HOPKINSVILLE ELECTRIC SYSTEM

OF THE

CITY OF HOPKINSVILLE, KENTUCKY

FINANCIAL STATEMENTS

FOR THE YEARS ENDED

JUNE 30, 2018 AND 2017

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY

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CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

The Board of Directors
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, 2018 and 2017, 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, 2018 and 2017, 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.

Emphasis of Matter

As discussed in Note 16 to the financial statements, during the year ended June 30, 2018, the Hopkinsville Electric System of the City of Hopkinsville, Kentucky adopted new accounting guidance, GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits other than Pensions (OPEB)*, which resulted in a restatement of the Board's July 1, 2017 net position in the amount of ($2,192,361). Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and pension and postemployment benefit schedules on pages 4-14 and 52-57 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 58-64 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 26, 2018, 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.

Duguid, Gentry & Associates, PSC

Duguid, Gentry & Associates, PSC

Certified Public Accountants
Hopkinsville, Kentucky

October 26, 2018

MANAGEMENT'S DISCUSSION AND ANALYSIS

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2018

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, 2018. 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 2018 fiscal year by $18,270,845 (*net position*).

- The System's total net position decreased by $2,339,324 during the period. The components of this decrease were a decrease in net position of electric operations of $359,694 and an increase in net position of telecom operations of $212,731 and a restatement of beginning net position for implementation of GASB 75 (see note 16) reducing the beginning balance by $2,192,361.

- Total operating revenues for the 2018 fiscal year decreased by $726,260 or about 1.83% compared to the previous period.

- FY 2018 operating expenses totaled $38,785,921 which was $222,680 or about .58% 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 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.

<u>Financial Analysis of the Fiscal Year Ended June 30, 2018</u>

Over the past year, total assets of the System increased by $6,602,578 while total liabilities increased by $10,068,217. Also, deferred outflows of resources increased by $1,838,705 while deferred inflows of resources increased by $712,390. And for the current period, the net operating loss of the System totaled $146,963. Net operating loss included ($359,694) from Electric and $212,731 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 decreased from the prior year by $2,339,324 or about 11.35% for the period.

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 2017 to FY 2018	
	2018	2017	Amount	Percent
Current and other assets	$ 15,007,279	$ 8,691,850	$ 6,315,429	72.66%
Capital assets	33,286,760	32,999,611	287,149	0.87%
TOTAL ASSETS	48,294,039	41,691,461	6,602,578	15.84%
Deferred outflows	3,721,761	1,883,056	1,838,705	97.64%
Current liabilities	10,033,850	9,079,050	954,800	10.52%
Long-term liabilities	22,814,315	13,700,898	9,113,417	66.52%
TOTAL LIABILITIES	32,848,165	22,779,948	10,068,217	44.20%
Deferred inflows	896,790	184,400	712,390	386.33%
Invested in utility plant, net of related debt	20,719,871	25,016,016	(4,296,145)	-17.17%
Restricted for capital projects	5,766,676	4	5,766,672	144166800.00%
Unrestricted	(8,215,702)	(4,405,851)	(3,809,851)	-86.47%
TOTAL NET POSITION	$ 18,270,845	$ 20,610,169	$ (2,339,324)	-11.35%

Analysis of Net Position

To better understand the System's actual financial positions and its ability to deliver services in future periods, the reader will need to review the various components of the net position category and obtain an understanding of how each relate specifically to the business activities that we perform. For example, the vast majority of net position ($20,719,871 or 113.40% 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 2017 to FY 2018	
	2018	2017	Amount	Percent
Invested in capital assets, net of related debt	$ 20,719,871	$ 25,016,016	$ (4,296,145)	-17.17%
Restricted for capital projects	5,766,676	4	5,766,672	144166800.00%
Unrestricted	(8,215,702)	(4,405,851)	(3,809,851)	-86.47%
	$ 18,270,845	$ 20,610,169	$ (2,339,324)	-11.35%

For the 2018 fiscal year, *Net Position Invested in Capital Assets, Net of Related Debt* decreased by $4,296,145 or 17.17% 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 $3,809,851 or 86.47%.

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

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MANAGEMENT'S DISCUSSION AND ANALYSIS
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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, 2018 and 2017 balances by asset classification are shown in the table below.

TABLE 3
Comparison of Current Assets

	Fiscal Year		Change from FY 2017 to FY 2018	
	2018	2017	Amount	Percent
Cash and cash equivalents	$ 8,400,220	$ 2,368,962	$ 6,031,258	254.59%
Accounts receivable (net)	3,038,534	2,839,696	198,838	7.00%
Unbilled revenue	1,498,468	1,343,925	154,543	11.50%
Inventories	784,497	792,985	(8,488)	-1.07%
Prepaid expenses	97,086	81,245	15,841	19.50%
Other current assets	68,763	152,711	(83,948)	-54.97%
	$ 13,887,568	$ 7,579,524	$ 6,308,044	83.22%

Analysis of Noncurrent Assets

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

TABLE 4
Comparison of Noncurrent Assets

	Fiscal Year		Change from FY 2017 to FY 2018	
	2018	2017	Amount	Percent
Restricted:				
Investments - special funds	$ -	$ 4	$ (4)	-100.00%
Investment in affiliated organization	312,018	239,541	72,477	30.26%
Nonutility property	33,958	33,958	-	0.00%
Deferred charges	113,453	94,296	19,157	20.32%
Heat pump loans	660,282	744,527	(84,245)	-11.32%
Capital assets (net)	33,286,760	32,999,611	287,149	0.87%
	$ 34,406,471	$ 34,111,937	$ 294,534	0.86%

The table above demonstrates the relatively large investment that the System has made in capital assets. At the end of the 2018 fiscal year, capital assets represented about 96.74% of the noncurrent assets.

Analysis of Liabilities

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

TABLE 5
Comparison of Current Liabilities Payable from Unrestricted Net Position

	Fiscal Year		Change From FY 2017 to FY 2018	
	2018	2017	Amount	Percent
Accounts payable - purchased power	$ 4,789,801	$ 4,621,782	$ 168,019	3.64%
Accounts payable - other	426,899	330,397	96,502	29.21%
Line of credit	500,000	-	500,000	100.00%
Customer deposits	1,451,511	1,504,021	(52,510)	-3.49%
Accrued taxes	363,621	308,766	54,855	17.77%
Accrued interest	30,625	4,470	26,155	585.12%
Deferred revenue - MuniNet	101,553	108,324	(6,771)	-6.25%
Other current and accrued liabilities	1,002,566	778,798	223,768	28.73%
	$ 8,666,576	$ 7,656,558	$ 1,010,018	13.19%

Current Liabilities Payable from Unrestricted Assets had a net increase in its various components of $1,010,018 or about 13.19% 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, 2018 was ($146,963).

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

	Fiscal Year Ended June 30		Change From FYE 2017 To FYE 2018	
	2018	2017	Amount	Percent
Operating revenues:				
Electric revenues	$ 35,483,445	$ 36,151,159	$ (667,714)	-1.85%
Telecom revenues	3,437,839	3,496,385	(58,546)	-1.67%
Total operating revenues	38,921,284	39,647,544	(726,260)	-1.83%
Operating expenses:				
Purchased power	26,333,443	27,651,948	(1,318,505)	-4.77%
Other expenses	12,452,478	10,911,293	1,541,185	14.12%
Total operating expenses	38,785,921	38,563,241	222,680	0.58%
Net operating income	135,363	1,084,303	(948,940)	-87.52%
Non-operating income, net	(282,326)	(367,707)	85,381	-23.22%
Change in net position	(146,963)	716,596	(863,559)	-120.51%
Net position, beginning of year	20,610,169	19,893,573	716,596	3.60%
Implementation of GASB 75 (Note 16)	(2,192,361)	-	(2,192,361)	-100.00%
Net position, beginning of year, restated	18,417,808	-	-	100.00%
Net position, end of year	$ 18,270,845	$ 20,610,169	$(2,339,324)	-11.35%

Analysis of Revenue

For the 2018 fiscal year, The *Operating Revenues* of the System totaled $38,921,284. This amount represented a decrease of 1.83% when compared to the previous year's total of $39,647,544.

