HOPKINSVILLE ELECTRIC SYSTEM

OF THE

CITY OF HOPKINSVILLE, KENTUCKY

FINANCIAL STATEMENTS

FOR THE YEARS ENDED

JUNE 30, 2017 AND 2016

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY

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YORK, NEEL & ASSOCIATES, LLP
CERTIFIED PUBLIC ACCOUNTANTS

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, 2017 and 2016, 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.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Hopkinsville Electric System of the City of Hopkinsville, Kentucky as of June 30, 2017 and 2016, 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 and other required supplemental information on pages 4-14 and 44-47 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 accompanying additional information on pages 48-54 is presented for the purpose of additional analysis and is not a required part of the basic financial statements.

The additional information is the responsibility of management and was 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 additional information, as identified in the table of contents, is fairly stated in all material respects in relation to the basic 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 October 27, 2017, 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.

York, Neel & Associates, LLP

York, Neel & Associates LLP

Certified Public Accountants
Hopkinsville, Kentucky

October 27, 2017

MANAGEMENT’S DISCUSSION AND ANALYSIS

HOPKINSVILLE ELECTRIC SYSTEM
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MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2017

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, 2017. 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 2017 fiscal year by $20,610,169 (*net position*).

- The System's total net position increased by $716,596 during the period. The components of this increase were an increase in net position of electric operations of $235,236 and an increase in net position of telecom operations of $481,360.

- Total operating revenues for the 2017 fiscal year increased by $2,016,396 or about 5.36% compared to the previous period.

- FY 2017 operating expenses totaled $38,563,241 which was $1,556,443 or about 4.21% more than the previous year's amount.

OVERVIEW OF THE FINANCIAL STATEMENTS

This 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.

The basic financial statements provide information about the System's business-type activities. The financial statements are prepared in accordance with U.S. generally accepted accounting principles as promulgated by the Governmental Accounting Standards Board (GASB).

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 presents information on the System's assets and deferred outflows of resources and liabilities and deferred inflows of resources with the difference between them 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, 2017

Over the past year, total assets of the System decreased by $1,095,394 while total liabilities decreased by $953,492. Also, deferred outflows of resources increased by $766,298 while deferred inflows of resources decreased by $92,200. And for the current period, the net operating income of the System totaled $1,084,303. Net operating income included $503,412 from Electric and $580,891 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 deferred outflows of resources and liabilities and deferred inflows of resources with the difference between them reported as net position. The System's total net position increased from the prior year by $716,596 or about 3.60% for the period.

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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 2016 to FY 2017	
	2017	2016	Amount	Percent
Current and other assets	$ 8,691,850	$ 10,438,229	$ (1,746,379)	-16.73%
Capital assets	32,999,611	32,348,626	650,985	2.01%
TOTAL ASSETS	41,691,461	42,786,855	(1,095,394)	-2.56%
Deferred outflows	1,883,056	1,116,758	766,298	68.62%
Current liabilities	9,079,050	9,280,572	(201,522)	-2.17%
Long-term liabilities	13,700,898	14,452,868	(751,970)	-5.20%
TOTAL LIABILITIES	22,779,948	23,733,440	(953,492)	-4.02%
Deferred inflows	184,400	276,600	(92,200)	-33.33%
Invested in utility plant, net of related debt	25,016,016	22,994,967	2,021,049	8.79%
Restricted for capital projects	4	270,803	(270,799)	-100.00%
Unrestricted	(4,405,851)	(3,372,197)	(1,033,654)	-30.65%
TOTAL NET POSITION	$ 20,610,169	$ 19,893,573	$ 716,596	3.60%

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 ($25,016,016 or 121.37% 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 2016 to FY 2017	
	2017	2016	Amount	Percent
Invested in capital assets, net of related debt	$ 25,016,016	$ 22,994,967	$ 2,021,049	8.79%
Restricted for capital projects	4	270,803	(270,799)	-100.00%
Unrestricted	(4,405,851)	(3,372,197)	(1,033,654)	-30.65%
	$ 20,610,169	$ 19,893,573	$ 716,596	3.60%

For the 2017 fiscal year, *Net Position Invested in Capital Assets, Net of Related Debt* increased by $2,021,049 or 8.79% 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.

Compared to the prior year's balance, there was a decrease in the *Unrestricted Net Position* category of $1,033,654 or 30.65%.

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, 2017 and 2016 balances by asset classification are shown in the table below.

**TABLE 3
Comparison of Current Assets**

	Fiscal Year		Change from FY 2016 to FY 2017	
	2017	2016	Amount	Percent
Cash and cash equivalents	$ 2,368,962	$ 3,761,016	$ (1,392,054)	-37.01%
Accounts receivable (net)	2,839,696	2,938,520	(98,824)	-3.36%
Unbilled revenue	1,343,925	1,120,444	223,481	19.95%
Inventories	792,985	1,017,224	(224,239)	-22.04%
Prepaid expenses	81,245	84,952	(3,707)	-4.36%
Other	152,711	60,105	92,606	154.07%
	$ 7,579,524	$ 8,982,261	$ (1,402,737)	-15.62%

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.

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TABLE 4
Comparison of Noncurrent Assets

	Fiscal Year		Change from FY 2016 to FY 2017	
	2017	2016	Amount	Percent
Restricted:				
Investments - special funds	$ 4	$ 270,803	$ (270,799)	-100.00%
Investment in affiliated organization	239,541	191,063	48,478	25.37%
Nonutility property	33,958	33,958	-	0.00%
Deferred charges	94,296	109,570	(15,274)	-13.94%
Heat pump loans	744,527	850,574	(106,047)	-12.47%
Capital assets (net)	32,999,611	32,348,626	650,985	2.01%
	$ 34,111,937	$ 33,804,594	$ 307,343	0.91%

The table above demonstrates the relatively large investment that the System has made in capital assets. At the end of the 2017 fiscal year, capital assets represented about 96.73% of the noncurrent assets.

In examining the balance for the Restricted Noncurrent Assets category at June 30, 2017, it shows an increase of $307,343 or 0.91% 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.

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TABLE 5
Comparison of Current Liabilities from Unrestricted Net Position

	Fiscal Year		Change From FY 2016 to FY 2017	
	2017	2016	Amount	Percent
Accounts payable - purchased power	$ 4,621,782	$ 4,515,704	$ 106,078	2.35%
Accounts payable - other	330,397	393,258	(62,861)	-15.98%
Customer deposits	1,504,021	1,764,043	(260,022)	-14.74%
Accrued taxes	308,766	262,701	46,065	17.54%
Accrued interest	4,470	1,812	2,658	146.69%
Deferred revenue - MuniNet	108,324	115,094	(6,770)	-5.88%
Other current and accrued liabilities	778,798	852,107	(73,309)	-8.60%
	$ 7,656,558	$ 7,904,719	$ (248,161)	-3.14%

Current Liabilities Payable from Unrestricted Assets had a net decrease in its various components of $248,161 or about 3.14% compared to the previous fiscal year's balance.

As indicated in Table 6, the change in net position for the fiscal year ended June 30, 2017 was $716,596.

