

**City of Henderson, Kentucky Utility Commission –
Henderson Municipal Power & Light
Management’s Discussion and Analysis**

Station Two – Future Expenditures:

In 1998, HMP&L and Big Rivers Electric Corporation entered into contracts with Western Kentucky Energy Corporation for the operation of the HMP&L Station Two Power Plant and other Big Rivers Electric Corporation Generation Plants. Big Rivers Electric Corporation and Western Kentucky Energy Corporation entered discussions to unwind the original 1998 contracts and return operational control of the Station Two Power Plant and the other Plants to Big Rivers Electric Corporation. The Unwind Transaction closed on July 16, 2009, and Big Rivers, thereafter, resumed operation of the Station Two generating plant. Big Rivers Electric Corporation has identified a number of facility upgrades and maintenance projects for the Station Two Power Plant. These Work Plans indicate HMP&L will incur an additional \$18 million to \$21 million in maintenance expenses in the near future at Station Two. Big Rivers and HMP&L are currently involved in litigation concerning the Excess Henderson Energy at Station Two. The litigation was heard in the Henderson County Circuit Court and the judge assigned the dispute to arbitration. On May 31, 2012 the Arbitration Panel issued a final ruling in favor of HMP&L. Big Rivers filed a motion with the court requesting that the Arbitration Panel’s ruling be vacated and set aside. The parties are currently waiting on the court’s ruling. This legal dispute may continue for several years.

In July 2011, HMP&L entered into litigation with the Kentucky Department of Labor related to the application of prevailing wage rates. The litigation is set to go to trial in December 2012.

In recent years, HMP&L has increased its reserved capacity at Station Two. The reserve capacity for FY 2012-2013 is 115 megawatts and HMP&L intends to continue increasing the reserved capacity by 5 megawatt increments each year until HMP&L’s reserve capacity is equal to the historical system peak demand. Each 5 megawatt increase in the reserved capacity will cost HMP&L approximately \$550,000/year. The actual cost of reserved capacity, however, is based upon the Station Two budget which varies each year.

Closing of Station One:

The Utility Commission considered Station One to no longer be a viable generating facility because of increasing federal and state restrictions for new air emissions and the increasing costs of maintenance and fuel for the facility. Therefore, Station One was closed effective December 31, 2008. Upon closing, Station One employed 13 full-time and 2 temporary personnel of which nine were placed internally, one was placed externally, one retired, three were laid off and one temporary employee was terminated. As of May 31, 2012 no decision has been made for the disposal of the Station One assets.

The Commission is currently investigating the cost to remediate certain environmental concerns at Station One. The Commission intends to make a final decision prior to the end of 2012.

Southeastern Power Administration (SEPA):

The Southeastern Power Administration (SEPA) has contracted with HMP&L to provide HMP&L a total of 18,000 megawatt hours of hydroelectric power each year. The 18,000 megawatt hours represent approximately 3 percent of HMP&L’s annual megawatt hour requirements. HMP&L is restricted to not more than 12 megawatt hours during any one hour period. The hydroelectric power is provided from SEPA generation units on the Cumberland River System Project.

**City of Henderson, Kentucky Utility Commission –
Henderson Municipal Power & Light
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Southeastern Power Administration (SEPA), continued:

In the fall of 2006, SEPA informed all contract project participants that the Wolf Creek Dam near Jamestown, Kentucky, had been inspected and serious seepage problems existed in the earthen dam. The seepage problems at the dam date back to 1968 and the US Army Corp of Engineers implemented various repairs since that time; however, the seepage became critical to the safety of the Wolf Creek Dam and surrounding communities. In an effort to respond to these safety concerns and make the needed repairs to the dam, SEPA reduced and curtailed electric service to the contract project participants. This reduction and curtailment of SEPA electric service began in early 2007.

In response to SEPA’s actions in 2006, during FY2012-2013, HMP&L budgeted additional expenses for additional purchases of power from the open market to offset the loss of the SEPA power. The SEPA Cumberland River Hydroelectric Power System may not return to normal operations for several more years.

Regulatory Compliance:

The North American Electric Reliability Corporation (NERC) adopted new electric system reliability standards for all electric utilities in the United States. NERC adopted and began enforcement of the new standards beginning in June 2007. The new standards were approved by the Federal Energy Regulatory Commission (FERC). HMP&L is required to comply with the new reliability standards and HMP&L will incur administrative expenses related to NERC compliance. HMP&L has established an internal committee to address NERC Compliance Standards. Also, HMP&L has retained an external consulting firm to assist, support, and facilitate HMP&L’s compliance with NERC Reliability Standards. In November, 2010 HMP&L hired a new Reliability Compliance Manager who is responsible for compliance with NERC Reliability Standards. In November 2008, SERC audited HMP&L for compliance with NERC Reliability Standards. Subsequent to the November audit, a number of formal and informal discussions took place between HMP&L and SERC. HMP&L and SERC reached an agreement concerning non-compliance issues identified during the audit; and a final settlement agreement was approved.

Federal air quality and emission standards continue to be increasingly more stringent. The current standards and proposed new standards will increase the cost of energy production at Station Two.

Transfer to City:

In FY2011-2012, HMP&L’s cash transfer to the City was \$1.24 million. HMP&L has budgeted this same level of cash transfer to the City for FY2012-2013 and subsequent budget periods. HMP&L also pays the City \$575,667 for internal service fees and HMP&L provides the City free electric service valued at \$386,142 and communication services valued at \$378,000 annually. Excluding the annual fuel adjustment revenue and expense, the annual cash transfer payments, internal service fees, and value of the free electric and communication services represent 9.58 percent of estimated gross electric revenue in FY2011-2012.

For more information contact Mark Powers, CPA, at 100 Fifth Street Henderson, Kentucky 42420 or via telephone at 270.826.2726



INDEPENDENT AUDITORS' REPORT

To the Board of Commissioners
City of Henderson, Kentucky
Utility Commission
Henderson, Kentucky

We have audited the accompanying statement of net assets of the City of Henderson, Kentucky Utility Commission (a component unit of the City of Henderson, Kentucky) as of May 31, 2012 and 2011 and the related statements of revenue, expenses and changes in net assets, and statement of cash flows for the fiscal years then ended. These financial statements are the responsibility of the Commission's management. 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the City of Henderson, Kentucky Utility Commission as of May 31, 2012 and 2011 and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 1 to 9 is not a required part of the component unit financial statements, but are supplemental information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the supplemental information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated September 14, 2012 on our consideration of the City of Henderson, Kentucky Utility Commission's internal control over financial reporting and our tests of its compliance with laws, regulations and contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audit was performed for the purpose of forming an opinion on the financial statements of the City of Henderson, Kentucky Utility Commission, taken as a whole. The accompanying supplemental information on pages 28-31, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements, and in our opinion, is fairly stated, in all material respects, in relation to the financial statement.

Myriad CPA Group, LLC

Henderson, Kentucky
September 14, 2012

City of Henderson, Kentucky Utility Commission
Statement of Net Assets
As of May 31, 2012 and 2011

<u>Assets:</u>	<u>2012</u>	<u>2011</u>
<u>Current assets:</u>		
Cash and cash equivalents	\$ 1,385,733	\$ 93,919
Investment securities	16,742,179	20,332,325
Restricted assets per bond ordinance:		
Certificates of deposit and money market accounts	7,111,272	-
Short-term U.S. Government Securities	1,625,529	-
Accounts receivable, net of allowance for uncollectible	3,122,373	3,462,462
Accounts receivable, Station Two Operator	1,446,224	2,854,800
Accrued interest receivable	-	30,901
Accrued revenue	2,684,246	2,292,277
Inventory and supplies	7,451,690	7,702,632
Prepaid expenses	57,499	63,558
	<u>41,626,745</u>	<u>36,832,874</u>
<u>Utility plant and equipment:</u>		
Utility plant, net of accumulated depreciation	<u>64,988,870</u>	<u>66,184,194</u>
<u>Other assets:</u>		
Bond issue costs, net of accumulated amortization	<u>489,510</u>	<u>-</u>
	<u>\$ 107,105,125</u>	<u>\$ 103,017,068</u>
<u>Liabilities and net assets:</u>		
<u>Liabilities:</u>		
<u>Current liabilities:</u>		
Accounts payable and accrued expenses	\$ 7,053,601	\$ 6,377,930
Accounts payable-Construction in progress Station Two	2,307,768	1,222,100
Current portion-bonds payable	570,000	-
Asset retirement obligation	1,430,771	1,430,771
Customer deposits	622,585	654,081
	<u>11,984,725</u>	<u>9,684,882</u>
<u>Long-term debt:</u>		
Bond anticipation notes	-	7,975,535
Long-term portion bonds payable	14,450,000	-
	<u>14,450,000</u>	<u>7,975,535</u>
	<u>26,434,725</u>	<u>17,660,417</u>
<u>Net assets:</u>		
Unrestricted	21,964,729	27,147,992
Restricted per bond ordinance	8,736,801	-
Investment in plant assets, net of related debt	49,968,870	58,208,659
	<u>80,670,400</u>	<u>85,356,651</u>
	<u>\$ 107,105,125</u>	<u>\$ 103,017,068</u>

The accompanying notes are an integral part of these financial statements.

City of Henderson, Kentucky Utility Commission
Statement of Revenues, Expenses and Changes in Net Assets
For the fiscal years ended May 31, 2012 and 2011

<u>Operating revenues:</u>	<u>2012</u>	<u>2011</u>
Sale of electricity-Existing System	\$ 36,971,905	\$ 32,651,935
Sale of electricity-Station Two	21,737,258	21,148,276
Communication services	985,380	1,062,343
Other	338,084	563,429
Total operating revenues	<u>60,032,627</u>	<u>55,425,983</u>
 <u>Operating expenses:</u>		
Production of electricity	46,749,774	40,968,460
Operating expenses	10,494,758	9,503,126
Depreciation	5,020,277	5,030,003
Total operating expenses	<u>62,264,809</u>	<u>55,501,589</u>
Income (loss) from operations	<u>(2,232,182)</u>	<u>(75,606)</u>
 <u>Interest income (expense):</u>		
Interest income	6,872	114,041
Interest expense	(452,207)	(172,255)
Total interest expense	<u>(445,335)</u>	<u>(58,214)</u>
Income (loss) before transfers	<u>(2,677,517)</u>	<u>(133,820)</u>
 <u>Non-operating items:</u>		
Gain on sale of emission allowances	132	-
Capital contributions(distributions)-Station Two, net	-	(500,000)
Transfers to City of Henderson	(1,244,724)	(1,244,724)
Power furnished to City of Henderson	(386,142)	(376,704)
Communication services provided to the City of Henderson and other local government agencies	(378,000)	(420,000)
Total non-operating items	<u>(2,008,734)</u>	<u>(2,541,428)</u>
Change in net assets	<u>(4,686,251)</u>	<u>(2,675,248)</u>
Net assets, beginning of year	<u>85,356,651</u>	<u>88,031,899</u>
Net assets, end of year	<u><u>\$ 80,670,400</u></u>	<u><u>\$ 85,356,651</u></u>

The accompanying notes are an integral part of these financial statements.

City of Henderson, Kentucky Utility Commission
Statement of Cash Flows
For the fiscal years ended May 31, 2012 and 2011

	2012	2011
<u>Cash flows from operating activities:</u>		
Receipts from customers	\$ 64,902,936	\$ 54,435,899
Payments to suppliers and employees	(59,535,444)	(55,363,080)
	5,367,492	(927,181)
<u>Cash flows from non-capital financing activities:</u>		
Distribution from Former Station Two Operator	-	-
Distributions to the City of Henderson	(1,244,724)	(1,244,724)
	(1,244,724)	(1,244,724)
<u>Cash flows from capital and related financing activities</u>		
Acquisition and construction of capital assets	(3,824,953)	(2,712,205)
Proceeds from issuance of long-term debt	15,020,000	2,542,284
Principal payments on bond anticipation notes	(7,975,535)	-
Distribution to Station Two Operator	-	(500,000)
Interest payments on long-term debt and bond anticipation notes	(452,207)	(172,255)
Bond issue costs	(489,510)	-
	2,277,795	(842,176)
<u>Cash flows provided by investing activities</u>		
Proceeds from sale of emission allowances	132	-
Proceeds from sale and maturities of investments	10,263,856	2,759,731
Purchases of investments	(15,410,511)	-
Investment income	37,773	105,114
	(5,108,750)	2,864,845
 Increase (decrease) in cash and cash equivalents	1,291,813	(149,236)
Cash and cash equivalents, beginning of year	93,920	243,156
Cash and cash equivalents, end of year	\$ 1,385,733	\$ 93,920

The accompanying notes are an integral part of these financial statements.

City of Henderson, Kentucky Utility Commission
Statement of Cash Flows-Reconciliation of Net Cash Provided by Operations
For the fiscal years ended May 31, 2012 and 2011

	2012	2011
<u>Operating activities:</u>		
Operating income (loss)	\$ (2,232,182)	\$ (75,606)
<u>Adjustments to reconcile operating income</u>		
<u>(loss) to net cash provided by operations:</u>		
Depreciation	5,020,277	5,030,003
Power furnished to the City of Henderson	(386,142)	(376,704)
Communication services provided at no charge	(378,000)	(420,000)
<u>Changes in operating assets and liabilities:</u>		
Accounts receivable	340,089	(990,084)
Due from Station Two Operator	1,408,576	(1,264,253)
Accrued revenue	(391,969)	(118,177)
Inventory and supplies	250,942	(2,534,002)
Prepaid expenses and other assets	6,059	(44)
Accounts payable and accrued expenses	675,671	1,133,107
Accounts payable-construction	1,085,668	(600,187)
Customer deposits	(31,497)	21,266
Due to Station Two Operator	-	(732,500)
	<u>\$ 5,367,492</u>	<u>\$ (927,181)</u>
Net cash provided by operating activities		

The accompanying notes are an integral part of these financial statements.

1. Organization and Contracts:

The City of Henderson Utility Commission is organized under the provisions of Section 96.530 of the Kentucky Revised Statutes to operate, manage, and control the Henderson Municipal Power & Light System. The members of the Utility Commission are appointed by the Mayor and are approved by the City Commissioners of the City of Henderson, Kentucky (City). The Mayor and the City Commission authorize all rates and bond issues of the Utility Commission. As a municipal entity, the Utility Commission is exempt from all federal and state income taxes. Certain real estate utilized by the Utility Commission is owned by the City of Henderson.

The Utility Commission operates the “Existing System” and pursuant to certain contracts and agreements described as follows, reserves power from “Station Two” which is owned by the Commission, and currently operated by Big Rivers Electric Corporation (Big Rivers), pursuant to various lease, assignment, and other agreements between the parties

The Commission provides retail electric service to the residents of the City of Henderson within its service territory. The Commission also provided wholesale electricity to Big Rivers through July 18, 1998 and subsequently to an affiliate of LG&E Energy Corporation. LG&E was purchased by Powergen in 2000 and thereafter acquired by E.ON. Effective July 16, 2009, Big Rivers resumed its role as operator of Station Two as part of the “Unwind Transaction”.

The Commission entered into certain contracts with Big Rivers relating to Station Two, as follows:

A. Power Plant Construction and Operation Agreement:

Under this agreement, Big Rivers agreed to furnish certain construction and start-up services for which it was paid out-of-pocket expenses plus overhead allowances and operate Station Two upon completion for which the Station Two Operator is paid reasonable expenditures allocable to the operation and maintenance of Station Two, as defined in the agreement. The original agreement was amended to include an option to extend through the useful operating life of Station Two. Big Rivers exercised this option in 1998.

B. Power Sales Contract:

Under this agreement, The Station Two Operator purchases all of the Station Two capacity in excess of the City of Henderson’s requirements. Payments for capacity purchased by the Station Two Operator are made monthly based on the portion of Station Two capacity allocated to the Station Two Operator compared to the total monthly Station Two capacity costs as defined in the agreement. The original agreement was executed in 1970 and extended through 2023. During 1993, the agreement was amended to include an option to extend through the useful operating life of Station Two. Big Rivers exercised this option in 1998.

C. Joint Facilities Agreement:

This agreement provides for the continuing joint use by the Commission and Station Two Operator of certain auxiliary facilities presently owned and used by the Station Two Operator at its generating station and of auxiliary facilities provided by the Commission in connection with the construction of Station Two, which is located adjacent to the generating station also operated by the Station Two Operator.

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements
For the fiscal years ended May 31, 2012 and 2011

1. Organization and Contracts, continued:

Power sales to the Station Two Operator under the agreement amounted to \$21,737,258 and \$21,148,276 for the fiscal years ended May 31, 2012 and 2011, respectively.

In connection with the negotiations related to the funding and construction of the Flue Gas Desulfurization System (FGD System) Station Two various aforementioned contracts were amended effective May 31, 1993. Significant provisions of the amendments include:

- The total capacity of Station Two, a factor in determining various Station Two costs allocations, was reduced as a result of the power required to operate the FGD System.
- The total capacity of Station Two, a factor in determining various Station Two costs allocations, was reduced as a result of the power required to operate the FGD System.
- FGD System costs, up to the amount of proceeds from the sale of Emission Allowances, will be borne in the same proportion as the Emission Allowances are allocated. Additional FGD System costs will be borne in proportion to the new capacity allocation as determined by the contract amendments.
- The Commission will reimburse the Station Two Operator for certain allocated costs of an existing Big Rivers' FGD System to be jointly used by the Station Two Operator and Station Two based upon an allocation formula defined in the amendments.

Amounts charged by the Station Two Operator as reasonable expenditures allocable to the operation and maintenance of Station Two are subject to review and approval by the Commission. Differences, if any, between amounts originally charged as allocable by the Station Two Operator and amounts accepted by the Utility Commission are recorded when a final determination of such amounts is made. Operating revenues and expenses would be reduced by any amount subsequently determined not to be allocable to Station Two.

Station Two became commercially operable and construction was substantially completed during 1974. A certificate of completion from the consulting engineers has been filed with the Trustee.

2. Summary of Significant Accounting Policies:

The Commission is a component unit of the City of Henderson, Kentucky (the primary government), due to its financial accountability to the City Commission.

The financial statements of the Commission have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The Commission applies all Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements, in which case GASB prevails. The more significant of the Commission's accounting policies are described below:

A. Cash and Cash Equivalents:

Cash and cash equivalents consist of certificates of deposit and repurchase agreements with an original maturity of three months or less from the date of purchase. The carrying amount of each of these instruments approximates fair value.

2. **Summary of Significant Accounting Policies, continued:**

B. Investment Securities:

Investments are recorded at fair value based on quoted market prices. Any gains or losses are reflected in the statement of revenues, expenses and changes in net assets in accordance with GASB No.31, "Accounting and Reporting For Certain Investments and For Internal Investment Pools." Kentucky Revised Statute 66.480 limits the types of securities that a municipal entity may invest in to obligations of the United States Treasury and its agencies, certain Federal securities, repurchase agreements, commercial bank certificates of deposit, and the Commonwealth of Kentucky Investment Pool.

C. Accounts Receivable and Unbilled Revenue:

The Commission has entered into an agreement with the City of Henderson to perform its billing and collection services. All monies due to the Utility Commission are collected and deposited in the City of Henderson's Utility Clearing Fund and are remitted to the Utility Commission on a weekly basis. The amount included in accounts receivable due from the Utility Clearing Fund was \$1,659,846 and \$2,390,567 as of May 31, 2012 and 2011, respectively.

D. Inventories:

Coal inventories of the Existing System and Station Two are stated at cost using the first-in-first-out method. Materials and supplies are stated at the weighted average cost.

