,461</u>

OWENSBORO MUNICIPAL UTILITIES WATER WORKS SYSTEM

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

1. Organization and Summary of Significant Accounting Policies

General Information

In 1940, the City of Owensboro, Kentucky (the City), established the City Utility Commission to manage, control, and operate Owensboro Municipal Utilities (OMU). City officials appoint the five individuals who comprise the City Utility Commission. OMU consists of the Electric Light and Power System (Electric System) and the Water Works System (Water System), which are component units of the City. Accordingly, the Electric System and the Water System are part of the financial reporting entity of the City. The accompanying financial statements present only the Water System and are not intended to present fairly the financial position of the City and changes in its financial position or, where applicable, its cash flows, in conformity with accounting principles generally accepted in the United States of America. The Water System is subject to regulation, including approval of rates charged for utility services, by the City, as set forth in the applicable city ordinances.

The Water System provides water to approximately 24,000 residential, commercial and industrial customers in Owensboro, Kentucky. The Water System also furnishes water to three rural water districts in Daviess County, Kentucky, under wholesale supply agreements.

System of Accounts and Basis of Accounting

The Water System's accounts are maintained substantially in accordance with the Uniform System of Accounts for water companies developed by the National Association of Regulatory Utility Commissioners and in conformity with accounting principles generally accepted in the United States of America using the economic resources measurement focus and the accrual basis of accounting.

The financial statements are prepared in accordance with generally accepted accounting principles and follow accounting guidance provided by the Governmental Accounting Standards Board (GASB) in the regulated operations provisions of GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which permit certain entities with cost-based rates to defer certain costs or income that would otherwise be recognized when incurred to the extent that the rate-regulated entity is recovering or expects to recover such amounts in future rates charged to its customers. Regulatory assets are the deferral of costs expected to be recovered in future customer rates and regulatory liabilities represent current recovery of expected future costs.

The Water System considers water revenues and costs that are directly related to production, purification, transmission, and distribution of water to be operating revenues and expenses.

OWENSBORO MUNICIPAL UTILITIES WATER WORKS SYSTEM

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

1. Organization and Summary of Significant Accounting Policies, Continued

System of Accounts and Basis of Accounting, Continued

Revenues and expenses related to financing and other activities are reflected as nonoperating. The Water System accrues revenues as services are rendered to utility customers.

Utility Plant and Depreciation

Utility plant is stated at original cost, which includes the cost of contracted services, materials, labor, labor-related expenditures, general and administrative costs and an allowance for borrowed funds used during construction.

Replacements of depreciable property units, except minor replacements, are charged to utility plant. In addition, the costs of refurbishments of water tanks are charged to utility plant. Property units replaced or retired, including cost of removal net of any salvage, are charged to accumulated depreciation. Routine maintenance, repairs and minor replacement costs are charged to expense as incurred.

Allowance for borrowed funds used during construction includes capitalized interest during the construction period less any interest income on construction fund investments from bond proceeds during such period. Capitalization of interest is discontinued when the project is completed and the related utility plant is placed in service.

Depreciation of utility plant and unclassified plant in service is provided using the straight-line composite rate method over the estimated service lives of the depreciable assets. Estimated service lives of assets range from 5 to 80 years. Depreciation expense during 2020 and 2019 was approximately 3.4% of the average original cost of depreciable utility plant in service.

Restricted Assets

The City ordinances that authorized the Water Revenue Bonds require that certain amounts from bond proceeds and payments by customers for services provided be deposited into designated funds and be used only for the specified purposes of the funds. The Water System's policy is to first apply restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

Cash and Investments

Cash deposits are reported at carrying amounts. The Water System categorizes the fair value measurements of its investments based on the hierarchy established by generally accepted accounting principles. U.S. treasury and agency securities and negotiable certificates of deposit are stated at fair values based upon externally developed models that use rates and prices of similar securities.

OWENSBORO MUNICIPAL UTILITIES WATER WORKS SYSTEM

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

1. Organization and Summary of Significant Accounting Policies, Continued

Cash and Investments, Continued

The Water System considers all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash equivalents. Unrestricted investments with initial maturities exceeding three months, consisting of U.S. treasury and agency securities and negotiable certificates of deposit, are classified as temporary investments.

Inventories

Inventories consisting of materials and supplies are valued at the lower of weighted average cost or net realizable value.

Bond Issuance Costs

Premiums and discounts arising from various bond issues are deferred and amortized using the straight-line method over the lives of the bond issues.

The Water System's rate making methodology allows for future recovery of debt costs, including bond issuance costs, in its rate making process. Accordingly, under GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, debt issuance costs are deferred and amortized using the straight-line method over the lives of the bond issues.

The difference between the reacquisition price and the net carrying amount of defeased bond issues has been deferred and is being amortized using the straight-line method over the lives of the refunding bond issues.

Pension and Other Postemployment Benefits

For purposes of measuring the net liabilities, deferred outflows of resources and deferred inflows of resources related to pensions and other postemployment benefits (OPEB), information about the fiduciary net position of the pension/OPEB plans, and additions to/deductions from the pension/OPEB plans' fiduciary net position have been determined on the same basis as they are reported by the pension/OPEB plans. For this purpose, revenues are recognized when earned. Contributions are recognized when due, pursuant to legal (or statutory) requirements. Benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Plan investments are reported at fair value.