Included in the *Non-Operating Revenues (Expenses)* of ($282,326) is interest income of $33,514, interest expense of $306,518, amortization expense of $17,843 and other income of $8,521.

Analysis of Expenses

The *Total Operating Expenses* for FY 2018 were $38,785,921. That amount represents an increase of $222,680 or about .58% more than the prior fiscal year total of $38,563,241. The eight major categories of Operating Expenses are shown in the chart below.

**TABLE 7
Comparison of Operating Expenses**

	Fiscal Year Ended June 30		Change from FY 2017 to FY 2018	
	2018	2017	Amount	Percent
Cost of power	$ 26,333,443	$ 27,651,948	$ (1,318,505)	-4.77%
Cost of sales - telecom	326,543	260,543	66,000	25.33%
Distribution:				
Operation	2,060,723	2,517,750	(457,027)	-18.15%
Maintenance	1,264,770	1,161,248	103,522	8.91%
Transmission - maintenance	-	2,325	(2,325)	-100.00%
Customer accounts	1,139,424	987,113	152,311	15.43%
Sales	129,962	157,213	(27,251)	-17.33%
Administrative and general	3,750,375	2,318,374	1,432,001	61.77%
Depreciation	2,279,032	2,080,227	198,805	9.56%
Taxes	1,501,649	1,426,500	75,149	5.27%
	$ 38,785,921	$ 38,563,241	$ 222,680	0.58%

As indicated by the comparative information presented above, *Cost of Power* decreased by $1,318,505 or 4.77% compared to the prior year. This decrease is primarily due to the change in the TVA wholesale rate structure from Demand and Energy to Modified Time of Use (MTOU).

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
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MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2018

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

Hopkinsville Electric System's investment in capital assets as of June 30, 2018 was $33,286,760 (net of accumulated depreciation), as shown in the following table.

TABLE 8
Schedule of Capital Assets (Net of Depreciation)

	Fiscal Year		Increase
	2018	2017	(Decrease)
Land	$ 283,389	$ 283,389	$ -
Construction in progress -			
Electric	1,065,214	1,001,704	63,510
Telecommunications	149,752	181,730	(31,978)
Transmission plant	448,108	468,103	(19,995)
Distribution plant	18,405,463	18,016,269	389,194
General plant	5,990,646	6,534,118	(543,472)
Telecommunications plant	6,944,188	6,514,298	429,890
Total capital assets	$ 33,286,760	$ 32,999,611	$ 287,149

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

Long-term Debt

At June 30, 2018, the System had $12,582,407 long-term debt outstanding, an increase of $4,577,509 or approximately 57.18% more than the previous fiscal year. The System's debt is comprised of various bonds and notes. A comparative schedule at June 30, 2018 and 2017 is shown in the tabular information provided below.

TABLE 9
Schedule of Long Term Debt

	Fiscal Year 2018	Fiscal Year 2017	Increase (Decrease)
Revenue bond - 2013A	$ 531,250	$ 633,333	$ (102,083)
KY League of Cities leases	4,524,956	5,546,470	(1,021,514)
KIA loan	1,526,201	1,825,095	(298,894)
Regions Bank - Bond anticipation	6,000,000	-	6,000,000
	$ 12,582,407	$ 8,004,898	$ 4,577,509

Additional detailed information concerning the System's liabilities can be found in the notes to the financial statements, Note 7.

Economic Factors

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 down 2,674,886.

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

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
STATEMENTS OF NET POSITION
JUNE 30, 2018 AND 2017

ASSETS

	2018	2017
Utility plant	$ 56,701,282	$ 54,907,919
Less accumulated depreciation	23,414,522	21,908,308
Net utility plant	33,286,760	32,999,611
Restricted assets		
Cash	5,766,676	4
Other assets		
Investment in affiliated organizations	312,018	239,541
Nonutility property	33,958	33,958
Heat pump loans	660,282	744,527
	1,006,258	1,018,026
Current assets		
Cash - general funds	2,633,544	2,368,962
Accounts receivable (less accumulated provision for uncollectible accounts of $25,509 in 2018 and $22,431 in 2017)	3,038,534	2,839,696
Unbilled revenue	1,498,468	1,343,925
Inventories (at weighted-average cost)	784,497	792,985
Prepaid expenses	97,086	81,245
Other current assets	68,763	152,711
Total current assets	8,120,892	7,579,524
Deferred charges	113,453	94,296
Total assets	48,294,039	41,691,461
DEFERRED OUTFLOWS OF RESOURCES		
Deferred amounts from pension and other postemployment benefits	3,721,761	1,883,056

See accompanying notes to financial statements

HOPKINSVILLE ELECTRIC SYSTEM
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CITY OF HOPKINSVILLE, KENTUCKY
STATEMENTS OF NET POSITION
JUNE 30, 2018 AND 2017, continued

	2018	**2017**
LIABILITIES		
Current liabilities		
Current maturities of long-term debt	1,367,274	1,422,492
Line of credit	500,000	-
Accounts payable - purchased power	4,789,801	4,621,782
Accounts payable - other	426,899	330,397
Customer deposits	1,451,511	1,504,021
Accrued taxes	363,621	308,766
Accrued interest	30,625	4,470
Unearned revenue - MuniNet	101,553	108,324
Other current & accrued liabilities	1,002,566	778,798
Total current liabilities	10,033,850	9,079,050
Noncurrent liabilities		
Long-term debt	11,199,615	6,561,103
Net pension and other postemployment benefit liabilities	10,933,146	6,371,513
Advances from others:		
Conservation advances - TVA	681,554	768,282
Total noncurrent liabilities	22,814,315	13,700,898
Total liabilities	32,848,165	22,779,948
DEFERRED INFLOWS OF RESOURCES		
Deferred amounts from pension and other postemployment benefits	896,790	184,400
NET POSITION		
Invested in capital assets, net of related debt	20,719,871	25,016,016
Restricted	5,766,676	4
Unrestricted	(8,215,702)	(4,405,851)
Total net position	$ 18,270,845	$ 20,610,169

See accompanying notes to financial statements

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
FOR THE YEARS ENDED JUNE 30, 2018 AND 2017

	2018	2017
OPERATING REVENUES	$ 38,921,284	$ 39,647,544
OPERATING EXPENSES		
Cost of power	26,333,443	27,651,948
Cost of sales - telecommunications	326,543	260,543
Distribution - operation	2,060,723	2,517,750
- maintenance	1,264,770	1,161,248
Transmission - maintenance	-	2,325
Customer accounts	1,139,424	987,113
Sales	129,962	157,213
Administrative and general	3,750,375	2,318,374
Depreciation and amortization	2,279,032	2,080,227
Taxes	1,501,649	1,426,500
Total operating expenses	38,785,921	38,563,241
Net operating revenues	135,363	1,084,303
NONOPERATING REVENUES (EXPENSES)		
Interest on long-term debt	(294,876)	(320,880)
Other interest	(11,642)	(45,427)
Amortization of debt expense	(17,843)	(15,274)
Interest income	33,514	4,435
Other revenue (expenses)	8,521	9,439
Net nonoperating revenues (expenses)	(282,326)	(367,707)
CHANGE IN NET POSITION	(146,963)	716,596
NET POSITION, BEGINNING OF YEAR	20,610,169	19,893,573
Implementation of GASB 75 (Note 16)	(2,192,361)	-
NET POSITION, BEGINNING OF YEAR, restated	18,417,808	-
NET POSITION, END OF YEAR	$ 18,270,845	$ 20,610,169