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

	Fiscal Year		Change From FYE 2016 To FYE 2017	
	2017	2016	Amount	Percent
Operating revenues:				
Electric revenues	$ 36,151,159	$ 34,100,550	$ 2,050,609	6.01%
Telecom revenues	3,496,385	3,530,598	(34,213)	-0.97%
Total operating revenues	39,647,544	37,631,148	2,016,396	5.36%
Operating expenses:				
Purchased power	27,651,948	26,046,019	1,605,929	6.17%
Other expenses	10,911,293	10,960,779	(49,486)	-0.45%
Total operating expenses	38,563,241	37,006,798	1,556,443	4.21%
Net operating income	1,084,303	624,350	459,953	73.67%
Non-operating income, net	(367,707)	(385,064)	17,357	-4.51%
Change in net position	716,596	239,286	477,310	199.47%
Net position, beginning of year	19,893,573	19,654,287	239,286	1.22%
Net position, end of year	$ 20,610,169	$ 19,893,573	$ 716,596	3.60%

Analysis of Revenue

For the 2017 fiscal year, The *Operating Revenues* of the System totaled $39,647,544. This amount represented an increase of 5.36% when compared to the previous year's total of $37,631,148.

Included in the *Non-Operating Revenues (Expenses)* of ($367,707) is interest income of $4,435, interest expense of $366,307, amortization expense of $15,274 and other income of $9,439.

Analysis of Expenses

The *Total Operating Expenses* for FY 2017 were $38,563,241. That amount represents an increase of $1,556,443 or about 4.21% more than the prior fiscal year total of $37,006,798. The eight major categories of Operating Expenses are shown in the chart below.

TABLE 7
Comparison of Operating Expenses

	Fiscal Year		Change from FY 2016 to FY 2017	
	2017	2016	Amount	Percent
Cost of power	$ 27,651,948	$ 26,046,019	$ 1,605,929	6.17%
Cost of sales - telecom	260,543	245,131	15,412	6.29%
Distribution:				
Operation	2,517,750	2,337,556	180,194	7.71%
Maintenance	1,161,248	985,135	176,113	17.88%
Transmission - maintenance	2,325	239	2,086	872.80%
Customer accounts	987,113	807,214	179,899	22.29%
Sales	157,213	155,865	1,348	0.86%
Administrative and general	2,318,374	3,002,223	(683,849)	-22.78%
Depreciation	2,080,227	2,133,572	(53,345)	-2.50%
Taxes	1,426,500	1,293,844	132,656	10.25%
	$ 38,563,241	$ 37,006,798	$ 1,556,443	4.21%

As indicated by the comparative information presented above, *Cost of Power* increased by $1,605,929 or 6.17% compared to the prior year. This increase is primarily due to the change in the TVA wholesale rate structure from Demand and Energy to Modified Time of Use (MTOU).

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CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

Hopkinsville Electric System's investment in capital assets as of June 30, 2017 was $32,999,611 (net of accumulated depreciation), as shown in the following table.

TABLE 8
Schedule of Capital Assets (Net of Depreciation)

	Fiscal Year		Increase
	2017	2016	(Decrease)
Land	$ 283,389	$ 283,389	$ -
Construction in progress -			
Electric	1,001,704	1,785,613	(783,909)
Telecommunications	181,730	216,005	(34,275)
Transmission plant	468,103	447,345	20,758
Distribution plant	18,016,269	17,242,958	773,311
General plant	6,534,118	1,464,519	5,069,599
Telecommunications plant	6,514,298	10,908,797	(4,394,499)
Total capital assets	$ 32,999,611	$ 32,348,626	$ 650,985

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

The increase in general plant as well as the decrease in telecommunications plant are a result of a departmental asset reclassification to satisfy TVA separation of cash initiative.

Long-term Debt

At June 30, 2017, the System had $8,004,898 debt outstanding, a decrease of $1,375,852 or approximately 14.67% less than the previous fiscal year. The System's debt is comprised of various bonds and notes. A comparative schedule at June 30, 2017 and 2016 is shown in the tabular information provided below.

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TABLE 9
Schedule of Long Term Debt

	Fiscal Year		Increase
	2017	2016	(Decrease)
Revenue bond - 2013A	$ 633,333	$ 733,333	$ (100,000)
KY League of Cities leases	5,546,470	6,525,510	(979,040)
KIA loan	1,825,095	2,121,907	(296,812)
	$ 8,004,898	$ 9,380,750	$ (1,375,852)

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 consumer use patterns. 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. kWh sales this year were up 5,714,108.

HES electric sales continue to trend down by a small percentage like other electric utilities nationwide, due to house construction and appliance efficiencies.

Also affecting the System's financial condition is the recent change to Modified Time of Use (MTOU) rates put in place by TVA. These rates were implemented October 1, 2015.

HES EnergyNet continues to gain high speed broadband customers.

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 Jeff Hurd, Manager, Hopkinsville Electric System, 1820 East Ninth Street, Hopkinsville, KY 42240.

FINANCIAL STATEMENTS

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STATEMENTS OF NET POSITION
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ASSETS

	2017	2016
Utility plant	$ 54,907,919	$ 52,827,580
Less accumulated depreciation	21,908,308	20,478,954
Net utility plant	32,999,611	32,348,626
Restricted assets		
Investments	4	270,803
Other assets		
Investment in affiliated organizations	239,541	191,063
Nonutility property	33,958	33,958
Heat pump loans	744,527	850,574
	1,018,026	1,075,595
Current assets		
Cash - general funds	2,368,962	3,761,016
Accounts receivable (less accumulated provision for uncollectible accounts of $22,431 in 2017 and $22,860 in 2016)	2,839,696	2,938,520
Unbilled revenue	1,343,925	1,120,444
Inventories (at weighted-average cost)	792,985	1,017,224
Prepaid expenses	81,245	84,952
Other current assets	152,711	60,105
Total current assets	7,579,524	8,982,261
Deferred charges	94,296	109,570
Total assets	41,691,461	42,786,855
DEFERRED OUTFLOWS OF RESOURCES		
Deferred pension amounts	1,883,056	1,116,758

See accompanying notes to financial statements

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STATEMENTS OF NET POSITION, continued
JUNE 30, 2017 AND 2016

LIABILITIES

	2017	2016
Current liabilities		
Current maturities of long-term debt	1,422,492	1,375,853
Accounts payable - purchased power	4,621,782	4,515,704
Accounts payable - other	330,397	393,258
Customer deposits	1,504,021	1,764,043
Accrued taxes	308,766	262,701
Accrued interest	4,470	1,812
Unearned revenue - MuniNet	108,324	115,094
Other current & accrued liabilities	778,798	852,107
Total current liabilities	9,079,050	9,280,572
Noncurrent liabilities		
Long-term debt	6,561,103	7,977,806
Net pension liability	6,371,513	5,603,152
Advances from others:		
Conservation advances - TVA	768,282	871,910
Total noncurrent liabilities	13,700,898	14,452,868
Total liabilities	22,779,948	23,733,440
DEFERRED INFLOWS OF RESOURCES		
Deferred pension amounts	184,400	276,600
NET POSITION		
Invested in capital assets, net of related debt	25,016,016	22,994,967
Restricted	4	270,803
Unrestricted	(4,405,851)	(3,372,197)
Total net position	$ 20,610,169	$ 19,893,573

See accompanying notes to financial statements

HOPKINSVILLE ELECTRIC SYSTEM
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STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
FOR THE YEARS ENDED JUNE 30, 2017 AND 2016