**OWENSBORO MUNICIPAL UTILITIES
WATER WORKS SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

1. Organization and Summary of Significant Accounting Policies, Continued

Pension and Other Postemployment Benefits, Continued

The Water System's rate making methodology allows for future recovery of certain pension and other postemployment benefit costs in its rate making process. Accordingly, under GASBS No. 62, pension and other postemployment benefit costs in excess of required contributions are deferred.

Customers' Advances for Construction

Customers' advances for construction are refundable to depositors over a 10-year period. Refund amounts under the contracts are based on annual revenues from the extensions. Unrefunded balances at the end of the contract period are credited to contributions in aid of construction and are no longer refundable.

Contributed Property and Equipment

The donor cost or appraised value of contributed property and equipment is included in contributions.

Income Taxes

The Water System is exempt from federal and state income taxes and, accordingly, the financial statements include no provision for such taxes.

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.

**OWENSBORO MUNICIPAL UTILITIES
WATER WORKS SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

2. Utility Plant

Water utility plant activity for the year ended May 31, 2020, was as follows:

	Beginning Balance	Additions	Retirements	Ending Balance
Utility plant:				
Source of supply plant	\$ 5,471,219	\$ -	\$ -	\$ 5,471,219
Pumping plant	1,201,471	-	-	1,201,471
Water treatment plant	30,688,655	-	-	30,688,655
Transmission and distribution plant	41,814,908	10,586,901	(100,860)	52,300,949
General plant	5,346,698	102,397	(59,306)	5,389,789
Unclassified plant in service	4,017,882	(2,683,803)	-	1,334,079
Total, at original cost	<u>88,540,833</u>	<u>8,005,495</u>	<u>(160,166)</u>	<u>96,386,162</u>
Accumulated depreciation:				
Source of supply plant	(2,828,149)	(186,629)	-	(3,014,778)
Pumping plant	(844,684)	(30,682)	-	(875,366)
Water treatment plant	(17,846,936)	(901,639)	-	(18,748,575)
Transmission and distribution plant	(20,547,867)	(1,959,352)	100,860	(22,406,359)
General plant	<u>(3,974,527)</u>	<u>(172,998)</u>	<u>59,306</u>	<u>(4,088,219)</u>
Total accumulated depreciation	<u>(46,042,163)</u>	<u>(3,251,300)</u>	<u>160,166</u>	<u>(49,133,297)</u>
Construction in progress	<u>8,112,618</u>	<u>22,083,181</u>	<u>-</u>	<u>30,195,799</u>
Utility plant, net	<u>\$ 50,611,288</u>	<u>\$ 26,837,376</u>	<u>\$ -</u>	<u>\$ 77,448,664</u>

Depreciation expense for the years ended May 31 was as follows:

	<u>2020</u>	<u>2019</u>
Water utility plant	\$ 3,151,300	\$ 3,005,491
Transportation depreciation charged to construction activities or other operating expenses	<u>100,000</u>	<u>90,000</u>
	<u>\$ 3,251,300</u>	<u>\$ 3,095,491</u>

3. Restricted Assets

Restricted assets at May 31 consists of the following:

	<u>2020</u>	<u>2019</u>
Cash and cash equivalents	\$ 23,174,959	\$ 40,389,543
Investments	7,974,630	16,659,954
Accrued interest receivable	<u>84,192</u>	<u>72,709</u>
	<u>\$ 31,233,781</u>	<u>\$ 57,122,206</u>

**OWENSBORO MUNICIPAL UTILITIES
WATER WORKS SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

3. Restricted Assets, Continued

The above balances are contained in the following funds:

	<u>2020</u>	<u>2019</u>
Sinking Fund	\$ 6,857,233	\$ 6,667,970
Renewal and Replacement Fund	658,804	31,198
Construction Fund	<u>23,717,744</u>	<u>50,423,038</u>
	\$ <u>31,233,781</u>	\$ <u>57,122,206</u>

Under the terms of the Water Revenue Bond ordinances, interest income from the temporary investment of the Water System's restricted assets must be credited to the various restricted asset funds. In addition, whenever all specified and required payments and transfers into the restricted asset funds have been made as provided in the Water Revenue Bond ordinances and there is a balance in excess of the estimated amounts required to pay current month operation and maintenance costs (approximately \$622,000 at May 31, 2020), all or any part of such excess may be used for any lawful purpose related to the Water System.

The Water System follows GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investments Pools* (GASBS No. 31), which requires certain investments to be carried at fair value in the statements of net position and changes in the fair value of investments to be reported in the statements of revenues, expenses and changes in net assets. In accordance with GASBS No. 31, the Water System recorded unrealized gains (losses) of \$25,489 and \$219,793 for the years ended May 31, 2020 and 2019, respectively. The Water System's rate making methodology does not consider unrealized gains or losses on marketable securities in its rate making process. Accordingly, under GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, as it relates to rate-regulated entities, the unrealized gains (losses) for the years ended May 31, 2020 and 2019, have been deferred.