See accompanying notes to financial statements

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2018 AND 2017

	2018	2017
Cash flows from operating activities		
Receipts from customers and users	$ 38,651,851	$ 39,430,281
Payments to suppliers	(30,453,177)	(32,372,664)
Payments to employees	(2,827,830)	(2,778,762)
Payments of taxes	(1,446,794)	(1,380,435)
Net cash provided (used) by operating activities	3,924,050	2,898,420
Cash flows from capital financing activities		
Expenditures for utility plant	(2,513,496)	(7,342,326)
Net cost of retiring plant	(112,303)	4,546,953
Principal payments on long-term debt	(1,422,491)	(1,375,852)
Conservation advances from TVA	(86,728)	(103,628)
Proceeds from debt issuance	6,000,000	-
Bond issue cost from issuance of debt	(37,000)	-
Proceeds from line of credit	500,000	-
Interest paid	(274,577)	(357,863)
Net cash provided (used) by capital financing activities	2,053,405	(4,632,716)
Cash flows from investing activities		
Conservation loan receivable	84,245	106,047
Investment in affiliated companies	(72,477)	(48,478)
Purchases/maturities of investments	-	270,799
Interest and other revenues	42,035	13,874
Net cash provided (used) by investing activities	53,803	342,242
Net increase (decrease) in cash	6,031,258	(1,392,054)
Cash, beginning of year	2,368,962	3,761,016
Cash, end of year	$ 8,400,220	$ 2,368,962

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, 2018 AND 2017

	2018	2017
Reconciliation of operating income to net cash provided by operating activities:		
Net operating revenues	$ 135,363	$ 1,084,303
Adjustments to reconcile net operating revenues to net cash provided by operating activities:		
Depreciation	2,338,653	2,144,390
Changes in assets and liabilities:		
Receivables	(198,838)	98,824
Unbilled revenues	(154,543)	(223,481)
Materials and supplies	8,488	224,239
Prepaid expenses and other current assets	68,107	(88,899)
Accounts payable	264,521	43,217
Deferred pension and postemployment benefits amounts	1,242,957	(90,137)
Accrued taxes	54,855	46,065
Other current and accrued liabilities	223,768	(73,309)
Customer deposits	(52,510)	(260,022)
Unearned revenue - MuniNet	(6,771)	(6,770)
Total adjustments	3,788,687	1,814,117
	$ 3,924,050	$ 2,898,420

See accompanying notes to financial statements

NOTES TO FINANCIAL STATEMENTS

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Financial Reporting Entity

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

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

The Board consists of four appointed members, the term of one expiring each year, and a fifth member from the City's governing body, presently represented by Terry Parker, 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.

System Plant

System 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 System 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 $817,259 and $717,334 for the years ended June 30, 2018 and 2017, 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, 2018 and 2017.

Pensions and Postemployment Benefits Other than Pensions (OPEB)

For purposes of measuring the liability, deferred outflows of resources and deferred inflows of resources related to pensions, pension expense, OPEB and OPEB expense, information about the fiduciary net position of the County Employees Retirement System ("CERS"), and additions to/deductions from CERS's fiduciary net position have been determined on the same basis as they are reported by CERS. 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, except for money market investments and participating interest-earning investment contracts that have a maturity at the time of purchase of one year or less, which are reported at cost.

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 System has two items that qualify for reporting in this category. The deferred outflows of resources relate to the net pension liability described in Note 10 and the OPEB liability described in Note 11.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

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 System has two items that qualify for reporting in this category: The deferred inflows of resources relate to the net pension liability as described in Note 10 and the OPEB liability described in Note 11.

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 System 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 26, 2018, which is the date the financial statements were available to be issued.

NOTE 2 – BOARD PLANT AND DEPRECIATION PROCEDURES

A summary of changes in major classifications of the System plant in service as of June 30, 2018 follows:

	Balance June 30, 2017	Additions	Reclassifications/ Retirements	Balance June 30, 2018
Utility plant not depreciated:				
Land	$ 283,389	$ -	$ -	$ 283,389
Construction in progress - electric	1,001,704	63,510	-	1,065,214
Construction in progress - telecommunications	181,731	-	31,979	149,752
Total utility plant not depreciated	1,466,824	63,510	31,979	1,498,355
Utility plant depreciated:				
Transmission plant	730,867	-	-	730,867
Distribution plant	28,951,900	1,174,405	377,662	29,748,643
General plant	14,652,044	366,315	251,079	14,767,280
Telecommunications plant	9,106,284	941,248	91,395	9,956,137
Total utility plant depreciated	53,441,095	2,481,968	720,136	55,202,927
Accumulated depreciation	(21,908,308)	(2,354,152)	847,938	(23,414,522)
Total utility plant depreciated, net	31,532,787	127,816	(127,802)	31,788,405
Total utility plant	$ 32,999,611	$ 191,326	$ (95,823)	$ 33,286,760

NOTE 2 – BOARD PLANT AND DEPRECIATION PROCEDURES, continued

A summary of changes in major classifications of the System plant in service as of June 30, 2017 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

For 2017, 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 – BOARD PLANT AND DEPRECIATION PROCEDURES, continued

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

General plant	3.00%
Poles	4.00
Office furniture and equipment	7.25
Computers	VAR/straight line
Vehicles	VAR/straight line
Transmission tower and fixtures	14.00
Telecommunications equipment	6.67

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

Distribution plant depreciation rates have been applied on a straight-line basis and 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	VAR
Laboratory equipment	8.00

NOTE 2 – BOARD PLANT AND DEPRECIATION PROCEDURES, continued

Transactions through the Accumulated Provision for Depreciation account for the years ended June 30, 2018 and 2017 are summarized as follows:

	2018	2017
Accumulated provision for depreciation, July 1	$ 21,908,308	$ 20,478,954
Add:		
Depreciation charged directly to expense	2,207,510	2,008,705
Depreciation charged to transportation - clearing	131,143	135,685
Other additions	15,499	3,108,050
Subtotal	24,262,460	25,731,394
Deduct:		
Original cost of plant retired	648,619	489,861
Cost of removal less salvage	240,217	236,603
Salvage	(40,898)	-
Other subtractions	-	3,096,622
Total charges against provision	847,938	3,823,086
Accumulated provision for depreciation, June 30	$ 23,414,522	$ 21,908,308

NOTE 3 – CASH AND CASH EQUIVALENTS

At June 30, 2018, the System's deposits in depository institutions had a carrying amount of $8,400,220 and bank balances of $8,439,673. At June 30, 2018, the deposits were covered entirely by FDIC insurance or a properly executed collateral security agreement. At June 30, 2017, the System'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.

NOTE 3 – CASH AND CASH EQUIVALENTS, continued

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

Unrestricted cash at June 30 consisted of:

	2018	2017
Change funds	$ 1,750	$ 1,750
Checking accounts	2,622,392	2,353,374
TVA power bill early payment	26	18
Other	9,376	13,820
Total	$ 2,633,544	$ 2,368,962

Restricted cash at June 30 consisted of:

	2018	2017
2007 Telecom bond issue fund	$ 4	$ 4
Series 2018 note proceeds	5,616,642	-
KIA 2008 maintenance and replacement	150,030	-
Total investments	$ 5,766,676	$ 4

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.

Custodial Credit risk

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

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

At June 30, 2018 and 2017, the System was not exposed to custodial credit risk.

Interest Rate Risk

The System does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

NOTE 3 – CASH AND CASH EQUIVALENTS, continued

Credit Risk

Under Kentucky Revised Statutes Section 66.480, the System is authorized to invest in obligations of the United States and its agencies and instrumentalities, obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States or of its agencies, obligations or 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. The System has no investment policy that would further limit its investment choices.

