HOPKINSVILLE ELECTRIC SYSTEM

OF THE

CITY OF HOPKINSVILLE, KENTUCKY

FINANCIAL STATEMENTS

FOR THE YEARS ENDED

JUNE 30, 2014 AND 2013

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY

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INDEPENDENT AUDITORS' REPORT

The Board of the
Hopkinsville Electric System of the
City of Hopkinsville, Kentucky
Hopkinsville, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the Hopkinsville Electric System of the City of Hopkinsville, Kentucky as of and for the years ended June 30, 2014 and 2013, and the related notes to the financial statements, which collectively comprise the System's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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.

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Hopkinsville Electric System of the City of Hopkinsville, Kentucky as of June 30, 2014 and 2013, and the respective changes in financial position, and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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 4–14 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Hopkinsville Electric System of the City of Hopkinsville, Kentucky's basic financial statements. The introductory section and the accompanying financial information listed as supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements.

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

The introductory section has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 10, 2014, on our consideration of the Hopkinsville Electric System of the City of Hopkinsville, Kentucky'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 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 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 Hopkinsville Electric System of the City of Hopkinsville, Kentucky's internal control over financial reporting and compliance.

Kem, Duguid & Associates, P.S.C.
Kem, Duguid & Associates, P.S.C.
Certified Public Accountants
Hopkinsville, Kentucky

November 10, 2014

MANAGEMENT’S DISCUSSION AND ANALYSIS

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2014

The management of Hopkinsville Electric System of the City of Hopkinsville (HES, the "System") offers Management's Discussion and Analysis to provide an overview and analysis of the System's financial activities for the year ended June 30, 2014. To fully understand the entire scope of the System's financial activities, this information should be read in conjunction with the financial statements provided in this document.

FINANCIAL HIGHLIGHTS

- The assets of HES exceeded its liabilities at the close of the 2014 fiscal year by $22,362,619 (*net position*). Of this amount, $1,418,742 (*unrestricted net position*) may be used to meet the System's ongoing obligations to citizens and creditors.

- The System's total net position increased by $1,256,740 during the period.

- Total operating revenues for the 2014 fiscal year increased by $2,265,503 or about 5.96% compared to the previous period. This increase was primarily due to the increase in Tennessee Valley Authority's (TVA) fuel cost adder.

- FY 2014 operating expenses totaled $38,680,396 which was $2,138,715 or about 5.85% more than the previous year's amount.

OVERVIEW OF THE FINANCIAL STATEMENTS

The discussion and analysis is intended to serve as an introduction to the Electric System's basic financial statements. The System's basic financial statements are comprised of two components: (1) basic financial statements and (2) notes to basic financial statements. The basic financial statements and notes to these statements reflect the combined accounts and activities of both the electric and broadband divisions. The report also contains other supplementary information in addition to the basic financial statements. The supplementary information section contains statements that show the results of operations for the separate divisions.

REQUIRED FINANCIAL STATEMENTS

The financial statements of the System report information utilizing the full accrual basis of accounting. This method of accounting recognizes revenues when earned instead of when received and recognizes expenses when incurred rather than when paid. The financial statements conform to accounting principles which are generally accepted in the United States of America.

Statement of Net Position

The Statement of Net Position includes information on the System's assets and liabilities, with the difference between the two reported as net position. Over time, increases and decreases in net position may serve as a useful indicator of whether the financial position of the System is improving or deteriorating.

Statement of Revenues, Expenses and Changes in Net Position

While the Statement of Net Position 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 System's operations over the course of the operating cycle. This statement can be used to determine whether the System has successfully recovered all of its actual costs including depreciation through user fees and other charges. All changes in net position are reported during the period in which the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods, such as delayed collection of operating revenues and delayed payment of current year expenses.

Statement of Cash Flows

The Statement of Cash Flows provides information on the System's cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. From the Statement of Cash Flows, the reader can obtain information on the source and use of cash and the change in the cash balance for the operating cycle.

Financial Analysis of the Fiscal Year Ended June 30, 2014

Over the past year, total assets of the System increased by $527,051 while total liabilities decreased by $729,689. And for the current period, the net operating revenues of the System totaled $1,565,138. Net operating revenues include $911,180 from Electric and $653,958 from Telecommunications.

Condensed Statements of Net Position

The Statement of Net Position, shown in tabular format below, represents information on all of the System's assets and liabilities with the difference between the two reported as net position. The System's total net position increased from the prior year by $1,256,740 or about 5.95% for the period.

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2014

Our analysis that follows focuses on the System's net position (shown in Table 1) and the changes in net position (shown in Table 2) during the year.

TABLE 1
Condensed Statements of Net Position

	Fiscal Year		Change in FY 2013 to FY 2014	
	2014	2013	Amount	Percent
Current and other assets	$ 11,549,104	$ 11,052,512	$ 496,592	4.49%
Capital assets	32,026,648	31,996,189	30,459	0.10%
Total assets	43,575,752	43,048,701	527,051	1.22%
Current liabilities	9,452,946	8,586,809	866,137	10.09%
Long-term liabilities	11,760,187	13,356,013	(1,595,826)	-11.95%
Total liabilities	21,213,133	21,942,822	(729,689)	-3.33%
Invested in utility plant, net of related debt	20,030,764	18,752,048	1,278,716	6.82%
Restricted for capital projects	577,705	1,000,003	(422,298)	-73.10%
Restricted for debt service	335,408	335,247	161	0.05%
Unrestricted	1,418,742	1,018,581	400,161	39.29%
Total net position	$ 22,362,619	$ 21,105,879	$ 1,256,740	5.95%

Analysis of Net Position

To better understand the System's actual financial positions and its ability to deliver services in future periods, the reader will need to review the various components of the net position category and obtain an understanding of how each relate specifically to the business activities that we perform. For example, the vast majority of net position ($20,030,764 or 89.57% of total net position) represents investment in plant assets, which is the lifeblood to the provision of electric and telecommunication services.

**TABLE 2
Components of Net Position**

	Fiscal Year		Change FY 2013 to FY 2014	
	2014	2013	Amount	Percent
Invested in capital assets, net of related debt	$ 20,030,764	$ 18,752,048	$ 1,278,716	6.82%
Restricted for capital projects	577,705	1,000,003	(422,298)	-73.10%
Restricted for debt service	335,408	335,247	161	0.05%
Unrestricted	1,418,742	1,018,581	400,161	39.29%
	$ 22,362,619	$ 21,105,879	$ 1,256,739	5.95%

For the 2014 fiscal year, *Net Position Invested in Capital Assets, Net of Related Debt* increased by $1,278,716 or 6.82% compared to the previous year. The amount shown in this category is calculated by taking the depreciated value of our capital assets and subtracting the associated bond debt. The significance of this increase on future operations is that it represents additional equity that the System has accumulated in its plant, equipment and infrastructure.

In comparing the total amount of *Restricted Net Position for Capital Projects* with the previous fiscal year, there was a decrease of $422,298 or 73.10%. The decrease was due to a drawn down of restricted funds for operations.

Compared to the prior year's balance, there was an increase in the *Unrestricted Net Position* category of $400,161 or 39.29%.

Unrestricted net position consists of net position that does not meet the definition of "restricted" or "invested in capital assets, net of related debt".

Analysis of Current Assets

The textbook definition of "current assets" is balance sheet items which equal the sum of cash and cash equivalents, accounts receivable, inventory, marketable securities, prepaid expenses, and other assets that could be converted to cash in less than one year. Current assets are important in any financial analysis because it is from current assets that a business funds its ongoing, day-to-day operations. A comparison of the June 30, 2014 and 2013 balances by asset classification is shown in the table below.

**TABLE 3
Comparison of Current Assets**

	Fiscal Year		Change from FY 2013 to FY 2014	
	2014	2013	Amount	Percent
Cash and cash equivalents	$ 3,934,833	$ 2,679,750	$ 1,255,083	46.84%
Accounts receivable (net)	3,295,093	2,972,282	322,811	10.86%
Unbilled revenue	1,074,887	1,081,499	(6,612)	-0.61%
Inventories	828,695	774,032	54,663	7.06%
Prepaid expenses	86,083	78,454	7,629	9.72%
Other	60,045	70,527	(10,482)	-14.86%
	$ 9,279,636	$ 7,656,544	$ 1,623,092	21.20%

Analysis of Noncurrent Assets

Noncurrent assets represent assets that are not reasonably expected to be realized in cash or sold or consumed during the next fiscal year. When making the distinction between whether an asset should be considered current or noncurrent, liquidity or nearness to cash is not the proper basis for determining the classification. In making this determination, any encumbrances on the use of the asset must be considered. Thus, cash investments intended for liquidation or liabilities due beyond the one-year period are noncurrent assets, as would assets segregated or restricted for the liquidation of long-term debts (including amounts due within the next operating cycle). Assets designated to be used to acquire, construct, or improve capital assets would also be noncurrent.