E. Utility Plant and Equipment:

The utility plant is carried at cost, which includes interest capitalized, aggregating \$15,342,300, which was capitalized during the period of construction. No interest was capitalized during the fiscal years ended May 31, 2012 and 2011. The Commission's policy is to provide for depreciation over its utility plant and equipment as follows:

Production plant and structures	33 ½	years
Transmission and distribution	25	years
Automotive equipment	6	years
Wireless internet equipment	5	years
Other equipment	10	years

F. Use of Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at May 31, 2012 and 2011, as well as revenues and expenses for the years then ended. Actual results could differ from the estimates and assumptions used.

G. Compensated Absences:

Employees of the Commission are entitled to paid vacations and sick-leave. The Commission's policy is to recognize these costs when earned under the accrual method of accounting in accordance with GASB No.16 "Accounting For Compensated Absences."

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements
For the fiscal years ended May 31, 2012 and 2011

2. Summary of Significant Accounting Policies, continued:

H. Emission Allowances:

The Commission does not record the value of emission allowances granted by the Environmental Protection Agency for sulfur dioxide and nitrous oxide on its financial statements as there is no cost basis in these allowances.

3. Cash and Cash Equivalents:

As of May 31, 2012, the City of Henderson Utility Commission maintained deposits with several local financial institutions. Of the bank balance, all was insured by the Federal Depositor's Insurance Corporation and excess of FDIC was secured by pledged United States Government securities.

4. Investment Securities:

Investments are included in the statement of net assets under the caption "Investments Securities." A summary of investments held by the City of Henderson Utility Commission along with the scheduled maturities is presented below:

<u>Investment Type:</u>	<u>Fair Value</u>	<u>Less Than One Year</u>	<u>One to Five Years</u>	<u>Six to Ten Years</u>
<u>Unrestricted Investments</u>				
U.S. Government Treasury	\$ 12,572,236	\$ 12,572,236	\$ -	\$ -
Other	10,000	-	-	10,000
Certificate of Deposits and Money Markets	4,159,943	4,159,943	-	-
Total Unrestricted Investments	<u>\$ 16,742,179</u>	<u>\$ 16,732,179</u>	<u>\$ -</u>	<u>\$ 10,000</u>
<u>Restricted Per Bond Ordinance:</u>				
Certificate of Deposit and Money Market	\$ 7,111,272	\$ 7,111,272	\$ -	\$ -
Short term U.S. Treasuries	1,625,529	1,625,529	-	-
Total Restricted Investments	<u>\$ 8,736,801</u>	<u>\$ 8,736,801</u>	<u>\$ -</u>	<u>\$ -</u>
<u>Restricted Assets consisted of the following:</u>				
Repair and replacement fund	\$ 1,867,000			
Operation and maintenance reserve	100,000			
Bond Project Funds	5,144,272			
Debt Service Reserve	1,083,538			
Debt Service Sinking Fund	541,991			
Total restricted assets	<u>\$ 8,736,801</u>			

A. Interest Rate Risk:

The City of Henderson Utility Commission has a formal investment policy that limits investment maturities as a means to manage its exposure to fair value losses resulting from increasing interest rates.

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements
For the fiscal years ended May 31, 2012 and 2011

4. Investment Securities, continued:

B. Credit Risk:

The City of Henderson Utility Commission limits its investments to those allowed by Kentucky Revised Statute 66.480. Kentucky Revised Statute 66.480 limits investments to U.S. Government Treasury and Agency securities, certificates of deposit, securities issued by a state or local government rated in one of the three highest categories by a nationally recognized credit agency.

C. Custodial Credit Risk:

Custodial credit risk is the risk that in the event of the failure of the counterparty, The City of Henderson Utility Commission will not be able to recover the value of its investments, or collateral securities that are in the possession of the outside party. All investments of the Commission, with the exception of certificates of deposit, consist of unregistered and uninsured securities held by the Commission's trustee in their trust department not in the name of the Commission.

5. Utility Plant and Equipment:

Utility plant and equipment consisted of the following as of May 31, 2012 and 2011:

<u>Existing System:</u>	<u>Beginning</u>		<u>Deletions</u>	<u>Ending</u>
	<u>Balance</u>	<u>Additions</u>		<u>Balance</u>
Vehicles	\$ 2,444,312	\$ -	\$ (314,526)	\$ 2,129,786
Asset retirement obligation	296,793	-	-	296,793
Transmission plant	9,090,266	18,250	-	9,108,516
Distribution plant	22,901,601	1,677,634	-	24,579,235
Land and land rights	1,235,451	-	-	1,235,451
Telecommunications, internet and fiber optics	5,515,050	112,995	-	5,628,045
General plant	11,065,881	-	-	11,065,881
	<u>52,549,354</u>	<u>1,808,879</u>	<u>(314,526)</u>	<u>54,043,707</u>
Accumulated depreciation:				
Asset retirement obligation	(286,483)	-	-	(286,483)
Accumulated depreciation	(41,971,946)	(694,384)	-	(42,666,330)
Existing System total	<u>\$ 10,290,925</u>	<u>\$ 1,114,495</u>	<u>\$ (314,526)</u>	<u>\$ 11,090,894</u>
<u>Station Two:</u>				
General plant	\$ 170,754,127	\$ 2,120,936	\$ -	\$ 172,875,063
Accumulated depreciation	(114,860,858)	(4,116,229)	-	(118,977,087)
Station Two total	<u>\$ 55,893,269</u>	<u>\$ (1,995,293)</u>	<u>\$ -</u>	<u>\$ 53,897,976</u>
Total utility, plant, and equipment, net of accumulated depreciation	<u>\$ 66,184,194</u>			<u>\$ 64,988,870</u>

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements
For the fiscal years ended May 31, 2012 and 2011

Depreciation expense for the fiscal years ended May 31, 2012 and 2011 was \$5,020,277 and \$5,030,003 respectively.

6. Retirement Plans:

All Commission employees participate in the County Employees Retirement System (CERS), a multi-employer defined benefit retirement plan sponsored by the City of Henderson and administered by the Commonwealth of Kentucky. Under the plan, employees contribute 5% of their gross salary to the plan. The Commission also contributes a percentage of the employee's gross salary to the plan. The Commission's contribution rate into the plan is determined on an annual basis by the Kentucky General Assembly.

Contributions and the related percentages for the previous three fiscal years ended were as follows:

<u>Fiscal year ended May 31</u>	<u>Amount</u>	<u>Matching Percentage</u>
2012	\$ 518,504	18.96%
2011	\$ 459,118	16.89%
2010	\$ 420,197	16.16%

A copy of the annual report for the County Employees Retirement System can be obtained from the County Employees Retirement System 1260 Louisville Road, Frankfort, Kentucky 40601, or by calling 1.502.564.4646.

7. Accounts Payable and Accrued Expenses:

Accounts payable and accrued expenses consisted of the following as of May 31, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Accounts payable and accrued expenses - Existing System	\$ 2,756,415	\$ 2,602,904
Accounts payable and accrued liabilities - Station Two	<u>4,297,186</u>	<u>3,775,026</u>
Total	<u>\$ 7,053,601</u>	<u>\$ 6,377,930</u>

8. Bond Anticipation Notes:

During December of 2008, the Commission issued bond anticipation notes through an area financial institution. The obligations were retired via issuance of bonds on December 1, 2011. All bond anticipation notes were repaid in full from the proceeds of revenue bonds issued (Refer to Note 9).

9. Long-Term Debt-Revenue Bonds:

During the fiscal year ended May 31, 2012, the City of Henderson Utility Commission issued revenue bonds for the purpose of financing capital improvements throughout its system through two revenue bond series, *Electric System Revenue Bonds, Series 2011A* in the amount of \$11,350,000, and *Electric System Revenue Bonds, Series 2011 B*, in the amount of \$3,670,000.

9. Long-Term Debt-Revenue Bonds, continued:

The bond ordinance requires that certain accounts for each issue be established and held by a trustee as follows:

Debt Service Fund:

A monthly transfer of 1/12 of principal and 1/6 of the interest due is required to be deposited in the Debt Service Fund.

Debt Service Reserve Fund:

A reserve account was established, so that as of any date of calculation, an amount equal to at least the highest amount of aggregate debt service, or an amount equal to 125% of the average aggregate debt service and an amount equal to 10% of the "proceeds" of the bonds with respect to all series is maintained by the Commission.

Series 2011A:

The Series 2011A bonds are secured by a pledge of the revenues of the City of Henderson, Kentucky Utility Commission. The Series 2011A Bonds are additionally secured by a debt service reserve and a non-foreclosable statutory mortgage lien on the System. The Series 2011A Bonds are also secured by a debt service reserve in an amount equal to the least of the maximum annual debt service on the Series 2011A Bonds. The proceeds from the sale of these bonds were used to retire the Bond Anticipation Note, Series 2008B in the amount of \$5,281,067, with the remaining proceeds to be used for capital improvements of the City's electric transmission and distribution system, and at its Station Two generating station. Interest is due semi-annually on these obligations on December 1st and June 1st of each year.

It is the opinion from the City of Henderson, Kentucky Utility Commission's bond counsel, that under existing laws, interest on the Series 2011A Bonds is not subject to income tax

Optional Redemption Series 2011A:

The Series 2011A Bonds maturing on and after December 1, 2021, are subject to redemption by the City, at its option, before maturity on September 1, 2021, and on any date thereafter in whole or from time to time in part in any order of maturity (less than all of a single maturity to be selected by lot in such manner as the Trustee and Paying Agent may determine) at a redemption price equal to 100% of the principal amount thereof plus accrued interest to the redemption date.

Series 2011B:

The Series 2011B bonds are secured by a pledge of the revenues of the City of Henderson, Kentucky Utility Commission. The Series 2011B Bonds are additionally secured by a debt service reserve and a non-foreclosable statutory mortgage lien on the System. The Series 2011B Bonds are also secured by a debt service reserve in an amount equal to the least of the maximum annual debt service on the Series 2011B bonds. The proceeds from the sale of these bonds were used to retire the Bond Anticipation Note, Series 2008A and 2010A, in the amounts of \$3,500,000 and \$170,000, respectively. Interest is due semi-annually on these obligations on December 1st and June 1st of each year.

It is the opinion from the City of Henderson, Kentucky Utility Commission's bond counsel, that under existing laws, interest on the Series 2011B bonds is not subject to income tax.

**City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements
For the fiscal years ended May 31, 2012 and 2011**

9. Long-Term Debt-Revenue Bonds, continued:

Optional Redemption Series 2011B:

The Series 2011B Bonds maturing on and after December 1, 2021, are subject to redemption by the City, at its option, before maturity on September 1, 2021, and on any date thereafter in whole or from time to time in part in any order of maturity (less than all of a single maturity to be selected by lot in such manner as the Trustee and Paying Agent may determine) at a redemption price equal to 100% of the principal amount thereof plus accrued interest to the redemption date.

A summary of the long-term debt of the Commission is as follows:

	<u>2012</u>	<u>2011</u>
City of Henderson, Kentucky Utility Commission Series 2011A Revenue Bonds, secured by pledge of system revenues and non-forecloseable statutory lien, maturing December 1, 2031, annual principal payments ranger from \$420,000 to \$725,000 interest rates range from 2.5% to 4.5%.	\$ 11,350,000	\$ -
City of Henderson, Kentucky Utility Commission Series 2011B Revenue Bonds, secured by pledge of system revenues and non-forecloseable statutory lien, maturing December 1, 2031, annual principal payments ranger from \$150,000 to \$245,000 interest rates range from 2.5% to 4.5%.	<u>3,670,000</u>	<u>-</u>
Total long termdebt as of May 31, 2012	\$ 15,020,000	\$ -
Less current portion due	<u>570,000</u>	<u>-</u>
Long termdebt net of current portion	<u>\$ 14,450,000</u>	<u>\$ -</u>

Future maturities of long-termdebt for the next five years as of May 31, 2012 are as follows:

	<u>Series 2011 A</u>	<u>Series 2011 B</u>	<u>Totals</u>
2013	\$ 420,000	\$ 150,000	\$ 570,000
2014	435,000	150,000	585,000
2015	445,000	155,000	600,000
2016	455,000	155,000	610,000
2017	465,000	155,000	620,000
Later years	<u>9,130,000</u>	<u>2,905,000</u>	<u>12,035,000</u>
	<u>\$ 11,350,000</u>	<u>\$ 3,670,000</u>	<u>\$ 15,020,000</u>

10. Asset Retirement Obligation:

Effective December 31, 2008, the Commission terminated operation of its Station One generation facility. The Commission is legally obligated to remove asbestos, lead paint, and other contaminants located there. Accordingly, a liability has been established in accordance with SFAS No. 143 *Accounting for Asset Retirement Obligations*.

**City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements
For the fiscal years ended May 31, 2012 and 2011**

10. Asset Retirement Obligation, continued:

The following is a reconciliation of the aggregate retirement liability associated with the Commission's obligation to remove the contaminants:

	Asset Retirement Obligation
Balance as of June 1, 2011	\$ 1,430,771
Additional obligations incurred	-
Increase in present value of the obligation	-
Increase based on revised estimates of costs to dismantle and remove assets	-
Liabilities extinguished	-
Balance as of May 31, 2012	<u>\$ 1,430,771</u>

11. Discounted Internet and Broadband Services:

A summary of discounted internet and broadband services provided by the Commission to other governmental concerns is as follows:

<u>Governmental Organizations</u>	<u>2012</u>	<u>2011</u>
Henderson County GIS System	\$ 54,000	\$ 98,568
Henderson Water Utility	121,000	106,395
City of Henderson	201,000	205,484
Other organizations	2,000	9,553
	<u>\$ 378,000</u>	<u>\$ 420,000</u>

12. Concentration of Sales:

Three industrial customers of the Existing System accounted for sales in the amount of \$9.9 million (27% of sales), and \$8.7 million (28% of sales) for the fiscal years ended May 31, 2012 and 2011.

13. Emission Allowances:

Amendments to the Clean Air Act in 1990 established a system whereby emission allowances were created and allocated to generating units subject to Phase 1 of the emission restrictions. Station Two was allotted a total of 226,901 allowances through 1999 (one emission allowance represents the authorization to emit one ton of sulfur dioxide in a given year). The allowances are allocated between the Commission and the Station Two Operator based upon the Station Two capacity allocations. As of May 31, 2012, and 2011, there were remaining sulfur dioxide emission allowances valued at \$18,189 and \$54,567, respectively each year ended.

14. Related Party Transactions:

The Commission incurred the following transactions with the City of Henderson, Kentucky for the fiscal years ended May 31, 2012 and 2011:

- Paid the City \$575,667 and \$546,750 each year, respectively, for data processing and other services related to billings and collections.
- Paid the City \$1,244,724 and \$1,244,724 May 31, 2012 and 2011 of the fiscal years ended, respectively.
- Paid the City \$593,706 and \$695,422 for participation in the City of Henderson's self-insured employee health insurance plan for the fiscal years ended May 31, 2012 and 2011 respectively. Risk is minimized in this area by the purchase of re-insurance for amounts in excess of the \$125,000 stop loss limit. Charges are based on estimated amounts determined by the City of Henderson's insurance coordinator as necessary to fund claims as they become due and payable.
- Provided the City of Henderson with power for the fiscal years ended May 31, 2012 and 2011 in the amount of \$386,142 and \$376,704 respectively. The City of Henderson was also provided significantly reduced communication service fees totaling approximately \$201,000 for the fiscal year May 31, 2012.

15. Commitments and Contingencies:

A. Southeastern Power Administration:

The Southeastern Power Administration (SEPA) has contracted with the Commission to provide it a total of 18,000 megawatt hours of hydroelectric power each year. The 18,000 megawatt hours represent approximately 3 % of the Commission's annual megawatt hour requirements. Henderson Municipal Power & Light is restricted to not more than 12 megawatt hours during any hour, and not more than 2,640 megawatt hours during any month.

In the Fall of 2006, SEPA informed all participants that the Wolf Creek Dam near Jamestown, Kentucky, had been inspected and serious seepage problems existed. In an effort to respond to these safety concerns and make the needed repairs to the dam, SEPA reduced and curtailed electric service to the project participants. This reduction and curtailment of electric service began in early 2007 and is expected to continue for an extended period of time until repairs are completed.

In response to SEPA's actions, for the next fiscal year, the Commission has budgeted for additional power from Station Two to offset the loss of the SEPA power. The SEPA Cumberland River Hydroelectric Power System may not return to normal operations for several years.

During the year ended May 31, 2012 and 2011, the Commission purchased power on the spot market and from SEPA to supply the needs of its customers. Purchased power from these sources for the fiscal year ended May 31, 2012 was \$1,138,059 and \$828,037 during 2011.

15. Commitments and Contingencies, continued:

B. Regulatory Compliance:

The North American Electric Reliability Corporation (NERC) adopted new electric system reliability standards for all electric utilities in the United States. NERC has adopted and began enforcement of the new standards effective June of 2007. The new standards have been approved by the Federal Energy Regulatory Commission (FERC). The Commission must comply with the new standards and will incur administrative expenses related to NERC compliance.

Federal air quality and emission standards have become more stringent. The current standards and proposed standards resulted in the cost of compliance being excessive to operate Station One. As a result of the new regulations, the Commission approved the cessation of operations at Station One on August 25, 2008, and Station One was taken out of service in December of 2008.

C. Unwind Transaction- Station Two:

In 1998, HMP&L, Big Rivers Electric Corporation, and Western Kentucky Energy Corporation entered into contracts for the operation of the HMP&L Station Two Power Plant and other Big Rivers Electric Corporation Generation Plants. On July 16, 2009, Big Rivers Electric Corporation and Western Kentucky Energy Corporation (E.ON) signed an agreement under which the original 1998 contracts are rescinded and operational control of the Station Two Power Plant returned to Big Rivers Electric Corporation. As part of this agreement E.ON paid the Commission approximately \$17.4 million to settle claims.

HMP&L and Big Rivers Electric Corporation have identified a number of facility upgrades and maintenance projects for the Station Two Power Plant. Big Rivers Electric Corporation has developed Work Plans for the five years period 2009 to 2014. These preliminary Work Plans estimate that HMP&L will incur additional maintenance expenses at Station Two.

D. Pending Litigation:

The Commission is currently engaged in litigation with the Station Two Operator, Big Rivers Electric Corporation, related to which party has the rights to certain surplus generation capacity of the Commission's Station Two Facility. Big Rivers has filed a petition in Henderson County, Kentucky Circuit Court requesting binding arbitration over the matter. It is the assertion of the Commission that it has the right to all power from the facility related to its reserved capacity.

15. Commitments and contingencies, continued:

D. Pending Litigation, continued:

The Commission has filed a declaratory judgment action for the interpretation of the application of Kentucky Prevailing Wage laws to the maintenance and repair outages which occur on an annual basis at its Station Two Facility. The declaratory judgment action requests the determination as to whether the annual outages that occur at this facility are considered one project or multiple projects occurring during a defined time period. The final hearing is scheduled for December 5, 2012 in Henderson Circuit Court. The declaratory judgment action does not involve any financial exposure on behalf of the Commission and an adverse ruling would not have any impact on the Commission's financial position. The Commission has tendered an advance payment of the application of the prevailing wage standard.

16. Risk Management:

The Commission is exposed to various risks of loss related to torts, theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Commission carries commercial insurance for these types of risk of loss, including workers' compensation. Settled claims from these risks have not exceeded commercial insurance coverage in any of the past four fiscal years.

17. Amounts Due From Station Two Operator:

As of the fiscal years ended May 31, 2012 and 2011, the amount the Station Two Operator owed to the Commission, as part of the annual settlement, was \$1,446,224 and \$2,854,800, respectively. Subsequent events have been evaluated through September 14, 2012.