NOTE 4 – RECEIVABLES

Net receivables include the following at June 30:

	2018	2017
Accounts Receivable		
Electric	$ 3,066,101	$ 2,793,288
Other miscellaneous	(2,058)	68,839
	3,064,043	2,862,127
Less:		
Reserve for uncollectible accounts	(25,509)	(22,431)
Total net receivables	$ 3,038,534	$ 2,839,696

NOTE 4 – RECEIVABLES, continued

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, 2018		June 30, 2017	
	Amount	Percent	Amount	Percent
Accounts having discount dates after June 30	$ 2,856,035	93.21%	$ 2,595,875	90.70%
Accounts with credit balances	-	0.00%	-	0.00%
Accounts less than one month past due	-	0.00%	-	0.00%
Accounts 31 to 60 days past due	60,063	1.96%	58,313	2.04%
Accounts 61 to 90 days past due	18,856	0.62%	16,029	0.56%
Accounts over 90 days past due	129,089	4.21%	191,910	6.70%
	$ 3,064,043	100.00%	$ 2,862,127	100.00%

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, 2018. 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:

	2018	2017
Beginning balance	$ 22,431	$ 22,860
Monthly additions and adjustments	120,000	36,166
Charge-off of bad accounts	(116,922)	(36,595)
Balance, June 30	$ 25,509	$ 22,431

NOTE 5 – 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.

NOTE 6 – DEFERRED CHARGES

Deferred Charges at June 30 consisted of:

	2018	2017
Deferred costs on bond issue - 2004	$ 161	$ 417
Deferred costs on bond issue - 2007	50,731	60,711
Deferred costs on bond issue - 2013 KLC	28,130	33,168
Deferred costs on bond issue - 2018	34,431	-
Total	$ 113,453	$ 94,296

NOTE 7 – BONDED INDEBTEDNESS

Issue Date	Original Proceeds	Interest Rates	Maturity Date	Balance at June 30, 2018
Series 2004	$ 3,553,065	3.45%	2/15/2019	$ 202,676
Series 2007	10,189,500	3.62%	8/1/2023	4,322,280
Series 2013	3,000,000	0.70%	6/1/2023	1,526,201
Series 2013A	1,055,000	2.00%	1/1/2024	531,250
Series 2018	6,000,000	2.45%	2/16/2021	6,000,000

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

On April 16, 2018, the System issued the Electric Revenue Bond Anticipation Notes, Series 2018 in the aggregate principal amount of $6,000,000 to provide interim financing on a temporary basis for a portion of the costs of certain additions and improvements to the System's electric plant and distribution system. The bond anticipation note will mature on February 16, 2021 and will be payable from the proceeds of the Board's Electric System Revenue Bonds Series 2021. Interest is payable semi-annual at an interest rate of 2.45%. The System will pay interest only until final maturity.

NOTE 7 – BONDED INDEBTEDNESS, continued

The changes in outstanding debt as of June 30, 2018 follows:

	Balance July 1, 2017	New Issues	Debt Payments and Refunds	Balance June 30, 2018
KY League of Cities - Series 2004	$ 499,631	$ -	$ 296,955	$ 202,676
KY League of Cities - Series 2007	5,046,839	-	724,559	4,322,280
KY Infrastructure Authority - Series 2013	1,825,095	-	298,894	1,526,201
Revenue Bond - Series 2013A	633,333	-	102,083	531,250
2018 - Bond anticipation note	-	6,000,000	-	6,000,000
	$ 8,004,898	$ 6,000,000	$ 1,422,491	12,582,407
Less: Unamortized discount				(15,518)
Net total				$ 12,566,889

The changes in outstanding debt as of June 30, 2017 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 7 – 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:

	2018	2017
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:

	2018	2017
Series 2004	$ 256	$ 256
Series 2007	9,980	9,980
Series 2013	5,038	5,038
Series 2018	2,569	-
	$ 17,843	$ 15,274

NOTE 7 – BONDED INDEBTEDNESS, continued

The following represents principal and interest payments on outstanding debt.

	Series 2004			Series 2007		
	Principal	Interest	Total	Principal	Interest	Total
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	-	-	-	870,553	73,605	944,158
2023	-	-	-	911,438	33,365	944,803
2024	-	-	-	156,023	1,516	157,539
	$ 202,676	$ 5,716	$ 208,392	$ 4,322,280	$ 553,077	$ 4,875,357

	KIA 2013			Series 2013A		
	Principal	Interest	Total	Principal	Interest	Total
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	307,366	3,781	311,147	112,082	5,227	117,309
2023	309,520	1,626	311,146	79,584	2,427	82,011
2024	-	-	-	17,500	438	17,938
	$ 1,526,201	$ 29,534	$ 1,555,735	$ 531,250	$ 39,200	$ 570,450

	2018 Bond Anticipation Note			All Series Combined		
	Principal	Interest	Total	Principal	Interest	Total
2019	$ -	$ 147,000	$ 147,000	$ 1,367,274	$ 359,323	$ 1,726,597
2020	-	147,000	147,000	1,204,169	314,280	1,518,449
2021	6,000,000	147,000	6,147,000	7,246,898	272,939	7,519,837
2022	-	-	-	1,290,001	82,613	1,372,614
2023	-	-	-	1,300,542	37,418	1,337,960
2024	-	-	-	173,523	1,954	175,477
	$ 6,000,000	$ 441,000	$ 6,441,000	$ 12,582,407	$ 1,068,527	$ 13,650,934

NOTE 8 – LINE OF CREDIT

On May 1, 2017, Hopkinsville Electric System entered into a revolving line of credit with Heritage Bank as a bridge for short-term cash needs. The revolving line of credit has a maximum principal amount of $1,000,000 with a maturity date of May 1, 2019. The balance as of June 30, 2018 was $500,000. The interest rate is 4.00%. The revolving line of credit is secured by a Commercial Security Agreement.

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 $681,554 and $768,282 as of June 30, 2018 and 2017, 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, 2018 and 2017, the System reported a liability for its proportionate share of the net pension liability for CERS. The amount recognized by the System as its proportionate share of the net pension liability and the total portion of the net pension liability that was associated with the System were as follows:

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

2018	2017
$ 8,138,087	$ 6,371,513

The net pension liability of the plan was measured as of June 30, 2017 and 2016, 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, 2018 and 2017, the System's proportion was 0.139034% and 0.12941%, respectively.

For the year ended June 30, 2018 and 2017, the System recognized pension expense of $1,525,793 $890,018, respectively, related to CERS.

NOTE 10 – PENSION PLANS, continued

At June 30, 2018 and 2017, the System reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	2018		2017	
	Deferred Outflows of Resources	Deferred Inflows of Resources	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ 10,094	$ 206,580	$ 50,191	$ -
Changes in assumptions	1,501,698	-	609,035	-
Net difference between projected and actual earnings on pension plan investments	317,297	-	509,326	184,400
Changes in proportion and differences between HES contributions and proportionate share of contributions	644,527	543,868	82,162	-
HES contributions subsequent to the measurement date	483,139	-	632,342	-
Total	$ 2,956,755	$ 750,448	$ 1,883,056	$ 184,400

The amount of $483,139 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, 2019. Other amounts reported as deferred outflows of resources and deferred inflows related to pensions will be recognized in pension expense as follows:

Years Ending June 30,	
2018	$ 757,494
2019	738,494
2020	331,677
2021	(104,497)
2022	-
Thereafter	-
Total	$ 1,723,168

NOTE 10 – PENSION PLANS, continued

Actuarial assumptions – The total pension liability in the June 30, 2017 and 2016 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

	Measurement Period	
	2017	2016
Inflation	2.30%	3.25%
Projected salary increases, average, including inflation	3.05%	4.00%
Investment rate of return, net of plan investment expense, including inflation	6.25%	7.50%

For the June 30, 2017 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 assumptions used in the June 30, 2016 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 2017 Asset Class	Target Allocation	Long Term Expected Nominal Return
US equity	17.50%	5.97%
International equity	17.50%	7.85%
Global bonds	4.00%	2.63%
Global credit	2.00%	3.63%
High yield	7.00%	5.75%
Emerging market debt	5.00%	5.50%
Private credit	10.00%	8.75%
Real estate	5.00%	7.63%
Absolute return	10.00%	5.63%
Real return	10.00%	6.13%
Private equity	10.00%	8.25%
Cash	2.00%	1.88%
Total	100.00%	

2016 Asset Class		
Combined equity	44.00%	5.40%
Combined fixed income	19.00%	1.50%
Real return (diversified inflation strategies)	10.00%	3.50%
Rea estate	5.00%	4.50%
Absolute return (diversified hedge funds)	10.00%	4.25%
Private equity	10.00%	8.50%
Cash equivalent	2.00%	(.25%)
Total	100.00%	

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, 2017 and 2016 was 6.25% 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 26-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, 2017 and 2016 of 6.25% 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 System's proportionate share of the net pension liability, calculated using the discount rates selected by the pension system, as well as what the System'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
2018	5.25%	6.25%	7.25%
HES's proportionate share of net pension liability	$ 6,359,872	$ 8,138,087	$ 10,263,887
2017	6.50%	7.50%	8.50%
HES's proportionate share of net pension liability	$ 7,940,114	$ 6,371,513	$ 5,027,173

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.