**TABLE 4
Comparison on Noncurrent Assets**

	Fiscal Year		Change from FY 2013 to FY 2014	
	2014	2013	Amount	Percent
Restricted:				
Investments - special funds	$ 913,113	$ 2,035,250	$ (1,122,137)	-55.14%
Investment in affiliated organization	110,394	75,423	34,971	31.68%
Nonutility property	33,958	33,958	-	0.00%
Deferred charges	1,212,003	1,251,337	(39,334)	-3.14%
Capital assets (net)	32,026,648	31,996,189	30,459	0.10%
	$ 34,296,116	$ 35,392,157	$ (1,096,041)	-3.10%

The table above demonstrates the relatively large investment that the System has made in capital assets. At the end of the 2014 fiscal year, capital assets represented about 93.38% of the noncurrent assets.

In examining the balance for the Restricted Noncurrent Assets category at June 30, 2014, it shows a decrease of $1,096,041 or 3.10% compared to the previous fiscal year.

Analysis of Liabilities

In financial accounting, the term "liability" is defined as an obligation of an entity arising from past transactions or events, the settlement of which may result in the transfer or use of assets, provision of services or other yielding of economic benefits in the future. To put it in more simplistic terms, this section analyzes the various claims that creditors have against the System's assets.

**TABLE 5
Comparison of Current Liabilities from Unrestricted Net Position**

	Fiscal Year		Change From FY 2013 to FY 2014	
	2014	2013	Amount	Percent
Accounts payable - purchased power	$ 5,163,128	$ 4,693,179	$ 469,949	10.01%
Accounts payable - other	328,613	271,614	56,999	20.99%
Customer deposits	1,637,206	1,558,029	79,177	5.08%
Accrued taxes	290,738	372,706	(81,968)	-21.99%
Accrued interest	2,032	-	2,032	0.00%
Unearned pole rental	-	(79,214)	79,214	-100.00%
Deferred revenue - MuniNet	128,634	135,405	(6,771)	-5.26%
Line of credit	-	200,000	(200,000)	-100.00%
Other current and accrued liabilities	616,496	477,487	139,009	29.11%
	$ 8,166,847	$ 7,629,206	$ 537,641	7.05%

Current Liabilities Payable from Unrestricted Assets had a net increase in its various components of $537,641 or about 7.05% compared to the previous fiscal year's balance. The increase is primarily due to the increase in purchased power, a slight increase in customer deposits, the clearing of unearned pole rental overpayment, offset by the payoff of the line of credit.

As the reader of the financial statements might surmise from the preceding discussion, an argument can certainly be made that the System's financial position has indeed improved over that of the previous year. Management feels that each of the positive indicators discussed above speak to the continued financial viability of the System's operations.

As indicated in Table 6, the change in net position for the fiscal year ended June 30, 2014 was $1,256,740.

TABLE 6
Condensed Statements of Revenues, Expenses and Changes in Net Position

	Fiscal Year		Change From FYE 2013 To FYE 2014	
	2014	2013	Amount	Percent
Operating revenues:				
Electric revenues	$ 37,062,945	$ 35,728,517	$ 1,334,428	3.73%
Telecom revenues	3,182,589	2,251,514	931,075	41.35%
Total operating revenues	40,245,534	37,980,031	2,265,503	5.96%
Operating expenses:				
Purchased power	28,445,310	27,797,919	647,391	2.33%
Other expenses	10,235,086	8,743,762	1,491,324	17.06%
Total operating expenses	38,680,396	36,541,681	2,138,715	5.85%
Net operating income	1,565,138	1,438,350	126,788	8.81%
Non-operating income, net	(308,398)	(814,743)	506,345	-62.15%
Change in net position	1,256,740	623,607	633,133	101.53%
Net position, beginning of year	21,105,879	20,482,272	623,607	3.04%
Net position, end of year	$ 22,362,619	$ 21,105,879	$ 1,256,740	5.95%

Analysis of Revenue

For the 2014 fiscal year, The *Operating Revenues* of the System totaled $40,245,534. This amount represented an increase of 5.96% more than the previous year's total of $37,980,031. The increase was primarily due to an increase in TVA's fuel cost adder.

Included in the *Non-Operating Revenues* (net) of $308,398 is interest income of $18,304, interest expense of $324,643, amortization expense of $15,121 and other income of $13,062.

Analysis of Expenses

The *Total Operating Expenses* for FY 2014 were $38,680,396. That amount represents an increase of $2,138,715 or about 5.85% more than the prior fiscal year total of $36,541,681. The eight major categories of Operating Expenses are shown in the chart below.

TABLE 7
Comparison of Operating Expenses

	Fiscal Year		Change from FY 2013 to FY 2014	
	2014	2013	Amount	Percent
Cost of power	$ 28,445,310	$ 27,797,919	$ 647,391	2.33%
Cost of sales - telecom	228,639	194,383	34,256	17.62%
Distribution:				
operation	2,151,715	1,541,649	610,066	39.57%
maintenance	1,092,782	953,281	139,501	14.63%
Transmission - maintenance	805	1,975	(1,170)	100.00%
Customer accounts	801,037	680,099	120,938	17.78%
Sales	132,315	128,827	3,488	2.71%
Administrative and general	2,259,509	2,144,140	115,369	5.38%
Depreciation	2,183,633	1,580,561	603,072	38.16%
Taxes	1,384,651	1,518,847	(134,196)	-8.84%
	$ 38,680,396	$ 36,541,681	$ 2,138,715	5.85%

As indicated by the comparative information presented above, *Cost of Power* increased by $647,391 or 2.33% compared to the prior year. The increase in cost of power was a direct correlation to energy sale increase with cost of power to energy sales being 76.7% this year and 77.8% last year.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

Hopkinsville Electric System's investment in capital assets as of June 30, 2014 was $32,026,648 (net of accumulated depreciation), as shown in the following table.

**TABLE 8
Schedule of Capital Assets (Net of Depreciation)**

	Fiscal Year		Increase
	2014	2013	(Decrease)
Land	$ 431,057	$ 425,717	$ -
Construction in progress-			
Electric	651,005	5,026,629	(4,375,624)
Telecommunications	259,629	250,779	8,850
Transmission plant	395,047	382,215	12,832
Distribution plant	17,184,909	12,920,975	4,263,934
General plant	1,627,367	1,472,447	154,920
Telecommunications plant	11,477,634	11,517,427	(39,793)
Total capital assets	$ 32,026,648	$ 31,996,189	$ 25,119

Additional detailed information concerning the System's capital assets can be found in Note 2 in the notes to the financial statements.

Long-term Debt

At June 30, 2014, the System had roughly $12 million in debt outstanding, a decrease of $1,248,257 or approximately 9.42% less than the previous fiscal year. The System's debt is comprised of various bonds and notes. A comparative schedule at June 30, 2014 and 2013 is shown in the tabular information provided below.

TABLE 9

	Fiscal Year		Increase
	2014	2013	(Decrease)
Revenue bond	$ 925,417	$ 1,022,273	$ (96,856)
KY League of Cities leases	8,361,122	9,221,868	(860,746)
KIA loan	2,709,345	3,000,000	(290,655)
	$ 11,995,884	$ 13,244,141	$ (1,248,257)

Additional detailed information concerning the System's liabilities can be found in the notes to the financial statements, Note 8.

Economic Factors

Although the System had a healthy income margin this year, the future financial condition of the System will be affected by two factors in the future: weather conditions and the length of the current recession. Weather is a tremendous driver in kWh sales – extreme hot conditions and extreme cold conditions will drive up kWh sales and mild temperatures drive down usage.

Also affecting the System's financial condition is the recent change to Seasonal Demand and Energy rates put in place by TVA. These rates were implemented April 1, 2011. TVA is trending toward all utilities being billed under Time-of-Use (TOU) rates. When this will be mandatory is still a huge question. HES moved forward with installing new electronic metering system to accommodate TOU rates, eliminate manual meter reading, connection/disconnect of service and provide better information to customers on energy volume.