18. Subsequent Events:

Subsequent events have been evaluated through September 14, 2012.

CITY OF HENDERS ON, KENTUCKY UTILITY COMMISSION
COMBINING STATEMENT OF NET ASSETS-BY SYSTEM
As of May 31, 2012 and 2011

	May 31, 2012				May 31, 2011			
	Existing System	Station Two	Elimination	Total	Existing System	Station Two	Elimination	Total
Assets								
Current assets:								
Cash and cash equivalents	\$ 1,316,418	\$ 69,315	\$ -	\$ 1,385,733	\$ 43,399	\$ 50,520	\$ -	\$ 93,919
Investment securities	16,742,179	-	-	16,742,179	20,332,325	-	-	20,332,325
Restricted cash equivalents and investments:								
Certificates of deposit and money market	7,111,272	-	-	7,111,272	-	-	-	-
Short-term U.S. Government securities	1,625,529	-	-	1,625,529	-	-	-	-
Accounts receivable, net of allowance for uncollectible	1,581,873	1,540,500	-	3,122,373	2,453,908	1,008,554	-	3,462,462
Accounts receivable-Station Two Operator	1,446,224	-	-	1,446,224	2,854,800	-	-	2,854,800
Accrued interest receivable	-	-	-	-	30,901	-	-	30,901
Accrued revenue	2,684,246	-	-	2,684,246	2,292,277	-	-	2,292,277
Inventory and supplies	4,772,080	2,679,610	-	7,451,690	4,994,443	2,708,189	-	7,702,632
Prepaid expenses	57,499	-	-	57,499	63,558	-	-	63,558
Total current assets	37,337,320	4,289,425	-	41,626,745	33,065,611	3,767,263	-	36,832,874
Utility plant, net of accumulated depreciation	11,090,894	53,897,976	-	64,988,870	10,290,925	55,893,269	-	66,184,194
Other assets:								
Bond issue costs, net of amortization	489,510	-	-	489,510	-	-	-	-
Investment in Station Two	31,058,999	-	(31,058,999)	-	31,058,999	-	(31,058,999)	-
Total assets	\$ 79,976,723	\$ 58,187,401	\$ (31,058,999)	\$107,105,125	\$ 74,415,535	\$ 59,660,532	\$ (31,058,999)	\$103,017,068

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
COMBINING STATEMENT OF NET ASSETS-BY SYSTEM
As of May 31, 2012 and 2011

	<u>May 31, 2012</u>				<u>May 31, 2011</u>			
	<u>Existing System</u>	<u>Station Two</u>	<u>Elimination</u>	<u>Total</u>	<u>Existing System</u>	<u>Station Two</u>	<u>Elimination</u>	<u>Total</u>
Liabilities and net assets:								
Current liabilities:								
Accounts payable and accrued expenses	\$ 2,756,415	\$ 4,297,186	\$ -	\$ 7,053,601	\$ 2,602,904	\$ 3,775,026	\$ -	\$ 6,377,930
Accounts payable-Construction in progress - Station Two	-	2,307,768	-	2,307,768	-	1,222,100	-	1,222,100
Asset retirement obligation	1,430,771	-	-	1,430,771	1,430,771	-	-	1,430,771
Accounts payable-Station Two Operator	-	-	-	-	-	-	-	-
Current portion-bonds payable	570,000	-	-	570,000	-	-	-	-
Customer deposits	622,585	-	-	622,585	654,081	-	-	654,081
Total current liabilities	5,379,771	6,604,954	-	11,984,725	4,687,756	4,997,126	-	9,684,882
Long-term debt:								
Long-term portion of bonds payable	14,450,000	-	-	14,450,000	-	-	-	-
Bond anticipation notes	-	-	-	-	7,975,535	-	-	7,975,535
Total long-term liabilities	14,450,000	-	-	14,450,000	7,975,535	-	-	7,975,535
Net assets:								
Unrestricted	24,280,258	(2,315,529)	-	21,964,729	28,377,855	(1,229,863)	-	27,147,992
Restricted per bond ordinance	8,736,801	-	-	8,736,801	-	-	-	-
Investment in plant assets, net of related debt	27,129,893	53,897,976	(31,058,999)	49,968,870	33,374,389	55,893,269	(31,058,999)	58,208,659
Total net assets	60,146,952	51,582,447	(31,058,999)	80,670,400	61,752,244	54,663,406	(31,058,999)	85,356,651
Total liabilities and net assets	\$ 79,976,723	\$ 58,187,401	\$ (31,058,999)	\$107,105,125	\$ 74,415,535	\$ 59,660,532	\$ (31,058,999)	\$103,017,068

COMBINING STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS-BY SYSTEM
For the fiscal years ended May 31, 2012 and 2011

	May 31, 2012				May 31, 2011			
	Existing System	Station Two	Elimination	Consolidated Total	Existing System	Station Two	Elimination	Consolidated Total
Operating Revenues:								
Sale of electricity	\$ 36,971,905	\$ 33,171,480	\$ (11,434,222)	\$ 58,709,163	\$ 32,651,935	\$ 29,226,631	\$ (8,113,355)	\$ 53,765,211
Communication services	985,380	-	-	985,380	1,062,343	-	-	1,062,343
Other	338,084	-	-	338,084	563,429	35,000	-	598,429
Total Operating Revenues	38,295,369	33,171,480	(11,434,222)	60,032,627	34,277,707	29,261,631	(8,113,355)	55,425,983
Operating Expenses:								
Production of electricity	29,299,230	28,884,766	(11,434,222)	46,749,774	22,890,647	26,191,168	(8,113,355)	40,968,460
Operating, general and administrative	7,143,135	3,351,623	-	10,494,758	6,304,809	3,198,318	-	9,503,127
Depreciation	1,003,822	4,016,455	-	5,020,277	984,140	4,045,862	-	5,030,002
Total Operating Expenses	37,446,187	36,252,844	(11,434,222)	62,264,809	30,179,596	33,435,348	(8,113,355)	55,501,589
Income (Loss) from Operations	849,182	(3,081,364)	-	(2,232,182)	4,098,111	(4,173,717)	-	(75,606)
Interest Income (Expense):								
Investment income	6,599	273	-	6,872	113,544	497	-	114,041
Interest expense	(452,207)	-	-	(452,207)	(172,255)	-	-	(172,255)
Total Interest Income (Expense)	(445,608)	273	-	(445,335)	(58,711)	497	-	(58,214)
Income (Loss) Before Transfers	403,574	(3,081,091)	-	(2,677,517)	4,039,400	(4,173,220)	-	(133,820)
Non-operating Items:								
Gain on sale of emission allowances	-	132	-	132	-	-	-	-
Capital contributions-distributions,net	-	-	-	-	600,000	1,052,896	(2,152,896)	(500,000)
Transfers to City of Henderson	(1,244,724)	-	-	(1,244,724)	(1,244,724)	-	-	(1,244,724)
Power furnished to City of Henderson	(386,142)	-	-	(386,142)	(376,704)	-	-	(376,704)
Communication services provided to the City of Henderson and local governmental agencies	(378,000)	-	-	(378,000)	(420,000)	-	-	(420,000)
Total non-operating Items	(2,008,866)	132	-	(2,008,734)	(1,441,428)	1,052,896	(2,152,896)	(2,541,428)
Increase (Decrease) in Net Assets	(1,605,292)	(3,080,959)	-	(4,686,251)	2,597,972	(3,120,324)	(2,152,896)	(2,675,248)
Net Assets, Beginning of Year	61,752,244	54,663,406	(31,058,999)	85,356,651	59,154,272	57,783,730	(28,906,103)	88,031,899
Net Assets, End of Year	\$ 60,146,952	\$ 51,582,447	\$ (31,058,999)	\$ 80,670,400	\$ 61,752,244	\$ 54,663,406	\$ (31,058,999)	\$ 85,356,651

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
SUPPLEMENTAL SCHEDULE OF CHANGES IN NET ASSETS - BY SYSTEM
For the fiscal years ended May 31, 2012 and 2011

	<u>Existing System</u>	<u>Station Two</u>			<u>Eliminations *</u>	<u>Total Net Assets</u>
		<u>Utility Commission</u>	<u>Big Rivers</u>	<u>Total Station Two</u>		
Beginning balance, June 1, 2010	\$ 59,154,272	20,371,368	37,412,362	57,783,730	(28,906,103)	\$ 88,031,899
Net income (loss)	<u>2,597,972</u>	<u>(1,186,515)</u>	<u>(1,933,809)</u>	<u>(3,120,324)</u>	<u>(2,152,896)</u>	<u>(2,675,248)</u>
Balance, May 31, 2011	61,752,244	19,184,853	35,478,553	54,663,406	(31,058,999)	\$ 85,356,651
Net income (loss)	<u>(1,605,292)</u>	<u>(1,147,150)</u>	<u>(1,933,809)</u>	<u>(3,080,959)</u>	<u>-</u>	<u>(4,686,251)</u>
Balance May 31, 2012	<u>\$ 60,146,952</u>	<u>\$ 18,037,703</u>	<u>\$ 33,544,744</u>	<u>\$ 51,582,447</u>	<u>\$ (31,058,999)</u>	<u>\$ 80,670,400</u>

* Elimination of interest of Existing System in investment in the equity of Station Two.

Shown on the Statement of Net Assets

	<u>2012</u>	<u>2011</u>
Investment in Utility Plant and Equipment, net of related debt	\$ 49,968,870	\$ 58,208,659
Restricted per bond ordinance	8,736,801	-
Unrestricted	<u>21,964,729</u>	<u>27,147,992</u>
	<u>\$ 80,670,400</u>	<u>\$ 85,356,651</u>



Independent Auditors' Report on Internal Control Over Financial Reporting, Compliance and Other Matters Based on an Audit of Primary Government Financial Statements Performed in Accordance with *Government Auditing Standards*

Dr. William Smith, Chairman
and the Board of Commissioners
City of Henderson, Kentucky Utility Commission
Henderson, Kentucky

We have audited the financial statements of the City of Henderson, Kentucky Utility Commission as of and for the year ended May 31, 2012, and have issued our report thereon dated August 31, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City of Henderson, Kentucky Utility Commission's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City of Henderson, Kentucky Commission's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City of Henderson, Kentucky Utility Commission's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as a result of our audit procedures we did not note any items that constitute significant deficiencies.

A *deficiency in internal control over compliance* 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 misstatements on a timely basis. A material weakness in internal control is a deficiency, significant deficiency, or combination of control deficiencies, that adversely affects the City of Henderson, Kentucky Utility Commission's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles, such that there is more than a remote likelihood that a misstatement of the organization's financial statements that is more than inconsequential will not be prevented or detected by the City of Henderson, Kentucky Utility Commission's internal control. We noted no items we consider to be significant deficiencies.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Henderson, Kentucky Utility Commission's financial statements are free of 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*.

We noted certain matters that we reported to management of the City of Henderson, Kentucky Utility Commission in a separate letter dated September 14, 2012.

This report is intended solely for the information and use of management, the audit committee, Board of Commissioners, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in cursive script that reads "Myriad CPA Group, LLC". The signature is written in black ink and is positioned above the typed name of the firm.

Henderson, Kentucky
September 14, 2012



**City of Henderson, Kentucky Utility Commission –
Henderson Municipal Power & Light**

Report on Audited Financial Statements

For the fiscal years ended May 31, 2013 and 2012

**Case No: 2019-00269
Attachment 1 to BREC 1-31
HMPL Audits 2011-2019**

Contents

	<u>Page(s)</u>
Management's Discussion and Analysis	1-8
Independent Auditors' Report	9-10
Basic Financial Statements:	
Statement of Net Position	11
Statement of Revenues, Expenses and Changes in Net Position	12
Statement of Cash Flows	13
Statement of Cash Flows – Reconciliation of Net Cash Provided by Operations	14
Notes to the Financial Statements	15-27
Supplemental Information:	
Combining Statement of Net Position – By System	28-29
Combining Statement of Revenues, Expenses and Changes in Net Position – By System	30
Supplemental Schedule of Changes in Net Position – By System	31
Independent Auditors' Report on Internal Control Over Financial Reporting, Compliance and Other Matters Based on an Audit of Primary Government Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	32-33

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION- HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT'S DISCUSSION AND ANALYSIS

The City of Henderson, Kentucky Utility Commission (HMP&L) is in the business of providing electricity and internet communication services for residential, commercial, and industrial customers within the incorporated territory of the City of Henderson, Kentucky. The Commission also provides electricity and internet communication services to customers in a few areas outside of the incorporated territory of Henderson. The following discussion and analysis of HMP&L's financial performance provides an overview of the Utility's financial activities for fiscal year ended May 31, 2013.

Overview of the Financial Statements:

This annual financial report consists of three parts: 1) Management's Discussion and Analysis, 2) Financial Statements, and 3) Supplemental Additional Information. The Financial Statements also include notes that explain in more detail some of the information in the financial statements. The statements are followed by a section of supplemental information that further explains and supports the information in the basic financial statements. The Supplemental schedules present the financial position and results of operations for the Existing System and Station Two. The Consolidated Financial Statements report information about HMP&L using accounting methods similar to those used by private sector companies, except for the reporting of contributions in aid of construction, equity capital, and retained earnings. Refer to the Summary of Significant Accounting Policies in the footnotes to the Financial Statements relating to the adoption of Statement No. 34 of the Governmental Accounting Standard Board (GASB 34).

The Statement of Net Position, successor to the Balance Sheet, includes all of the Utility's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to HMP&L's creditors (liabilities). It also provides the basis for evaluating the capital structure of HMP&L and assessing the liquidity and financial flexibility of HMP&L.

All of the current year's revenues and expenses are accounted for in the Statement of Revenues, Expenses, and Changes in Net Position, successor to the Income Statement. This statement measures the success of the Utility's operations over the past year and can be used to determine whether the Utility has successfully recovered all of its costs through the sale of electricity, communications, and other charges, and has earned a reasonable profit, as well as, maintained a sound financial position.

The final required financial statement is the Statement of Cash Flows. The primary purpose of this statement is to provide information about the Utility's cash receipts, cash payments, and net changes in cash resulting from operations, investing and financing activities, and provides information on the sources and uses of cash and the changes in cash balances during the year.

Financial Statements:

- HMP&L's total assets decreased from \$107,105,125 at May 31, 2012 to \$101,191,642 at May 31, 2013. This decrease is primarily attributable to the decreased balances in accounts receivable and restricted assets.
- Operating revenues for HMP&L Existing System increased by approximately \$648,597 or 1.6% from \$38,295,369 to \$38,943,966. The increase in Existing System sales was primarily due to increase power demand over that of the previous year. Internet revenue decreased by \$4,000.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION- HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT'S DISCUSSION AND ANALYSIS

Financial Statements, continued:

	<u>2013</u>	<u>2012</u>	<u>Change</u>	<u>Change</u>
Sale of electricity	\$ 37,407	\$ 36,972	\$ 435	1%
Internet service	981	985	(4)	0%
Other	556	338	218	64%
Total operating revenues	\$ 38,944	\$ 38,295	\$ 649	2%

Note: All amounts presented in thousands -000's omitted

- Operating expenses for HMP&L Existing System increased by approximately \$1,783,194 or 5%. The following table represents the changes in the expenses for the Existing System:

<u>Existing System:</u>	<u>2013</u>	<u>2012</u>	<u>Increase Decrease</u>	<u>Percentage Change</u>
Production of electricity	\$ 31,906	\$ 29,299	\$ 2,607	9%
Other operating expenses	6,347	7,143	(796)	-11%
Depreciation	976	1,004	(28)	-3%
Total operating expenses	\$ 39,229	\$ 37,446	\$ 1,783	5%

Note: All amounts presented in thousands -000's omitted

- Operating revenues for Station Two increased approximately \$6,461,227 over that of the previous year. The Station Two Agreement is not designed to generate a profit for each of the participants in the venture, but rather to break-even on a cash flow basis. Operating expenses increased for Station Two.

<u>Station Two:</u>	<u>2013</u>	<u>2012</u>	<u>Change</u>
Sales-BREC	\$ 25,097	\$ 21,737	\$ 3,360
Sales-HMPL	14,536	11,434	3,102
Sale of emission allowances and other	-	-	-
Total operating revenues	\$ 39,633	\$ 33,171	\$ 6,462
Expenses:			
Production of electricity	\$ 36,944	\$ 32,237	\$ 4,707
Depreciation	4,073	4,016	57
Administrative	-	-	-
Total operating expenses	\$ 41,017	\$ 36,253	\$ 4,764
Income from operations	(1,384)	(3,082)	1,698
Interest income	0	1	(1)
Net income before transfers	\$ (1,384)	\$ (3,081)	\$ 1,697

Note: All amounts in thousands, 000's omitted

Upon the consolidation of the financial statements for each system, transactions between Henderson Municipal Power and Light and Station Two Operator are eliminated.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION- HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT'S DISCUSSION AND ANALYSIS

Statement of Net Position:

Net position of HMP&L decreased by \$4,060,205 for the fiscal year ended May 31, 2013, while net position decreased by \$4,686,251 in the fiscal year ended May 31, 2012.

Investment securities increased by \$1,000,108 over Fiscal Year 2012.

Cash and cash equivalents decreased by \$480,304 for the fiscal year ended May 31, 2013 versus an increase of \$1,292,000 over that of the previous fiscal year ended.

A summary of the assets of the Commission for the previous three years is as follows:

<u>Assets:</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>
Cash and cash equivalents	\$ 905	\$ 1,386	\$ 94
Investment securities	17,742	16,742	20,332
Restricted assets	6,913	8,737	-
Accounts receivable and unbilled revenue	1,692	3,122	3,494
Accounts receivable Station Two Operator	832	1,446	2,855
Accrued revenue	2,641	2,683	2,292
Inventories	6,034	7,452	7,703
Prepaid expenses	58	58	63
Total current assets	<u>\$ 36,817</u>	<u>\$ 41,626</u>	<u>\$ 36,833</u>
Utility, plant, and equipment, net	63,910	64,989	66,184
Bond issue cost	464	490	-
Total assets	<u>\$ 101,191</u>	<u>\$ 107,105</u>	<u>\$ 103,017</u>

Note: All amounts in thousands, 000's omitted

Current liabilities decreased by \$1,268,278. Accounts payable and accrued expenses decreased \$1,675,817 over the previous year mainly due to the decrease in the price of coal.

A summary of the liabilities section of the Statement of Net Position is as follows:

<u>Liabilities:</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>
Accounts payable and accrued expenses	\$ 5,378	\$ 7,054	\$ 6,378
Accounts payable construction	2,689	2,308	1,222
Asset retirement obligation	1,431	1,431	1,431
Current portion bonds payable	585	570	-
Customer deposits	634	622	654
Total current liabilities	<u>\$ 10,717</u>	<u>\$ 11,985</u>	<u>\$ 9,685</u>
Bond anticipation notes	-	-	7,976
Long term portion bond payable	13,865	14,450	-
Total liabilities	<u>\$ 24,582</u>	<u>\$ 26,435</u>	<u>\$ 17,661</u>

Note: All amounts in thousands, 000's omitted

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION- HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT'S DISCUSSION AND ANALYSIS

Statement of Revenues, Expenses, and Changes in Net Position:

Operating Revenues for the entire entity increased by \$4,008,460 over that of the previous year. Sales for HMP&L Station Two increased by \$3,359,863 or 15.45% while Sales Existing System increased by \$648,597 or 1.69%.

Operating Expenses increased by \$3.5 million. This was due to increased operating costs incurred with the operation of Station Two.