	2017	2016
OPERATING REVENUES	$ 39,647,544	$ 37,631,148
OPERATING EXPENSES		
Cost of power	27,651,948	26,046,019
Cost of sales - telecommunications	260,543	245,131
Distribution - operation	2,517,750	2,337,556
- maintenance	1,161,248	985,135
Transmission - maintenance	2,325	239
Customer accounts	987,113	807,214
Sales	157,213	155,865
Administrative and general	2,318,374	3,002,223
Depreciation	2,080,227	2,133,572
Taxes	1,426,500	1,293,844
Total operating expenses	38,563,241	37,006,798
Net operating revenues	1,084,303	624,350
NONOPERATING REVENUES (EXPENSES)		
Interest on long-term debt	(320,880)	(368,936)
Other interest	(45,427)	(4,389)
Amortization of debt expense	(15,274)	(15,274)
Interest income	4,435	3,530
Other revenue (expenses)	9,439	5
Net nonoperating revenues (expenses)	(367,707)	(385,064)
CHANGE IN NET POSITION	716,596	239,286
NET POSITION, BEGINNING OF YEAR	19,893,573	19,654,287
NET POSITION, END OF YEAR	$ 20,610,169	$ 19,893,573

See accompanying notes to financial statements

HOPKINSVILLE ELECTRIC SYSTEM
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STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2017 AND 2016

	2017	2016
Cash flows from operating activities		
Receipts from customers and users	$ 39,430,281	$ 37,630,319
Payments to suppliers	(32,372,664)	(30,211,375)
Payments to employees	(2,778,762)	(2,574,357)
Payments of taxes	(1,380,435)	(1,300,035)
Net cash provided (used) by operating activities	2,898,420	3,544,552
Cash flows from capital financing activities		
Expenditures for utility plant	(7,342,326)	(2,315,845)
Net cost of retiring plant	4,546,953	(121,302)
Principal payments on long-term debt	(1,375,852)	(1,329,035)
Conservation advances from TVA	(103,628)	(35,578)
Interest paid	(357,863)	(367,539)
Net cash provided (used) by capital financing activities	(4,632,716)	(4,169,299)
Cash flows from investing activities		
Conservation loan receivable	106,047	36,023
Investment in affiliated companies	(48,478)	(43,655)
Purchases/maturities of investments	270,799	551,464
Interest and other revenues	13,874	3,535
Net cash provided (used) by investing activities	342,242	547,367
Net increase (decrease) in cash	(1,392,054)	(77,380)
Cash, beginning of year	3,761,016	3,838,396
Cash, end of year	$ 2,368,962	$ 3,761,016

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, 2017 AND 2016

	2017	2016
Reconciliation of operating income to net cash provided by operating activities:		
Net operating revenues	$ 1,084,303	$ 624,350
Adjustments to reconcile net operating revenues to net cash provided by operating activities:		
Depreciation	2,144,390	2,168,232
Changes in assets and liabilities:		
Receivables	98,824	(54,330)
Unbilled revenues	(223,481)	53,501
Materials and supplies	224,239	(120,266)
Prepaid expenses and other current assets	(88,899)	27,422
Accounts payable	43,217	76,862
Deferred pension amounts	(90,137)	697,243
Accrued taxes	46,065	(6,191)
Other current and accrued liabilities	(73,309)	108,147
Customer deposits	(260,022)	(23,648)
Unearned revenue - MuniNet	(6,770)	(6,770)
Total adjustments	1,814,117	2,920,202
	$ 2,898,420	$ 3,544,552

See accompanying notes to financial statements

NOTES TO FINANCIAL STATEMENTS

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017 AND 2016

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.

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.

Investments

Investment purchases and sales are recorded as of the trade date. Dividend income is recognized on the ex-dividend date. Other investment income is recognized when earned.

Investments are reported at fair value. Fair value is the amount reasonably expected to be received for an investment in a current sale between a willing buyer and a willing seller. Fixed income securities, real estate investment trusts (REITs), derivatives, and common and preferred stocks are valued based on published market prices and quotations from national security exchanges and securities pricing services. International stocks are then adjusted to reflect the current exchange rate of the underlying currency. Investments, for which no national exchanges or pricing services exist, such as private equity assets, are valued at fair value by the investment partnership based on the valuation methodology outlined in the partnership agreement. Real estate may be valued by the manager or independent appraisers. Commingled assets that are not traded on a national exchange are valued by the commingled manager. The System performs due diligence reviews of the investment pricing, process, and infrastructure of private equity, commingled, and real estate investments to assure that the asset values provided by the managers are available.

Net appreciation (depreciation) is determined by calculating the change in the fair value of investments between the beginning of the year and the end of the year, less purchases of investments at cost, plus sales of investments at fair value. Investment expenses consist of external expenses directly related to the System’s investment operations, as well as the internal administrative expenses associated with the System’s investment program.

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.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

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 $717,334 and $686,312 for the years ended June 30, 2017 and 2016, respectively.

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, 2017 and 2016.

Pensions

For purposes of measuring the net pension liability, deferred inflows of resources and deferred outflows of resources related to pensions, pension expense, information about the fiduciary net position of the County Employees Retirement System ("CERS"), and additions to/deductions from fiduciary net position have been determined on the same basis as they are reported by the pensions. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

Deferred Outflows/Inflows of Resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (expense/expenditure) until then. The Utility has one item that qualifies for reporting in this category. The deferred outflows or resources relates to the net pension liability described in Note 10.

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (revenue) until that time. The Utility has one item that qualifies for reporting in this category. The deferred inflows of resources relate to the net pension liability as described in Note 10.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

Revenues and Expenses

Proprietary funds distinguish 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.

Subsequent Events

Subsequent events have been evaluated through October 27, 2017, which is the date the financial statements were available to be issued.

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017 AND 2016

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, 2016	Additions	Reclassifications/ Retirements	Balance June 30, 2017
Utility plant not depreciated:				
Land	$ 283,389	$ -	$ -	$ 283,389
Construction in progress - electric	1,785,614	3,563,719	4,347,629	1,001,704
Construction in progress - telecommunications	216,015	798,397	832,681	181,731
Total utility plant not depreciated	2,285,018	4,362,116	5,180,310	1,466,824
Utility plant depreciated:				
Transmission plant	706,656	33,995	9,784	730,867
Distribution plant	27,843,898	1,444,304	336,302	28,951,900
General plant	5,819,875	8,954,793	122,624	14,652,044
Telecommunications plant	16,172,133	835,481	7,901,330	9,106,284
Total utility plant depreciated	50,542,562	11,268,573	8,370,040	53,441,095
Accumulated depreciation	(20,478,954)	(5,252,440)	3,823,086	(21,908,308)
Total utility plant depreciated, net	30,063,608	6,016,133	4,546,954	31,532,787
Total utility plant	$ 32,348,626	$ 10,378,249	$ 9,727,264	$ 32,999,611

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

The increase in general plant as well as the decrease in telecommunications plant are a result of a departmental asset reclassification to satisfy TVA separation of cash initiative.