HES EnergyNet continues to gain high speed broadband customers. Annual net income was $432,252 for the current year compared to a net loss the prior year of $15,668 when expenditures were increased due to expansion.

As we demonstrate financial responsibility, we continue to strive to deliver the highest quality of services to our community at the lowest feasible cost.

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the Hopkinsville Electric System's finances for all those with an interest in the System's finances. Questions or requests for additional information may be addressed to Austin Carroll, Manager, Hopkinsville Electric System, 1820 East Ninth Street, Hopkinsville, KY 42240.

FINANCIAL STATEMENTS

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
STATEMENTS OF NET POSITION
JUNE 30, 2014 AND 2013

ASSETS

	2014	2013
Utility plant	$ 49,877,222	$ 48,264,566
Less accumulated depreciation	17,850,574	16,268,377
Net utility plant	32,026,648	31,996,189
Restricted assets		
Investments - special funds	913,113	2,035,250
Other assets		
Investment in affiliated organizations	110,394	75,423
Nonutility property	33,958	33,958
	144,352	109,381
Current assets		
Cash - general funds	3,934,833	2,679,750
Accounts receivable (less accumulated provision for uncollectible accounts of $30,804 in 2014 and $28,995 in 2013)	3,295,093	2,972,282
Unbilled revenue	1,074,887	1,081,499
Inventories (at weighted-average cost)	828,695	774,032
Prepaid expenses	86,083	78,454
Other current assets	60,045	70,527
Total current assets	9,279,636	7,656,544
Deferred charges	1,212,003	1,251,337
Total assets	43,575,752	43,048,701

See accompanying notes to financial statements

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
STATEMENTS OF NET POSITION, continued
JUNE 30, 2014 AND 2013

	2014	2013
LIABILITIES		
Current liabilities		
Current maturities of long-term debt	1,286,099	957,603
Accounts payable - purchased power	5,163,128	4,693,179
Accounts payable - other	328,613	271,614
Customer deposits	1,637,206	1,558,029
Accrued taxes	290,738	372,706
Accrued interest	2,032	-
Unearned pole rental	-	(79,214)
Unearned revenue - MuniNet	128,634	135,405
Line of credit	-	200,000
Other current & accrued liabilities	616,496	477,487
Total current liabilities	9,452,946	8,586,809
Noncurrent liabilities		
Long-term debt	10,709,785	12,286,538
Advances from others:		
Conservation advances - TVA	1,050,402	1,069,475
Total noncurrent liabilities	11,760,187	13,356,013
Total liabilities	21,213,133	21,942,822
NET POSITION		
Invested in capital assets, net of related debt	20,030,764	18,752,048
Restricted for capital projects	577,705	1,000,003
Restricted for debt service	335,408	335,247
Unrestricted	1,418,742	1,018,581
Total net position	$ 22,362,619	$ 21,105,879

See accompanying notes to financial statements

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
FOR THE YEARS ENDED JUNE 30, 2014 AND 2013

	2014	2013
OPERATING REVENUES	$ 40,245,534	$ 37,980,031
OPERATING EXPENSES		
Cost of power	28,445,310	27,797,919
Cost of sales - telecommunications	228,639	194,383
Distribution - operation	2,151,715	1,541,649
- maintenance	1,092,782	953,281
Transmission - maintenance	805	1,975
Customer accounts	801,037	680,099
Sales	132,315	128,827
Administrative and general	2,259,509	2,144,140
Depreciation	2,183,633	1,580,561
Taxes	1,384,651	1,518,847
Total operating expenses	38,680,396	36,541,681
Net operating revenues	1,565,138	1,438,350
NONOPERATING REVENUES (EXPENSES)		
Interest on long-term debt	(304,764)	(294,932)
Other interest	(19,879)	(24,634)
Amortization of debt expense	(15,121)	(12,069)
Interest income	18,304	30,083
Other revenue (expenses)	13,062	(513,191)
Net nonoperating revenues (expenses)	(308,398)	(814,743)
CHANGE IN NET POSITION	1,256,740	623,607
NET POSITION, BEGINNING OF YEAR	21,105,879	20,482,272
NET POSITION, END OF YEAR	$ 22,362,619	$ 21,105,879

See accompanying notes to financial statements

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2014 AND 2013

	2014	2013
Cash flows from operating activities		
Receipts from customers and users	$ 39,939,817	$ 37,817,287
Payments to suppliers	(31,395,248)	(30,728,034)
Payments to employees	(2,876,126)	(2,678,151)
Payments of taxes	(1,466,619)	(1,526,588)
Net cash provided (used) by operating activities	4,201,824	2,884,514
Cash flows from capital financing activities		
Expenditures for utility plant	(2,227,709)	(2,737,847)
Net cost of retiring plant	(71,836)	843,163
Principal payments on long-term debt	(1,448,257)	(1,367,984)
Conservation advances from TVA	(19,073)	(72,043)
Proceeds from debt issuance	-	1,303,192
Bond issue cost from issuance of debt	-	(55,000)
Proceeds from line of credit	-	200,000
Interest paid	(316,825)	(322,304)
Net cash provided (used) by capital financing activities	(4,083,700)	(2,208,823)
Cash flows from investing activities		
Conservation loan receivable	18,427	65,919
Investment in affiliated companies	(34,971)	(65,307)
Purchases/maturities of investments	1,122,137	(314,230)
Interest and other revenues	31,366	(483,112)
Net cash provided (used) by investing activities	1,136,959	(796,730)
Net increase (decrease) in cash	1,255,083	(121,039)
Cash, beginning of year	2,679,750	2,800,789
Cash, end of year	$ 3,934,833	$ 2,679,750

See accompanying notes to financial statements

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
STATEMENTS OF CASH FLOWS, continued
FOR THE YEARS ENDED JUNE 30, 2014 AND 2013

	2014	2013
Reconciliation of operating income to net cash provided by operating activities:		
Net operating revenues	$ 1,565,138	$ 1,438,350
Adjustments to reconcile net operating revenues to net cash provided by operating activities:		
Depreciation	2,269,086	1,603,692
Changes in assets and liabilities:		
Receivables	(322,811)	(208,867)
Unbilled revenues	6,612	(19,263)
Materials and supplies	(54,663)	11,245
Prepaid expenses and other current assets	2,853	82,297
Accounts payable	526,948	(224,344)
Accrued taxes	(81,968)	(7,741)
Other current and accrued liabilities	139,009	94,322
Unearned pole rental	79,214	(145,827)
Customer deposits	79,177	125,245
Unearned revenue - MuniNet	(6,771)	135,405
Total adjustments	2,636,686	1,446,164
	$ 4,201,824	$ 2,884,514

See accompanying notes to financial statements

NOTES TO FINANCIAL STATEMENTS

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Financial Reporting Entity

The Electric Plant Board of the City of Hopkinsville (d.b.a. Hopkinsville Electric System) was created by Ordinance No. 382, passed June 2, 1942, pursuant to authority conferred upon the City by Chapter 119 of the General Assembly of Kentucky, 1932, amended.

The Board was established for the purpose of owning and operating all properties, real, personal, and mixed tangible or intangible, acquired or used or held for use, in connection with the electric plant acquired by purchase from Kentucky – Tennessee Light and Power Company.

The Board consists of four appointed members, the term of one expiring each year, and a fifth member from the City's governing body, presently represented by Thomas Grant, a member of the Common Council. The Hopkinsville Electric System elects its own officers and management.

Basis of Presentation and Accounting

The records of the Board are maintained in accordance with provisions of the power contract with the Tennessee Valley Authority, and are consistent with requirements of the Federal Energy Regulatory Commission's system of accounts. Revenues and expenses are recognized on the accrual basis.

Proprietary Fund Type

The Board is intended to be self-supporting through user charges. All of its revenues, expenses, assets, and liabilities, including fixed assets and long-term debt associated with the specific activity, are accounted for within its financial statements.

Proprietary funds are used to account for activities similar to those found in the private sector, where the determination of net income is necessary or useful to sound financial administration. Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses result from providing services and delivering goods in connection with the fund's principle ongoing operations such as charges to customers for sales and services and expenses such as salaries, product costs, administrative expenses, and depreciation. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

Cash and Cash Equivalents

For the purposes of the statements of cash flows, the System considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Material and Supplies Inventory

Material and supplies inventory (which consists of wire, poles, and other supplies) is valued at cost determined by the weighted-average method.