Payable to the Pension plan: At June 30, 2018, the System reported a payable of $0 for the outstanding amount of contributions to the pension plan required for the year ended June 30, 2018.

<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.

NOTE 10 – PENSION PLANS, continued

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, John Hancock, to be held or invested in accordance with provisions in the Thrift Plan Trust Agreement executed November 24, 1969. Employer contributions, which totaled $111,706 and $107,917 in the years ended June 30, 2018 and 2017, respectively, are charged monthly to plant and expense in the same ratio as payroll.

NOTE 11 – OTHER POST- EMPLOYMENT BENEFITS (OPEB)

General Information about the OPEB Plan

Plan description: County Employees Retirement System consists of two plans, Non-Hazardous and Hazardous. Each plan is a cost-sharing multiple-employer defined benefit OPEB plan administered by the Kentucky Retirement Systems (KRS) under the provision of Kentucky Revised Statute 61.645. The plan covers all regular full-time members employed in non-hazardous and hazardous duty positions of each participating county, city and any additional eligible local agencies electing to participate in CERS. The System participates in the Non-Hazardous plan.

Benefits provided: The KRS' Insurance Fund was established to provide hospital and medical insurance for eligible members receiving benefits from CERS. The eligible non-Medicare retirees are covered by the Department of Employee Insurance (DEI) plans. KRS submits the premium payments to DEI. The System contracts with Humana to provide health care benefits to the eligible Medicare retirees through a Medicare Advantage Plan. The Insurance Fund pays a prescribed contribution for whole or partial payment of required premiums to purchase hospital and medical insurance.

The amount of contribution paid by the Insurance Fund is based on years of service. For members participating prior to July 1, 2003, years of service and respective percentages of the maximum contribution are as follows:

Portion Paid by Insurance Fund	
Years of Service	Paid by Insurance Fund (%)
20+ Years	100.00%
15-19 Years	75.00%
10-14 Years	50.00%
4-9 Years	25.00%
< 4 Years	0.00%

NOTE 11 – OTHER POST- EMPLOYMENT BENEFITS (OPEB), continued

As a result of House Bill 290 (2004 Kentucky General Assembly), medical insurance benefits are calculated differently for members who began participating on, or after July 1, 2003. Once members reach a minimum vesting period of 10 years, non-hazardous employees whose participation began on, or after July 1, 2003, earn $10 per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount. Hazardous employees whose participation began on, or after July 1, 2003 earn $15 per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount. Upon death of a hazardous employee, the employee's spouse receives $10 per month for insurance benefits for each year of the deceased employee's earned hazardous service. This dollar amount is subject to adjustment annually, which is currently 1.5% based upon Kentucky Revised Statutes. This benefit is not protected under the inviolable contract provisions of KRS 61.692. The Kentucky General Assembly reserves the right to suspend or reduce this benefit if, in its judgement, the welfare of the Commonwealth so demands.

There was no legislation enacted during the 2017 legislative session that had a material change in benefit provisions for either system.

Contributions: The employee contribution rate is set by state statute. Non-Hazardous employees contribute 5%. Employees hired on or after September 1, 2018, contribute an additional 1% to health insurance.

The employer contribution rates are set by the KRS Board under Kentucky Revised Statute 61.565 based on an annual actuarial valuation, unless altered by legislation enacted by the Kentucky General Assembly. For the fiscal year ended June 30, 2018 and 2017, participating employers contributed 19.18% (14.48% pension fund and 4.70% insurance fund) and 18.68% (13.95% pension fund and 4.73% insurance fund), respectively, of each employee's creditable compensation. The actuarially determined rates set by the System for the fiscal years were a percentage of each employee's creditable compensation. Contributions to the insurance fund from the System were $156,819 and $160,117 for the years ended June 30, 2018 and 2017, respectively.

The System has met 100% of the contribution funding requirement for the year ended June 30, 2018. Total current year contributions recognized by the Plan were $156,819 for the year ended June 30,2018. The OPEB contribution amount does not include the implicit subsidy reported in the amount of $34,160.

NOTE 11 – OTHER POST- EMPLOYMENT BENEFITS (OPEB), continued

OPEB Liabilities, OPEB Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB

At June 30, 2018, the System reported a liability of $2,795,059 for its proportionate share of the net OPEB liability. The net OPEB liability was measured as of June 30, 2017, and the total OPEB liability used to calculate the net OPEB liability was determined by an actuarial valuation as of June 30, 2016. The total OPEB liability was rolled-forward from the valuation date to the plan's fiscal year end, June 30, 2017, using generally accepted actuarial principles. The System's proportion of the net OPEB liability was based on the System's share of contributions to the OPEB plan relative to the contributions of all participating employers. At June 30, 2018, the System's proportion for the non-hazardous system was 0.139034%.

For the year ended June 30,2018, the System recognized OPEB expense of $318,508. At June 30, 2018, the System reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources:

	2018	
County Employees Retirement System (CERS) OPEB	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	$ -	$ 7,763
Net difference between projected and actual earnings on OPEB plan investments	608,187	-
Changes of assumptions	-	6,486
Changes in proportion and differences between employer contributions and proportionate share of contributions	-	132,093
System contributions subsequent to the measurement date	156,819	-
Total	$ 765,006	$ 146,342

$156,819 reported as deferred outflows of resources related to OPEB resulting from System contributions subsequent to the measurement date will be recognized as a reduction of the net OPEB liability in the year ending June 30, 2019. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to OPEB will be recognized in OPEB expense as follows:

NOTE 11 – OTHER POST- EMPLOYMENT BENEFITS (OPEB), continued

Years Ending June 30,		
2018	$	79,465
2019		79,465
2020		79,465
2021		79,465
2022		112,489
Thereafter		31,496
Total	$	461,845

Actuarial assumptions: The total OPEB liability in the June 30, 2017 actuarial valuation was determined using the following actuarial methods and assumptions, applied to all periods included in the measurement:

Valuation date	June 30, 2017
Payroll growth rate	2.00%
Inflation	2.30%
Salary increase	3.05%, average
Investment rate of return	6.25%
Healthcare cost trend rates (pre-65)	Initial trend starting at 7.25% at January 1, 2019 and gradually decreasing to an ultimate trend rate of 4.05% over a period of 13 years.
Healthcare cost trend rates (post-65)	Initial trend starting at 5.10% at January 1, 2019 and gradually decreasing to an ultimate trend rate of 4.05% over a period of 11 years.