The net increase (decrease) in the fair value of investments consists of the following:

	<u>2020</u>	<u>2019</u>
Net unrealized gains (losses) on investments	\$ <u>25,489</u>	\$ <u>219,793</u>

The calculation of realized gains or losses on sales of investments is independent of the calculation of the net change in the fair value of investments. Realized gains or losses on investments that were held in more than one fiscal year and sold in the current year were included as a net change in the fair value of investments reported in prior years and the current year.

**OWENSBORO MUNICIPAL UTILITIES
WATER WORKS SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

4. Cash Deposits and Investments

At May 31, the carrying amounts of the Water System's deposits in financial institutions and investments other than deposits were:

	<u>2020</u>	<u>2019</u>
Deposits in financial institutions	\$ 27,810,106	\$ 42,890,220
Investments other than deposits	<u>7,643,447</u>	<u>17,945,493</u>
	<u>\$ 35,453,553</u>	<u>\$ 60,835,713</u>

These amounts are reflected in the statements of net position as:

	<u>2020</u>	<u>2019</u>
Cash and cash equivalents	\$ 4,154,327	\$ 1,831,723
Investments	149,637	1,954,493
Restricted assets:		
Cash and cash equivalents	23,174,959	40,389,543
Investments	<u>7,974,630</u>	<u>16,659,954</u>
	<u>\$ 35,453,553</u>	<u>\$ 60,835,713</u>

Deposit and Investment Policy. The Water System's deposit and investment policy prescribes to the prudent-person rule: Investments shall be made with applicable law and under prevailing circumstances which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital, as well as the probable income to be derived.

Custodial Credit Risk. Custodial credit risk is the risk that, in the event of a bank failure, the Water System's deposits may not be returned to it. The Water System's deposit and investment policy permits uncollateralized deposits only if issued by institutions ranked in one of the three highest categories by a nationally recognized rating agency. As of May 31, 2020, \$27,263,062 of the Water System's bank balance of \$27,810,106 was exposed to custodial credit risk as follows:

Uninsured with collateral held by pledging bank's agent	<u>\$ 27,263,062</u>
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**OWENSBORO MUNICIPAL UTILITIES
WATER WORKS SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

4. Cash Deposits and Investments, Continued

Investments are measured at fair value on a recurring basis. Recurring fair value measurements are those that Governmental Accounting Standards Board (GASB) Statements require or permit in the statement of net position at the end of each reporting period. Fair value measurements are categorized based on the valuation inputs used to measure an asset's fair value: Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs. The Water System's Investments consist of U.S. treasury and agency securities and negotiable certificates of deposit, which utilize Level 2 inputs for fair value measurements. Fair value is based upon externally developed models that use rates and prices of similar securities, due to the limited market activity of the securities.

As of May 31, 2020, the Water System had the following investments:

<u>Investments</u>	<u>Maturities</u>	
Federal Home Loan Bank – Callable	11/30/2020 thru 09/21/2028	\$ 5,642,647
Federal Farm Credit Bank – Callable	06/17/2020 thru 2/12/2029	2,000,800
Negotiable Certificates of Deposit	06/17/2020 thru 05/24/2022	<u>480,820</u>
		<u>\$ 8,124,267</u>

Interest Rate Risk. As a means of limiting its exposure to fair value losses arising from rising interest rates, the Water Works System's deposit and investment policy limits investment maturities based upon provisions of bond ordinances.

Credit Risk. The Water System's deposit and investment policy authorizes the investment of funds in any manner permitted by bond ordinances and the Kentucky Revised Statutes and does not further limit its investment choices.

Concentration of Credit Risk. Other than the prudent-person rule, the Water System's deposit and investment policy places no limit on the amount the Water System may invest in any one issuer. The Water System's investments, other than deposits, consist of U.S. treasury securities at May 31, 2020.

**OWENSBORO MUNICIPAL UTILITIES
WATER WORKS SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

5. Long-Term Debt

Long-term debt activity for the year ended May 31, 2020, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Bonds payable:					
Series of 2014	\$ 7,225,000	\$ -	\$ (300,000)	\$ 6,925,000	\$ 305,000
Series of 2015	5,285,000	-	(30,000)	5,255,000	35,000
Series of 2016	6,425,000	-	(240,000)	6,185,000	250,000
Series of 2018	63,190,000	-	(930,000)	62,260,000	970,000
	82,125,000	-	(1,500,000)	80,625,000	1,560,000
Add unamortized debt premium	1,558,216	-	(55,576)	1,502,640	-
Total bonds payable	\$ 83,683,216	\$ -	\$ (1,555,576)	\$ 82,127,640	\$ 1,560,000

Long-term debt at May 31 consists of the following Water Revenue Bonds:

	2020	2019
Series of 2014:		
1.75% to 3.9%, due serially		
September 15, 2020 to 2038	\$ 6,925,000	\$ 7,225,000
Series of 2015:		
3.0% to 4.0%, due serially		
September 15, 2020 to 2041	5,255,000	5,285,000
Series of 2016:		
2.0% to 3.0%, due serially		
September 15, 2020 to 2035	6,185,000	6,425,000
Series of 2018:		
3.0% to 5.0%, due serially		
September 15, 2020 to 2048	62,260,000	63,190,000
Total long-term debt	80,625,000	82,125,000
Less current maturities	(1,560,000)	(1,500,000)
Add unamortized debt premium	1,502,640	1,558,216
	\$ 80,567,640	\$ 82,183,216