Utility Plant

Utility plant is stated at original cost, which includes payroll related costs such as taxes, fringe benefits, and administrative and general costs. Interest expense incurred during a construction period is capitalized. Construction work in progress has been included in the rate base for determining retail customer rates. The System has not recorded any significant allowance for funds used during construction.

When property subject to depreciation is retired or otherwise disposed of in the normal course of business, its original cost, together with its cost of removal less salvage, is charged to the accumulated provision for depreciation. The System charges maintenance and repairs, including the cost of renewals of minor items of property, to maintenance expense accounts or applicable clearing accounts. Placements of property (exclusive of minor items of property) are capitalized to utility plant accounts.

Depreciation

Property and equipment in plant accounts are recorded at cost with depreciation being computed at rates recommended by the Tennessee Valley Authority. The rates used throughout the current year were consistent with those in use in the prior year.

Compensated Absences

Full-time employees are allowed to carryover a maximum of forty (40) hours accumulated annual leave. Upon retirement from Hopkinsville Electric System, the employee is entitled to payment for unused accumulated annual leave time. Accrued vacation leave was $509,146 and $386,896 for the years ended June 30, 2014 and 2013, respectively.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

Impairment of Capital Assets

In accordance with GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, management evaluates prominent events or changes in circumstances affecting capital assets to determine whether impairment of a capital asset has occurred. A capital asset is generally considered impaired if both (a) the decline in service utility of the capital asset is large in magnitude, and (b) the event or change in circumstance is outside the normal life cycle of the capital asset. No impairment losses were recognized in the years ended June 30, 2014 and 2013.

Revenues and Expenses

Revenues and expenses are distinguished between operating and non-operating items. Operating revenues generally result from providing services, producing, and delivering goods in connection with the System's principal ongoing operations. The principal operating revenues of the System are charges to customers for sales and services. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Net Position

Net position is categorized as invested in capital assets (net of related debt), restricted, and unrestricted and further described as follows.

- *Invested in Capital Assets, Net of Related Debt* - This category groups all capital assets including infrastructure into one component of net position. Accumulated depreciation and the outstanding balances of debt that are attributed to the acquisition, construction or improvement of these assets reduce the balance in this category.

- *Restricted* - This category represents those assets which have constraints placed on the expenditures either externally imposed or imposed by law or enabled by legislature.

- *Unrestricted* - This category presents the net position of the Board not included elsewhere.

When both restricted and unrestricted resources are available for use, it is the System's policy to use restricted resources first, then unrestricted resources as they are needed.

Income Tax Status

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

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

Subsequent Events

Subsequent events have been evaluated through November 10, 2014, which is the date the financial statements were available to be issued.

Implementation of GASB Pronouncements

In June 2012, the GASB issued Statement 67, *Financial Reporting for Pension Plans – an amendment of GASB Statement 25.* GASB 67 improves financial reporting by state and local governmental pension plans. The requirements of this Statement will improve financial reporting primarily through enhanced note disclosures and schedules of required supplementary information that will be presented by the pension plans that are within its scope. This Statement is effective for financial statements for fiscal years beginning after June 15, 2013. Management has determined GASB 67 has no impact on the System's financial statements as the System participates in a multiple-employer plan (and is not the trustee).

In June 2012, the GASB issued Statement 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement 27.* GASB 68 improves accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and inter-period equity, and creating additional transparency. This Statement is effective for fiscal years beginning after June 15, 2014. Management is currently evaluating the impact of the adoption of this statement on the System's financial statements.

HOPKINSVILLE ELECTRIC SYSTEM
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CITY OF HOPKINSVILLE, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2014 AND 2013

NOTE 2 – UTILITY PLANT AND DEPRECIATION PROCEDURES

A summary of changes in major classifications of the utility plant in service is as follows:

	Balance June 30, 2013	Additions	Reclassifications/ Retirements	Balance June 30, 2014
Utility plant not depreciated:				
Land	$ 425,715	$ 5,340	$ -	$ 431,055
Construction in progress - electric	5,026,629	-	4,375,623	651,006
Construction in progress - telecommunications	250,797	8,850	-	259,647
Total utility plant not depreciated	5,703,141	14,190	4,375,623	1,341,708
Utility plant depreciated:				
Transmission plant	650,630	28,363	8,902	670,091
Distribution plant	21,595,024	5,197,763	150,331	26,642,456
General plant	5,146,646	440,218	144,870	5,441,994
Telecommunications plant	15,169,125	922,798	310,950	15,780,973
Total utility plant depreciated	42,561,425	6,589,142	615,053	48,535,514
Accumulated depreciation	(16,268,377)	(2,269,086)	686,889	(17,850,574)
Total utility plant depreciated, net	26,293,048	4,320,056	(71,836)	30,684,940
Total utility plant	$ 31,996,189	$ 4,334,246	$ 4,303,787	$ 32,026,648

Transmission Plant depreciation rates have been applied on a straight-line basis and are as follows:

Towers and fixtures	2.00%
Poles and fixtures	3.00

HOPKINSVILLE ELECTRIC SYSTEM
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NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2014 AND 2013

NOTE 2 – UTILITY PLANT AND DEPRECIATION PROCEDURES, continued

Provision has been made for depreciation of Distribution Plant on a straight-line basis and rates are as follows:

Station equipment	4.00%
Poles, towers, and fixtures	4.00
Overhead conductors and devices	1.75
Underground equipment	4.00
Line transformers	2.00
Services	5.25
Meters	2.00
Security lighting	6.00
Street lighting and signal systems	3.75

General Plant depreciation rates have been applied on a straight-line basis and are as follows:

Structures and improvements	3.00%
Office furniture	VAR
Transportation equipment	25.00
Laboratory equipment	8.00

Transactions through the Accumulated Provision for Depreciation account for the years ended June 30, 2014 and 2013 are summarized as follows:

	2014	2013
Accumulated provision for depreciation, July 1	$ 16,268,377	$ 15,349,582
Add:		
Depreciation charged directly to expense	2,183,633	1,509,040
Depreciation charged to transportation - clearing	85,453	94,652
Subtotal	18,537,463	16,953,274
Deduct:		
Original cost of plant retired	613,427	1,222,536
Cost of removal less salvage	73,462	(537,639)
Total charges against provision	686,889	684,897
Accumulated provision for depreciation, June 30	$ 17,850,574	$ 16,268,377

NOTE 3 – INVESTMENTS – SPECIAL FUNDS

Investments - Special Funds at June 30 consisted of:

	2014	2013
Operation and maintenance fund	$ -	$ 700,000
2007 Telecom bond issue fund	244,530	244,505
Certificate of deposit - BBT	90,878	90,742
New York Mellon-575036	577,705	1,000,003
Total investments - special funds	$ 913,113	$ 2,035,250

Excess monies in the above funds have been invested in certificates of deposit at local banks and in trust for short-term U.S. Government securities.

The operation and maintenance fund, established by the bond ordinance, is a reserve for extraordinary costs of operating and maintaining the plant over and above ordinary operation and maintenance.

At year end, the amount of total investments held in banks was $913,113, all of which was covered by collateral held in safekeeping by agents of the respective banks or by government backed securities.

The System has invested Other Special Funds in repurchase agreements with local banks. Securities investments that the company has the positive intent and the ability to hold to maturity are classified as held-to-maturity securities and are recorded in investments and other assets at amortized cost, which approximates fair value. The other special funds of $700,000 matured January 14, 2014.

Interest Rate Risk

The System does not have a formal investment policy that limits its investment maturities as a means of managing its exposure to losses arising from changes in interest rates. In general, certificates of deposit are not subject to interest rate risk.

Custodial Credit Risk

Under Kentucky Revised Statutes Section 66.480, the System is authorized to invest in obligations of the United States and its agencies and instrumentalities, obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States or of its agencies, obligations of any corporation of the United States government, certificates of deposit, commercial paper rated in one of the three highest categories by nationally recognized rating agencies and shares in mutual funds. For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the System will not be able to recover the value of its investments held in possession of an outside party. The System does not have an investment policy that would further limit its investment choices. In general, certificates of deposit are not subject to investment credit risk.

NOTE 4 – CASH - GENERAL FUND

The carrying amounts are reflected in the financial statements as follows:

	2014	2013
Change funds	$ 1,750	$ 1,750
Checking accounts	3,931,815	2,676,750
TVA power bill early payment	18	-
Other	1,250	1,250
Total	$ 3,934,833	$ 2,679,750

Custodial Credit Risk

Custodial credit risk is the risk that, in the event of a depository institution failure, the System's deposits may not be returned to it. The System does not have a policy regarding custodial credit risk for deposits.