NOTE 11 – OTHER POST- EMPLOYMENT BENEFITS (OPEB), continued

The mortality for active members is RP-2000 Combined Mortality Table projected with Scale BB to 2013 (male mortality rates are multiplied by 50% and female mortality rates are multiplied by 30%). The mortality table for healthy retired members and beneficiaries is the RP-2000 Combined Mortality Table projected with Scale BB to 2013 (female mortality rates are set back on year). The mortality table for disabled members is the RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (male mortality rates are set back four years). 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 long-term expected return on plan assets was determined by using a building-block method in which best-estimated ranges of expected future real returns are developed for each asset class. The ranges are combined by weighting the expected future real rate of return by the target asset allocation percentage.

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

Asset Class	Target Allocation	Long Term Expected Nominal Return
US equity	17.50%	5.97%
International equity	17.50%	7.85%
Global bonds	4.00%	2.63%
Global credit	2.00%	3.63%
High yield	7.00%	5.75%
Emerging market debt	5.00%	5.50%
Private credit	10.00%	8.75%
Real estate	5.00%	7.63%
Absolute return	10.00%	5.63%
Real return	10.00%	6.13%
Private equity	10.00%	8.25%
Cash	2.00%	1.88%
Total	100.00%	

NOTE 11 – OTHER POST- EMPLOYMENT BENEFITS (OPEB), continued

Discount rate: The discount rate used to measure the total OPEB liability was 5.84% for non-hazardous and 5.96% for hazardous. The single discount rate was based on the expected rate of return on the OPEB plan investments of 6.25% and a municipal bond rate of 3.56%, as reported in the Fidelity Index's "20-Year Municipal GO AA Index" as of June 30, 2017. Future contributions are projected in accordance with the System's current funding policy, which includes the requirement that each participating employer in the System contribute the actuarially determined contribution rate, which is determined using a closed funding period (26 years as of June 30, 2017) and the actuarial assumptions and methods adopted by the System of Trustees.

Period of projected benefit payments – Current assets, future contributions and investment earnings are projected to be sufficient to pay the projected benefit payments from the retirement system. However, the cost associated with the implicit employer subsidy is not currently being included in the calculation of the System's actuarial determined contributions, and any cost associated with the implicit subsidy will not be paid out of the System's trust. Therefore, the municipal bond rate was applied to future expected benefit payments associated with the implicit subsidy.

Sensitivity of the System's proportionate share of the net OPEB liability to changes in the discount rate: The following presents the System's proportionate share of the net OPEB liability, as well as what the System's proportionate share of the net OPEB liability would be if it were calculated using a discount rate that is 1-percentage-point lower (4.84% for non-hazardous and 4.96% for hazardous) or 1-percentage-point higher (6.84% for non-hazardous and 6.96% for hazardous) than the current rate:

1% Decrease 4.84%	Current Discount Rate 5.84%	1% Increase 6.84%
$ 3,556,558	$ 2,795,059	$ 2,161,372

Sensitivity of the System's proportionate share of the net OPEB liability to changes in the healthcare cost trend rates: The following presents the System's proportionate share of the net OPEB liability, as well as what the System's proportionate share of the net OPEB liability would be if it were calculated using healthcare cost trend rates that are 1-percentage-point lower or 1-percentage-point higher than the current healthcare cost trend rates:

1% Decrease	Current Healthcare Cost Trend Rate	1% Increase
$ 2,143,954	$ 2,795,059	$ 3,641,457

NOTE 11 – OTHER POST- EMPLOYMENT BENEFITS (OPEB), continued

Changes of assumptions: Subsequent to the actuarial valuation date, but prior to the measurement dates, the KRS Board of Trustees adopted updated actuarial assumptions which will be used in performing the actuarial valuation as of June 30, 2017. Specifically, total OPEB liability as of June 30, 2017 is determined using a 2.30% price inflation assumption and an assumed rate of return of 6.25%.

Payable to the OPEB plan: At June 30,2018, the System reported a payable of $0 for the outstanding amount of contributions to the OPEB plan required for the year ended June 30, 2018.

Pension plan fiduciary net position: Detailed information about the OPEB plan's fiduciary net position is available in the separately issued Kentucky Retirement Systems Comprehensive Annual Financial Report on the KRS website at www.kyret.ky.gov.

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, 2018 and 2017:

	2018	2017
Accrued pole rentals	$ 34,370	$ 27,444
Accrued payroll	150,937	34,020
Compensated absences	817,259	717,334
	$ 1,002,566	$ 778,798

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: The ratio of Tennessee Valley Authority (TVA) purchased power to total energy sales in fiscal year 2018 was 76.2% and 78.3% in fiscal year 2017. TVA has increased their wholesale rates by 1.5% each October since 2013 with another 1.5% wholesale increase effective October 2018. TVA has also given the System the option of implementing a “Grid Access Charge” in October 2018 or deferring until October 2019.The System has chosen to defer the implementation until October 2019. The GAC is a way for TVA to recover their fixed cost and lowering the wholesale energy rate by $.005/kWh. The GAC will be based on the System’s previous 5 years’ standard service kWh purchases.

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 implemented a customer service charge increase with corresponding decreases in energy charges effective October 2013 - October 2017. The System did implement a 1.5% local rate increase in energy charges in October 2017. In October 2018, the System implemented a customer service charge increase, increased the GSA-1 revenue by 1% and lowered GSA-2 revenue by 0.5%, increased the first 50 kW demand charge in GSA-2 class by $1/kW and lowered first block of energy by the same amount of revenue. These 2018 changes will be revenue neutral for the System.

NOTE 15 – COMMITMENTS

<u>TVA</u>

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 Board 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, 2016, $135,404 was received. A substantial portion of the additional $135,404 is expected to be received in fiscal year 2019. 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 System paid $67,477 and $43,78 for administrative and operating costs during fiscal years ended June 30, 2018 and 2017.

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

	2018	2017
Initial investment	$ 5,000	$ 5,000
Project 2 Investment in Muninet		
Beginning balance July 1	239,541	191,063
Program revenue		
Costs incurred	67,477	43,478
Less MuniNet reimbursements	-	-
	307,018	234,541
Ending balance June 30	$ 312,018	$ 239,541

NOTE 16 – ADOPTION OF NEW ACCOUNTING PRONOUNCEMENTS

During fiscal year 2018, the System adopted the following accounting pronouncements:

- GASB Statement No. 81, *Irrevocable Split-Interest Agreements*, issued March 2016.
- GASB Statement No. 85, *Omnibus 2017*, issued March 2017.
- GASB Statement No. 86, *Certain Debt Extinguishment Issues*, issued May 2017.

Adoption of these statements did not have a significant impact on the System's financial position or results of operations.

- GASB Statement No. 75, Accounting and Financial Reporting for Postemployment Benefits other than Pensions, issued on June 2015 aims to improve financial reporting by state and local governments for postemployment benefits other than pensions (other post employment benefits or OPEB). It also improves information provided by the state and local government employers regarding financial support for OPEB that is provided by other entities.

Adoption of this statement had a significant impact on the System's financial position. As a result, the System restated the July 1, 2017 net position in the amount of ($2,192,361) as outlined below.

	Beginning Balance	As Restated	GASB 75 Adjustment
Statement of revenues, expenses and changes in net position			
Net position, July 1, 2017	$ 20,610,169	$ 18,417,808	$ (2,192,361)

NOTE 17 – SUBSEQUENT EVENTS

On June 12, 2018, the Kentucky Infrastructure Authority approved a $1,800,000 loan to fund the Fiber to Home – Phase 2 project. The total cost of the project is estimated at $4,300,000 of which the Authority will provide $1,800,000. Construction began in August 2018 and is expected to be completed by January 2019.

On October 2, 2018, the System entered into a Dark Fiber Lease with Pennyrile Rural Electric Cooperative Corporation (PRECC). The System transferred sections of their fiber optic cable network to PRECC to become part of the PRECC network. PRECC made a lump sum payment to the System in the amount of $1,170,000 upon the execution of the Bill of Sale.