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	2.00%
Poles, towers, and fixtures	4.00
Overhead conductors and devices	1.75
Underground equipment	4.00
Line transformers	2.00
Services	5.00
Meters	5.00
Security lighting	6.00
Street lighting and signal systems	4.00

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, 2017 and 2016 are summarized as follows:

	2017	2016
Accumulated provision for depreciation, July 1	$ 20,478,954	$ 19,731,715
Add:		
Depreciation charged directly to expense	2,008,705	2,062,051
Depreciation charged to transportation - clearing	135,685	106,181
Other additions	3,108,050	-
Subtotal	25,731,394	21,899,947
Deduct:		
Original cost of plant retired	489,861	1,227,783
Cost of removal less salvage	236,603	193,210
Other subtractions	3,096,622	-
Total charges against provision	3,823,086	1,420,993
Accumulated provision for depreciation, June 30	$ 21,908,308	$ 20,478,954

NOTE 3 – RESTRICTED ASSETS

Restricted assets at June 30 consisted of:

	2017	2016
2007 Telecom bond issue fund	$ 4	$ 4
Money market portfolio	-	270,799
Total investments	$ 4	$ 270,803

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 $4, all of which was covered by collateral held in safekeeping by agents of the respective banks or by government backed securities.

Fair Value Measurement

The System measures and records its investments using fair value measurement guidelines established by generally accepted accounting principles. These guidelines recognized a three tiered fair value hierarchy, as follows:

Level 1 – Quoted prices for identical investments in active markets;
Level 2 – Observable inputs other than quoted market prices; and,
Level 3 – Unobservable inputs.

At June 30, 2017, the System had $0 recurring fair value measurements. At June 30, 2016, the System had the following recurring fair value measurements.

	Fair Value Measurements Using		
	Level 1	Level 2	Level 3
Goldman Sachs Financial Square Treasury Instrument 524	$ 270,799	$ -	$ -
Total investment measured at fair value	$ 270,799	$ -	$ -

Debt and equity securities in Level 1 are valued using prices quoted in active markets for those securities.

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. The System's investments are in a money market fund portfolio comprised of short-term securities representing high-quality, liquid debt, limiting the System's exposure to interest rate risk.

NOTE 3 – RESTRICTED ASSETS, continued

Custodial Credit Risk for Investments: 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

Credit Risk for Investments: Credit risk for investments is the risk that an issuer or other counter-party to an investment will not fulfill its obligations. The System does not have an investment policy for credit risk but follows the investment policy statutes of the State of Kentucky. The money market instrument investments of the System have high quality credit ratings of AAAm (Moody’s Investor Service) and Aaa-mf (Standard and Poor’s), which minimize the System’s credit risk.

Concentration of Credit Risk: The System places no limit on the amount the System may invest in any one issuer. Investments issued by or explicitly guaranteed by the U. S. Government and investments in mutual funds, external investment pools and other pooled investments are exempt from concentration of credit risk disclosures. As of June 30, 2017 and 2016, the System held $0 and $279,799 in a high quality money market portfolio that comprises U. S. securities only.

NOTE 4 – CASH - GENERAL FUNDS

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

	2017	2016
Change funds	$ 1,750	$ 1,750
Checking accounts	2,353,374	3,757,998
TVA power bill early payment	18	18
Other	13,820	1,250
Total	$ 2,368,962	$ 3,761,016

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.

NOTE 4 – CASH - GENERAL FUNDS, continued

At June 30, 2017, the Board's deposits in depository institutions had a carrying amount of $2,368,962 and bank balances of $2,827,010. At June 30, 2017, the deposits were covered entirely by FDIC insurance or a properly executed collateral security agreement. At June 30, 2016, the System's deposits in depository institutions had a carrying amount of $3,761,016 and bank balances of $3,823,111. At June 30, 2016, 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:

	2017	2016
Accounts Receivable		
Electric	$ 2,793,288	$ 2,824,578
	2,793,288	2,824,578
Other Receivables		
Other miscellaneous	68,839	136,802
	68,839	136,802
Total receivables	2,862,127	2,961,380
Less: Reserve for uncollectible accounts	(22,431)	(22,860)
Total	$ 2,839,696	$ 2,938,520

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, 2017		June 30, 2016	
	Amount	Percent	Amount	Percent
Accounts having discount Dates after June 30	$ 2,595,875	90.70	$ 2,798,869	94.51
Accounts with credit balances	-	-	-	-
Accounts less than one month past due	-	-	-	-
Accounts 31 to 60 days past due	58,313	2.04	89,531	3.02
Accounts 61 to 90 days past due	16,029	0.56	20,060	0.68
Accounts over 90 days past due	191,910	6.70	52,920	1.79
	$ 2,862,127	100.00	$ 2,961,380	100.00

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, 2017. 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:

	2017	2016
Beginning balance	$ 22,860	$ 27,622
Monthly additions and adjustments	36,166	93,059
Charge-off of bad accounts	(36,595)	(103,072)
Recoveries	-	5,251
Balance, June 30	$ 22,431	$ 22,860

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 $6,939 and ($5,304) as of June 30, 2017 and 2016, respectively.

NOTE 7 – DEFERRED CHARGES

Deferred Charges at June 30 consisted of:

	2017	2016
Deferred costs on bond issue-2004	$ 417	$ 672
Deferred costs on bond issue-2007	60,711	70,692
Deferred costs on bond issue - 2013 KLC	33,168	38,206
Total	$ 94,296	$ 109,570

NOTE 8 – BONDED INDEBTEDNESS

Issue Date	Original Proceeds	Interest Rates	Maturity Date	Balance at June 30, 2017
Series 2004	$ 3,553,065	3.45%	2/15/2019	$ 499,631
Series 2007	10,189,500	0.70%	6/1/2023	5,046,839
Series 2013	3,000,000	3.62%	8/1/2023	1,825,095
Series 2013A	1,055,000	2.00%	1/1/2024	633,333

All bonded debt is secured by revenues or property of the System.

The changes in outstanding debt are as follows:

	Balance July 1, 2016	New Issues	Debt Payments and Refunds	Balance June 30, 2017
KY League of Cities-Series 2004	$ 786,244	$ -	$ 286,613	$ 499,631
KY League of Cities - Series 2007	5,739,266	-	692,427	5,046,839
KY Infrastructure Authority - Series 2013	2,121,907	-	296,812	1,825,095
Revenue Bond - Series 2013A	733,333	-	100,000	633,333
	$ 9,380,750	$ -	$ 1,375,852	8,004,898
Less: Unamortized discount				(21,303)
Net total				$ 7,983,595

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:

	2017	2016
Series 2004	$ 3,120	$ 3,120
Series 2007	2,666	2,666
	$ 5,786	$ 5,786

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:

	2017	2016
Series 2004	$ 256	$ 256
Series 2007	9,980	9,980
Series 2013	5,038	5,038
	$ 15,274	$ 15,274

NOTE 8 – BONDED INDEBTEDNESS, continued

The following represents principal and interest payments on outstanding debt.