State law requires collateralization of all deposits with federal depository insurance; bonds and other obligations of the U.S. Treasury, U.S. agencies or instrumentalities of the State of Kentucky; bonds of any city, county, school district or special road district of the State of Kentucky; bonds of any state; or a surety bond having an aggregate value at least equal to the amount of deposits.

At June 30, 2014, the Board's deposits in depository institutions had a carrying amount of $3,931,815 and bank balances of $3,999,699. At June 30, 2014, the deposits were covered entirely by FDIC insurance or a properly executed collateral security agreement. At June 30, 2013, the System's deposits in depository institutions had a carrying amount of $2,676,750 and bank balances of $2,692,280. At June 30, 2013, the deposits were covered entirely by FDIC insurance or a properly executed collateral security agreement.

NOTE 5 – RECEIVABLES

Net receivables include the following at June 30:

	2014	2013
Accounts Receivable		
Electric	$ 3,323,411	$ 2,856,276
	3,323,411	2,856,276
Other Receivables		
Employee appliance/computer loans	2,599	9,660
FEMA receivable	-	-
Other miscellaneous	(113)	135,341
	2,486	145,001
Total Receivables	3,325,897	3,001,277
Less: Reserve for Uncollectible Accounts	(30,804)	(28,995)
Total	$ 3,295,093	$ 2,972,282

Electric accounts and miscellaneous accounts together with the current billing for home insulation, heat pump, and wood burning stove loans, were aged as follows:

	June 30, 2014		June 30, 2013	
	Amount	Percent	Amount	Percent
Accounts Having Discount Dates After June 30	$ 3,064,216	92.13	$ 2,795,612	93.15
Accounts With Credit Balances	-	-	-	-
Accounts Less Than One Month Past Due	-	-	-	-
Accounts 31 to 60 Days Past Due	151,317	4.55	106,578	3.55
Accounts 61 to 90 Days Past Due	49,231	1.10	25,515	0.85
Accounts Over 90 Days Past Due	61,133	9.86	73,572	2.45
	$ 3,325,897	107.64	$ 3,001,277	100.00

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NOTE 5 – RECEIVABLES, continued

A reserve for uncollectible electric accounts is maintained by means of monthly charges to operations. Lists of accounts considered to be worthless are charged to the reserve account annually, with the last such list having been prepared as of June 30, 2014. Accounts charged off are turned over to various agencies for collection as authorized by HES.

A summary of the reserve's transactions for each year is as follows:

	2014	2013
Beginning balance	$ 28,995	$ 28,289
Monthly additions and adjustments	122,671	85,770
Charge-off of bad accounts	(124,005)	(93,700)
Recoveries	3,143	8,636
Balance, June 30	$ 30,804	$ 28,995

NOTE 6 – MATERIAL AND SUPPLIES

The values of electric materials at balance sheet dates were ascertained by reference to perpetual inventory records. Hopkinsville Electric System personnel make physical counts of stock at the end of each year and adjust the perpetual inventory records to actual count. The adjustment to the general ledger control is made to bring it into conformity with perpetual stock records. This amount is charged against stores expense (clearing) in January of each year. The positive (negative) adjustments required were ($950) and ($6,665) as of June 30, 2014 and 2013, respectively.

NOTE 7 – DEFERRED CHARGES

Deferred Charges at June 30 consisted of:

	2014	2013
Deferred costs on bond issue-2004	$ 15,633	$ 19,009
Deferred costs on bond issue-2007	90,652	100,632
Deferred costs on bond issue - 2013 KLC	48,282	53,167
Unamortized debt discount-2007	24,214	26,880
Customers energy conservation loans-TVA	1,033,222	1,051,649
Total	$ 1,212,003	$ 1,251,337

NOTE 8 – BONDED INDEBTEDNESS

On January 27, 2004, the System entered into a lease with Kentucky League of Cities Funding Trust to fund an electric substation/transformer. Payments of principal and interest are paid monthly with the last principal payment scheduled for February 15, 2019. The interest rate is 3.45 percent. This debt is secured by the property.

On August 1, 2008, the System entered into a lease with Kentucky League of Cities Funding Trust in the amount of $10,189,560 for refunding of the $4,000,000 Electric Revenue Bond Anticipation Notes, Series 2007A and $6,000,000 Electric Revenue Bond Anticipation Notes, Series 2007B. The proceeds of the notes were used to acquire improvements to the electric plant and distribution system, including broadband and telecommunications improvements and to pay issuance costs of the obligations. Payments of principal and interest are paid monthly with the last principal payment scheduled for August 1, 2023. The lease is to bear interest at a rate of 3.62% per annum. The debt is secured by revenues of the electric system. Interest paid on the 2007 bonds is capitalized during the construction phase. Capitalized interest for each year is $171,069 and $181,161 for June 30, 2014 and 2013, respectively.

On February 1, 2008, the System entered into a loan agreement with Kentucky Infrastructure Authority in the amount of $3,000,000 to assist in funding the construction of a fiber optic communication line from Hopkinsville, Kentucky to Bowling Green, Kentucky. The loan is to bear interest at 0.7% semi-annually. Interest payment dates for the loan are December 1 or June 1 succeeding the first draw which is at least three months, but no more than nine months, after the first draw. Principal payments will commence on June 1 or December 1 immediately succeeding the date of the last draw of funds. The loan is for ten years. The debt is secured by revenues of the telecommunications system.

On February 14, 2013, the System entered into a lease agreement with Kentucky Bond Corporation in the amount of $1,055,000 for system upgrades and enhancements for various projects. Monthly payments are made into the Debt Service Fund for principal retirement, interest payment and fees. The interest rate is 2 percent. Debt is secured with the pledge of net revenues set forth in existing bond resolutions.

The changes in outstanding debt are as follows:

	Balance July 1, 2013	New Issues	Debt Payments and Refunds	Balance June 30, 2014
KY League of Cities-Series 2004	$ 1,587,570	$ -	$ 257,698	$ 1,329,872
Kentucky Infrastructure Authority	3,000,000	-	290,655	2,709,345
KY League of Cities - Series 2007	7,634,298	-	603,048	7,031,250
Revenue Bond, Series 2013A	1,022,273	-	96,856	925,417
	$ 13,244,141	$ -	$ 1,248,257	$ 11,995,884

NOTE 8 – BONDED INDEBTEDNESS, continued

The discount associated with the issuance of the revenue bonds payable is being amortized on the straight-line method over the term of the bonds. The amount charged to interest expense for the year ending June 30 follows:

	2014	2013
Series 1998-A	$ -	$ 4,117
Series 2004	3,120	3,120
Series 2007	2,666	2,666
	$ 5,786	$ 9,903

The cost of issuance associated with the issuance of the revenue bonds payable is being amortized on the straight-line method over the term of the bonds. Amortization charged to expense for the year ending June 30 follows:

	2014	2013
Series 2004	$ 256	$ 256
Series 2007	9,980	9,980
Series 2013	4,885	1,833
	$ 15,121	$ 12,069

HOPKINSVILLE ELECTRIC SYSTEM
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NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2014 AND 2013

NOTE 8 – BONDED INDEBTEDNESS, continued

The following represents principal and interest payments on outstanding debt.