**OWENSBORO MUNICIPAL UTILITIES
WATER WORKS SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

5. Long-Term Debt, Continued

Sinking fund requirements and scheduled aggregate maturities of long-term debt are as follows:

<u>Year Ending May 31:</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2021	\$ 1,560,000	\$ 3,039,839	\$ 4,599,839
2022	1,620,000	2,976,670	4,596,670
2023	1,690,000	2,909,789	4,599,789
2024	1,760,000	2,839,020	4,599,020
2025	1,840,000	2,760,820	4,600,820
2026 – 2030	10,365,000	12,625,601	22,990,601
2031 – 2035	12,235,000	10,755,131	22,990,131
2036 – 2040	14,730,000	8,258,608	22,988,608
2041 – 2045	17,820,000	5,168,094	22,988,094
2046 – 2049	17,005,000	1,394,100	18,399,100
	<u>\$ 80,625,000</u>	<u>\$ 52,727,672</u>	<u>\$ 133,352,672</u>

The Water System is subject to certain debt covenants, compliance with which is required by the ordinances authorizing its bond issues. Such ordinances require revenue to be first applied to the Sinking Fund, next to the Operations and Maintenance Fund, and, finally, to the Renewal and Replacement Fund.

On June 12, 2014, the City issued \$9,730,000 of Water Revenue Refunding and Improvement Bonds, Series 2014, dated July 31, 2014. The 2014 Bonds were issued to refund all 1999 and 2003 series bonds due after September 15, 2014, and to fund various capital improvement expenditures for the Water System. The in-substance defeasance of the 1999 and 2003 Bonds was accomplished by placing \$3,835,802 in proceeds from the 2014 Bonds and \$40,700 in funds from the 1999 and 2003 Bond Sinking Funds in an irrevocable escrow fund to be used solely for satisfying scheduled debt service payments of the 1999 and 2003 Bonds. Accordingly, 1999 and 2003 Bonds in the amount of \$1,305,000 and \$2,510,000, respectively, net of unamortized discount and issuance costs of \$60,176 and accrued interest payable of \$47,483, were extinguished resulting in the accounting recognition of a loss from defeasance of \$74,195, reported in the accompanying financial statements as a deferred outflow of resources. The City advance refunded the 1999 and 2003 bonds to reduce the effective rate on the debt. The advance refunding resulted in an economic gain (difference between the present value of the debt service payment on the old and new debt) of \$252,617.

**OWENSBORO MUNICIPAL UTILITIES
WATER WORKS SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

5. Long-Term Debt, Continued

The Series 2014 Bonds maturing on and after September 15, 2023, are subject to redemption prior to maturity in whole or in part on September 15, 2022, and on any date thereafter, at the redemption price of 100% of the principal amount redeemed, plus accrued interest to the redemption date.

On December 16, 2015, the City issued \$5,385,000 of Water Revenue Improvement Bonds, Series 2015, dated December 1, 2015. The 2015 Bonds were issued to provide funds for the various capital improvement expenditures for the Water System and to fully fund the Bond Reserve Account. The Series 2015 Bonds maturing on and after September 15, 2024, are subject to redemption in whole or in part on September 15, 2023, and on any date thereafter, at the redemption price of 100% of the principal amount redeemed, plus accrued interest to the redemption date.

On June 8, 2016, the City issued \$6,590,000 of Water Revenue Refunding Bonds, Series 2016, dated June 8, 2016. The 2016 Bonds were issued to refund a portion of the outstanding Series 2009 Bonds. The in-substance defeasance of the 2009 Bonds was accomplished by placing \$6,417,071 in proceeds from the 2014 Bonds and \$104,023 in funds from the 2009 Bond Sinking Fund in an irrevocable escrow fund to be used solely for satisfying scheduled debt service payments of the 2009 Bonds. Accordingly, 2009 Bonds in the amount of \$5,895,000, net of unamortized discount and issuance costs of \$129,024 and accrued interest payable of \$69,133, were extinguished resulting in the accounting recognition of a loss from defeasance of \$685,985, reported in the accompanying financial statements as a deferred outflow of resources. The City advance refunded the 2009 bonds to reduce the effective rate on the debt. The advance refunding resulted in an economic gain (difference between the present value of the debt service payment on the old and new debt) of \$771,709.

The Series 2016 Bonds maturing on and after September 15, 2025, are subject to redemption in whole or in part on September 15, 2024, and on any date thereafter, at the redemption price of 100% of the principal amount redeemed, plus accrued interest to the redemption date.