The Net Operating Loss of the Existing System, after interest expense and interest income, was (\$765,742). Transfers were made to the City of Henderson in the amount of \$1.2 million for the fiscal year ended, the value of power furnished to the City of Henderson at no charge was \$288,000, and the value of communication services provided to the City of Henderson and other governmental agencies, at no charge, was \$378,000.

Station Two had a net operating loss of \$1.4 million, however, the net loss relates primarily to depreciation expense which is a non-cash item.

<u>Summary of Changes in Net Position:</u>	<u>Existing System</u>	<u>Station Two</u>	<u>Total</u>
Income (loss) before transfers	\$ (765,742)	\$ (1,383,792)	\$ (2,149,534)
Non-operating items:			
Extraordinary item			
Contributed capital-net of HMP&L	-	-	-
Transfer to City		-	-
Gain on sale of emission allowances	-	53	53
Transfers to City of Henderson	(1,244,724)	-	(1,244,724)
Communication services provided to the City and other governmental agencies	(378,000)	-	(378,000)
Power furnished to City of Henderson	(288,000)	-	(288,000)
Increase (decrease) in net assets	<u>\$ (2,676,466)</u>	<u>\$ (1,383,739)</u>	<u>\$ (4,060,205)</u>

Statement of Cash Flows:

Cash generated from operating activities decreased by \$517,496 over the level from Fiscal Year 2012.

Cash Flows from non-capital financing activities include the funds transferred to the City of Henderson. For the fiscal year ended May 31, 2013, \$1.2 million was transferred.

Cash used by capital and related financing activities was \$4.9 million.

Cash and cash equivalents for the year, which consist primarily of checking and money market accounts of HMP&L, decreased by \$480,304.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Statement of Cash Flows, continued:

<u>Cash Flow Summary</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>
Net cash generated by operations	\$ 4,849	\$ 5,368	\$ (927)
Cash transferred to City of Henderson	(1,245)	(1,245)	(1,244)
Distribution from former Station Two Operator.	-	-	-
Net cash used by capital and related financing	(4,939)	2,278	(842)
Investing activities	<u>854</u>	<u>(5,109)</u>	<u>2,864</u>
 Increase (decrease) in cash equivalents	 (481)	 1,292	 (149)
 Cash equivalents beginning of year	 <u>1,386</u>	 <u>94</u>	 <u>242</u>
Cash equivalents, end of year	<u>\$ 905</u>	<u>\$ 1,386</u>	<u>\$ 93</u>

Note: All amounts in thousands,000's omitted

The following is a summary of cash and investment balances as of May 31, 2013, to 2011:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Cash and cash equivalents	\$ 905	\$ 1,386	\$ 94
Investments	17,742	16,742	20,332
Restricted investments	6,913	8,736	-
	<u>\$ 25,560</u>	<u>\$ 26,864</u>	<u>\$ 20,426</u>

Note: All amounts presented in thousands, 000's omitted

Capital Assets:

As noted in the footnotes to this report, HMP&L has 19,131 sulfur dioxide emission allowances from the Existing System and Station Two available as of May 31, 2013. The value of the allowances is not reflected in the financial statements due to the fact that the Commission has no cost basis in the allowances. The estimated current market value of these allowances at May 31, 2013, is approximately \$28,697.

Debt Administration:

HMP&L entered into two Bond Anticipation Notes with Fifth Third Bank on December 22, 2008, a non-taxable series 2008A in the amount of \$3,500,000 and a taxable series 2008B in the amount of \$9,000,000. The series 2008A was used for capital improvements to the City's retail electric system. The taxable series 2008B was used to make capital improvements to the City's Station Two generating plant. HMP&L entered into an additional Bond Anticipation Note with Fifth Third Bank on March 25, 2010, a non-taxable series 2010A in the amount of \$1,500,000. This note was repaid at the same time as the series 2008A note. On December 1, 2011 HMP&L issued Revenue Bonds in the amount of \$15,020,000 and retired all outstanding Bond Anticipation Notes.

On January 29, 2009, the City Commission approved an Ordinance increasing electric rates by 3.855 percent for all customer rate classifications. The purpose of the rate increase was to provide additional revenue to make the principal and interest payments on the short-term Bond Anticipation Notes and the long-term Bonds issued to replace the Bond Anticipation Notes. HMP&L set up a separate Bond Payment Account and, as of May 31, 2013, HMP&L had accrued \$1,526,040 for future principal and interest payments for the Bonds.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION- HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT'S DISCUSSION AND ANALYSIS

System Improvements and Replacement of Capital Assets:

During the period of June 1, 2012, through May 31, 2013, HMP&L made a number of improvements to the electric and communication facilities and replaced certain assets. The improvements to the facilities and asset replacements increased service reliability and extended the useful-life of certain existing assets.

During the FY2012-2013, HMP&L made \$906,036 in capital improvements and replacements in the Existing System and \$3,070,255 in capital improvements and replacements of Station Two.

Economic Factors:

The current economic recession has impacted HMP&L kilowatt hour sales. The decline in HMP&L sales began in December 2008 and has leveled off through the end of May 2013. As the depressed economy continues, HMP&L anticipates static kilowatt hour sales. However, based upon monthly sales data subsequent to June 1, 2012, it appears the decline in gross sales has stabilized and sales now appear to be increasing due to seasonal weather fluctuations.

Station Two – Future Expenditures:

In 1998, HMP&L and Big Rivers Electric Corporation entered into contracts with Western Kentucky Energy Corporation for the operation of the HMP&L Station Two Power Plant and other Big Rivers Electric Corporation Generation Plants. Big Rivers Electric Corporation and Western Kentucky Energy Corporation entered discussions to unwind the original 1998 contracts and return operational control of the Station Two Power Plant and the other Plants to Big Rivers Electric Corporation. The Unwind Transaction closed on July 16, 2009, and Big Rivers, thereafter, resumed operation of the Station Two generating plant. Big Rivers Electric Corporation has identified a number of facility upgrades and maintenance projects for the Station Two Power Plant. These Work Plans indicate HMP&L will incur an additional \$18 million to \$21 million in maintenance expenses in the future at Station Two. Big Rivers and HMP&L are currently involved in litigation concerning the Excess Henderson Energy at Station Two. The litigation was heard in the Henderson County Circuit Court and the judge assigned the dispute to arbitration. On May 30, 2012 the Arbitration Panel issued a final ruling in favor of HMP&L. Big Rivers filed a motion with the Appeals Court requesting that the Arbitration Panel's ruling be vacated and set aside. The parties are currently waiting on the Court's ruling. This legal dispute may continue for several years.

In July 2012, HMP&L entered into litigation with the Kentucky Department of Labor related to the application of prevailing of wage rates at Station Two. The litigation went to trial in December 2012. The Circuit Court ruled in favor of the Labor Cabinet on May 24, 2013. HMP&L has filed an appeal in the Kentucky Appeals Court.

In recent years, HMP&L has increased its reserved capacity at Station Two. The reserve capacity for FY 2012-2013 was 115 megawatts and HMP&L did not raise its reserve capacity for FY 2013-2014. HMP&L intends to keep the reserve capacity at 115 megawatts which is in line with HMP&L historical system peak demand. Each 5 megawatt increase in the reserved capacity will cost HMP&L approximately \$696,513/year. The actual cost of reserved capacity, however, is based upon the Station Two budget which varies each year.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION- HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT'S DISCUSSION AND ANALYSIS

Closing of Station One:

The Utility Commission considered Station One to no longer be a viable generating facility because of increasing federal and state restrictions for new air emissions and the increasing costs of maintenance and fuel for the facility. Therefore, Station One was closed effective December 31, 2008. Upon closing, Station One employed 13 full-time and 2 temporary personnel of which nine were placed internally, one was placed externally, one retired, three were laid off and one temporary employee was terminated. As of May 31, 2013 no decision has been made for the disposal of the Station One assets. The Commission is currently investigating the cost to remediate certain environmental concerns at Station One. The Commission intends to make a final decision prior to the end of 2014.

Southeastern Power Administration (SEPA):

The Southeastern Power Administration (SEPA) has contracted with HMP&L to provide HMP&L a total of 18,000 megawatt hours of hydroelectric power each year. The 18,000 megawatt hours represent approximately 3 percent of HMP&L's annual megawatt hour requirements. HMP&L is restricted to not more than 12 megawatt hours during any one hour period. The hydroelectric power is provided from SEPA generation units on the Cumberland River System Project.

In the fall of 2006, SEPA informed all contract project participants that the Wolf Creek Dam near Jamestown, Kentucky, had been inspected and serious seepage problems existed in the earthen dam. The seepage problems at the dam date back to 1968 and the US Army Corp of Engineers implemented various repairs since that time; however, the seepage became critical to the safety of the Wolf Creek Dam and surrounding communities. In an effort to respond to these safety concerns and make the needed repairs to the dam, SEPA reduced and curtailed electric service to the contract project participants. This reduction and curtailment of SEPA electric service began in early 2007.

In response to SEPA's actions in 2006, during FY2013-2014, HMP&L budgeted additional expenses for additional purchases of power from the open market to offset the loss of the SEPA power. The SEPA Cumberland River Hydroelectric Power System may not return to normal operations for several more years.

Regulatory Compliance:

The North American Electric Reliability Corporation (NERC) adopted new electric system reliability standards for all electric utilities in the United States. NERC adopted and began enforcement of the new standards beginning in June 2007. The new standards were approved by the Federal Energy Regulatory Commission (FERC). HMP&L is required to comply with the new reliability standards and HMP&L will incur administrative expenses related to NERC compliance. HMP&L has established an internal committee to address NERC Reliability Standards. Also, HMP&L has retained an external consulting firm to assist, support, and facilitate HMP&L's compliance with NERC Reliability. In November 2008, SERC audited HMP&L for compliance with NERC Reliability Standards. Subsequent to the November audit, a number of formal and informal discussions took place between HMP&L and SERC. HMP&L and SERC reached an agreement concerning non-compliance issues identified during the audit; and a final settlement agreement was approved. In November 2010, HMP&L hired a new Reliability Compliance Manager who is responsible for compliance with NERC Reliability Standards.

Federal air quality and emission standards continue to be increasingly more stringent. The current standards and proposed new standards will increase the cost of energy production at Station Two.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION- HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT'S DISCUSSION AND ANALYSIS

Transfer to City:

In FY2012-2013, HMP&L's cash transfer to the City was \$1.24 million. HMP&L has budgeted this same level of cash transfer to the City for FY2013-2014 and subsequent budget periods. HMP&L also pays the City \$582,583 for internal service fees and HMP&L provides the City free electric service valued at \$288,000 and communication services valued at \$378,000 annually. Excluding the annual fuel adjustment revenue and expense, the annual cash transfer payments, internal service fees, and value of the free electric and communication services represent 8.75 percent of estimated gross electric revenue in FY2012-2013.

For more information contact Mark Powers, CPA, at 100 Fifth Street Henderson, Kentucky 42420 or via telephone at 270.826.2726.



INDEPENDENT AUDITORS' REPORT

To the Board of Commissioners
City of Henderson, Kentucky
Utility Commission
Henderson, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the City of Henderson, Kentucky Utility Commission (Commission), a component unit of the City of Henderson, Kentucky, as of May 31, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the basic financial statements as listed in the table of contents.

Implementation of GASB No. 63

As discussed in Note 18 to the financial statements, the Commission adopted the provisions of Governmental Accounting Standards Board No. 63, *Financial Reporting of Deferred Outflows, and Deferred Inflows of Resources and Net Position*.

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 opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of 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 auditors' 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 opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Commission as of May 31, 2013 and 2012, and the changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management discussion and analysis on pages 1 through 8 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. The accompanying supplemental information on pages 28 to 31, is presented for purpose of additional analysis. 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.

Our audit was performed for the purpose of forming an opinion on the financial statements of the City of Henderson, Kentucky Utility Commission taken as a whole. The accompanying supplemental information on pages 28 to 31, is presented for purpose of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements, and in our opinion is fairly stated in all material respects, in relation to the financial statements.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report on our consideration of the City of Henderson, Kentucky Utility Commission's internal control over financial reporting and 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 the 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 City of Henderson, Kentucky Utility Commission's internal control over reporting and compliance.

A handwritten signature in black ink that reads "Myriad CPA Group, LLC". The signature is written in a cursive, flowing style.

Henderson, Kentucky
September 30, 2013

City of Henderson, Kentucky Utility Commission
Statement of Net Position
As of May 31, 2013 and 2012

<u>Assets:</u>	<u>2013</u>	<u>2012</u>
<u>Current assets:</u>		
Cash and cash equivalents	\$ 905,429	\$ 1,385,733
Investment securities	17,742,287	16,742,179
Restricted assets per bond ordinance:		
Certificates of deposit and money market accounts	5,286,383	7,111,272
Short-term U.S. Government Securities	1,626,842	1,625,529
Accounts receivable, net of allowance for uncollectible	1,692,383	3,122,373
Accounts receivable, Station Two Operator	832,193	1,446,224
Accrued interest receivable	-	-
Accrued revenue	2,641,247	2,684,246
Inventory and supplies	6,033,216	7,451,690
Prepaid expenses	57,261	57,499
	<u>36,817,241</u>	<u>41,626,745</u>
<u>Utility plant and equipment:</u>		
Utility plant, net of accumulated depreciation	<u>63,910,320</u>	<u>64,988,870</u>
<u>Other assets:</u>		
Bond issue costs, net of accumulated amortization	<u>464,081</u>	<u>489,510</u>
	<u>\$ 101,191,642</u>	<u>\$ 107,105,125</u>
<u>Liabilities and net assets:</u>		
<u>Liabilities:</u>		
<u>Current liabilities:</u>		
Accounts payable and accrued expenses	\$ 5,377,784	\$ 7,053,601
Accounts payable-Construction in progress Station Two	2,688,919	2,307,768
Current portion-bonds payable	585,000	570,000
Asset retirement obligation	1,430,771	1,430,771
Customer deposits	633,973	622,585
	<u>10,716,447</u>	<u>11,984,725</u>
<u>Long-term debt:</u>		
Long-term portion bonds payable	<u>13,865,000</u>	<u>14,450,000</u>
	<u>13,865,000</u>	<u>14,450,000</u>
	<u>24,581,447</u>	<u>26,434,725</u>
<u>Net position:</u>		
Unrestricted	20,236,650	21,964,729
Restricted per bond ordinance	6,913,225	8,736,801
Investment in plant assets, net of related debt	<u>49,460,320</u>	<u>49,968,870</u>
	<u>76,610,195</u>	<u>80,670,400</u>
	<u>\$ 101,191,642</u>	<u>\$ 107,105,125</u>

The accompanying notes are an integral part of these financial statements.

City of Henderson, Kentucky Utility Commission
Statement of Revenues, Expenses and Changes in Net Position
For the fiscal years ended May 31, 2013 and 2012

<u>Operating revenues:</u>	<u>2013</u>	<u>2012</u>
Sale of electricity-Existing System	\$ 37,406,971	\$ 36,971,905
Sale of electricity-Station Two	25,097,121	21,737,258
Communication services	980,662	985,380
Other	556,333	338,084
	<u>64,041,087</u>	<u>60,032,627</u>
<u>Operating expenses:</u>		
Production of electricity	50,883,263	46,749,774
Operating expenses	9,778,284	10,494,758
Depreciation	5,049,126	5,020,277
	<u>65,710,673</u>	<u>62,264,809</u>
Income (loss) from operations	<u>(1,669,586)</u>	<u>(2,232,182)</u>
<u>Interest income (expense):</u>		
Investment income	29,702	6,872
Interest expense	(509,650)	(452,207)
	<u>(479,948)</u>	<u>(445,335)</u>
Income (loss) before transfers	<u>(2,149,534)</u>	<u>(2,677,517)</u>
<u>Non-operating items:</u>		
Gain on sale of emission allowances	53	132
Capital contributions(distributions)-Station Two, net	-	-
Transfers to City of Henderson	(1,244,724)	(1,244,724)
Power furnished to City of Henderson	(288,000)	(386,142)
Communication services provided to the City of Henderson and other local government agencies	-	-
	(378,000)	(378,000)
	<u>(1,910,671)</u>	<u>(2,008,734)</u>
Change in net position	<u>(4,060,205)</u>	<u>(4,686,251)</u>
Net position, beginning of year	<u>80,670,400</u>	<u>85,356,651</u>
Net position, end of year	<u><u>\$ 76,610,195</u></u>	<u><u>\$ 80,670,400</u></u>

The accompanying notes are an integral part of these financial statements.

City of Henderson, Kentucky Utility Commission
Statement of Cash Flows
For the fiscal years ended May 31, 2013 and 2012

	2013	2012
<u>Cash flows from operating activities:</u>		
Receipts from customers	\$ 63,943,555	\$ 64,902,936
Payments to suppliers and employees	(59,093,559)	(59,535,444)
Net cash provided (used) by operating activities	4,849,996	5,367,492
<u>Cash flows from non-capital financing activities:</u>		
Distribution from Former Station Two Operator		-
Distributions to the City of Henderson	(1,244,724)	(1,244,724)
Net cash provided (used) by non-capital financing activities	(1,244,724)	(1,244,724)
<u>Cash flows from capital and related financing activities:</u>		
Acquisition and construction of capital assets	(3,859,149)	(3,824,953)
Proceeds from issuance of long-term debt	-	15,020,000
Principal payments on long term debt	(570,000)	(7,975,535)
Distribution to Station Two Operator	-	-
Interest payments on long-term debt and bond anticipation notes	(509,650)	(452,207)
Bond issue costs	-	(489,510)
Net cash provided (used) by capital and related financing activities	(4,938,799)	2,277,795
<u>Cash flows provided by investing activities:</u>		
Proceeds from sale of emission allowances	53	132
Proceeds from sale and maturities of investments	4,575,264	10,263,856
Investment income	29,702	37,773
Purchases of investment securities	(3,751,796)	(15,410,511)
Net cash provided (used) by investing activities	853,223	(5,108,750)
Increase (decrease) in cash and cash equivalents	(480,304)	1,291,813
Cash and cash equivalents, beginning of year	1,385,733	93,920
Cash and cash equivalents, end of year	\$ 905,429	\$ 1,385,733

The accompanying notes are an integral part of these financial statements.

City of Henderson, Kentucky Utility Commission
Statement of Cash Flows-Reconciliation of Net Cash Provided by Operations
For the fiscal years ended May 31, 2013 and 2012

	2013	2012
<u>Operating activities:</u>		
Operating income (loss)	\$ (1,669,586)	\$ (2,232,182)
<u>Adjustments to reconcile operating income</u>		
<u>(loss) to net cash provided by operations:</u>		
Depreciation	5,049,126	5,020,277
Power furnished to the City of Henderson	(288,000)	(386,142)
Communication services provided at no charge	(378,000)	(378,000)
<u>Changes in operating assets and liabilities:</u>		
Accounts receivable	1,343,992	340,089
Due from Station Two Operator	614,031	1,408,576
Accrued revenue	42,999	(391,969)
Inventory and supplies	1,418,474	250,942
Prepaid expenses and other assets	238	6,059
Accounts payable and accrued expenses	(1,704,801)	675,671
Accounts payable-construction	381,151	1,085,668
Customer deposits	11,388	(31,497)
Due to Station Two Operator	28,984	-
	\$ 4,849,996	\$ 5,367,492

The accompanying notes are an integral part of these financial statements.