	Series 2004			Series 2007		
	Principal	Interest	Total	Principal	Interest	Total
2015	$ 266,997	$ 55,201	$ 322,198	$ 631,409	$ 308,986	$ 940,395
2016	253,031	67,280	320,311	660,575	279,872	940,447
2017	310,214	8,069	318,283	692,427	249,294	941,721
2018	296,955	19,247	316,202	724,559	217,300	941,859
2019	202,675	5,716	208,391	758,608	183,789	942,397
2020-2024	-	-	-	3,563,672	369,288	3,932,960
	$ 1,329,872	$ 155,513	$ 1,485,385	$ 7,031,250	$ 1,608,529	$ 8,639,779

	Series 2013A			KIA 2013		
	Principal	Interest	Total	Principal	Interest	Total
2015	$ 95,000	$ 20,543	$ 115,543	$ 292,693	$ 18,454	$ 311,147
2016	97,084	18,643	115,727	294,745	16,401	311,146
2017	100,000	16,702	116,702	296,812	14,335	311,147
2018	102,084	14,702	116,786	298,894	12,254	311,148
2019	105,000	12,660	117,660	300,990	10,158	311,148
2020-2024	426,249	26,540	452,789	1,225,211	19,375	1,244,586
	$ 925,417	$ 109,790	$ 1,035,207	$ 2,709,345	$ 90,977	$ 2,800,322

	All Series Combined		
	Principal	Interest	Total
2015	$ 1,286,099	$ 403,184	$ 1,689,283
2016	1,305,435	382,196	1,687,631
2017	1,399,453	288,400	1,687,853
2018	1,422,492	263,503	1,685,995
2019	1,367,273	212,323	1,579,596
2020-2024	5,215,132	415,203	5,630,335
	$ 11,995,884	$ 1,964,809	$ 13,960,693

NOTE 9 – ADVANCES FROM OTHERS

Advances have been received from Tennessee Valley Authority for the purpose of making long-term loans to electric customers under various energy conservation programs. The balances due Tennessee Valley Authority were $1,050,402 and $1,069,475 as of June 30, 2014 and 2013, respectively.

NOTE 10 – PENSION PLANS

County Employee Retirement System

Plan Description: Effective August 1, 1988, the Board and the employees elected to discontinue participation in the "Electric Plant Board of the City of Hopkinsville Retirement Plan" and participate in the statewide County Employees' Retirement System (CERS) as provided under Section 78.530 of the Kentucky Revised Statutes. The County Employees' Retirement System, a component unit of the Commonwealth of Kentucky (CERS), is a cost-sharing multiple-employer defined benefit plan. The CERS provides retirement and disability benefits, annual cost-of-living adjustments, medical insurance, and death benefits to Plan members and beneficiaries. Under the provisions of the Kentucky Revised Statutes Section 61.645, the Board of Trustees of Kentucky Retirement Systems administers the CERS and has the ability to establish and amend benefit provisions. The CERS issues a publicly available financial report that includes financial statements and required supplementary information. CERS' report may be obtained by writing to Kentucky Retirement Systems, Perimeter Park West, 1260 Louisville Road, Frankfort, KY 40601-6124 or by calling (502) 564-5656.

Funding Policy: CERS plan members who began participating before September 1, 2008 are required to contribute 5% of their covered salary. Members who began participating on or after September 1, 2008 are required to contribute 6% of their covered salary. The System is required to contribute to the CERS at an actuarially determined rate. The current rate is 18.89% of annual covered payroll. For those employees hired before June 1, 1994, the Hopkinsville Electric System Board elected to pay the entire contribution up to 12.68%.

The three year trend information of the System's contribution requirement to CERS is as follows:

Year Ending	Annual Pension Cost	Percentage of APC Contributed
6/30/2014	$ 555,222	100%
6/30/2013	548,201	100%
6/30/2012	543,433	100%

CERS does not make separate measurement of assets and pension benefit obligation for individual employers. The following table represents certain information regarding the plan's status as of the whole, derived from actuarial valuations (all dollar amounts are $1,000's) performed as of June 30, 2013, (the actuarial reports for the year ended June 30, 2014 are not available):

NOTE 10 – PENSION PLANS, continued

	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Underfunded AAL
CERS	$ 7,438,785	$ 12,503,081	$ 5,064,295

	Funded Ratio	Covered Payroll	Underfunded Actuarial Liability as Percentage of Covered Payroll
CERS	59.50%	$ 2,697,950	187.71%

As the System is only one of several employers participating in the plan, it is not practical to determine the System's portion of the unfunded past service cost or the vested benefits of the System's portion of the plan assets.

<u>Medical Insurance Plan</u>

Plan Description – In addition to the pension benefits described above, Kentucky Revised Statute 61.702 requires the CERS to provide post-retirement healthcare benefits to eligible members and dependents. The CERS medical insurance benefit is a cost-sharing multiple employer defined benefit plan. Changes made to the medical plan may be made by the Board of Trustees of Kentucky Retirement Systems, the Kentucky Department of Employee Insurance and the General Assembly.

Funding Policy – The post-retirement healthcare provided by CERS is financed on a pay-as-you-go basis. In order to fund the post-retirement healthcare benefit, one and five tenths percent (1.5%) of the gross annual payroll of all active members is contributed. One-half (1/2) of this amount is derived from member contributions and one-half (1/2) from state appropriation. Also, the premiums collected from retirees as described in the plan description and investment interest help with the medical expenses of the plan.

<u>System's Thrift Plan</u>

Plan Description – The System's employees hired after September 1, 1969 have the option to participate in the System's Thrift Plan, which consists of a 401K plan and a 401M plan.

Funding Policy – Employees who participate in the Plan may contribute up to 100% (in multiples of 1%) of their base annual compensation. Employees who elect to also participate in the 401M plan are limited to 14% in their contributions. All such amounts were deposited with the trustee, Manulife, Clarksville, Tennessee, to be held or invested in accordance with provisions in the Thrift Plan Trust Agreement executed November 24, 1969. Employer contributions, which totaled $99,131 and $91,907 in the years ended June 30, 2014 and 2013, respectively, are charged monthly to plant and expense in the same ratio as payroll.

NOTE 11 – OTHER CURRENT AND ACCRUED LIABILITIES

Following is a summary of the amounts recorded as other current and accrued liabilities as of June 30, 2014 and 2013:

	2014	2013
Accrued pole rentals	$ 31,385	$ 31,080
Accrued payroll	75,965	59,511
Compensated absences	509,146	386,896
	$ 616,496	$ 477,487

NOTE 12 – COMMITMENTS

Under its wholesale power agreement, dated April 20, 1982, the System is committed to purchase its electric power and energy requirements from the Tennessee Valley Authority (TVA). As provided by amendment dated October 1, 1997, the contract may be terminated by either party at any time upon not less than five years prior written notice. Neither party shall exercise its right to give notice of termination before the date occurring five years after the date of the agreement. The rates paid for such purchases are subject to change periodically by the supplier. As provided by amendment effective October 1, 1999, the System has a decreasing term contract beginning on that date. The term decreases one year each year until the term levels off at five years.

NOTE 13 – RISK MANAGEMENT AND LITIGATION

The System is exposed to various risks of loss related torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees and natural disasters. The System carries commercial insurance for the risks of loss, including worker's compensation, and property and casualty loss insurance. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years. Limits of insurance coverage remain unchanged in the past three years.

From time to time, the System is party to various pending claims and legal proceedings. Although the outcome of such matters cannot be forecast with certainty, it is the opinion of management and legal counsel that the likelihood is remote that any such claims or proceedings will have a material adverse effect on the System's financial statements.

NOTE 14 – CONSTRUCTION WORK IN PROGRESS

The balances of construction work in progress – electric were $651,006 and $5,026,629 as of June 30, 2014 and 2013, respectively. Included in the June 30, 2013 balance is $4,637,305 for the automated meter infrastructure project.

The balances of construction work in progress – telecommunications were $259,647 and $250,797 as of June 30, 2014 and 2013, respectively.

NOTE 15 – RATE INCREASE

Wholesale Base Rates: In April 2011, the Tennessee Valley Authority changed its wholesale rate calculation from one based on actual Retail Customer Usage to one based on Demand and Energy metered at the wholesale delivery point. The implementation of demand and energy rates along with mild weather patterns, has kept cost of purchased power to energy at a constant percentage—76.7% in fiscal year 2014 and 77.8% in fiscal year 2013.

Fuel Cost Adjustment: In October 2009, TVA changed from a quarterly FCA to monthly FCA. In April 2011, TVA separated its fuel cost, which had been included in its Base Rates prior to the implementation of the quarterly FCA in October 2007, and started to include it in its monthly FCA.

Environmental Charge: In October 2003, TVA added a charge to its wholesale rates to recover its cost to add equipment to its generation facilities to meet government environmental standards. The charge is a fixed amount and is $0.00186 per kWh under the new Demand and Energy rate structure. The charge will automatically expire in September 2013.

Retail Adder: The System's margin is provided by a Retail Adder. The System's adder has not been changed since July 2010.

The System implemented a customer service charge increase effective October 2013.