On September 27, 2018, the City issued \$63,190,000 of Water Revenue Refunding and Improvement Bonds, Series 2018, dated September 27, 2018. The 2018 Bonds were issued to refund all outstanding 2009 series bonds due after September 15, 2018, and to fund various capital improvement expenditures for the Water System, including expansion of the Cavin Water Treatment Plant to treat an additional 20 million gallons of water per day. The refunding of the 2009 Bonds was accomplished by placing \$12,811,686 in proceeds from the 2018 Bonds with a paying agent to be used solely for refunding the outstanding 2009 Bonds. Accordingly, 2009 Bonds in the amount of \$12,790,000, net of unamortized discount and issuance costs of \$255,218 and accrued interest payable of \$21,686, were extinguished resulting in the accounting recognition of a loss from defeasance of \$255,218, reported in the

**OWENSBORO MUNICIPAL UTILITIES
WATER WORKS SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

5. Long-Term Debt, Continued

accompanying financial statements as a deferred outflow of resources. The City refunded the 2009 bonds to reduce the effective rate on the debt. The refunding resulted in an economic gain (difference between the present value of the debt service payment on the old and new debt) of \$1,777,076.

The Series 2018 Bonds maturing on and after September 15, 2028, are subject to redemption prior to maturity in whole or in part on September 15, 2027, and on any date thereafter, at the redemption price of 100% of the principal amount redeemed, plus accrued interest to the redemption date.

All bonds are secured by a pledge of, and are payable from, the gross revenues derived from the operation of the Water System and are secured by the statutory mortgage lien as provided and authorized by the Kentucky Revised Statutes.

For all bonds, in the event of default, any Bondholder may proceed to protect and enforce its rights and the rights of the holders of the Bonds under the Ordinance forthwith by a suit or suits in equity or at law.

The difference between the reacquisition price and the net carrying amount of defeased bond issues has been deferred and is being amortized using the straight-line method over the lives of the defeased bond issues.

6. Pension and Other Postemployment Benefits – CERS

Plan Description

The Water System contributes to the County Employees Retirement System (CERS), which is a cost-sharing multiple-employer defined benefit pension/OPEB plan administered by Kentucky Retirement Systems (KRS) that covers members employed in positions of each

Plan Description, Continued

participating county, city, and school board, and any additional eligible local agencies electing to participate in CERS. Kentucky Revised Statute Section 61.645 assigns the authority to establish and amend benefit provisions to the Board of Trustees of Kentucky Retirement Systems (Board). KRS issues a publicly available financial report that can be obtained at www.kyret.ky.gov.

Benefits Provided

CERS provides for retirement, disability, and death benefits to system members through its Pension Fund, as well as other postemployment benefits (OPEB) for hospital and medical insurance through its Insurance Fund.

**OWENSBORO MUNICIPAL UTILITIES
WATER WORKS SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

6. Pension and Other Postemployment Benefits – CERS, Continued

Benefits Provided, Continued

Retirement benefits may be extended to beneficiaries of members under certain circumstances. Retirement benefits are determined using a formula which considers the member's final compensation; benefit factors set by statute which vary depending upon the type/amount of service, participation date, and retirement date; and years of service. Plan members with a participation date prior to September 1, 2008, are eligible to retire with full benefits at any time with 27 or more years of service credit, or at age 65 with at least 4 years of service credit. Plan members with a participation date on or after September 1, 2008, are eligible to retire with full benefits at age 57 if the member's age and years of service equal 87, or at age 65 with at least 5 years of service credit.

Other postemployment benefits provided by CERS consist of prescribed contributions for whole or partial payments of required premiums to purchase hospital and medical insurance.

Contributions

State statute requires active members to contribute 5% of creditable compensation. For members participating on or after September 1, 2008, an additional 1% of creditable compensation is required. This amount is credited to the Insurance Fund and is non-refundable to the member. Employers contribute at the rate determined by the KRS Board to be necessary for the actuarial soundness of the systems, as required by KRS 61.565 and KRS 61.752.

The Water System's actuarially determined contribution rates and contribution amounts, based on annual creditable compensation, for the year ended May 31, 2020, were as follows:

	<u>Contribution Rates</u>	<u>Contributions</u>
Pension	19.30%	\$ 703,199
OPEB	4.76%	173,431
Total	24.06%	\$ 876,630

Pension Liabilities, Pension Expense, Deferred Outflows of Resources, and Deferred Inflows of Resources Related to Pensions

The net pension and OPEB liabilities reported as of May 31, 2020, were measured as of June 30, 2019, and the total pension and OPEB liabilities used to calculate the net pension and OPEB liability was determined by an actuarial valuation as of June 30, 2018. The Water

**OWENSBORO MUNICIPAL UTILITIES
WATER WORKS SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

6. Pension and Other Postemployment Benefits – CERS, Continued

Pension Liabilities, Pension Expense, Deferred Outflows of Resources, and Deferred Inflows of Resources Related to Pensions, Continued

System's proportion of the liabilities was based on a projection of the Water System's long-term share of contributions to the plan relative to the projected contributions of all participating entities, actuarially determined. Changes in the Water System's pension and OPEB proportions as of the measurement dates were as follows:

	<u>Pension</u>	<u>OPEB</u>
June 30, 2018	0.126208%	0.126208%
Increase	0.002452	0.002452
June 30, 2019	0.128660%	0.128660%

The Water System's pension and OPEB liabilities and expense as of and for the year ended May 31, 2020, were as follows:

	<u>Pension</u>	<u>OPEB</u>
Net Liability	\$ <u>9,048,688</u>	\$ <u>2,163,488</u>
Expense	\$ <u>703,199</u>	\$ <u>173,431</u>

At May 31, 2020, the Water System reported deferred outflows of resources and deferred inflows of resources related to pensions and OPEB from the following sources:

	<u>Pension</u>		<u>OPEB</u>	
	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual experience	\$ 231,040	\$ 38,233	\$ -	\$ 652,774
Changes of assumptions	915,830	-	640,196	4,281
Net difference between projected and actual earnings on plan investments		145,869	-	96,092
Changes in proportion and differences between contributions and proportionate share of contributions	47,231	16,106	17,190	15,830
Contributions subsequent to the measurement date	<u>657,092</u>	<u>-</u>	<u>162,060</u>	<u>-</u>
Total	\$ <u>1,851,193</u>	\$ <u>200,208</u>	\$ <u>819,446</u>	\$ <u>768,977</u>

**OWENSBORO MUNICIPAL UTILITIES
WATER WORKS SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

6. Pension and Other Postemployment Benefits – CERS, Continued

Pension Liabilities, Pension Expense, Deferred Outflows of Resources, and Deferred Inflows of Resources Related to Pensions, Continued

The \$657,092 and \$162,060 of deferred outflows of resources resulting from the Water System's pension and OPEB contributions subsequent to the measurement date will be recognized as a reduction of the net pension and OPEB liabilities in the year ending May 31, 2021. Other amounts reported as deferred outflows of resources and deferred inflows of resources will be recognized as follows:

Year ending May 31,	<u>Pension</u>	<u>OPEB</u>
2021	\$ 648,514	\$ (15,527)
2022	242,889	(15,527)
2023	92,142	15,025
2024	10,348	(43,505)
2025	-	(43,930)
Thereafter	-	(8,127)
	<u>\$ 993,893</u>	<u>\$ (111,591)</u>

Actuarial Assumptions

The total pension/OPEB liabilities in the June 30, 2018, actuarial valuation were determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	2.30%
Healthcare payroll growth rate	2.00%
Salary increases	3.30% to 10.30%, varies by service
Net investment rate of return	6.25%
Healthcare cost trend rates (OPEB)	Pre-65: Initial trend starting at 7.0% at January 1, 2020, and gradually decreasing to an ultimate trend rate of 4.05% over a period of 12 years. Post-65: Initial trend starting at 5.0% at January 1, 2020, and gradually decreasing to an ultimate trend rate of 4.05% over a period of 10 years.

**OWENSBORO MUNICIPAL UTILITIES
WATER WORKS SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

6. Pension and Other Postemployment Benefits – CERS, Continued

Actuarial Assumptions, Continued

The mortality table used for active members was a Pub-2010 General Mortality table, projected with the ultimate rates from the MP-2014 mortality improvement scale using a base year of 2010. The mortality table used for healthy retired members was a system-specific mortality table based on mortality experience from 2013-2018, projected with the ultimate rates from MP-2014 mortality improvement scale using a base year of 2019. The mortality table used for the disabled members was PUB-2010 Disabled Mortality table, with a 4-year set-forward for both male and female rates, projected with the ultimate rates from the MP-2014 mortality improvement scale using a base year of 2010.

The actuarial assumptions used in the June 30, 2018, valuation were based on the results of an actuarial experience study for the five-year period ended June 30, 2018.

The long-term expected rate of return 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 real rate of return for each major asset class are summarized in the tables below.

	Target Allocation	Long-Term Expected Real Rate of Return
US equity:		
US equity	18.75%	4.30%
Non US equity	18.75	4.80%
Private equity	10.00	6.65%
Specialty credit/high yield	15.00	2.60%
Liquidity:		
Core bonds	13.50	1.35%
Cash	1.00	.20%
Diversifying strategies:		
Real estate	5.00	4.85%
Opportunistic	3.00	2.97%
Real return	15.00	4.10%
Total	<u>100.00%</u>	

**OWENSBORO MUNICIPAL UTILITIES
WATER WORKS SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

6. Pension and Other Postemployment Benefits – CERS, Continued

Discount Rate

The discount rates used to measure the total pension / OPEB liabilities at the measurement dates and changes since the prior year were as follows:

	Pension	OPEB
Discount rate, June 30, 2018	6.25%	5.85%
Increase (decrease)	-	(0.17%)
Discount rate, June 30, 2019	6.25%	5.68%

The discount rate of 6.25% used to measure the total pension liability was based on the expected rate of return on pension plan investments. The discount rate of 5.68% used to measure the total OPEB liability was based on the expected rate of return of 6.25% and a municipal bond rate of 3.13%, as reported in Fidelity Index's "20-Year Municipal GO AA Index" as of June 30, 2019.

The projections of cash flows used to determine the pension discount rate assumed that the funds would receive the required employer contributions in each future year, as determined by the current funding policy established in Statue last amended by House Bill 362 (passed in 2018). The projection of cash flows used to determine the OPEB discount rate assumed that employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 24 years (closed) amortization period of the unfunded actuarial accrued liability.