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements
For the fiscal years ended May 31, 2013 and 2012

1. Organization and Contracts:

The City of Henderson Utility Commission is organized under the provisions of Section 96.530 of the Kentucky Revised Statutes to operate, manage, and control the Henderson Municipal Power & Light System. The members of the Utility Commission are appointed by the Mayor and are approved by the City Commissioners of the City of Henderson, Kentucky (City). The Mayor and the City Commission authorize all rates and bond issues of the Utility Commission. As a municipal entity, the Utility Commission is exempt from all federal and state income taxes. Certain real estate utilized by the Utility Commission is owned by the City of Henderson.

The Utility Commission operates the “Existing System” and pursuant to certain contracts and agreements described as follows, reserves power from “Station Two” which is owned by the Commission, and currently operated by Big Rivers Electric Corporation (Big Rivers), pursuant to various lease, assignment, and other agreements between the parties

The Commission provides retail electric service to the residents of the City of Henderson within its service territory. The Commission also provided wholesale electricity to Big Rivers through July 18, 1998 and subsequently to an affiliate of LG&E Energy Corporation. LG&E was purchased by Powergen in 2000 and thereafter acquired by E.ON. Effective July 16, 2009, Big Rivers resumed its role as operator of Station Two as part of the “Unwind Transaction”.

The Commission entered into certain contracts with Big Rivers relating to Station Two, as follows:

A. Power Plant Construction and Operation Agreement:

Under this agreement, Big Rivers agreed to furnish certain construction and start-up services for which it was paid out-of pocket expenses plus overhead allowances and operate Station Two upon completion for which the Station Two Operator is paid reasonable expenditures allocable to the operation and maintenance of Station Two, as defined in the agreement. The original agreement was amended to include an option to extend through the useful operating life of Station Two. Big Rivers exercised this option in 1998.

B. Power Sales Contract:

Under this agreement, The Station Two Operator purchases all of the Station Two capacity in excess of the City of Henderson’s requirements. Payments for capacity purchased by the Station Two Operator are made monthly based on the portion of Station Two capacity allocated to the Station Two Operator compared to the total monthly Station Two capacity costs as defined in the agreement. The original agreement was executed in 1970 and extended through 2023. During 1993, the agreement was amended to include an option to extend through the useful operating life of Station Two. Big Rivers exercised this option in 1998.

C. Joint Facilities Agreement:

This agreement provides for the continuing joint use by the Commission and Station Two Operator of certain auxiliary facilities presently owned and used by the Station Two Operator at its generating station and of auxiliary facilities provided by the Commission in connection with the construction of Station Two, which is located adjacent to the generating station also operated by the Station Two Operator.

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements
For the fiscal years ended May 31, 2013 and 2012

1. Organization and Contracts, Continued:

Power sales to the Station Two Operator under the agreement amounted to \$25,097,121 and \$21,737,258 for the fiscal years ended May 31, 2013 and 2012, respectively.

In connection with the negotiations related to the funding and construction of the Flue Gas Desulfurization System (FGD System) Station Two various aforementioned contracts were amended effective May 31, 1993. Significant provisions of the amendments include:

- The total capacity of Station Two, a factor in determining various Station Two costs allocations, was reduced as a result of the power required to operate the FGD System.
- The total capacity of Station Two, a factor in determining various Station Two costs allocations, was reduced as a result of the power required to operate the FGD System.
- FGD System costs, up to the amount of proceeds from the sale of Emission Allowances, will be borne in the same proportion as the Emission Allowances are allocated. Additional FGD System costs will be borne in proportion to the new capacity allocation as determined by the contract amendments.
- The Commission will reimburse the Station Two Operator for certain allocated costs of an existing Big Rivers' FGD System to be jointly used by the Station Two Operator and Station Two based upon an allocation formula defined in the amendments.

Amounts charged by the Station Two Operator as reasonable expenditures allocable to the operation and maintenance of Station Two are subject to review and approval by the Commission. Differences, if any, between amounts originally charged as allocable by the Station Two Operator and amounts accepted by the Utility Commission are recorded when a final determination of such amounts is made. Operating revenues and expenses would be reduced by any amount subsequently determined not to be allocable to Station Two.

Station Two became commercially operable and construction was substantially completed during 1974. A certificate of completion from the consulting engineers has been filed with the Trustee.

2. Summary of Significant Accounting Policies:

The Commission is a component unit of the City of Henderson, Kentucky (the primary government), due to its financial accountability to the City Commission.

The financial statements of the Commission have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The Commission applies all Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements, in which case GASB prevails.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the fund's principal ongoing operations. The principal operating revenues of the Commission are charges to customers for electric and communications sales and service.

2. Summary of Significant Accounting Policies, Continued:

Operating expenses for the Commission include the cost of power and services, administrative expenses, and depreciation. All other revenues and expenses not meeting this definition are classified as non-operating items.

Statement of Net Position:

The Statement of Net Position is designed to display the financial position of the Commission. The Commission's fund equity is reported as a net position, which is presented in three categories defined as follows:

- **Net invested in capital assets-** This component of net position consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- **Restricted-** This component of net position consists of constraints placed on net position use through external constraints imposed by creditors through debt covenants.
- **Unrestricted-** This component of net position consists of the remainder of net position that does not meet the definition of restricted or invested in capital assets, net of related debt.

Statement of Revenues, Expenses, and Changes in Net Position:

The statement of revenues, expenses, and changes in net position is the operating statement for proprietary funds. Revenues are reported by major source. This statement distinguishes between operating and non-operating revenues and expenses, and presents a separate subtotal for operating revenues, operating expenses, and operating income.

The more significant of the Commission's accounting policies are described below:

A. Cash and Cash Equivalents:

Cash and cash equivalents consist of certificates of deposit and repurchase agreements with an original maturity of three months or less from the date of purchase. The carrying amount of each of these instruments approximates fair value.

B. Investment Securities:

Investments are recorded at fair value based on quoted market prices. Any gains or losses are reflected in the statement of revenues, expenses and changes in net assets in accordance with GASB No.31, "Accounting and Reporting For Certain Investments and For Internal Investment Pools." Kentucky Revised Statute 66.480 limits the types of securities that a municipal entity may invest in to obligations of the United States Treasury and its agencies, certain Federal securities, repurchase agreements, commercial bank certificates of deposit, and the Commonwealth of Kentucky Investment Pool.

C. Accounts Receivable and Unbilled Revenue:

The Commission has entered into an agreement with the City of Henderson to perform its billing and collection services. All monies due to the Utility Commission are collected and deposited in the City of Henderson's Utility Clearing Fund and are remitted to the Utility Commission on a weekly basis. The amount included in accounts receivable due from the Utility Clearing Fund was \$1,765,202 and \$1,659,846 as of May 31, 2013 and 2012, respectively.

2. Summary of Significant Accounting Policies, Continued:

D. Inventory:

Coal inventory of Station Two is stated at cost using the first-in-first-out method. Materials and supplies are stated at the weighted average cost.

E. Utility Plant and Equipment:

The utility plant is carried at cost, which includes interest capitalized, aggregating \$15,342,300, which was capitalized during the period of construction. No interest was capitalized during the fiscal years ended May 31, 2013 and 2012. The Commission's policy for determining the useful lives of its utility plant and equipment is as follows:

Production plant and structures	33 ½	years
Transmission and distribution	25	years
Automotive equipment	6	years
Wireless internet equipment	5	years
Other equipment	10	years

F. Use of Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at May 31, 2013 and 2012, as well as revenues and expenses for the years then ended. Actual results could differ from the estimates and assumptions used.

G. Compensated Absences:

Employees of the Commission are entitled to paid vacations and sick-leave. The Commission's policy is to recognize these costs when earned under the accrual method of accounting in accordance with GASB No.16 "Accounting For Compensated Absences."

H. Emission Allowances:

The Commission does not record the value of emission allowances granted by the Environmental Protection Agency for sulfur dioxide and nitrous oxide on its financial statements as there is no cost basis in these allowances.

3. Cash and Cash Equivalents:

As of May 31, 2013, the City of Henderson Utility Commission maintained deposits with several local financial institutions. Of the bank balance, all was insured by the Federal Depositor's Insurance Corporation and excess of FDIC was secured by pledged United States Government securities.

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements
For the fiscal years ended May 31, 2013 and 2012

4. Investment Securities:

Investments are included in the statement of net position under the caption "Investments Securities." A summary of investments held by the City of Henderson Utility Commission along with the scheduled maturities is presented below:

<u>Investment Type:</u>	<u>Fair Value</u>	<u>Less Than One Year</u>	<u>One to Five Years</u>	<u>Six to Ten Years</u>
<u>Unrestricted Investments</u>				
U.S. Treasury Bills	\$ 7,506,447	\$ 7,506,447	\$ -	\$ -
Certificate of Deposits and Money Markets	10,235,840	10,235,840	-	-
Total Unrestricted Investments	<u>\$ 17,742,287</u>	<u>\$ 17,742,287</u>	<u>\$ -</u>	<u>\$ -</u>
<u>Restricted Per Bond Ordinance:</u>				
Certificate of Deposit and Money Market	\$ 6,913,223	\$ 6,913,223	\$ -	\$ -
Short term U.S. Treasuries	-	-	-	-
Total Restricted Investments	<u>\$ 6,913,223</u>	<u>\$ 6,913,223</u>	<u>\$ -</u>	<u>\$ -</u>
<u>Restricted Assets consisted of the following:</u>				
Repair and replacement fund	\$ 2,194,000			
Operation and maintenance reserve	100,000			
Bond Project Funds	2,982,156			
Debt Service Reserve	1,078,078			
Debt Service Sinking Fund	548,763			
Other	10,226			
Total restricted assets	<u>\$ 6,913,223</u>			

A. Interest Rate Risk:

The City of Henderson Utility Commission has a formal investment policy that limits investment maturities as a means to manage its exposure to fair value losses resulting from increasing interest rates.

B. Credit Risk:

The City of Henderson Utility Commission limits its investments to those allowed by Kentucky Revised Statute 66.480. Kentucky Revised Statute 66.480 limits investments to U.S. Government Treasury and Agency securities, certificates of deposit, securities issued by a state or local government rated in one of the three highest categories by a nationally recognized credit agency.

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements
For the fiscal years ended May 31, 2013 and 2012

4. Investment Securities, Continued:

C. Custodial Credit Risk:

Custodial credit risk is the risk that in the event of the failure of the counterparty, The City of Henderson Utility Commission will not be able to recover the value of its investments, or collateral securities that are in the possession of the outside party. All investments of the Commission, with the exception of certificates of deposit, consist of unregistered and uninsured securities held by the Commission's trustee in their trust department not in the name of the Commission.

5. Utility Plant and Equipment:

Utility plant and equipment consisted of the following as of May 31, 2013 and 2012:

<u>Existing System:</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending Balance</u>
Vehicles	\$ 2,129,786	\$ 227,369	\$ -	\$ 2,357,155
Asset retirement obligation	296,793	-	-	296,793
Transmission plant	9,108,516	62,667	-	9,171,183
Distribution plant	24,579,235	557,339	-	25,136,574
Land and land rights	1,235,451	-	-	1,235,451
Telecommunications, internet and fiber optics	5,628,045	58,661	-	5,686,706
General plant	11,065,881	-	-	11,065,881
	<u>54,043,707</u>	<u>906,036</u>	<u>-</u>	<u>54,949,743</u>
Accumulated depreciation:				
Asset retirement obligation	(286,483)	-	-	(286,483)
Accumulated depreciation	<u>(42,666,330)</u>	<u>(982,000)</u>	<u>-</u>	<u>(43,648,330)</u>
Existing System total	<u>\$ 11,090,894</u>	<u>\$ (75,964)</u>	<u>\$ -</u>	<u>\$ 11,014,930</u>
<u>Station Two:</u>				
General plant	\$ 172,875,063	\$ 3,070,255	\$ -	\$ 175,945,318
Accumulated depreciation	<u>(118,977,087)</u>	<u>(4,072,841)</u>	<u>-</u>	<u>(123,049,928)</u>
Station Two total	<u>\$ 53,897,976</u>	<u>\$ (1,002,586)</u>	<u>\$ -</u>	<u>\$ 52,895,390</u>
Total utility, plant, and equipment, net of accumulated depreciation	<u>\$ 64,988,870</u>			<u>\$ 63,910,320</u>

Depreciation expense for the fiscal years ended May 31, 2013 and 2012 was \$5,049,126 and \$5,020,073 respectively.

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements
For the fiscal years ended May 31, 2013 and 2012

6. Retirement Plans:

All Commission employees participate in the County Employees Retirement System (CERS), a multi-employer defined benefit retirement plan sponsored by the City of Henderson and administered by the Commonwealth of Kentucky. Under the plan, employees contribute 5% of their gross salary to the plan. The Commission also contributes a percentage of the employee's gross salary to the plan. The Commission's contribution rate into the plan is determined on an annual basis by the Kentucky General Assembly.

Contributions and the related percentages for the previous three fiscal years ended were as follows:

<u>Fiscal year ended May 31</u>	<u>Amount</u>	<u>Matching Percentage</u>
2013	\$ 539,503	19.55%
2012	\$ 518,504	18.96%
2011	\$ 459,118	16.89%

A copy of the annual report for the County Employees Retirement System can be obtained from the County Employees Retirement System 1260 Louisville Road, Frankfort, Kentucky 40601, or by calling 1.502.564.4646.

7. Accounts Payable and Accrued Expenses:

Accounts payable and accrued expenses consisted of the following as of May 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Accounts payable and accrued expenses - Existing System	\$ 2,590,015	\$ 2,756,415
Accounts payable and accrued liabilities - Station Two	<u>2,758,785</u>	<u>4,297,186</u>
Total	<u>\$ 5,348,800</u>	<u>\$ 7,053,601</u>

8. Bond Anticipation Notes:

During December of 2008, the Commission issued bond anticipation notes through an area financial institution. The obligations were retired via issuance of bonds on December 1, 2011. All bond anticipation notes were repaid in full from the proceeds of revenue bonds issued.

9. Long-Term Debt-Revenue Bonds:

During the fiscal year ended May 31, 2012, the City of Henderson Utility Commission issued revenue bonds for the purpose of financing capital improvements throughout its system through two revenue bond series, *Electric System Revenue Bonds, Series 2011A* in the amount of \$11,350,000, and *Electric System Revenue Bonds, Series 2011 B*, in the amount of \$3,670,000.

9. Long-Term Debt-Revenue Bonds, Continued:

The bond ordinance requires that certain accounts for each issue be established and held by a trustee as follows:

Debt Service Fund:

A monthly transfer of 1/12 of principal and 1/6 of the interest due is required to be deposited in the Debt Service Fund.

Debt Service Reserve Fund:

A reserve account was established, so that as of any date of calculation, an amount equal to at least the highest amount of aggregate debt service, or an amount equal to 125% of the average aggregate debt service and an amount equal to 10% of the "proceeds" of the bonds with respect to all series is maintained by the Commission.

Series 2011A:

The Series 2011A bonds are secured by a pledge of the revenues of the City of Henderson, Kentucky Utility Commission. The Series 2011A Bonds are additionally secured by a debt service reserve and a non-foreclosable statutory mortgage lien on the System. The Series 2011A Bonds are also secured by a debt service reserve in an amount equal to the least of the maximum annual debt service on the Series 2011A Bonds. The proceeds from the sale of these bonds were used to retire the Bond Anticipation Note, Series 2008B in the amount of \$5,281,067, with the remaining proceeds to be used for capital improvements of the City's electric transmission and distribution system, and at its Station Two generating station. Interest is due semi-annually on these obligations on December 1st and June 1st of each year.

It is the opinion from the City of Henderson, Kentucky Utility Commission's bond counsel, that under existing laws, interest on the Series 2011A Bonds is not subject to income tax

Optional Redemption Series 2011A:

The Series 2011A Bonds maturing on and after December 1, 2021, are subject to redemption by the City, at its option, before maturity on September 1, 2021, and on any date thereafter in whole or from time to time in part in any order of maturity (less than all of a single maturity to be selected by lot in such manner as the Trustee and Paying Agent may determine) at a redemption price equal to 100% of the principal amount thereof plus accrued interest to the redemption date.

Series 2011B:

The Series 2011B bonds are secured by a pledge of the revenues of the City of Henderson, Kentucky Utility Commission. The Series 2011B Bonds are additionally secured by a debt service reserve and a non-foreclosable statutory mortgage lien on the System. The Series 2011B Bonds are also secured by a debt service reserve in an amount equal to the least of the maximum annual debt service on the Series 2011B bonds. The proceeds from the sale of these bonds were used to retire the Bond Anticipation Note, Series 2008A and 2010A, in the amounts of \$3,500,000 and \$170,000, respectively. Interest is due semi-annually on these obligations on December 1st and June 1st of each year.

It is the opinion from the City of Henderson, Kentucky Utility Commission's bond counsel, that under existing laws, interest on the Series 2011B bonds is not subject to income tax.

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements
For the fiscal years ended May 31, 2013 and 2012

9. Long-Term Debt-Revenue Bonds, continued:

Optional Redemption Series 2011B:

The Series 2011B Bonds maturing on and after December 1, 2021, are subject to redemption by the City, at its option, before maturity on September 1, 2021, and on any date thereafter in whole or from time to time in part in any order of maturity (less than all of a single maturity to be selected by lot in such manner as the Trustee and Paying Agent may determine) at a redemption price equal to 100% of the principal amount thereof plus accrued interest to the redemption date.

A summary of the long-term debt of the Commission is as follows:

	<u>2013</u>	<u>2012</u>
City of Henderson, Kentucky Utility Commission Series 2011A Revenue Bonds, secured by pledge of system revenues and non-forecloseable statutory lien, maturing December 1, 2031, annual principal payments ranger from \$420,000 to \$725,000 interest rates range from 2.5% to 4.5%.	\$ 10,930,000	\$ 11,350,000
City of Henderson, Kentucky Utility Commission Series 2011B Revenue Bonds, secured by pledge of system revenues and non-forecloseable statutory lien, maturing December 1, 2031, annual principal payments ranger from \$150,000 to \$245,000 interest rates range from 2.5% to 4.5%.	<u>3,520,000</u>	<u>3,670,000</u>
Total long term debt as of May 31, 2013	\$ 14,450,000	\$ 15,020,000
Less current portion due	<u>585,000</u>	<u>570,000.00</u>
Long term debt net of current portion	<u>\$ 13,865,000</u>	<u>\$ 14,450,000</u>

Future maturies of long-term debt for the next five years as of May 31, 2013 are as follows:

	<u>Series 2011 A</u>	<u>Series 2011 B</u>	<u>Totals</u>
2014	\$ 435,000	\$ 150,000	\$ 585,000
2015	445,000	155,000	600,000
2016	455,000	155,000	610,000
2017	465,000	155,000	620,000
2018	490,000	160,000	650,000
Later years	<u>8,640,000</u>	<u>2,745,000</u>	<u>11,385,000</u>
	<u>\$ 10,930,000</u>	<u>\$ 3,520,000</u>	<u>\$ 14,450,000</u>

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements
For the fiscal years ended May 31, 2013 and 2012

10. Asset Retirement Obligation:

Effective December 31, 2008, the Commission terminated operation of its Station One generation facility. The Commission is legally obligated to remove asbestos, lead paint, and other contaminants located there. Accordingly, a liability has been established in accordance with SFAS No. 143 *Accounting for Asset Retirement Obligations*.