	Series 2004 Principal	Series 2004 Interest	Series 2004 Total	Series 2007 Principal	Series 2007 Interest	Series 2007 Total
2018	$ 296,955	$ 19,247	$ 316,202	$ 724,559	$ 217,300	$ 941,859
2019	202,676	5,716	208,392	758,608	183,789	942,397
2020	-	-	-	793,985	148,760	942,745
2021	-	-	-	831,673	112,042	943,715
2022-2024	-	-	-	1,938,014	108,486	2,046,500
	$ 499,631	$ 24,963	$ 524,594	$ 5,046,839	$ 770,377	$ 5,817,216

	KIA 2013 Principal	KIA 2013 Interest	KIA 2013 Total	Series 2013A Principal	Series 2013A Interest	Series 2013A Total
2018	$ 298,894	$ 12,254	$ 311,148	$ 102,084	$ 14,702	$ 116,786
2019	300,990	10,158	311,148	105,000	12,660	117,660
2020	303,100	8,047	311,147	107,084	10,473	117,557
2021	305,225	5,922	311,147	110,000	7,975	117,975
2022-2024	616,886	5,407	622,293	209,165	8,092	217,257
	$ 1,825,095	$ 41,788	$ 1,866,883	$ 633,333	$ 53,902	$ 687,235

	All Series Combined Principal	All Series Combined Interest	All Series Combined Total
2018	$ 1,422,492	$ 263,503	$ 1,685,995
2019	1,367,274	212,323	1,579,597
2020	1,204,169	167,280	1,371,449
2021	1,246,898	125,939	1,372,837
2022-2024	2,764,065	121,985	2,886,050
	$ 8,004,898	$ 891,030	$ 8,895,928

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 $768,202 and $871,910 as of June 30, 2017 and 2016, respectively.

NOTE 10 – PENSION PLANS

The System's employees are provided a pension plan through the County Employees Retirement System.

General information about the County Employees Retirement System Non-Hazardous ("CERS")

Plan description – CERS is a cost-sharing multiple-employer defined benefit pension plan administered by the Kentucky Retirement System, an agency of the Commonwealth of Kentucky. Under the provisions of the Kentucky Revised Statute ("KRS") Section 61.645, the Board of Trustees of the Kentucky Retirement System administers CERS and has the authority to establish and amend benefit provisions. The Kentucky Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for CERS. That report may be obtained from http://kyret.ky.gov/.

Benefits provided – CERS provides retirement, health insurance, death and disability benefits to Plan employees and beneficiaries. Employees are vested in the plan after five years' service. For retirement purposes, employees are grouped into three tiers, based on hire date:

Tier 1	Participation date	Before September 1, 2008
	Unreduced retirement	27 years service or 65 years old
	Reduced retirement	At least 5 years service and 55 years old
		At least 25 years service and any age
Tier 2	Participation date	September 1, 2008 – December 31, 2013
	Unreduced retirement	At least 5 years service and 65 years old
		Or age 57+ and sum of service years plus age equal 87
	Reduced retirement	At least 10 years service and 60 years old
Tier 3	Participation date	After December 31, 2013
	Unreduced retirement	At least 5 years service and 65 years old
		Or age 57+ and sum of service years plus age equal 87
	Reduced retirement	Not available

NOTE 10 – PENSION PLANS, continued

Cost of living adjustments are provided at the discretion of the General Assembly. Retirement is based on a factor of the number of years' service and hire date multiplied by the average of the highest five years' earnings. Reduced benefits are based on factors of both of these components. Participating employees become eligible to receive the health insurance benefit after at least 180 months of service. Death benefits are provided for both death after retirement and death prior to retirement. Death benefits after retirement are $5,000 in lump sum. Five years' service is required for death benefits prior to retirement and the employee must have suffered a duty-related death. The decedent's beneficiary will receive the higher of the normal death benefit and $10,000 plus 25% of the decedent's monthly final rate of pay and any dependent child will receive 10% of the decedent's monthly final rate of pay up to 40% for all dependent children. Five years' service is required for nonservice-related disability benefits.

Contributions – Required contributions by the employee are based on the tier:

	Required contributions
Tier 1	5%
Tier 2	5% + 1% for insurance
Tier 3	5% + 1% for insurance

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

At June 30, 2017 and 2016, the System reported a liability for its proportionate share of the net pension liability for CERS. The amount recognized by the Utility as its proportionate share of the net pension liability and the total portion of the net pension liability that was associated with the Utility were as follows:

The System's proportionate share of the CERS net pension liability:

2017	2016
$ 6,371,513	$ 5,603,152

The net pension liability of the plan was measured as of June 30, 2016 and 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date.

The System's proportion of the net pension liability for CERS was based on the actual liability of the employees and former employees relative to the total liability of the System as determined by the actuary. At June 30, 2017 and 2016, the Utility's proportion was .12941% and .13032%, respectively.

For the year ended June 30, 2017 and 2016, the System recognized pension expense of $890,018 and $660,611, respectively, related to CERS.

NOTE 10 – PENSION PLANS, continued

At June 30, 2017 and 2016, the System reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	2017		2016	
	Deferred Outflows of Resources	Deferred Inflows of Resources	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ 50,191	$ -	$ 37,251	$ -
Changes in assumptions	609,035	-	452,014	-
Net difference between projected and actual earnings on pension plan investments	509,326	184,400	40,182	276,600
Changes in proportion and differences between HES contributions and proportionate share of contributions	82,162	-	60,666	-
HES contributions subsequent to the measurement date	632,342	-	526,645	-
Total	$ 1,883,056	$ 184,400	$ 1,116,758	$ 276,600

The amount of $632,342 reported as deferred outflows of resources related to pensions resulting from System contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2018. Other amounts reported as deferred outflows of resources and deferred inflows related to pensions will be recognized in pension expense as follows:

Year 1	$ 257,362
Year 2	257,361
Year 3	349,558
Year 4	202,033
Year 5	-
Thereafter	-

NOTE 10 – PENSION PLANS, continued

Actuarial assumptions – The total pension liability in the June 30, 2016 and 2015 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

	Measurement Period	
	2016	2015
Inflation	3.25%	3.25%
Projected salary increases, average, including inflation	4.00%	4.00%
Investment rate of return, net of plan investment expense, including inflation	7.50%	7.50%

For the June 30, 2016 actuarial valuation, the mortality table used for active members is RP-2000 Combined Mortality Table projected with Scale BB to 2013 (multiplied by 50% for males and 30% for females). For healthy retired members and beneficiaries, the mortality table used is the RP-2000 Combined Mortality Table projected with Scale BB to 2013 (set back 1 year for females). For disabled members, the RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (set back 4 years for males) is used for the period after disability retirement. There is some margin in the current mortality tables for possible future improvement in mortality rates and that margin will be reviewed again when the next experience investigation is conducted.

The actuarial assumption used in the June 30, 2015 valuation were based on the results of an actuarial experience study for the period July 1, 2008 – June 30, 2013.

Long term rate of return - The long-term expected return on plan assets is reviewed as part of the regular experience studies prepared every five years. The most recent analysis, performed for the period covering fiscal years 2008 through 2013, is outlined in a report dated April 30, 2014. Several factors are considered in evaluating the long-term rate of return assumption including long-term historical data, estimates inherent in current market data, and a log-normal distribution analysis in which best-estimate ranges of expected future real rates of return (expected return, net of investment expense and inflation) were developed by the investment consultant for each major asset class. These ranges were combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and then adding expected inflation. The capital market assumptions developed by the investment consultant are intended for use over a 10-year horizon and may not be useful in setting the long-term rate of return for funding pension plans which covers a longer timeframe.