REQUIRED SUPPLEMENTARY INFORMATION

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
SCHEDULE OF PROPORTIONATE SHARE OF NET PENSION LIABILITY
JUNE 30, 2018
County Employees Retirement System

	2018	2017	2016	2015
HES's proportion of net pension liability (asset)	0.139034%	0.129410%	0.130320%	0.127380%
HES's proportionate share of net pension liability (asset)	$ 8,138,087	$ 6,371,513	$ 5,603,152	$ 4,224,200
HES's covered - employee payroll	$ 3,336,593	$ 3,385,128	$ 3,087,016	$ 2,989,520
HES's proportionate share of net pension liability (asset) as a percentage of its covered-employee payroll	243.90%	188.22%	181.51%	141.30%
Plan fiduciary net position as a percentage of total pension liability	53.30%	55.50%	59.97%	66.80%

Schedule is intended to present information for 10 years. Additional years will be displayed as they become available.
GASB 68 was implemented in fiscal year 2015.

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
SCHEDULE OF EMPLOYER CONTRIBUTIONS TO PENSION PLAN
JUNE 30, 2018
County Employees Retirement System

	2018	2017	2016	2015
Contractually required contribution	$ 483,139	$ 632,342	$ 526,645	$ 528,549
Contributions in relation to the contractually required contribution	$ 483,139	$ 632,342	$ 526,645	$ 528,549
Contribution deficiency (excess)	$ -	$ -	$ -	$ -
HES's covered-employee payroll	$ 3,336,593	$ 3,385,128	$ 3,087,016	$ 2,989,520
Contributions as a percentage of covered-employee payroll	14.48%	18.68%	17.06%	17.67%

Schedule is intended to present information for 10 years. Additional years will be displayed as they become available.
GASB 68 was implemented in fiscal year 2015.

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION – PENSION PLAN
JUNE 30, 2018 AND 2017

Changes in assumptions and benefit terms

2017: Since the prior measurement date, the demographic and economic assumptions that affect the measurement of the total pension liability have been updated as follows:

- The assumed investment rate of return was decreased from 7.50% to 6.25%.
- The assumed rate of inflation was reduced from 3.25% to 2.30%.
- Payroll growth assumption was reduced from 4.00% to 3.05%.

2016: There were no changes in assumptions and benefit terms since the prior measurement date.

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
SCHEDULE OF PROPORTIONATE SHARE OF NET OPEB LIABILITY
JUNE 30, 2018
County Employees Retirement System

	2018
HES's proportion of net OPEB liability (asset)	0.139034%
HES's proportionate share of OPEB liability (asset)	$ 2,795,059
HES's covered - employee payroll	$ 3,336,593
HES's proportionate share of net OPEB liability (asset) as a percentage of its covered-employee payroll	119.37%
Plan fiduciary net position as a percentage of total OPEB liability	55.30%

Schedule is intended to present information for 10 years. Additional years will be displayed as they become available. GASB 75 was implemented in fiscal year 2018

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
SCHEDULE OF EMPLOYER OPEB CONTRIBUTIONS
JUNE 30, 2018
County Employees Retirement System

		2018
Contractually required OPEB contribution	$	156,819
Contributions in relation to the contractually required contribution		156,819
Contribution deficiency (excess)	$	-
HES's covered-employee payroll	$	3,336,593
Contributions as a percentage of covered-employee payroll		4.70%

Schedule is intended to present information for 10 years. Additional years will be displayed as they become available. GASB 75 was implemented in fiscal year 2018.

Changes in assumptions and benefit terms

2017: Since the prior measurement date, the demographic and economic assumptions that affect the measurement of the total OPEB liability have been updated as follows:

- The assumed investment rate of return was decreased from 7.50% to 6.25%.
- The assumed rate of inflation was reduced from 3.25% to 2.30%.
- Payroll growth assumption was reduced from 4.00% to 3.05%.

ADDITIONAL INFORMATION

HOKINSVILLE ELCTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
COMBINED SCHEDULE OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
FOR THE YEAR ENDED JUNE 30, 2018

	ELECTRIC	TELECOM	TOTAL
OPERATING REVENUES	$ 35,483,445	$ 3,437,839	$ 38,921,284
OPERATING EXPENSES			
Cost of power	26,333,443	-	26,333,443
Cost of sales - telecom	-	326,543	326,543
Distribution - operation	1,084,758	975,965	2,060,723
- maintenance	1,193,404	71,366	1,264,770
Customer accounts	956,844	182,580	1,139,424
Sales	88,170	41,792	129,962
Administrative and general	2,745,037	1,005,338	3,750,375
Depreciation and amortization	1,794,446	484,586	2,279,032
Taxes	1,444,844	56,805	1,501,649
Total operating expenses	35,640,946	3,144,975	38,785,921
Net operating revenues	(157,501)	292,864	135,363
NONOPERATING REVENUES (EXPENSES)			
Interest on long-term debt	(218,436)	(76,440)	(294,876)
Other interest	(11,642)	-	(11,642)
Amortization of debt expense	(14,150)	(3,693)	(17,843)
Interest income	33,514	-	33,514
Other income (expenses)	8,521	-	8,521
Total nonoperating revenues (expenses)	(202,193)	(80,133)	(282,326)
CHANGE IN NET POSITION	(359,694)	212,731	(146,963)
NET POSITION, BEGINNING OF YEAR	18,355,931	2,254,238	20,610,169
Implementation of GASB 75 (Note 16)	(2,192,361)	-	(2,192,361)
NET POSITION, BEGINNING OF YEAR, restated	16,163,570	2,254,238	18,417,808
NET POSITION, END OF YEAR	$ 15,803,876	$ 2,466,969	$ 18,270,845

Note: Beginning net position was reallocated between electric and telecom. The overall total did not change.

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUKCY
COMPARATIVE SCHEDULE OF REVENUES AND EXPENSES – ELECTRIC
FOR THE YEARS ENDED JUNE 30, 2018 AND 2017

	ELECTRIC 2018	ELECTRIC 2017	VARIANCE FAVORABLE (UNFAVORABLE)
OPERATING REVENUES	$ 35,483,445	$ 36,151,159	$ (667,714)
OPERATING EXPENSES			
Cost of power	26,333,443	27,651,948	1,318,505
Distribution - operation	1,084,758	1,220,096	135,338
- maintenance	1,193,404	1,127,301	(66,103)
Transmission - maintenance	-	2,325	2,325
Customer accounts	956,844	870,436	(86,408)
Sales	88,170	116,023	27,853
Administrative and general	2,745,037	1,683,992	(1,061,045)
Depreciation and amortization	1,794,446	1,606,032	(188,414)
Taxes	1,444,844	1,369,594	(75,250)
Total operating expenses	35,640,946	35,647,747	6,801
Net operating revenues	(157,501)	503,412	(660,913)
NONOPERATING REVENUES (EXPENSES)			
Interest on long-term debt	(218,436)	(225,042)	6,606
Other interest	(11,642)	(45,427)	33,785
Amortization of debt expense	(14,150)	(11,581)	(2,569)
Interest income	33,514	4,435	29,079
Other revenues (expenses)	8,521	9,439	(918)
Total nonoperating revenues (expenses)	(202,193)	(268,176)	65,983
CHANGE IN NET POSITION	$ (359,694)	$ 235,236	$ (594,930)

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
COMPARATIVE STATEMENT OF REVENUES AND EXPENSES – TELECOMMUNICATIONS
FOR THE YEARS ENDED JUNE 30, 2018 AND 2017