The following is a reconciliation of the aggregate retirement liability associated with the Commission's obligation to remove the contaminants:

	Asset Retirement Obligation
Balance as of June 1, 2012	\$ 1,430,771
Additional obligations incurred	-
Increase in present value of the obligation	-
Increase based on revised estimates of costs to dismantle and remove assets	-
Liabilities extinguished	-
Balance as of May 31, 2013	<u>\$ 1,430,771</u>

11. Discounted Internet and Broadband Services:

A summary of discounted internet and broadband services provided by the Commission to other governmental concerns is as follows:

<u>Governmental Organizations</u>	<u>2013</u>	<u>2012</u>
Henderson County GIS System	\$ 54,000	\$ 54,000
Henderson Water Utility	121,000	121,000
City of Henderson	201,000	201,000
Other organizations	2,000	2,000
	<u>\$ 378,000</u>	<u>\$ 378,000</u>

12. Concentration of Sales:

Three industrial customers of the Existing System accounted for sales in the amount of \$11.7 million (31% of Existing System sales), and \$9.9 million (27% of Existing System sales) for the fiscal years ended May 31, 2013 and 2012.

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements
For the fiscal years ended May 31, 2013 and 2012

13. Emission Allowances:

Amendments to the Clean Air Act in 1990 established a system whereby emission allowances were created and allocated to generating units subject to Phase 1 of the emission restrictions. Station Two was allotted a total of 226,901 allowances through 1999 (one emission allowance represents the authorization to emit one ton of sulfur dioxide in a given year). The allowances are allocated between the Commission and the Station Two Operator based upon the Station Two capacity allocations. As of May 31, 2013, and 2012, there were remaining sulfur dioxide emission allowances valued at \$28,697 and \$18,189, respectively each year ended.

14. Related Party Transactions:

The Commission incurred the following transactions with the City of Henderson, Kentucky for the fiscal years ended May 31, 2013 and 2012:

- Paid the City \$582,583 and \$575,667 each year, respectively, for data processing and other services related to billings and collections.
- Paid the City \$1,244,724 and \$1,244,724 May 31, 2013 and 2012 of the fiscal years ended, respectively.
- Paid the City \$554,596 and \$593,706 for participation in the City of Henderson's self-insured employee health insurance plan for the fiscal years ended May 31, 2013 and 2012 respectively. Risk is minimized in this area by the purchase of re-insurance for amounts in excess of the \$125,000 stop loss limit. Charges are based on estimated amounts determined by the City of Henderson's insurance coordinator as necessary to fund claims as they become due and payable.
- Provided the City of Henderson with power for the fiscal years ended May 31, 2013 and 2012 in the amount of \$288,000 and \$386,142 respectively. The City of Henderson was also provided significantly reduced communication service fees totaling approximately \$201,000 for the fiscal year May 31, 2013 and 2012.

15. Commitments and Contingencies:

A. Southeastern Power Administration:

The Southeastern Power Administration (SEPA) has contracted with the Commission to provide it a total of 18,000 megawatt hours of hydroelectric power each year. The 18,000 megawatt hours represent approximately 3 % of the Commission's annual megawatt hour requirements. Henderson Municipal Power & Light is restricted to not more than 12 megawatt hours during any hour, and not more than 2,640 megawatt hours during any month.

In the Fall of 2006, SEPA informed all participants that the Wolf Creek Dam near Jamestown, Kentucky, had been inspected and serious seepage problems existed. In an effort to respond to these safety concerns and make the needed repairs to the dam, SEPA reduced and curtailed electric service to the project participants. This reduction and curtailment of electric service began in early 2007 and is expected to continue for an extended period of time until repairs are completed.

During the year ended May 31, 2013 and 2012, the Commission purchased power on the spot market and from SEPA to supply the needs of its customers. Purchased power from these sources for the fiscal year ended May 31, 2013 was \$634,539 and \$1,138,059 during 2012.

15. Commitments and Contingencies, continued:

B. Regulatory Compliance:

The North American Electric Reliability Corporation (NERC) adopted new electric system reliability standards for all electric utilities in the United States. NERC has adopted and began enforcement of the new standards effective June of 2007. The new standards have been approved by the Federal Energy Regulatory Commission (FERC). The Commission must comply with the new standards and will incur administrative expenses related to NERC compliance.

Federal air quality and emission standards have become more stringent. The current standards and proposed standards resulted in the cost of compliance being excessive to operate Station One. As a result of the new regulations, the Commission approved the cessation of operations at Station One on August 25, 2008, and Station One was taken out of service in December of 2008.

C. Unwind Transaction- Station Two:

In 1998, HMP&L, Big Rivers Electric Corporation, and Western Kentucky Energy Corporation entered into contracts for the operation of the HMP&L Station Two Power Plant and other Big Rivers Electric Corporation Generation Plants. On July 16, 2009, Big Rivers Electric Corporation and Western Kentucky Energy Corporation (E.ON) signed an agreement under which the original 1998 contracts are rescinded and operational control of the Station Two Power Plant returned to Big Rivers Electric Corporation.

HMP&L and Big Rivers Electric Corporation have identified a number of facility upgrades and maintenance projects for the Station Two Power Plant. Big Rivers Electric Corporation has developed Work Plans for the five years period 2009 to 2014. These preliminary Work Plans estimate that HMP&L will incur additional maintenance expenses at Station Two.

D. Pending Litigation:

Big Rivers and HMP&L are currently involved in litigation concerning the Excess Henderson Energy at Station Two. The litigation was heard in the Henderson County Circuit Court and the judge assigned the dispute to arbitration. On May 30, 2012 the Arbitration Panel issued a final ruling in favor of HMP&L. Big Rivers filed a motion with the Appeals Court requesting that the Arbitration Panel's ruling be vacated and set aside. The parties are currently waiting on the Court's ruling. This legal dispute may continue for several years.

In July 2012, HMP&L entered into litigation with the Kentucky Department of Labor related to the application of prevailing of wage rates at Station Two. The litigation went to trial in December 2012. The Circuit Court ruled in favor of the Labor Cabinet on May 24, 2013. HMP&L has filed an appeal in the Kentucky Appeals Court.

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements
For the fiscal years ended May 31, 2013 and 2012

16. Risk Management:

The Commission is exposed to various risks of loss related to torts, theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Commission carries commercial insurance for these types of risk of loss, including workers' compensation. Settled claims from these risks have not exceeded commercial insurance coverage in any of the past five fiscal years.

17. Amounts Due From Station Two Operator:

As of the fiscal years ended May 31, 2013 and 2012, the amount the Station Two Operator owed to the Commission, as part of the annual settlement, was \$832,193 and \$1,446,224, respectively.

18. Change in Accounting Principle:

For the fiscal year ended May 31, 2013, the Commission implemented GASB No. 63 *Financial Reporting of Deferred Outflows, and Deferred Inflows of Resources and Net Position*. This resulted in the establishment of categories outside of assets and liabilities titled deferred outflows and deferred inflows. The statement of net assets has been retitled the statement of net position in accordance with this pronouncement.

19. Subsequent Events:

Subsequent events have been evaluated through September 30, 2013.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
COMBINING STATEMENT OF NET POSITION-BY SYSTEM
As of May 31, 2013 and 2012

	May 31, 2013				May 31, 2012			
	Existing System	Station Two	Elimination	Total	Existing System	Station Two	Elimination	Total
Assets								
Current assets:								
Cash and cash equivalents	\$ 884,208	\$ 21,221	\$ -	\$ 905,429	\$ 1,316,418	\$ 69,315	\$ -	\$ 1,385,733
Investment securities	17,742,287	-	-	17,742,287	16,742,179	-	-	16,742,179
Restricted cash equivalents and investments:								
Certificates of deposit and money market	5,286,383	-	-	5,286,383	7,111,272	-	-	7,111,272
Short-term U.S. Government securities	1,626,842	-	-	1,626,842	1,625,529	-	-	1,625,529
Accounts receivable, net of								
allowance for uncollectible	1,692,383	-	-	1,692,383	1,581,873	1,540,500	-	3,122,373
Accounts receivable-Station Two Operator	832,193	-	-	832,193	1,446,224	-	-	1,446,224
Accrued interest receivable	-	-	-	-	-	-	-	-
Accrued revenue	2,641,247	-	-	2,641,247	2,684,246	-	-	2,684,246
Inventory and supplies	3,274,431	2,758,785	-	6,033,216	4,772,080	2,679,610	-	7,451,690
Prepaid expenses	57,261	-	-	57,261	57,499	-	-	57,499
Total current assets	34,037,235	2,780,006	-	36,817,241	37,337,320	4,289,425	-	41,626,745
Utility plant, net of accumulated depreciation	11,014,930	52,895,390	-	63,910,320	11,090,894	53,897,976	-	64,988,870
Other assets:								
Bond issue costs, net of amortization	464,081	-	-	464,081	489,510	-	-	489,510
Investment in Station Two	31,058,999	-	(31,058,999)	-	31,058,999	-	(31,058,999)	-
Total assets	\$ 76,575,245	\$ 55,675,396	\$ (31,058,999)	\$101,191,642	\$ 79,976,723	\$ 58,187,401	\$ (31,058,999)	\$107,105,125

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
COMBINING STATEMENT OF NET POSITION-BY SYSTEM
As of May 31, 2013 and 2012

	May 31, 2013				May 31, 2012			
	Existing System	Station Two	Elimination	Total	Existing System	Station Two	Elimination	Total
Liabilities and net assets:								
Current liabilities:								
Accounts payable and accrued expenses	\$ 2,590,015	\$ 2,758,785	\$ -	\$ 5,348,800	\$ 2,756,415	\$ 4,297,186	\$ -	\$ 7,053,601
Accounts payable-Construction in progress - Station Two	-	2,688,919	-	2,688,919	-	2,307,768	-	2,307,768
Asset retirement obligation	1,430,771	-	-	1,430,771	1,430,771	-	-	1,430,771
Accounts payable-Station Two Operator	-	28,984	-	28,984	-	-	-	-
Current portion-bonds payable	585,000	-	-	585,000	570,000	-	-	570,000
Customer deposits	633,973	-	-	633,973	622,585	-	-	622,585
Total current liabilities	5,239,759	5,476,688	-	10,716,447	5,379,771	6,604,954	-	11,984,725
Long-term debt:								
Long-term portion of bonds payable	13,865,000	-	-	13,865,000	14,450,000	-	-	14,450,000
Bond anticipation notes	-	-	-	-	-	-	-	-
Total long-term liabilities	13,865,000	-	-	13,865,000	14,450,000	-	-	14,450,000
Net assets:								
Unrestricted	22,933,332	(2,696,682)	-	20,236,650	24,280,258	(2,315,529)	-	21,964,729
Restricted per bond ordinance	6,913,225	-	-	6,913,225	8,736,801	-	-	8,736,801
Investment in plant assets, net of related debt	27,623,929	52,895,390	(31,058,999)	49,460,320	27,129,893	53,897,976	(31,058,999)	49,968,870
Total net assets	57,470,486	50,198,708	(31,058,999)	76,610,195	60,146,952	51,582,447	(31,058,999)	80,670,400
Total liabilities and net assets	\$ 76,575,245	\$ 55,675,396	\$ (31,058,999)	\$101,191,642	\$ 79,976,723	\$ 58,187,401	\$ (31,058,999)	\$107,105,125

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
COMBINING STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION-BY SYSTEM
For the fiscal years ended May 31, 2013 and 2012

	May 31, 2013				May 31, 2012			
	Existing System	Station Two	Elimination	Consolidated Total	Existing System	Station Two	Elimination	Consolidated Total
Operating Revenues:								
Sale of electricity	\$ 37,406,971	\$ 39,632,707	\$ (14,535,586)	\$ 62,504,092	\$ 36,971,905	\$ 33,171,480	\$ (11,434,222)	\$ 58,709,163
Communication services	980,662	-	-	980,662	985,380	-	-	985,380
Other	556,333	-	-	556,333	338,084	-	-	338,084
Total Operating Revenues	38,943,966	39,632,707	(14,535,586)	64,041,087	38,295,369	33,171,480	(11,434,222)	60,032,627
Operating Expenses:								
Production of electricity	31,906,031	33,512,818	(14,535,586)	50,883,263	29,299,232	28,884,768	(11,434,222)	46,749,778
Operating, general and administrative	6,347,067	3,431,217	-	9,778,284	7,143,135	3,351,625	-	10,494,760
Depreciation	976,285	4,072,841	-	5,049,126	1,003,822	4,016,451	-	5,020,273
Total Operating Expenses	39,229,383	41,016,876	(14,535,586)	65,710,673	37,446,189	36,252,844	(11,434,222)	62,264,811
Income (Loss) from Operations	(285,417)	(1,384,169)	-	(1,669,586)	849,180	(3,081,364)	-	(2,232,184)
Interest Income (Expense):								
Investment income	29,325	377	-	29,702	6,599	273	-	6,872
Interest expense	(509,650)	-	-	(509,650)	(452,205)	-	-	(452,205)
Total Interest Income (Expense)	(480,325)	377	-	(479,948)	(445,606)	273	-	(445,333)
Income (Loss) Before Transfers	(765,742)	(1,383,792)	-	(2,149,534)	403,574	(3,081,091)	-	(2,677,517)
Non-operating Items:								
Gain on sale of emission allowances	-	53	-	53	-	132	-	132
Capital contributions-distributions, net	-	-	-	-	-	-	-	-
Transfers to City of Henderson	(1,244,724)	-	-	(1,244,724)	(1,244,724)	-	-	(1,244,724)
Power furnished to City of Henderson	(288,000)	-	-	(288,000)	(386,142)	-	-	(386,142)
Communication services provided to the City of Henderson and local governmental agencies	(378,000)	-	-	(378,000)	(378,000)	-	-	(378,000)
Total non-operating Items	(1,910,724)	53	-	(1,910,671)	(2,008,866)	132	-	(2,008,734)
Increase (Decrease) in Net Position	(2,676,466)	(1,383,739)	-	(4,060,205)	(1,605,292)	(3,080,959)	-	(4,686,251)
Net Position, Beginning of Year	60,146,952	51,582,447	(31,058,999)	80,670,400	61,752,244	54,663,406	(31,058,999)	85,356,651
Net Position, End of Year	\$ 57,470,486	\$ 50,198,708	\$ (31,058,999)	\$ 76,610,195	\$ 60,146,952	\$ 51,582,447	\$ (31,058,999)	\$ 80,670,400

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
SUPPLEMENTAL SCHEDULE OF CHANGES IN NET POSITION -BY SYSTEM
For the fiscal years ended May 31, 2013 and 2012

	<u>Existing System</u>	<u>Station Two</u>			<u>Eliminations *</u>	<u>Total Net Assets</u>
		<u>Utility Commission</u>	<u>Big Rivers</u>	<u>Total Station Two</u>		
Beginning balance, June 1, 2011	\$ 61,752,244	\$ 19,184,853	\$ 35,478,553	\$ 54,663,406	\$ (31,058,999)	\$ 85,356,651
Net income (loss)	(1,605,292)	(1,147,150)	(1,933,809)	(3,080,959)	-	(4,686,251)
Balance, May 31, 2012	\$ 60,146,952	\$ 18,037,703	\$ 33,544,744	\$ 51,582,447	\$ (31,058,999)	\$ 80,670,400
Net income (loss)	(2,676,466)	550,070	(1,933,809)	(1,383,739)	-	(4,060,205)
Balance May 31, 2013	<u>\$ 57,470,486</u>	<u>\$ 18,587,773</u>	<u>\$ 31,610,935</u>	<u>\$ 50,198,708</u>	<u>\$ (31,058,999)</u>	<u>\$ 76,610,195</u>

* Elimination of interest of Existing System in investment in the equity of Station Two.

Shown on the Statement of Net Position	<u>2013</u>	<u>2012</u>
Investment in Utility Plant and Equipment, net of related debt	\$ 20,236,650	\$ 21,964,729
Restricted per bond ordinance	6,913,225	8,736,801
Unrestricted	49,460,320	49,968,870
	<u>\$ 76,610,195</u>	<u>\$ 80,670,400</u>



Independent Auditors' Report on Internal Control Over Financial Reporting, Compliance and Other Matters Based on an Audit of Primary Government Financial Statements Performed in Accordance with *Government Auditing Standards*

Members of the Board of Commissioners
City of Henderson, Kentucky Utility Commission
Henderson, 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 of America; the financial statements of the City of Henderson, Kentucky Utility Commission as of and for the year ended May 31, 2013, and have issued our report thereon dated September 30, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the City of Henderson, Kentucky Utility Commission's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City of Henderson, Kentucky Utility Commission's internal control. Accordingly, we do not express an opinion on the effectiveness of the City of Henderson, Kentucky Utility Commission's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or 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 the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in the internal control that might be significant deficiencies, or material weaknesses. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Henderson, Kentucky Utility Commission's financial statements are free of 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*.

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 result of that testing, and not to provide an opinion on the effectiveness of 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 report is not suitable for any other purpose.

This report is intended solely for the information and use of management, members of the Board of Commissioners of the City of Henderson, Kentucky Utility Commission, and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in cursive script that reads "Myriad Co Group, LLC".

Henderson, Kentucky
September 30, 2013



**City of Henderson, Kentucky Utility Commission –
Henderson Municipal Power & Light**

Report on Audited Financial Statements

For the fiscal years ended May 31, 2014 and 2013

**Case No: 2019-00269
Attachment 1 to BREC 1-31
HMPL Audits 2011-2019**

Contents

	<u>Page(s)</u>
Management's Discussion and Analysis	1-10
Independent Auditors' Report	11-12
Basic Financial Statements:	
Statement of Net Position	13
Statement of Revenues, Expenses and Changes in Net Position	14
Statement of Cash Flows	15
Statement of Cash Flows – Reconciliation of Net Cash Provided by Operations	16
Notes to the Financial Statements	17-30
Supplemental Information:	
Combining Statement of Net Position – By System	31-32
Combining Statement of Revenues, Expenses and Changes in Net Position – By System	33
Supplemental Schedule of Changes in Net Position – By System	34
Independent Auditors' Report on Internal Control Over Financial Reporting, Compliance and Other Matters Based on an Audit of Primary Government Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	35-36

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION- HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT’S DISCUSSION AND ANALYSIS

The City of Henderson, Kentucky Utility Commission (HMP&L) is in the business of providing electricity and internet communication services for residential, commercial, and industrial customers within the incorporated territory of the City of Henderson, Kentucky. The Commission also provides electricity and internet communication services to customers in a few areas outside of the incorporated territory of Henderson. The following discussion and analysis of HMP&L’s financial performance provides an overview of the Utility’s financial activities for fiscal year ended May 31, 2014.

Overview of the Financial Statements:

This annual financial report consists of three parts: 1) Management’s Discussion and Analysis, 2) Financial Statements, and 3) Supplemental Additional Information. The Financial Statements also include notes that explain in more detail some of the information in the financial statements. The statements are followed by a section of supplemental information that further explains and supports the information in the basic financial statements. The Supplemental schedules present the financial position and results of operations for the Existing System and Station Two. The Consolidated Financial Statements report information about HMP&L using accounting methods similar to those used by private sector companies, except for the reporting of contributions in aid of construction, equity capital, and retained earnings. Refer to the Summary of Significant Accounting Policies in the footnotes to the Financial Statements relating to the adoption of Statement No. 34 of the Governmental Accounting Standard Board (GASB 34).

The Statement of Net Position, successor to the Balance Sheet, includes all of the Utility’s assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to HMP&L’s creditors (liabilities). It also provides the basis for evaluating the capital structure of HMP&L and assessing the liquidity and financial flexibility of HMP&L.

All of the current year’s revenues and expenses are accounted for in the Statement of Revenues, Expenses, and Changes in Net Position, successor to the Income Statement. This statement measures the success of the Utility’s operations over the past year and can be used to determine whether the Utility has successfully recovered all of its costs through the sale of electricity, communications, and other charges, and has earned a reasonable profit, as well as maintained a sound financial position.