The target asset allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

NOTE 10 – PENSION PLANS, continued

Measurement Period 2016 Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Combined equity	44%	5.40%
Combined fixed income	19%	1.50%
Real return (diversified inflation strategies)	10%	3.50%
Real estate	5%	4.50%
Absolute return (diversified hedge funds)	10%	4.25%
Private equity	10%	8.50%
Cash equivalent	2%	(0.25%)
Total	100%	

Measurement Period 2015 Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Combined equity	44%	5.40%
Combined fixed income	19%	1.50%
Real return (diversified inflation strategies)	10%	3.50%
Real estate	5%	4.50%
Absolute return (diversified hedge funds)	10%	4.25%
Private equity	10%	8.50%
Cash equivalent	2%	(0.25%)
Total	100%	

NOTE 10 – PENSION PLANS, continued

Discount rate – The discount rate used to measure the total pension liability for the measurement periods with years ended June 30, 2016 and 2015 was 7.50% and 7.50%, respectively. The projection of cash flows used to determine the discount rate assumed that local employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 27 year amortization period of the unfunded actuarial accrued liability. The actuarial determined contribution rate is adjusted to reflect the phase in of anticipated gains on actuarial value of assets over the first four years of the projection period. The discount rate determination does not use a municipal bond rate. Projected future benefit payments for all current plan employees were projected through 2117. Projected inflows from investment earnings were calculated using the long-term assumed investment return for the years ended June 30, 2016 and 2015 of 7.50% and 7.50%. The long-term investment rate of return was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of CERS proportionate share of net pension liability to changes in the discount rate – The following table presents the Board's proportionate share of the net pension liability, calculated using the discount rates selected by the pension system, as well as what the Board's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower or 1-percentage-point higher than the current rate.

	1% Decrease	Current Discount Rate	1% Increase
2017	6.50%	7.50%	8.50%
HES's proportionate share of net pension liability	$ 7,940,114	$ 6,371,513	$ 5,027,173
2016	6.50%	7.50%	8.50%
HES's proportionate share of net pension liability	$ 7,153,106	$ 5,603,152	$ 4,275,734

Pension plan fiduciary net position – Detailed information about the pension plan's fiduciary net position is available in the separately issued financial reports of CERS.

<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 $107,917 and $98,684 in the years ended June 30, 2017 and 2016, respectively, are charged monthly to plant and expense in the same ratio as payroll.

NOTE 11 – POST-EMPLOYMENT HEALTH CARE BENEFITS

Retired Board employees receive some health care benefits depending on their length of service. In accordance with Kentucky Revised Statutes, these benefits are provided and advanced-funded on an actuarially determined basis through the CERS plan.

NOTE 12 – OTHER CURRENT AND ACCRUED LIABILITIES

Following is a summary of the amounts recorded as other current and accrued liabilities as of June 30, 2017 and 2016:

	2017	2016
Accrued pole rentals	$ 27,444	$ 34,280
Accrued payroll	34,020	131,515
Compensated absences	717,334	686,312
	$ 778,798	$ 852,107

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 – RATE INCREASE

Wholesale Base Rates: In October 2015, the Tennessee Valley Authority changed its wholesale rate calculation from one based on Demand and Energy metered at the wholesale delivery point to a Modified Time of Use (MTOU) wholesale rate calculation. The implementation of MTOU along with mild weather patterns and energy conservation initiatives has caused a slight increase in cost of purchased power to energy in fiscal year 2017. The cost of purchased power to energy in fiscal year 2017 was 78.3% and 77.9% in fiscal year 2016. TVA has increased their wholesale rates by 1.5% each October since October 2013. Another 1.5% wholesale increase will be effective in October 2017.

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 MTOU rate structure. The charge was to expire September 2013 but was extended indefinitely.

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 with corresponding decreases in energy charges effective October 2013 - October 2016. The system implemented a customer service charge increase with a corresponding 1.5% local rate increase in energy offset by the fixed cost adjustment effective October 2017.

NOTE 15 – COMMITMENTS

TVA

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 15 – COMMITMENTS, continued

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").

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 is on the Project Committee. The Superintendent/General Manager of the Participant also appoints one other member to the 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 to be amortized over 20 years with no interest. During fiscal year ending June 30, 2015, $135,404 was received. The additional $135,405 is not deemed receivable within the 2017 fiscal year. Amortization expense for the current and prior fiscal year was $6,770 per year on the $135,404 which has been received.

NOTE 15 – COMMITMENTS, continued

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 $43,478 and $43,655 for administrative and operating costs during fiscal years ended June 30, 2017 and 2016.

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

	2017	2016
Initial investment	$ 5,000	$ 5,000
Project 2 Investment in Muninet		
Beginning balance July 1	191,063	142,408
Program revenue		
Costs incurred	43,478	43,655
Less MuniNet reimbursements	-	-
	234,541	186,063
Ending balance June 30	$ 239,541	$ 191,063

NOTE 16 – UPCOMING PRONOUNCEMENTS

In June 2015, the GASB issued Statement No. 75, *Accounting and Reporting for Postemployment Other Than Pensions*. The provisions of this statement are effective for fiscal years beginning after June 15,2017. This statement establishes new accounting and financial reporting requirements of OPEB plans provided to employees of state and local governments. This statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expenses. For defined benefit OPEB, this Statement identifies the methods and assumptions required to project benefit payments, discount projected benefit payments to actuarial present value, and attribute present value to periods of employee service. Note disclosure and required supplementary information requirements of defined benefit OPEB also are addressed. The Board is currently evaluating the impact that will have on the financial statements when adopted.

In March 2016, the GASB issued GASB Statement No. 82 *Pension Issues – An Amendment of GASB Statements No. 67, 68 and 73*. The objective of the statement is to address certain issues that have been raised with respect to Statements No. 67, *Financial Reporting for Pension Plans*, No. 68, *Accounting and Financial Reporting for Pensions*, and No. 73, *Accounting and Financial Reporting for Pensions and Related Assets that are not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. Specifically, this Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The Board is currently evaluation the impact this standard will have on the financial statements when adopted. GASB 82 is effective for fiscal years beginning after June 15, 2017.

REQUIRED SUPPLEMENTARY INFORMATION

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
SCHEDULE OF PROPORTIONATE SHARE OF NET PENSION LIABILITY
County Employees Retirement System

	Year Ended June 30, 2017	Year Ended June 30, 2016	Year Ended June 30, 2015
Utility's proportion of the net pension liability (asset)	0.129410%	0.13032%	0.12738%
Utility's proportion share of the net pension liability (asset)	$ 6,371,513	$ 5,603,152	$ 4,224,200
State's proportionate share of the net pension liability (asset) associated with HES	-	-	-
Total	$ 6,371,513	$ 5,603,152	$ 4,224,200
Utility's covered-employee payroll	$ 3,315,229	$ 3,116,860	$ 2,989,520
Utility's proportionate share of the net pension liability (asset) as a percentage of its covered-employee payroll	192.19%	179.77%	141.30%
Plan fiduciary net position as a percentage of the total pension liability	55.50%	59.97%	66.80%

Note: GASB 68 was implemented in fiscal year 2015. This schedule is being built prospectively. Ultimately, 10 years of data will be presented.

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
SCHEDULE OF EMPLOYER CONTRIBUTIONS TO PENSION PLAN
County Employees Retirement System

	Year Ended June 30, 2017	Year Ended June 30, 2016	Year Ended June 30, 2015
Contractually required contribution	$ 632,342	$ 526,645	$ 528,249
Contributions in relation to the contractually required contribution	632,342	526,645	528,249
Contribution deficiency (excess)	$ -	$ -	$ -
Utility's covered employee payroll	$ 3,315,229	$ 3,116,860	$ 2,989,520
Contributions as a percentage of covered employee payroll	19.07%	17.06%	17.67%

Note: GASB 68 was implemented in fiscal year 2015. This schedule is being built prospectively. Ultimately, 10 years of data will be presented.