NOTE 16 – MUNINET

MuniNet Fiber Agency ("MuniNet") was formed to undertake the financing, acquisition, construction, management, operation, utilization and ownership of fiber network projects and any and all facilities, including all equipment, structures, machinery, and tangible and intangible property, real or personal, useful for such projects, either within or without the Commonwealth of Kentucky. Projects are approved by the MuniNet Board on a project-specific basis. After a project is approved, MuniNet and the individual MuniNet members who desire to participate in the project enter into a Project Participation Agreement which sets forth the terms and conditions of the project's development and operation and establishes each participant's rights and obligations with respect to the project.

MuniNet Project 2 ("Project 2") consists of the development of a fiber optic cable system and a contractual arrangement for a connection to an Internet Access Provider (IAP) located in Nashville, Tennessee that will provide each project participant with high speed access to the internet. The estimated cost of Project 2 is $3,173,049.

On April 30, 2013, the Board signed a Resolution approving the Project 2 Participation Agreement among the Board, MuniNet and the other Project 2 participants. Hopkinsville Electric System is one of seven (7) Kentucky public utility companies who are participants in Project 2. Each participant in Project 2 ("Participant") has a one-seventh (1/7) interest in the project ("Project Share").

NOTE 17 – MUNINET, continued

MuniNet obtained a loan from the Kentucky Infrastructure Authority in the amount of $3,200,000 to finance the development, construction and equipping of Project 2.

The Superintendent/General Manager of each participant appoints one representative to the Project Management Committee and one alternate, either or both of whom, may be employees of the Participant The Superintendent/General Manager of the participant may appoint himself as the representative or alternate to the Project Management Committee.

Costs and expenses associated with financing, development, equipping, maintenance and operation of Project 2, including debt service, will be paid from the revenue generated from the project. In the event the revenue generated from Project 2 is insufficient to pay the full amount of the costs and expenses associated with the project as they come due, each participant will be responsible for its Project Share of the deficit.

Hopkinsville Electric System has provided MuniNet with an indefeasible right of use (IRU) for fibers on the System's existing fiber system. MuniNet has agreed to pay Hopkinsville Electric System for its provision of an IRU in such fibers in the amount of $270,809 amortized over 20 years with no interest. During fiscal year ending June 30, 2014, $135,404 was received, and the additional $135,405 is not deemed receivable within the twelve month period. Amortization expense for the current fiscal year was $6,770.

MuniNet bills each participant monthly indicating the amount payable for its project share of payment obligations due under the Project Participation Agreement. In addition, MuniNet bills each participant administrative and operating costs which will be expensed. The Board paid $-0- for administrative and operating costs during fiscal year June 30, 2014.

The following are costs incurred for the initial investment in MuniNet and Project 2 costs:

	2014	2013
Initial investment	$ 5,000	$ 5,000
Project 2 Investment in Muninet		
Beginning balance July 1	70,423	5,115
Program revenue		
Costs incurred	34,971	94,365
Less MuniNet reimbursements	-	(29,057)
	105,394	70,423
Ending balance June 30	$ 110,394	$ 75,423

SUPPLEMENTARY INFORMATION

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
COMBINED SCHEDULE OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
FOR THE YEAR ENDED JUNE 30, 2014

	ELECTRIC	TELECOM	TOTAL
OPERATING REVENUES	$ 37,062,945	$ 3,182,589	$ 40,245,534
OPERATING EXPENSES			
Cost of power	28,445,310	-	28,445,310
Cost of sales - telecom	-	228,639	228,639
Distribution - operation	1,450,694	701,021	2,151,715
- maintenance	1,054,499	38,283	1,092,782
Transmission - maintenance	805	-	805
Customer accounts	739,979	61,058	801,037
Sales	94,840	37,475	132,315
Administrative and general	1,766,837	492,672	2,259,509
Depreciation and amortization	1,254,162	929,471	2,183,633
Taxes	1,344,639	40,012	1,384,651
Total operating expenses	36,151,765	2,528,631	38,680,396
Net operating revenues	911,180	653,958	1,565,138
NONOPERATING REVENUES (EXPENSES)			
Interest on long-term debt	(93,014)	(211,750)	(304,764)
Other interest	(19,879)	-	(19,879)
Amortization of debt expense	(5,141)	(9,980)	(15,121)
Interest income	18,280	24	18,304
Other income (expenses)	13,062	-	13,062
Total nonoperating revenues (expenses)	(86,692)	(221,706)	(308,398)
CHANGE IN NET POSITION	824,488	432,252	1,256,740
NET POSITION, BEGINNING OF YEAR	22,291,326	(1,185,447)	21,105,879
NET POSITION, END OF YEAR	$ 23,115,814	$ (753,195)	$ 22,362,619

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
COMPARATIVE SCHEDULE OF REVENUES AND EXPENSES - ELECTRIC
FOR THE YEARS ENDED JUNE 30, 2014 AND 2013

	ELECTRIC 2014	ELECTRIC 2013	VARIANCE FAVORABLE (UNFAVORABLE)
OPERATING REVENUES	$ 37,062,945	$ 35,728,517	$ 1,334,428
OPERATING EXPENSES			
Cost of power	28,445,310	27,797,919	(647,391)
Distribution - operation	1,450,694	849,894	(600,800)
- maintenance	1,054,499	930,993	(123,506)
Transmission - maintenance	805	1,975	1,170
Customer accounts	739,979	650,691	(89,288)
Sales	94,840	94,200	(640)
Administrative and general	1,766,837	1,680,626	(86,211)
Depreciation	1,254,162	1,033,107	(221,055)
Taxes	1,344,639	1,378,951	34,312
Total operating expenses	36,151,765	34,418,356	(1,733,409)
Net operating revenues	911,180	1,310,161	(398,981)
NONOPERATING REVENUES (EXPENSES)			
Interest on long-term debt	(93,014)	(156,791)	63,777
Other interest	(19,879)	(24,634)	4,755
Amortization of debt expense	(5,141)	(6,288)	1,147
Interest income	18,280	30,018	(11,738)
Other revenues (expenses)	13,062	(513,191)	526,253
Total nonoperating revenues (expenses)	(86,692)	(670,886)	584,194
CHANGE IN NET POSITION	$ 824,488	$ 639,275	$ 185,213

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
COMPARATIVE STATEMENT OF REVENUES AND EXPENSES - TELECOMMUNICATIONS
FOR THE YEARS ENDED JUNE 30, 2014 AND 2013

	TELECOM 2014	TELECOM 2013	VARIANCE FAVORABLE (UNFAVORABLE)
OPERATING REVENUES	$ 3,182,589	$ 2,251,514	$ 931,075
OPERATING EXPENSES			
Cost of sales - telecom	228,639	194,383	(34,256)
Distribution - operation	701,021	691,755	(9,266)
- maintenance	38,283	22,288	(15,995)
Customer accounts	61,058	29,408	(31,650)
Sales	37,475	34,627	(2,848)
Administrative and general	492,672	463,514	(29,158)
Depreciation and amortization	929,471	547,454	(382,017)
Taxes	40,012	139,896	99,884
Total operating expenses	2,528,631	2,123,325	(405,306)
Net operating revenues	653,958	128,189	525,769
NONOPERATING REVENUES (EXPENSES)			
Interest on long-term debt	(211,750)	(140,229)	(71,521)
Amortization of debt expense	(9,980)	(3,693)	(6,287)
Interest income	24	65	(41)
Total nonoperating revenues (expenses)	(221,706)	(143,857)	(77,849)
CHANGE IN NET POSITION	$ 432,252	$ (15,668)	$ 447,921