The final required financial statement is the Statement of Cash Flows. The primary purpose of this statement is to provide information about the Utility’s cash receipts, cash payments, and net changes in cash resulting from operations, investing and financing activities, and provides information on the sources and uses of cash and the changes in cash balances during the year.

Financial Statements:

- HMP&L’s total assets decreased from \$100,727,561 at May 31, 2013 to \$96,869,438 at May 31, 2014. This decrease is primarily attributable to the decreased balances in investment securities and restricted assets.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT’S DISCUSSION AND ANALYSIS**

Financial Statements, continued:

- Operating revenues for HMP&L Existing System decreased by approximately \$707,551 or 1.8% from \$38,943,966 to \$38,236,415. The decrease in Existing System sales was primarily due to decreased power demand and “other income” over that of the previous year. Internet revenue increased by \$75,016.

Existing System:

	<u>2014</u>	<u>2013</u>	<u>Change</u>	<u>Percentage Change</u>
Sale of electricity	\$ 36,886	\$ 37,407	\$ (521)	-1%
Internet service	1,056	981	75	8%
Other	295	556	(261)	-47%
Total operating revenues	<u>\$ 38,236</u>	<u>\$ 38,944</u>	<u>\$ (708)</u>	<u>-2%</u>

Note: All amounts presented in thousands-000's omitted

- Operating expenses for HMP&L Existing System decreased by approximately \$1,681,006 or 4.3%. The following table represents the changes in the expenses for the Existing System:

Existing System:

	<u>2014</u>	<u>2013</u>	<u>Increase Decrease</u>
Production of electricity	\$ 30,309	\$ 31,906	\$ (1,597)
Other operating expenses	6,262	6,347	(86)
Depreciation	978	976	1
Total operating expenses	<u>\$ 37,548</u>	<u>\$ 39,229</u>	<u>\$ (1,681)</u>

Note: All amounts presented in thousands -000's omitted

- Operating revenues for Station Two decreased approximately \$2,684,401 over that of the previous year. The Station Two Agreement is not designed to generate a profit for each of the participants in the venture, but rather to break-even on a cash flow basis. Operating expenses decreased for Station Two, also.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Financial Statements, continued:

<u>Station Two:</u>	<u>2014</u>	<u>2013</u>	<u>Change</u>
Sales-BREC	\$ 22,555	\$ 25,097	(\$2,542)
Sales-HMPL	14,393	14,536	(142)
Sale of emission allowances and other	-	-	-
Total operating revenues	<u>\$ 36,948</u>	<u>\$ 39,633</u>	<u>\$ (2,684)</u>
<u>Expenses:</u>			
Production of electricity	\$ 33,865	\$ 36,944	\$ (3,079)
Depreciation	4,108	4,073	35
Administrative	-	-	-
Total operating expenses	<u>\$ 37,973</u>	<u>\$ 41,017</u>	<u>\$ (3,043)</u>
Income from operations	\$ (1,025)	\$ (1,384)	\$ 359
Interest income	-	-	-
Net income before transfers	<u>\$ (1,025)</u>	<u>\$ (1,384)</u>	<u>\$ 359</u>

Note: All amounts in thousands, 000's omitted

Upon the consolidation of the financial statements for each system, transactions between Henderson Municipal Power and Light and Station Two Operator are eliminated.

Statement of Net Position:

Net position of HMP&L decreased by \$2,855,222 for the fiscal year ended May 31, 2014, while net position decreased by \$4,060,205 in the fiscal year ended May 31, 2013.

Investment securities decreased by \$2,278,129 over that of Fiscal Year 2013.

Cash and cash equivalents increased by \$458,197 for the fiscal year ended May 31, 2014 versus a decrease of \$480,304 over that of the previous fiscal year ended.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Statement of Net Position, continued:

A summary of the assets of the Commission for the previous three years is as follows:

<u>Assets:</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Cash and cash equivalents	\$ 1,364	\$ 905	\$ 1,386
Investment securities	17,869	19,936	18,936
Restricted assets	3,826	4,719	6,543
Accounts receivable and unbilled revenue	1,868	1,692	3,122
Accounts receivable Station Two Operator	1,156	832	1,446
Accrued revenue	2,803	2,641	2,683
Inventories	5,001	6,034	7,452
Prepaid expenses	103	58	58
Total current assets	<u>\$ 33,989</u>	<u>\$ 36,817</u>	<u>\$ 41,626</u>
Utility, plant, and equipment, net	62,880	63,910	64,989
Bond issue cost	-	-	490
Total assets	<u>\$ 96,869</u>	<u>\$ 100,727</u>	<u>\$ 107,105</u>

Note: All amounts in thousands, 000's omitted

Current liabilities decreased by \$407,901. Accounts payable and accrued expenses decreased \$286,573 over the previous year mainly due to normal variations in timing of payments.

A summary of the liabilities section of the Statement of Net Position is as follows:

<u>Liabilities:</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Accounts payable and accrued expenses	\$ 5,062	\$ 5,378	\$ 7,054
Accounts payable construction	2,565	2,689	2,308
Asset retirement obligation	1,431	1,431	1,431
Current portion bonds payable	595	585	570
Customer deposits	656	634	622
Total current liabilities	<u>\$ 10,309</u>	<u>\$ 10,717</u>	<u>\$ 11,985</u>
Bond anticipation notes	-	-	-
Long term portion bond payable	13,270	13,865	14,450
Total liabilities	<u>\$ 23,579</u>	<u>\$ 24,582</u>	<u>\$ 26,435</u>

Note: All amounts in thousands, 000's omitted

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT’S DISCUSSION AND ANALYSIS**

Statement of Revenues, Expenses, and Changes in Net Position:

Operating Revenues for the entire entity decreased by \$3,249,658 over that of the previous year. Sales for HMP&L Station Two decreased by \$2,684,401 or 6.77% while Sales Existing System decreased by \$707,551 or 1.82%.

Operating Expenses decreased by \$4.58 million. This was due to decreased operating costs incurred with the operation of Station Two.

The Net Operating Income of the Existing System, after interest expense and interest income, was \$213,525. Transfers were made to the City of Henderson in the amount of \$1.2 million for the fiscal year ended, the value of power furnished to the City of Henderson at no charge was \$408,000, and the value of communication services provided to the City of Henderson and other governmental agencies, at no charge, was \$378,000.

Station Two had a net operating loss of \$1.02 million, however, the net loss relates primarily to depreciation expense which is a non-cash item.

<u>Summary of Changes in Net Position:</u>	<u>Existing System</u>	<u>Station Two</u>	<u>Total</u>
Income (loss) before transfers	\$ 213,525	\$ (1,024,979)	\$ (811,454)
Non-operating items:			
Extraordinary item			
Contributed capital-net of HMP&L	-	-	-
Transfer to City			
Station One Remediation	(13,044)	-	(13,044)
Gain on sale of emission allowances	-	-	-
Transfers to City of Henderson	(1,244,724)	-	(1,244,724)
Communication services provided to the City and other governmental agencies	(378,000)		(378,000)
Power furnished to City of Henderson	<u>(408,000)</u>	<u>-</u>	<u>(408,000)</u>
Increase (decrease) in net assets	<u>\$ (1,830,243)</u>	<u>\$ (1,024,979)</u>	<u>\$ (2,855,222)</u>

Statement of Cash Flows:

Cash generated from operating activities decreased by \$932,048 over the level from Fiscal Year 2013.

Cash Flows from non-capital financing activities include the funds transferred to the City of Henderson. For the fiscal year ended May 31, 2014, \$1.2 million was transferred.

Cash used by capital and related financing activities was \$5.1 million.

Cash and cash equivalents for the year, which consist primarily of checking and money market accounts of HMP&L, increased by \$458,197.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Statement of Cash Flows, continued:

<u>Cash Flow Summary</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Net cash generated by operations	\$ 3,918	\$ 4,849	\$ 5,368
Cash transferred to City of Henderson Distribution from former Station Two Operator	(1,245)	(1,245)	(1,245)
Net cash used by capital and related financing	-	-	-
Investing activities	(5,146)	(4,939)	2,278
	<u>2,931</u>	<u>854</u>	<u>(5,109)</u>
Increase (decrease) in cash equivalents	458	(481)	1,292
Cash equivalents, beginning of year	905	1,386	94
Cash equivalents, end of year	<u>\$ 1,364</u>	<u>\$ 905</u>	<u>\$ 1,386</u>

Note: All amounts in thousands,000's omitted

The following is a summary of cash and investment balances as of May 31, 2012, to 2014

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Cash and cash equivalents	\$ 1,364	\$ 905	\$ 1,386
Investments	17,869	19,936	16,742
Restricted Investments	3,826	4,719	8,736
	<u>\$ 23,059</u>	<u>\$ 25,560</u>	<u>\$ 26,864</u>

Note: All amounts in thousands, 000's omitted

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION- HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT'S DISCUSSION AND ANALYSIS

Capital Assets:

As noted in the footnotes to this report, HMP&L has 20,682 sulfur dioxide emission allowances from the Existing System and Station Two available as of May 31, 2014. The value of the allowances is not reflected in the financial statements due to the fact that the Commission has no cost basis in the allowances. The estimated current market value of these allowances at May 31, 2014, is approximately \$41,364.

Debt Administration:

HMP&L entered into two Bond Anticipation Notes with Fifth Third Bank on December 22, 2008, a non-taxable series 2008A in the amount of \$3,500,000 and a taxable series 2008B in the amount of \$9,000,000. The series 2008A was used for capital improvements to the City's retail electric system. The taxable series 2008B was used to make capital improvements to the City's Station Two generating plant. HMP&L entered into an additional Bond Anticipation Note with Fifth Third Bank on March 25, 2010, a non-taxable series 2010A in the amount of \$1,500,000. This note was repaid at the same time as the series 2008A note. In September of 2012 HMP&L issued Revenue Bonds in the amount of \$15,020,000 and retired all outstanding Bond Anticipation Notes.

On January 29, 2009, the City Commission approved an Ordinance increasing electric rates by 3.855 percent for all customer rate classifications. The purpose of the rate increase was to provide additional revenue to make the principal and interest payments on the short-term Bond Anticipation Notes and the long-term Bonds issued to replace the Bond Anticipation Notes. HMP&L set up a separate Bond Payment Account and, as of May 31, 2014, HMP&L had accrued \$1,395,259 for future principal and interest payments for the Bonds.

System Improvements and Replacement of Capital Assets:

During the period of June 1, 2013, through May 31, 2014, HMP&L made a number of improvements to the electric and communication facilities and replaced certain assets. The improvements to the facilities and asset replacements increased service reliability and extended the useful-life of certain existing assets.

During the FY2013-2014, HMP&L made \$1,098,249 in capital improvements and replacements in the Existing System and \$2,958,938 in capital improvements and replacements of Station Two.

Economic Factors:

The current economic recession has impacted HMP&L kilowatt hour sales. The decline in HMP&L sales began in December 2008 and has leveled off through the end of May 2014. As the depressed economy continues, HMP&L anticipates static kilowatt hour sales. Based upon monthly sales data subsequent to June 1, 2014, it does appear as if the decline in gross sales has stabilized.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION- HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT'S DISCUSSION AND ANALYSIS

Station Two – Future Expenditures:

In 1998, HMP&L and Big Rivers Electric Corporation entered into contracts with Western Kentucky Energy Corporation for the operation of the HMP&L Station Two Power Plant and other Big Rivers Electric Corporation Generation Plants. Big Rivers Electric Corporation and Western Kentucky Energy Corporation entered discussions to unwind the original 1998 contracts and return operational control of the Station Two Power Plant and the other Plants to Big Rivers Electric Corporation. The Unwind Transaction closed on July 16, 2009, and Big Rivers, thereafter, resumed operation of the Station Two generating plant. Big Rivers Electric Corporation has identified a number of facility upgrades and maintenance projects for the Station Two Power Plant. These Work Plans indicate HMP&L will incur an additional \$18 million to \$21 million in maintenance expenses in the future at Station Two. Big Rivers and HMP&L are currently involved in litigation concerning the Excess Henderson Energy at Station Two. The litigation was heard in the Henderson County Circuit Court and the judge assigned the dispute to arbitration. On May 30, 2012 the Arbitration Panel issued a final ruling in favor of HMP&L. Big Rivers filed a motion with the Appeals Court requesting that the Arbitration Panel's ruling be vacated and set aside. The Appeals Court issued a final ruling on May 30, 2014 in favor of HMP&L. On October 1, 2014 Big Rivers filed A Motion for Discretionary Review with the Supreme Court of Kentucky. This legal dispute may continue for several years.

In July 2012, HMP&L entered into litigation with the Kentucky Department of Labor related to the application of prevailing of wage rates at Station Two. The litigation went to trial in December 2012. The Circuit Court ruled in favor of the Labor Cabinet on May 24, 2013. HMP&L filed an appeal in the Kentucky Appeals Court, and oral arguments were heard September 24, 2014. HMP&L anticipates a ruling from the Appeals Court within the next six months.

In recent years, HMP&L has increased its reserved capacity at Station Two. The reserve capacity for FY 2013-2014 was 115 megawatts and HMP&L did not increase its reserve capacity for FY 2014-2015. HMP&L intends to keep the reserve capacity at 115 megawatts which is in line with the current HMP&L historical system peak demand. Each 5 megawatt increase in the reserved capacity will cost HMP&L approximately \$660,324/year. The actual cost of reserved capacity, however, is based upon the Station Two budget which varies each year.

Closing of Station One:

The Utility Commission considered Station One to no longer be a viable generating facility because of increasing federal and state restrictions for new air emissions and the increasing costs of maintenance and fuel for the facility. Therefore, Station One was closed effective December 31, 2008. Upon closing, Station One employed 13 full-time and 2 temporary personnel of which nine were placed internally, one was placed externally, one retired, three were laid off and one temporary employee was terminated. At the September 2014 Commission Meeting, the Utility Commission approved awarding the bid in the compensated amount of \$37,000 to National Salvage & Service Corporation to provide remedial actions, equipment removal, and demolition of the Station One Power Plant. Work began the beginning of October 2014 and is scheduled to take approximately seven (7) months until completion.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION- HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT'S DISCUSSION AND ANALYSIS

Southeastern Power Administration (SEPA):

The Southeastern Power Administration (SEPA) has contracted with HMP&L to provide HMP&L a total of 18,000 megawatt hours of hydroelectric power each year. The 18,000 megawatt hours represent approximately 3 percent of HMP&L's annual megawatt hour requirements. HMP&L is restricted to not more than 12 megawatt hours during any one hour period. The hydroelectric power is provided from SEPA generation units on the Cumberland River System Project.

In the fall of 2006, SEPA informed all contract project participants that the Wolf Creek Dam near Jamestown, Kentucky, had been inspected and serious seepage problems existed in the earthen dam. The seepage problems at the dam date back to 1968 and the US Army Corp of Engineers implemented various repairs since that time; however, the seepage became critical to the safety of the Wolf Creek Dam and surrounding communities. In an effort to respond to these safety concerns and make the needed repairs to the dam, SEPA reduced and curtailed electric service to the contract project participants. This reduction and curtailment of SEPA electric service began in early 2007. The repairs were completed during 2014 and SEPA is currently in the process of allowing the basin to again fill with water. However, this area will take time to fill to its necessary level of water.

The SEPA Cumberland River Hydroelectric Power System may not return to normal operations for several years.

Regulatory Compliance:

The North American Electric Reliability Corporation (NERC) adopted new electric system reliability standards for all electric utilities in the United States. NERC adopted and began enforcement of the new standards beginning in June 2007. The new standards were approved by the Federal Energy Regulatory Commission (FERC). HMP&L is required to comply with the new reliability standards and HMP&L will incur administrative expenses related to NERC compliance. HMP&L has established an internal committee to address NERC Reliability Standards. Also, HMP&L has retained an external consulting firm to assist, support, and facilitate HMP&L's compliance with NERC Reliability. In November 2008, the Southeastern Electric Reliability Council (SERC) audited HMP&L for compliance with NERC Reliability Standards. Subsequent to the November audit, a number of formal and informal discussions took place between HMP&L and SERC. HMP&L and SERC reached an agreement concerning non-compliance issues identified during the audit; and a final settlement agreement was approved. In November 2010, HMP&L hired a new Reliability Compliance Manager who is responsible for compliance with NERC Reliability Standards. SERC performed a compliance audit of HMP&L in March of 2014, evaluating the utility for compliance with 11 reliability requirements, as well as, 3 infrastructure related items. This audit resulted in no findings, violations, or recommendations.

Federal air quality and emission standards continue to be increasingly more stringent. The current standards and proposed new standards will increase the cost of energy production at Station Two.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Transfer to City:

In FY2013-2014, HMP&L's cash transfer to the City was \$1.24 million. HMP&L has budgeted this same level of cash transfer to the City for FY2014-2015 and subsequent budget periods. HMP&L also pays the City \$611,417 for internal service fees and HMP&L provides the City free electric service valued at \$408,000 and communication services valued at \$378,000 annually. Excluding the annual fuel adjustment revenue and expense, the annual cash transfer payments, internal service fees, and value of the free electric and communication services represent 7.16 percent of estimated gross electric revenue in FY2013-2014.



INDEPENDENT AUDITORS' REPORT

To the Board of Commissioners
City of Henderson, Kentucky
Utility Commission
Henderson, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the City of Henderson, Kentucky Utility Commission (Commission), a component unit of the City of Henderson, Kentucky, as of May 31, 2014 and 2013, and the related notes to the financial statements, which collectively comprise the 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 opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of 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 auditors' 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 opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Commission as of May 31, 2014 and 2013, and the changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management discussion and analysis on pages 1 through 10 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.

Our audit was performed for the purpose of forming an opinion on the financial statements of the City of Henderson, Kentucky Utility Commission taken as a whole. The accompanying supplemental information on pages 31 to 34, is presented for purpose of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements, and in our opinion is fairly stated in all material respects, in relation to the financial statements.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report on our consideration of the City of Henderson, Kentucky Utility Commission's internal control over financial reporting and 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 the 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 City of Henderson, Kentucky Utility Commission's internal control over reporting and compliance.

A handwritten signature in black ink that reads "Myriad CPA Group, LLC". The signature is written in a cursive, flowing style.

Henderson, Kentucky
October 15, 2014

City of Henderson, Kentucky Utility Commission
Statement of Net Position
As of May 31, 2014 and 2013

<u>Assets:</u>	<u>2014</u>	<u>2013</u>
<u>Current assets:</u>		
Cash and cash equivalents	\$ 1,363,626	\$ 905,429
Investment securities	17,869,158	19,936,287
Restricted assets per bond ordinance:		
Certificates of deposit and money market accounts	1,690,383	3,092,383
Short-term U.S. Government Securities	2,135,838	1,626,842
Accounts receivable, net of allowance for uncollectible	1,867,750	1,692,383
Accounts receivable, Station Two Operator	1,155,650	832,193
Accrued interest receivable	-	-
Accrued revenue	2,803,484	2,641,247
Inventory and supplies	5,000,606	6,033,216
Prepaid expenses	103,324	57,261
	<u>33,989,819</u>	<u>36,817,241</u>
<u>Utility plant and equipment:</u>		
Utility plant, net of accumulated depreciation	<u>62,879,619</u>	<u>63,910,320</u>
	<u>\$ 96,869,438</u>	<u>\$100,727,561</u>
<u>Liabilities and net assets:</u>		
<u>Liabilities:</u>		
<u>Current liabilities:</u>		
Accounts payable and accrued expenses	\$ 5,062,227	\$ 5,348,800
Accounts payable-Construction in progress Station Two	2,564,544	2,688,919
Accounts payable-Station Two Operator	-	28,984
Current portion-bonds payable	595,000	585,000
Asset retirement obligation	1,430,771	1,430,771
Customer deposits	656,004	633,973
	<u>10,308,546</u>	<u>10,716,447</u>
<u>Long-term debt:</u>		
Long-term portion bonds payable	13,270,000	13,865,000
	<u>13,270,000</u>	<u>13,865,000</u>
	<u>23,578,546</u>	<u>24,581,447</u>
<u>Net position:</u>		
Unrestricted	20,450,052	19,772,569
Restricted per bond ordinance	3,826,221	6,913,225
Investment in plant assets, net of related debt	49,014,619	49,460,320
	<u>73,290,892</u>	<u>76,146,114</u>
	<u>\$ 96,869,438</u>	<u>\$100,727,561</u>

The accompanying notes are an integral part of these financial statements.