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION – PENSION PLAN
JUNE 30, 2017 AND 2016

<u>Changes of benefit terms</u>

The following changes were made by the Kentucky Legislature and reflected in the valuation performed as of June 30 listed below:

2009: A new benefit tier for members who first participate on or after September 1, 2008 was introduced which included the following changes:

- Tiered Structure for benefit accrual rates
- New retirement eligibility requirements
- Different rules for the computation of final average compensation

2014: A cash balance plan was introduced for member whose participation date is on or after January 1, 2014

<u>Changes of assumption</u>

The following changes were made by the Kentucky Legislature and reflected in the valuation performed as of June 30 listed below:

2015

- 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 mortality table used for active members is RP-2000 Combined Mortality Table projected with Scale BB to 2013 (multiplied by 50% for males and 30% for females).
- For healthy retired members and beneficiaries, the mortality table used is the RP-2000 Combined Mortality Table projected with Scale BB to 2013 (set back 1 year for females). For disabled members, the RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (set back 4 years for males) is used for the period after disability retirement. There is some margin in the current mortality tables for possible future improvement in mortality rates and that margin will be reviewed again when the next experience investigation is conducted.
- The assumed rates of Retirement, Withdrawal and Disability were updated to more accurately reflect experience.

Method and assumptions used in calculations of actuarially determined contributions. The actuarially determined contribution rates are determined on an annual basis beginning with the fiscal year ending 2018, determined as of July 1, 2016. The amortization period of the unfunded liability has been reset as of July 1, 2013 to a closed 30-year period. The following actuarial methods and assumptions were used to determine contribution rates reported in that schedule:

Actuarial cost method	Entry age
Amortization method	Level of percentage of payroll, closed
Remaining amortization period	27 years
Asset valuation method	5-year smoothed market
Inflation	3.25 percent
Salary increase	4.00, average including inflation
Investment rate of return	7.50 percent, net of pension plan investment expense, Including inflation

ADDITIONAL 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, 2017

	ELECTRIC	TELECOM	TOTAL
OPERATING REVENUES	$ 36,151,159	$ 3,496,385	$ 39,647,544
OPERATING EXPENSES			
Cost of power	27,651,948	-	27,651,948
Cost of sales - telecom	-	260,543	260,543
Distribution - operation	1,220,096	1,297,654	2,517,750
- maintenance	1,127,301	33,947	1,161,248
Transmission - maintenance	2,325	-	2,325
Customer accounts	870,436	116,677	987,113
Sales	116,023	41,190	157,213
Administrative and general	1,683,992	634,382	2,318,374
Depreciation and amortization	1,606,032	474,195	2,080,227
Taxes	1,369,594	56,906	1,426,500
Total operating expenses	35,647,747	2,915,494	38,563,241
Net operating revenues	503,412	580,891	1,084,303
NONOPERATING REVENUES (EXPENSES)			
Interest on long-term debt	(225,042)	(95,838)	(320,880)
Other interest	(45,427)	-	(45,427)
Amortization of debt expense	(11,581)	(3,693)	(15,274)
Interest income	4,435	-	4,435
Other income (expenses)	9,439	-	9,439
Total nonoperating revenues (expenses)	(268,176)	(99,531)	(367,707)
CHANGE IN NET POSITION	235,236	481,360	716,596
NET POSITION, BEGINNING OF YEAR	20,981,086	(1,087,513)	19,893,573
NET POSITION, END OF YEAR	$ 21,216,322	$ (606,153)	$ 20,610,169

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
COMPARATIVE SCHEDULE OF REVENUES AND EXPENSES - ELECTRIC
FOR THE YEARS ENDED JUNE 30, 2017 AND 2016

	ELECTRIC 2017	ELECTRIC 2016	VARIANCE FAVORABLE (UNFAVORABLE)
OPERATING REVENUES	$ 36,151,159	$ 34,100,550	$ 2,050,609
OPERATING EXPENSES			
Cost of power	27,651,948	26,046,019	(1,605,929)
Distribution - operation	1,220,096	1,427,133	207,037
- maintenance	1,127,301	958,365	(168,936)
Transmission - maintenance	2,325	239	(2,086)
Customer accounts	870,436	743,876	(126,560)
Sales	116,023	110,116	(5,907)
Administrative and general	1,683,992	2,223,843	539,851
Depreciation	1,606,032	1,105,496	(500,536)
Taxes	1,369,594	1,243,504	(126,090)
Total operating expenses	35,647,747	33,858,591	(1,789,156)
Net operating revenues	503,412	241,959	261,453
NONOPERATING REVENUES (EXPENSES)			
Interest on long-term debt	(225,042)	(263,921)	38,879
Other interest	(45,427)	(4,389)	(41,038)
Amortization of debt expense	(11,581)	(11,581)	-
Interest income	4,435	3,530	905
Other revenues (expenses)	9,439	5	9,434
Total nonoperating revenues (expenses)	(268,176)	(276,356)	8,180
CHANGE IN NET POSITION	$ 235,236	$ (34,397)	$ 269,633

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
COMPARATIVE STATEMENT OF REVENUES AND EXPENSES - TELECOMMUNICATIONS
FOR THE YEARS ENDED JUNE 30, 2017 AND 2016

	TELECOM 2017	TELECOM 2016	VARIANCE FAVORABLE (UNFAVORABLE)
OPERATING REVENUES	$ 3,496,385	$ 3,530,598	$ (34,213)
OPERATING EXPENSES			
Cost of sales - telecom	260,543	245,131	(15,412)
Distribution - operation	1,297,654	910,423	(387,231)
- maintenance	33,947	26,770	(7,177)
Customer accounts	116,677	63,338	(53,339)
Sales	41,190	45,749	4,559
Administrative and general	634,382	778,380	143,998
Depreciation and amortization	474,195	1,028,076	553,881
Taxes	56,906	50,340	(6,566)
Total operating expenses	2,915,494	3,148,207	232,713
Net operating revenues	580,891	382,391	198,500
NONOPERATING REVENUES (EXPENSES)			
Interest on long-term debt	(95,838)	(105,015)	9,177
Amortization of debt expense	(3,693)	(3,693)	-
Total nonoperating revenues (expenses)	(99,531)	(108,708)	9,177
CHANGE IN NET POSITION	$ 481,360	$ 273,683	$ 207,677