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
COMPARATIVE ANALYSIS OF OPERATING EXPENSES - ELECTRIC

	For the Year Ended June 30, 2014			For the Year Ended June 30, 2013			Increase
	Amount	Percent		Amount	Percent		(Decrease)
Distribution							
Supervision & engineering	$ 107,438	0.29	%	$ 104,524	0.29	%	$ 2,914
Station expense	149,133	0.40		153,919	0.43		(4,786)
Overhead lines expense	267,027	0.72		234,067	0.66		32,960
Underground line expense	770	0.00		-	0.00		770
Street light & signal system expense	37,375	0.10		35,235	0.10		2,140
Meter expense	75,198	0.20		30,325	0.08		44,873
Customer installation expense	26,464	0.07		31,439	0.09		(4,975)
Miscellaneous distribution expense	24,292	0.07		22,331	0.06		1,961
Rents	762,997	2.06		238,054	0.67		524,943
Total distribution	$ 1,450,694	3.91	%	$ 849,894	2.38	%	$ 600,800
Maintenance expense							
Distribution:							
Supervision & engineering	$ 20,293	0.05	%	$ 19,557	0.05	%	$ 736
Substations	14,761	0.04		38,353	0.11		(23,592)
Overhead lines	949,554	2.56		798,649	2.24		150,905
Underground services	4,811	0.01		12,072	0.03		(7,261)
Transformers	37,732	0.10		38,181	0.11		(449)
Street light & signal system	27,348	0.07		24,181	0.07		3,167
Meters	-	0.00		-	0.00		-
Total distribution maintenance	$ 1,054,499	2.83	%	$ 930,993	2.61	%	$ 123,506
Transmission:							
Maintenance of overhead lines	$ 805	0.00	%	$ 1,975	0.00	%	$ (1,170)
Total transmission maintenance	$ 805	0.00	%	$ 1,975	0.00	%	$ (1,170)
Customer accounts							
Supervision	$ 67	0.00	%	$ 310	0.00	%	$ -
Meter reading	48,674	0.13		44,627	0.12		4,047
Customer records & collection expense	465,845	1.26		421,021	1.18		44,824
Uncollectible accounts	120,883	0.33		82,913	0.23		37,970
Miscellaneous customer accounting	3,422	0.01		3,659	0.01		(237)
Customer assistance expense	49,706	0.13		48,387	0.14		1,319
Information & instructional advertising	51,382	0.14		49,774	0.14		1,608
Total customer accounts	$ 739,979	2.00	%	$ 650,691	1.82	%	$ 89,531

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
COMPARATIVE ANALYSIS OF OPERATING EXPENSES - ELECTRIC, continued

	For the Year Ended June 30, 2014		For the Year Ended June 30, 2013		Increase
	Amount	Percent	Amount	Percent	(Decrease)
Sales expense					
Demonstrating and selling expense	$ 71,363	0.19 %	$ 70,542	0.20 %	$ 821
Advertising expense	22,622	0.06	22,743	0.06	(121)
Miscellaneous	855	0.00	915	0.00	(60)
Total sales	$ 94,840	0.25 %	$ 94,200	0.26 %	$ 640
Administrative and general					
Administrative & office salaries	$ 381,176	1.03 %	$ 366,701	1.03 %	$ 14,475
Office supplies & expense	168,630	0.45	142,349	0.40	26,281
Outside services employed	63,769	0.17	59,473	0.17	4,296
Property insurance	127,811	0.34	125,398	0.35	2,413
Injuries & damages	49,510	0.13	48,977	0.14	533
Employees pension & other benefits	801,937	2.16	830,430	2.32	(28,493)
Duplicate charges (credit)	(122,640)	(0.33)	(117,669)	(0.33)	(4,971)
Miscellaneous general expense	58,766	0.16	71,068	0.20	(12,302)
Maintenance	237,878	0.64	153,899	0.43	83,979
Total administrative and general	$ 1,766,837	4.75 %	$ 1,680,626	4.71 %	$ 86,211

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
COMPARATIVE ANALYSIS OF OPERATING EXPENSES - TELECOMMUNICATIONS

	For the Year Ended June 30, 2014			For the Year Ended June 30, 2013			Increase
	Amount	Percent		Amount	Percent		(Decrease)
Distribution							
Supervision & engineering	$ 95,954	3.01	%	$ 90,682	4.03	%	$ 5,271
Hub expenses	39,046	1.23		65,997	2.93		(26,951)
Overhead cable expense	314,255	9.87		314,885	13.99		(630)
Meter expense	196	0.01		-	0.00		197
Customer installation expense	155,353	4.88		211,716	9.40		(56,363)
Miscellaneous distribution expense	7,024	0.22		9,976	0.44		(2,952)
Rents	89,193	2.80		(1,501)	(0.07)		90,694
Total distribution	$ 701,021	22.02	%	$ 691,755	30.72	%	$ 9,266
Maintenance expense							
Distribution:							
Supervision & engineering	$ 13,174	0.41	%	$ 12,172	0.54	%	$ 1,002
Hub expenses	15,650	0.49		638	0.03		15,012
General maintenance	9,459	0.30		9,478	0.42		(19)
Maintenance underground services	-	0.00		-	0.00		-
Total distribution maintenance	$ 38,283	1.20	%	$ 22,288	0.99	%	$ 15,995
Customer accounts							
Billing expense	$ 14,489	0.46	%	$ 6,167	0.27	%	$ 8,322
Customer records & collection expense	16,483	0.52		2,577	0.11		13,906
Uncollectible accounts	20,490	0.64		13,331	0.59		7,159
Customer assistance expense	9,596	0.30		7,333	0.33		2,263
Total customer accounts	$ 61,058	1.92	%	$ 29,408	1.30	%	$ 31,650

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
COMPARATIVE ANALYSIS OF OPERATING EXPENSES -
TELECOMMUNICATIONS, continued

	For the Year Ended June 30, 2014		For the Year Ended June 30, 2013		Increase
	Amount	Percent	Amount	Percent	(Decrease)
Sales expense					
Demonstrating and selling expense	$ 16,822	0.53 %	$ 14,428	0.64 %	$ 2,393
Advertising expense	20,653	0.65	20,199	0.90	454
Total sales	$ 37,475	1.18 %	$ 34,627	1.54 %	$ 2,847
Administrative and general					
Administrative & office salaries	$ 66,908	2.10 %	$ 61,639	2.74 %	$ 5,269
Office supplies & expense	33,609	1.06	22,680	1.01	10,929
Meeting expenses	13,318	0.42	17,074	0.76	(3,756)
Outside services employed	19,047	0.60	16,872	0.75	2,175
Property insurance	20,595	0.65	21,059	0.94	(464)
Injuries & damages	12,780	0.40	10,946	0.49	1,834
Employees pension & other benefits	230,971	7.26	199,250	8.85	31,721
General advertising	30	0.00	19	0.00	11
Miscellaneous general expense	7,084	0.22	1,208	0.05	5,876
Maintenance	88,330	2.78	112,767	5.01	(24,437)
Total administrative and general	$ 492,672	15.49 %	$ 463,514	20.60 %	$ 29,158

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Certified Public Accountants

To the Board of the
Hopkinsville Electric System of the
City of Hopkinsville, Kentucky
Hopkinsville, 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 Hopkinsville Electric System of the City of Hopkinsville, Kentucky, as of and for the years ended June 30, 2014 and 2013, and the related notes to the financial statements, which collectively comprise the Hopkinsville Electric System of the City of Hopkinsville, Kentucky's basic financial statements and have issued our report thereon dated November 10, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Hopkinsville Electric System of the City of Hopkinsville, Kentucky's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Hopkinsville Electric System of the City of Hopkinsville, Kentucky's internal control. Accordingly, we do not express an opinion on the effectiveness of the Hopkinsville Electric System of the City of Hopkinsville, Kentucky'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 a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. 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. We did identify a certain deficiency in internal control, described in the accompanying schedule of findings and responses that we consider to be significant deficiency (item 2014-01)

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Hopkinsville Electric System of the City of Hopkinsville, Kentucky'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 determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

Hopkinsville Electric System of the City of Hopkinsville, Kentucky's Response to Findings

The Hopkinsville Electric System of the City of Hopkinsville, Kentucky's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. The Hopkinsville Electric System of the City of Hopkinsville, Kentucky's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Kem, Duguid & Associates, P.S.C.

Kem, Duguid & Associates, P.S.C.

Certified Public Accountants
Hopkinsville, Kentucky

November 10, 2014

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
SUMMARY SCHEDULE OF FINDINGS AND RESPONSES
JUNE 30, 2014

2014-01 Internal Controls

Condition: The System does not have control over the preparation of the financial statements footnote disclosures in order to prevent or detect a misstatement in the disclosures. The independent auditor cannot be a compensating control for the client.

Criteria: Statement on Auditing Standards (SAS 115) states that a control deficiency exists when an entity does not have controls in place which would prevent or detect a misstatement in the financial statements and related footnote disclosures.

Effect: Lack of accountability and possible misstatement of financial statement footnote disclosures.

Recommendation: The System should designate an individual who possesses suitable skill, knowledge, and/or experience to review the financial statements footnote disclosures, and take responsibility for these disclosures.

Response: It is not feasible for the System to invest the resources for a member of the financial accounting staff to obtain the training necessary to obtain knowledge related to Financial Accounting Standards Board (FASB) and Government Accounting Standards Board (GASB) pronouncements and to remain current with this knowledge. Management does not consider the deficiency to be imperative to the daily internal control operations of the System.