Sensitivity of the Water System's Proportionate Share of the Liabilities to Changes in the Discount Rate

The following presents the Water System's proportionate share of the net pension/OPEB liabilities, as well as what the Water System's proportionate share of the net pension/OPEB liabilities would be if they were calculated using a discount rate that is 1-percentage-point lower or 1-percentage-point higher than the current rate:

	Water System's Proportionate Share			
	Discount Rate	Net pension Liability	Discount Rate	Net OPEB Liability
1% decrease	5.25%	\$ 11,317,342	4.68%	\$ 2,898,184
Current discount rate	6.25%	\$ 9,048,688	5.68%	\$ 2,163,488
1% increase	7.25%	\$ 7,157,786	6.68%	\$ 1,558,148

**OWENSBORO MUNICIPAL UTILITIES
WATER WORKS SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

6. Pension and Other Postemployment Benefits – CERS, Continued

Sensitivity of the Water System's Proportionate Share of the Net OPEB Liability to Changes in the Healthcare Cost Trend Rates

The following presents the Water System's proportionate share of the net OPEB liability, as well as what the Water System's 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 rate:

	Healthcare Cost Trend Rate		Water System's Proportionate Share of Net OPEB Liability
1% decrease	6.0% Pre-65 or 4.0% Post-65	\$	1,608,997
Current healthcare cost trend rate	7.0% Pre-65 or 5.0% Post-65	\$	2,163,488
1% increase	8.0% Pre-65 or 6.0% Post-65	\$	2,835,874

Plan Fiduciary Net Position

Detailed information about the CERS fiduciary net position is available in the separately issued Kentucky Retirement Systems Comprehensive Annual Financial Report.

Payables to the Pension/OPEB Plans

The Water System reported the following payables for the outstanding amount of pension/OPEB contributions due to CERS for the year ended May 31, 2020.

	Pension		OPEB
\$	50,450	\$	12,443

7. Dividends - City of Owensboro

The Water System transfers to the City each year a sum equal to the dollar value of services purchased by the City from the Water System.

8. Major Customers

Water revenues from three rural water district customers in Daviess County, Kentucky, under wholesale supply agreements totaled approximately \$3,140,000 and \$2,595,000 for 2020 and 2019, respectively.

**OWENSBORO MUNICIPAL UTILITIES
WATER WORKS SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2020 and 2019

9. Risk Management

OMU is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. OMU manages its risks through coverages provided by private insurance carriers for various risks of losses to which it is exposed, including directors and officers, employee dishonesty, workers' compensation, and other property risks. OMU is self-insured for group health and limits its risks of loss by purchasing reinsurance coverage.

10. Commitments and Contingencies

During fiscal year 2019, the Water System entered into a construction contract totaling \$39,735,000 for the expansion of the Cavin Water Treatment Plant. Remaining commitment under this contract was \$12,672,237 at May 31, 2020, of which \$1,618,374 was included in accounts payable.

11. COVID-19 Considerations

In December 2019, a novel strain of coronavirus, known as COVID-19, was reported in Wuhan, China and has since extensively impacted the global health and economic environment. In March 2020, the World Health Organization characterized COVID-19 as a pandemic, and the President declared the COVID-19 outbreak in the United States as a national emergency.

During the COVID-19 pandemic, our services have generally been considered essential in nature and have not been materially interrupted. As the situation continues to evolve, we are closely monitoring the impact of the COVID-19 pandemic on all aspects of our business, including how it impacts our customers, subcontractors, suppliers, vendors and employees, in addition to how the COVID-19 pandemic impacts our ability to provide services to our customers. We believe the ultimate impact of the COVID-19 pandemic on our operating results, cash flows and financial condition is likely to be determined by factors which are uncertain, unpredictable and outside of our control. The situation surrounding COVID-19 remains fluid, and if disruptions do arise, they could materially adversely impact our business.

During the period from March through May 31, 2020, we have not written off any past due customer receivables and have allowed our reserves to increase for the economic disruption caused by COVID-19, which is reflected in our bad debt expense in the current year. This increase was primarily, but not exclusively, due to concern over collectability of receivables from customers more directly impacted by COVID-19.

**OWENSBORO MUNICIPAL UTILITIES
WATER SYSTEM**

**SCHEDULE OF PROPORTIONATE SHARE OF THE NET PENSION LIABILITY
COUNTY EMPLOYEES RETIREMENT SYSTEM**

Last 10 Fiscal Years *

	<u>2020</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Water System's proportion of the net pension liability	0.128660%	0.126208%	0.122463%	0.123810%	0.120923%	0.126427%
Water System's proportionate share of the net pension liability \$	9,048,688	\$ 7,686,431	\$ 7,168,159	\$ 6,095,910	\$ 5,199,116	\$ 4,101,776
Water System's covered payroll	\$ 3,491,495	\$ 3,316,556	\$ 2,923,793	\$ 2,869,077	\$ 2,803,919	\$ 2,920,692
Water System's proportionate share of the net pension liability as a percentage of its covered payroll	259.16%	231.76%	245.17%	212.47%	185.42%	140.44%
Plan fiduciary net position as a percentage of the total pension liability	50.45%	53.54%	53.32%	55.50%	59.97%	66.80%

* Presented for those years for which the information is available.