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

	For the Year Ended June 30, 2017		For the Year Ended June 30, 2016		Increase
	Amount	Percent	Amount	Percent	(Decrease)
Distribution					
Supervision & engineering	$ 102,902	0.28 %	$ 104,271	0.31 %	$ (1,369)
Station expense	122,179	0.34	129,948	0.38	(7,769)
Overhead lines expense	287,992	0.80	272,961	0.80	15,031
Underground line expense	630	0.00	94	0.00	536
Street light & signal system expense	31,087	0.09	29,982	0.09	1,105
Meter expense	39,866	0.11	46,544	0.14	(6,678)
Customer installation expense	53,960	0.15	47,228	0.14	6,732
Miscellaneous distribution expense	36,743	0.10	34,146	0.10	2,597
Rents	544,737	1.51	761,959	2.23	(217,222)
Total distribution	$ 1,220,096	3.38 %	$ 1,427,133	4.19 %	$ (207,037)
Maintenance expense					
Distribution:					
Supervision & engineering	$ 22,789	0.06 %	$ 21,862	0.06 %	$ 927
Substations	41,909	0.12	20,561	0.06	21,348
Overhead lines	972,279	2.69	851,816	2.50	120,463
Underground services	5,565	0.02	5,666	0.02	(101)
Transformers	58,304	0.16	35,675	0.10	22,629
Street light & signal system	26,253	0.07	22,785	0.07	3,468
Total distribution maintenance	$ 1,127,301	3.12 %	$ 958,365	2.81 %	$ 168,936
Transmission:					
Maintenance of overhead lines	$ 2,325	0.00 %	$ 239	0.00 %	$ 2,086
Total transmission maintenance	$ 2,325	0.00 %	$ 239	0.00 %	$ 2,086
Customer accounts					
Supervision	$ 67	0.00 %	$ 67	0.00 %	$ -
Meter reading	159,028	0.44	100,608	0.30	58,420
Customer records & collection expense	571,658	1.58	451,796	1.32	119,862
Uncollectible accounts	32,631	0.09	91,228	0.27	(58,597)
Miscellaneous customer accounting	3,401	0.01	3,278	0.01	123
Customer assistance expense	53,698	0.15	48,132	0.14	5,566
Information & instructional advertising	49,953	0.14	48,767	0.14	1,186
Total customer accounts	$ 870,436	2.41 %	$ 743,876	2.18 %	$ 126,560

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

	For the Year Ended June 30, 2017		For the Year Ended June 30, 2016		Increase
	Amount	Percent	Amount	Percent	(Decrease)
Sales expense					
Demonstrating and selling expense	$ 90,035	0.25 %	$ 86,504	0.20 %	$ 3,531
Advertising expense	25,138	0.07	22,793	0.05	2,345
Miscellaneous	850	0.00	819	0.00	31
Total sales	$ 116,023	0.32 %	$ 110,116	0.25 %	$ 5,907
Administrative and general					
Administrative & office salaries	$ 442,767	1.22 %	$ 378,918	1.11 %	$ 63,849
Office supplies & expense	146,630	0.41	141,808	0.42	4,822
Outside services employed	120,035	0.33	136,469	0.40	(16,434)
Property insurance	100,070	0.28	117,579	0.34	(17,509)
Injuries & damages	56,320	0.16	57,800	0.17	(1,480)
Employees pension & other benefits	726,563	2.01	1,237,717	3.63	(511,154)
Duplicate charges (credit)	(128,180)	(0.35)	(127,242)	(0.37)	(938)
Miscellaneous general expense	64,406	0.18	65,241	0.19	(835)
Maintenance	155,381	0.43	215,553	0.63	(60,172)
Total administrative and general	$ 1,683,992	4.67 %	$ 2,223,843	6.52 %	$ (539,851)

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

	For the Year Ended June 30, 2017		For the Year Ended June 30, 2016		Increase
	Amount	Percent	Amount	Percent	(Decrease)
Distribution					
Supervision & engineering	$ 125,471	3.59 %	$ 114,647	3.25 %	$ 10,823
Hub expenses	41,959	1.20	31,229	0.88	10,730
Overhead cable expense	657,533	18.81	442,025	12.52	215,508
Meter expense	-	0.00	418	0.01	(417)
Customer installation expense	248,665	7.11	220,819	6.25	27,846
Miscellaneous distribution expense	4,170	0.12	2,830	3.08	1,340
Rents	219,856	6.29	98,455	2.79	121,401
Total distribution	$ 1,297,654	37.12 %	$ 910,423	28.78 %	$ 387,231
Maintenance expense					
Distribution:					
Supervision & engineering	$ 13,522	0.39 %	$ 13,747	0.39 %	$ (225)
Hub expenses	10,297	0.29	4,155	0.12	6,142
General maintenance	9,778	0.28	7,454	0.21	2,324
Maintenance underground services	350	0.01	1,414	0.04	(1,064)
Total distribution maintenance	$ 33,947	0.97 %	$ 26,770	0.76 %	$ 7,177
Customer accounts					
Billing expense	$ 33,819	0.97 %	$ 8,251	0.23 %	$ 25,568
Customer records & collection expense	45,403	1.30	14,215	0.40	31,188
Uncollectible accounts	27,294	0.78	29,333	0.83	(2,039)
Customer assistance expense	10,161	0.29	11,539	0.33	(1,378)
Total customer accounts	$ 116,677	3.34 %	$ 63,338	1.79 %	$ 53,339

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

	For the Year Ended June 30, 2017			For the Year Ended June 30, 2016			
	Amount	Percent		Amount	Percent		Increase (Decrease)
Sales expense							
Demonstrating and selling expense	$ 22,409	0.64	%	$ 23,169	0.66	%	$ (760)
Advertising expense	18,781	0.54		22,580	0.64		(3,799)
Total sales	$ 41,190	1.18	%	$ 45,749	1.30	%	$ (4,559)
Administrative and general							
Administrative & office salaries	$ 112,504	3.22	%	$ 99,975	2.83	%	$ 12,529
Office supplies & expense	33,682	0.96		40,215	1.14		(6,533)
Meeting expenses	10,277	0.29		18,338	0.52		(8,061)
Outside services employed	28,961	0.83		29,896	0.85		(935)
Property insurance	17,612	0.50		20,494	0.58		(2,882)
Injuries & damages	29,786	0.85		23,394	0.66		6,392
Employees pension & other benefits	272,627	7.80		433,866	12.29		(161,239)
General advertising	-	0.00		10	0.00		(10)
Miscellaneous general expense	9,536	0.26		7,438	0.21		2,098
Maintenance	119,397	3.41		104,754	2.97		14,643
Total administrative and general	$ 634,382	18.12	%	$ 778,380	22.05	%	$ (143,998)

INTERNAL CONTROL AND COMPLIANCE

YORK, NEEL & ASSOCIATES, LLP
CERTIFIED PUBLIC ACCOUNTANTS

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*

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, 2017 and 2016, 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 October 27, 2017.

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. We did identify a certain deficiency in internal control, described in the accompanying schedule of findings and responses that we consider to be a significant deficiency (item 2017-01).

1113 BETHEL STREET | HOPKINSVILLE, KY 42240 | PHONE: (270) 886-0206 | FAX: (270) 886-0875 | WWW.YORKNEEL.COM

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. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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.

York, Neel & Associates, LLP

York, Neel & Associates LLP

Certified Public Accountants
Hopkinsville, Kentucky

October 27, 2017

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
SUMMARY SCHEDULE OF FINDINGS AND RESPONSES
JUNE 30, 2017

2017-01 Internal Controls

Condition – There was inadequate design of internal controls over the preparation of the financial statements of the System.

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.

Effect – There was an increased risk that controls in place might not prevent, or detect and correct, misstatements in the financial statements.

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

Response – Management outsourced the preparation of their financial statements and the related notes to York, Neel & Associates, LLP. Management maintained responsibility for the financial statements and related notes and for the establishment of controls over the financial reporting process and acknowledged that outsourcing preparation of the financial statements and related notes does not relieve management of the responsibility for the financial statements. Management provided oversight for the financial statement preparation service by designating an individual within senior management who possesses suitable technical skill, knowledge, and experience sufficient to (a) understand the financial statement preparation service enough to be able to provide general direction for the service; (b) understand the key issues the auditors identify; (c) make any required management decisions; and (d) evaluate the adequacy of, and accept responsibility for, the results of the auditors' work.