	TELECOM 2018	TELECOM 2017	VARIANCE FAVORABLE (UNFAVORABLE)
OPERATING REVENUES	$ 3,437,839	$ 3,496,385	$ (58,546)
OPERATING EXPENSES			
Cost of sales - telecom	326,543	260,543	(66,000)
Distribution - operation	975,965	1,297,654	321,689
- maintenance	71,366	33,947	(37,419)
Customer accounts	182,580	116,677	(65,903)
Sales	41,792	41,190	(602)
Administrative and general	1,005,338	634,382	(370,956)
Depreciation and amortization	484,586	474,195	(10,391)
Taxes	56,805	56,906	101
Total operating expenses	3,144,975	2,915,494	(229,481)
Net operating revenues	292,864	580,891	(288,027)
NONOPERATING REVENUES (EXPENSES)			
Interest on long-term debt	(76,440)	(95,838)	19,398
Amortization of debt expense	(3,693)	(3,693)	-
Total nonoperating revenues (expenses)	(80,133)	(99,531)	19,398
CHANGE IN NET POSITION	$ 212,731	$ 481,360	$ (268,629)

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

	For the Year Ended June 30, 2018		For the Year Ended June 30, 2017		Increase
	Amount	Percent	Amount	Percent	(Decrease)
Distribution					
Supervision & engineering	$ 130,201	0.37 %	$ 102,902	0.28 %	$ 27,299
Station expense	115,519	0.33	122,179	0.34	(6,660)
Overhead lines expense	245,075	0.69	287,992	0.80	(42,917)
Underground line expense	-	0.00	630	0.00	(630)
Street light & signal system expense	31,221	0.09	31,087	0.09	134
Meter expense	82,201	0.23	39,866	0.11	42,335
Customer installation expense	33,243	0.09	53,960	0.15	(20,717)
Miscellaneous distribution expense	23,157	0.07	36,743	0.10	(13,586)
Rents	424,141	1.20	544,737	1.51	(120,596)
Total distribution	$ 1,084,758	3.06 %	$ 1,220,096	3.38 %	$ (135,338)
Maintenance expense					
Distribution					
Supervision & engineering	$ 29,565	0.08 %	$ 22,789	0.06 %	$ 6,776
Substations	57,338	0.16	41,909	0.12	15,429
Overhead lines	1,026,455	2.89	972,279	2.69	54,176
Underground services	3,006	0.01	5,565	0.02	(2,559)
Transformers	51,418	0.14	58,304	0.16	(6,886)
Street light & signal system	23,532	0.07	26,253	0.07	(2,721)
Meters	2,090	0.00	202	0.00	1,888
Total distribution maintenance	$ 1,193,404	3.36 %	$ 1,127,301	3.12 %	$ 66,103
Transmission					
Maintenance of overhead lines	$ -	0.00 %	$ 2,325	0.00 %	$ (2,325)
Total transmission maintenance	$ -	0.00 %	$ 2,325	0.00 %	$ (2,325)
Customer accounts					
Supervision	$ 67	0.00 %	$ 67	0.00 %	$ -
Meter reading	107,234	0.30	159,028	0.44	(51,794)
Customer records & collection expense	672,635	1.90	571,658	1.58	100,977
Uncollectible accounts	71,804	0.20	32,631	0.09	39,173
Miscellaneous customer accounting	3,555	0.01	3,401	0.01	154
Customer assistance expense	51,285	0.14	53,698	0.15	(2,413)
Information & instructional advertising	50,264	0.14	49,953	0.14	311
Total customer accounts	$ 956,844	2.70 %	$ 870,436	2.41 %	$ 86,408

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

	For the Year Ended June 30, 2018		For the Year Ended June 30, 2017		Increase
	Amount	Percent	Amount	Percent	(Decrease)
Sales expense					
Demonstrating and selling expense	$ 61,090	0.17 %	$ 90,035	0.25 %	$ (28,945)
Advertising expense	26,191	0.07	25,138	0.07	1,053
Miscellaneous	889	0.00	850	0.00	39
Total sales	$ 88,170	0.25 %	$ 116,023	0.32 %	$ (27,853)
Administrative and general					
Administrative & office salaries	$ 532,133	1.50 %	$ 442,767	1.22 %	$ 89,366
Office supplies & expense	186,465	0.53	146,630	0.41	39,835
Outside services employed	55,299	0.16	120,035	0.33	(64,736)
Property insurance	99,281	0.28	100,070	0.28	(789)
Injuries & damages	61,836	0.17	56,320	0.16	5,516
Employees pension & other benefits	1,788,782	5.04	726,563	2.01	1,062,219
Duplicate charges (credit)	(126,619)	(0.36)	(128,180)	(0.35)	1,561
Miscellaneous general expense	81,823	0.23	64,406	0.18	17,417
Maintenance	66,037	0.19	155,381	0.43	(89,344)
Total administrative and general	$ 2,745,037	7.74 %	$ 1,683,992	4.67 %	$ 1,061,045

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

	For the Year Ended June 30, 2018		For the Year Ended June 30, 2017		Increase
	Amount	Percent	Amount	Percent	(Decrease)
Distribution					
Supervision & engineering	$ 128,420	3.74 %	$ 125,471	3.59 %	$ 2,949
Hub expenses	42,766	1.24	41,959	1.20	807
Overhead cable expense	379,849	11.05	657,533	18.81	(277,684)
Meter expense	-	0.00	-	0.00	-
Customer installation expense	156,700	4.56	248,665	7.11	(91,965)
Miscellaneous distribution expense	2,234	0.06	4,170	0.12	(1,936)
Rents	265,996	7.74	219,856	6.29	46,140
Total distribution	$ 975,965	28.39 %	$ 1,297,654	37.12 %	$ (321,689)
Maintenance expense					
Distribution					
Supervision & engineering	$ 18,359	0.53 %	$ 13,522	0.39 %	$ 4,837
Hub expenses	26,739	0.78	10,297	0.29	16,442
General maintenance	26,268	0.76	9,778	0.28	16,490
Maintenance underground services	-	0.00	350	0.01	(350)
Total distribution maintenance	$ 71,366	2.08 %	$ 33,947	0.97 %	$ 37,419
Customer accounts					
Billing expense	$ 64,350	1.87 %	$ 33,819	0.97 %	$ 30,531
Customer records & collection expense	92,662	2.70	45,403	1.30	47,259
Uncollectible accounts	15,063	0.44	27,294	0.78	(12,231)
Customer assistance expense	10,505	0.31	10,161	0.29	344
Total customer accounts	$ 182,580	5.31 %	$ 116,677	3.34 %	$ 65,903

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

	For the Year Ended June 30, 2018		For the Year Ended June 30, 2017		
	Amount	Percent	Amount	Percent	Increase (Decrease)
Sales expense					
Demonstrating and selling expense	$ 21,826	0.63 %	$ 22,409	0.64 %	$ (583)
Advertising expense	19,966	0.58	18,781	0.54	1,185
Total sales	$ 41,792	1.22 %	$ 41,190	1.18 %	$ 602
Administrative and general					
Administrative & office salaries	$ 130,696	3.80 %	$ 112,504	3.22 %	$ 18,192
Office supplies & expense	39,127	1.14	33,682	0.96	5,445
Meeting expenses	3,922	0.11	10,277	0.29	(6,355)
Outside services employed	42,573	1.24	28,961	0.83	13,612
Property insurance	17,472	0.51	17,612	0.50	(140)
Injuries & damages	30,182	0.88	29,786	0.85	396
Employees pension & other benefits	607,210	17.66	272,627	7.80	334,583
General advertising	18	0.00	-	0.00	18
Miscellaneous general expense	11,638	0.34	9,536	0.26	2,102
Maintenance	122,498	3.56	119,397	3.41	3,101
Total administrative and general	$ 1,005,336	29.24 %	$ 634,382	18.12 %	$ 370,954

INTERNAL CONTROL AND COMPLIANCE

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CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' 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, 2018 and 2017, 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 26, 2018.

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 2018-01).

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.

Duguid, Gentry & Associates, PSC

Duguid, Gentry & Associates, PSC

Certified Public Accountants
Hopkinsville, Kentucky

October 26, 2018

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
SUMMARY SCHEDULE OF FINDINGS AND RESPONSES
JUNE 30, 2018

2018-01 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 Duguid, Gentry & Associates, PSC. 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.