**OWENSBORO MUNICIPAL UTILITIES
WATER SYSTEM**

**SCHEDULE OF PENSION CONTRIBUTIONS
COUNTY EMPLOYEES RETIREMENT SYSTEM**

Last 10 Fiscal Years

	<u>2020</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Contractually required contributions	\$ 703,199	\$ 564,166	\$ 484,778	\$ 407,575	\$ 355,884	\$ 363,125
Contributions in relation to the contractually required contributions	<u>(703,199)</u>	<u>(564,166)</u>	<u>(484,778)</u>	<u>(407,575)</u>	<u>(355,884)</u>	<u>(363,125)</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Water System's covered payroll	\$ 3,673,597	\$ 3,507,140	\$ 3,355,482	\$ 2,941,934	\$ 2,815,932	\$ 2,838,215
Contributions as a percentage of covered payroll	19.14%	16.09%	14.45%	13.85%	12.64%	12.79%

* Presented for those years for which the information is available.

**OWENSBORO MUNICIPAL UTILITIES
WATER SYSTEM**

**SCHEDULE OF PROPORTIONATE SHARE OF THE NET OPEB LIABILITY
COUNTY EMPLOYEES RETIREMENT SYSTEM**

Last 10 Fiscal Years *

	<u>2020</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>
Water System's proportion of the net OPEB liability	0.128660%	0.126208%	0.122463%	0.123810%
Water System's proportionate share of the net OPEB liability	\$ 2,163,488	\$ 2,240,753	\$ 2,461,933	\$ 1,908,895
Water System's covered payroll	\$ 3,491,495	\$ 3,316,556	\$ 2,923,793	\$ 2,869,077
Water System's proportionate share of the net OPEB liability as a percentage of its covered payroll	61.96%	67.56%	84.20%	66.53%
Plan fiduciary net position as a percentage of the total OPEB liability	60.44%	57.62%	52.39%	55.24%

* Presented for those years for which the information is available.

**OWENSBORO MUNICIPAL UTILITIES
WATER SYSTEM**

**SCHEDULE OF OPEB CONTRIBUTIONS
COUNTY EMPLOYEES RETIREMENT SYSTEM**

Last 10 Fiscal Years

	<u>2020</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Contractually required contributions	\$ 173,431	\$ 182,954	\$ 157,352	\$ 138,196	\$ 132,955	\$ 139,262
Contributions in relation to the contractually required contributions	<u>(173,431)</u>	<u>(182,954)</u>	<u>(157,352)</u>	<u>(138,196)</u>	<u>(132,955)</u>	<u>(139,262)</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Water System's covered payroll	\$ 3,673,597	\$ 3,507,140	\$ 3,355,482	\$ 2,941,934	\$ 2,815,932	\$ 2,838,215
Contributions as a percentage of covered payroll	4.72%	5.22%	4.69%	4.70%	4.72%	4.91%

* Presented for those years for which the information is available.

**OWENSBORO MUNICIPAL UTILITIES
WATER WORKS SYSTEM**

**NOTES TO REQUIRED SUPPLEMENTARY INFORMATION
COUNTY EMPLOYEES RETIREMENT SYSTEM**

Year Ended May 31, 2020

Changes of Benefit Terms

2020	None
2019	None
2018	None
2017	None
2016	None

Changes of Assumptions

2020 Pension and OPEB:

The salary increases assumption was changed from 3.05% to 3.30% - 10.30%.

OPEB:

The single discount rate changed from 5.85% to 5.68%.

2019 Pension and OPEB:

The salary increases assumption was changed from 2.00% to 3.05%.

OPEB:

The single discount rate changed from 5.84% to 5.85%.

2018 Pension and OPEB:

The assumed investment return was changed from 7.50% to 6.25%.

The price inflation assumption was changed from 3.25% to 2.30%, which also resulted in a 0.95% decrease in the salary increase assumption at all years of service.

The payroll growth assumption (applicable for the amortization of unfunded actuarial accrued liabilities) was changed from 4.00% to 2.00%.

OPEB:

The single discount rate changed from 6.89% to 5.84%.

2017 None

2016 Pension:

The assumed investment rate of return was decreased from 7.75% to 7.50%.

The assumed rate of inflation was reduced from 3.50% to 3.25%.

The assumed rate of wage inflation was reduced from 1.00% to 0.75%.

Payroll growth assumption was reduced from 4.50% to 4.00%.

The assumed rates of Retirement, Withdrawal and Disability were updated to more accurately reflect experience.



Riney Hancock CPAs
PSC

**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**

City Utility Commission
City of Owensboro, Kentucky

We have audited, in accordance with the 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, the financial statements of the Owensboro Municipal Utilities Water Works System (Water System) of the City of Owensboro, Kentucky as of and for the year ended May 31, 2020, and the related notes to the financial statements, and have issued our report thereon dated September 23, 2020.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Water System's internal control over financial reporting (internal control) as a basis for designing 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 the Water System's internal control. Accordingly, we do not express an opinion on the effectiveness of the Water System's 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 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 the Water System's financial statements are free from 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 financial statements. 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 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.

Owensboro, Kentucky
September 23, 2020

Ring Damore CPA PSC