City of Henderson, Kentucky Utility Commission
Statement of Revenues, Expenses and Changes in Net Position
For the fiscal years ended May 31, 2014 and 2013

<u>Operating revenues:</u>	<u>2014</u>	<u>2013</u>
Sale of electricity-Existing System	\$ 36,885,855	\$ 37,406,971
Sale of electricity-Station Two	22,555,014	25,097,121
Communication services	1,055,678	980,662
Other	294,882	556,333
Total operating revenues	<u>60,791,429</u>	<u>64,041,087</u>
<u>Operating expenses:</u>		
Production of electricity	46,389,323	50,883,263
Operating expenses	9,653,404	9,778,284
Depreciation	5,085,827	5,049,126
Total operating expenses	<u>61,128,554</u>	<u>65,710,673</u>
Income (loss) from operations	<u>(337,125)</u>	<u>(1,669,586)</u>
<u>Interest income (expense):</u>		
Investment income	22,834	29,702
Interest expense	(497,163)	(509,650)
Total interest expense	<u>(474,329)</u>	<u>(479,948)</u>
Income (loss) before transfers	<u>(811,454)</u>	<u>(2,149,534)</u>
<u>Non-operating items:</u>		
Station One Remediation	(13,044)	-
Gain on sale of emission allowances	-	53
Transfers to City of Henderson	(1,244,724)	(1,244,724)
Power furnished to City of Henderson	(408,000)	(288,000)
Communication services provided to the City of Henderson and other local government agencies	(378,000)	(378,000)
Total non-operating items	<u>(2,043,768)</u>	<u>(1,910,671)</u>
Change in net position before extraordinary item	<u>(2,855,222)</u>	<u>(4,060,205)</u>
Net position, beginning of year	76,146,114	80,670,400
Cumulative effect of change in accounting principal-Adoption GASB No. 65	-	(464,081)
Net position, end of year	<u>\$ 73,290,892</u>	<u>\$ 76,146,114</u>

The accompanying notes are an integral part of these financial statements.

City of Henderson, Kentucky Utility Commission
Statement of Cash Flows
For the fiscal years ended May 31, 2014 and 2013

	2014	2013
<u>Cash flows from operating activities:</u>		
Receipts from customers	\$ 61,013,117	\$ 63,943,555
Payments to suppliers and employees	(57,095,169)	(59,093,559)
Net cash provided (used) by operating activities	3,917,948	4,849,996
<u>Cash flows from non-capital financing activities:</u>		
Distributions to the City of Henderson	(1,244,724)	(1,244,724)
Net cash provided (used) by non-capital financing activities	(1,244,724)	(1,244,724)
<u>Cash flows from capital and related financing activities:</u>		
Acquisition and construction of capital assets	(4,063,445)	(3,859,149)
Principal payments on long term debt	(585,000)	(570,000)
Interest payments on long-term debt and bond anticipation notes	(497,163)	(509,650)
Net cash provided (used) by capital and related financing activities	(5,145,608)	(4,938,799)
<u>Cash flows provided by investing activities:</u>		
Proceeds from sale of emission allowances	-	53
Proceeds from sale and maturities of investments	6,666,416	4,575,264
Investment income	22,834	29,702
Purchases of investment securities	(3,758,669)	(3,751,796)
Net cash provided (used) by investing activities	2,930,581	853,223
Increase (decrease) in cash and cash equivalents	458,197	(480,304)
Cash and cash equivalents, beginning of year	905,429	1,385,733
Cash and cash equivalents, end of year	\$ 1,363,626	\$ 905,429

The accompanying notes are an integral part of these financial statements.

City of Henderson, Kentucky Utility Commission
Statement of Cash Flows-Reconciliation of Net Cash Provided by Operations
For the fiscal years ended May 31, 2014 and 2013

	2014	2013
<u>Operating activities:</u>		
Operating income (loss)	\$ (337,125)	\$ (1,669,586)
<u>Adjustments to reconcile operating income</u>		
<u>(loss) to net cash provided by operations:</u>		
Depreciation	5,085,827	5,049,126
Power furnished to the City of Henderson	(408,000)	(288,000)
Communication services provided at no charge	(378,000)	(378,000)
<u>Changes in operating assets and liabilities:</u>		
Accounts receivable	(175,367)	1,343,992
Due from Station Two Operator	(323,457)	614,031
Accrued revenue	(162,237)	42,999
Inventory and supplies	1,032,610	1,418,474
Prepaid expenses and other assets	(46,063)	238
Accounts payable and accrued expenses	(286,573)	(1,704,801)
Accounts payable-construction	(124,375)	381,151
Customer deposits	22,031	11,388
Due to Station Two Operator and other items	18,677	28,984
	\$ 3,917,948	\$ 4,849,996

The accompanying notes are an integral part of these financial statements.

1. Organization and Contracts:

The City of Henderson Utility Commission is organized under the provisions of Section 96.530 of the Kentucky Revised Statutes to operate, manage, and control the Henderson Municipal Power & Light System. The members of the Utility Commission are appointed by the Mayor and are approved by the City Commissioners of the City of Henderson, Kentucky (City). The Mayor and the City Commission authorize all rates and bond issues of the Utility Commission. As a municipal entity, the Utility Commission is exempt from all federal and state income taxes. Certain real estate utilized by the Utility Commission is owned by the City of Henderson.

The Utility Commission operates the “Existing System” and pursuant to certain contracts and agreements described as follows, reserves power from “Station Two” which is owned by the Commission, and currently operated by Big Rivers Electric Corporation (Big Rivers), pursuant to various lease, assignment, and other agreements between the parties

The Commission provides retail electric service to the residents of the City of Henderson within its service territory. The Commission also provided wholesale electricity to Big Rivers through July 18, 1998 and subsequently to an affiliate of LG&E Energy Corporation. LG&E was purchased by Powergen in 2000 and thereafter acquired by E.ON. Effective July 16, 2009, Big Rivers resumed its role as operator of Station Two as part of the “Unwind Transaction.”

The Commission entered into certain contracts with Big Rivers relating to Station Two, as follows:

A. Power Plant Construction and Operation Agreement:

Under this agreement, Big Rivers agreed to furnish certain construction and start-up services for which it was paid out-of-pocket expenses plus overhead allowances and operate Station Two upon completion for which the Station Two Operator is paid reasonable expenditures allocable to the operation and maintenance of Station Two, as defined in the agreement. The original agreement was amended to include an option to extend through the useful operating life of Station Two. Big Rivers exercised this option in 1998.

B. Power Sales Contract:

Under this agreement, The Station Two Operator purchases all of the Station Two capacity in excess of the City of Henderson’s requirements. Payments for capacity purchased by the Station Two Operator are made monthly based on the portion of Station Two capacity allocated to the Station Two Operator compared to the total monthly Station Two capacity costs as defined in the agreement. The original agreement was executed in 1970 and extended through 2023. During 1993, the agreement was amended to include an option to extend through the useful operating life of Station Two. Big Rivers exercised this option in 1998.

C. Joint Facilities Agreement:

This agreement provides for the continuing joint use by the Commission and Station Two Operator of certain auxiliary facilities presently owned and used by the Station Two Operator at its generating station and of auxiliary facilities provided by the Commission in connection with the construction of Station Two, which is located adjacent to the generating station also operated by the Station Two Operator.

1. Organization and Contracts, Continued:

Power sales to the Station Two Operator under the agreement amounted to \$22,555,014 and \$25,097,121 for the fiscal years ended May 31, 2014 and 2013, respectively.

In connection with the negotiations related to the funding and construction of the Flue Gas Desulfurization System (FGD System) Station Two various aforementioned contracts were amended effective May 31, 1993. Significant provisions of the amendments include:

- The total capacity of Station Two, a factor in determining various Station Two costs allocations, was reduced as a result of the power required to operate the FGD System.
- FGD System costs, up to the amount of proceeds from the sale of Emission Allowances, will be borne in the same proportion as the Emission Allowances are allocated. Additional FGD System costs will be borne in proportion to the new capacity allocation as determined by the contract amendments.
- The Commission will reimburse the Station Two Operator for certain allocated costs of an existing Big Rivers' FGD System to be jointly used by the Station Two Operator and Station Two based upon an allocation formula defined in the amendments.

Amounts charged by the Station Two Operator as reasonable expenditures allocable to the operation and maintenance of Station Two are subject to review and approval by the Commission. Differences, if any, between amounts originally charged as allocable by the Station Two Operator and amounts accepted by the Utility Commission are recorded when a final determination of such amounts is made. Operating revenues and expenses would be reduced by any amount subsequently determined not to be allocable to Station Two.

Station Two became commercially operable and construction was substantially completed during 1974.

2. Summary of Significant Accounting Policies:

The Commission is a component unit of the City of Henderson, Kentucky (the primary government), due to its financial accountability to the City Commission.

The financial statements of the Commission have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the fund's principal ongoing operations. The principal operating revenues of the Commission are charges to customers for electric and communications sales and service.

Operating expenses for the Commission include the cost of power and services, administrative expenses, and depreciation. All other revenues and expenses not meeting this definition are classified as non-operating items.

2. **Summary of Significant Accounting Policies, Continued:**

Statement of Net Position:

The Statement of Net Position is designed to display the financial position of the Commission. The Commission's fund equity is reported as a net position, which is presented in three categories defined as follows:

- **Net invested in capital assets-** This component of net position consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- **Restricted-** This component of net position consists of constraints placed on net position use through external constraints imposed by creditors through debt covenants.
- **Unrestricted-** This component of net position consists of the remainder of net position that does not meet the definition of restricted or invested in capital assets, net of related debt.

Statement of Revenues, Expenses, and Changes in Net Position:

The statement of revenues, expenses, and changes in net position is the operating statement for proprietary funds. Revenues are reported by major source. This statement distinguishes between operating and non-operating revenues and expenses, and presents a separate subtotal for operating revenues, operating expenses, and operating income. The more significant of the Commission's accounting policies are described below:

A. Cash and Cash Equivalents:

Cash and cash equivalents consist of certificates of deposit and repurchase agreements with an original maturity of three months or less from the date of purchase. The carrying amount of each of these instruments approximates fair value.

B. Investment Securities:

Investments are recorded at fair value based on quoted market prices. Any gains or losses are reflected in the statement of revenues, expenses and changes in net assets in accordance with GASB No.31, "Accounting and Reporting For Certain Investments and For Internal Investment Pools." Kentucky Revised Statute 66.480 limits the types of securities that a municipal entity may invest in to obligations of the United States Treasury and its agencies, certain Federal securities, repurchase agreements, commercial bank certificates of deposit, and the Commonwealth of Kentucky Investment Pool.

C. Accounts Receivable and Unbilled Revenue:

The Commission has entered into an agreement with the City of Henderson to perform its billing and collection services. All monies due to the Utility Commission are collected and deposited in the City of Henderson's Utility Clearing Fund and are remitted to the Utility Commission on a weekly basis. The amount included in accounts receivable due from the Utility Clearing Fund was \$1,868,911 and \$1,765,202 as of May 31, 2014 and 2013, respectively.

2. Summary of Significant Accounting Policies, Continued:

D. Inventory:

Coal inventory of Station Two is stated at cost using the first-in-first-out method. Materials and supplies are stated at the weighted average cost.

E. Utility Plant and Equipment:

The utility plant is carried at cost, which includes interest capitalized, aggregating \$15,342,300, which was capitalized during the period of construction. No interest was capitalized during the fiscal years ended May 31, 2014 and 2013. The Commission's policy for determining the useful lives of its utility plant and equipment is as follows:

Production plant and structures	33 ½	years
Transmission and distribution	25	years
Automotive equipment	6	years
Wireless internet equipment	5	years
Other equipment	10	years

F. Use of Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at May 31, 2014 and 2013, as well as revenues and expenses for the years then ended. Actual results could differ from the estimates and assumptions used.

G. Compensated Absences:

Employees of the Commission are entitled to paid vacations and sick-leave. The Commission's policy is to recognize these costs when earned under the accrual method of accounting in accordance with GASB No.16 "Accounting For Compensated Absences."

H. Emission Allowances:

The Commission does not record the value of emission allowances granted by the Environmental Protection Agency for sulfur dioxide and nitrous oxide on its financial statements as there is no cost basis in these allowances.

3. Cash and Cash Equivalents:

As of May 31, 2014, the City of Henderson Utility Commission maintained deposits with several local financial institutions. Of the bank balance, all was insured by the Federal Depositor's Insurance Corporation and excess of FDIC was secured by pledged United States Government securities.

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements

4. Investment Securities:

Investments are included in the statement of net position under the caption “Investments Securities.” A summary of investments held by the City of Henderson Utility Commission along with the scheduled maturities is presented below:

<u>Investment Type:</u>	<u>Fair Value</u>	<u>Less Than One Year</u>	<u>One to Five Years</u>	<u>Six to Ten Years</u>
<u>May 31, 2014:</u>				
<u>Unrestricted Investments</u>				
U.S. Treasury Bills	\$ 12,590,114	\$ 12,590,114	\$ -	\$ -
Certificate of Deposits and Money Markets	5,279,044	5,279,044	-	-
Total Unrestricted Investments	<u>\$ 17,869,158</u>	<u>\$ 17,869,158</u>	<u>\$ -</u>	<u>\$ -</u>
<u>Restricted Per Bond Ordinance:</u>				
Certificate of Deposit and Money Market	\$ 1,690,383	\$ 1,690,383	\$ -	\$ -
Short term U.S. Treasuries	2,135,838	2,135,838	-	-
Total Restricted Investments	<u>\$ 3,826,221</u>	<u>\$ 3,826,221</u>	<u>\$ -</u>	<u>\$ -</u>
<u>May 31, 2013:</u>				
<u>Unrestricted Investments</u>				
U.S. Treasury Bills	\$ 7,506,447	\$ 7,506,447	\$ -	\$ -
Certificate of Deposits and Money Markets	12,429,840	12,429,840	-	-
Total Unrestricted Investments	<u>\$ 19,936,287</u>	<u>\$ 19,936,287</u>	<u>\$ -</u>	<u>\$ -</u>
<u>Restricted Per Bond Ordinance:</u>				
Certificate of Deposit and Money Market	\$ 5,286,383	\$ 3,092,383	\$ -	\$ -
Short term U.S. Treasuries	1,626,842	1,626,842	-	-
Total Restricted Investments	<u>\$ 6,913,225</u>	<u>\$ 4,719,225</u>	<u>\$ -</u>	<u>\$ -</u>
<u>Restricted Assets consisted of the following:</u>				
	<u>2014</u>	<u>2013</u>		
Operation and maintenance reserve	\$ 100,000	\$ 100,000		
Bond Project Funds	195,125	2,982,156		
Debt Service Reserve	2,983,479	1,078,078		
Debt Service Sinking Fund	547,617	558,991		
Total restricted assets	<u>\$ 3,826,221</u>	<u>4,719,225</u>		

A. Interest Rate Risk:

The City of Henderson Utility Commission has a formal investment policy that limits investment maturities as a means to manage its exposure to fair value losses resulting from increasing interest rates.

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements

4. Investment Securities, Continued:

B. Credit Risk:

The City of Henderson Utility Commission limits its investments to those allowed by Kentucky Revised Statute 66.480. Kentucky Revised Statute 66.480 limits investments to U.S. Government Treasury and Agency securities, certificates of deposit, securities issued by a state or local government rated in one of the three highest categories by a nationally recognized credit agency.

C. Custodial Credit Risk:

Custodial credit risk is the risk that in the event of the failure of the counterparty, The City of Henderson Utility Commission will not be able to recover the value of its investments, or collateral securities that are in the possession of the outside party. All investments of the Commission, with the exception of certificates of deposit, consist of unregistered and uninsured securities held by the Commission's trustee in their trust department not in the name of the Commission.

5. Utility Plant and Equipment:

Utility plant and equipment consisted of the following as of May 31, 2014:

<u>Existing System:</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending Balance</u>
Vehicles	\$ 2,357,155	\$ 20,688	\$ -	\$ 2,377,843
Asset retirement obligation	296,793	-	(296,793)	-
Transmission plant	9,171,183	82,106	(706)	9,252,583
Distribution plant	25,136,574	893,438	(19,834)	26,010,178
Land and land rights	1,235,451	-	-	1,235,451
Telecommunications, internet and fiber optics	5,686,706	102,017	(7,198)	5,781,525
General plant	11,065,881	-	-	11,065,881
	<u>54,949,743</u>	<u>1,098,249</u>	<u>(324,531)</u>	<u>55,723,461</u>
Accumulated depreciation:				
Asset retirement obligation	(286,483)	-	286,483	-
Accumulated depreciation	<u>(43,648,330)</u>	<u>(977,536)</u>	<u>35,987</u>	<u>(44,589,879)</u>
Existing System total	<u>\$ 11,014,930</u>	<u>\$ 120,713</u>	<u>\$ (288,544)</u>	<u>\$ 11,133,582</u>
<u>Station Two:</u>				
General plant	\$ 175,945,318	\$ 2,958,938	\$ -	\$ 178,904,256
Accumulated depreciation	<u>(123,049,928)</u>	<u>(4,108,291)</u>	<u>-</u>	<u>(127,158,219)</u>
Station Two total	<u>\$ 52,895,390</u>	<u>\$ (1,149,353)</u>	<u>\$ -</u>	<u>\$ 51,746,037</u>
Total utility, plant, and equipment, net	<u>\$ 63,910,320</u>			<u>\$ 62,879,619</u>

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements

5. Utility Plant and Equipment:

Utility plant and equipment consisted of the following as of May 31, 2013:

<u>Existing System:</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending Balance</u>
Vehicles	\$ 2,129,786	\$ 227,369	\$ -	\$ 2,357,155
Asset retirement obligation	296,793	-	-	296,793
Transmission plant	9,108,516	62,667	-	9,171,183
Distribution plant	24,579,235	557,339	-	25,136,574
Land and land rights	1,235,451	-	-	1,235,451
Telecommunications, internet and fiber optics	5,628,045	58,661	-	5,686,706
General plant	11,065,881	-	-	11,065,881
	<u>54,043,707</u>	<u>906,036</u>	<u>-</u>	<u>54,949,743</u>
Accumulated depreciation:				
Asset retirement obligation	(286,483)	-	-	(286,483)
Accumulated depreciation	<u>(42,666,330)</u>	<u>(982,000)</u>	<u>-</u>	<u>(43,648,330)</u>
Existing System total	<u>\$ 11,090,894</u>	<u>\$ (75,964)</u>	<u>\$ -</u>	<u>\$ 11,014,930</u>
<u>Station Two:</u>				
General plant	\$ 172,875,063	\$ 3,070,255	\$ -	\$ 175,945,318
Accumulated depreciation	<u>(118,977,087)</u>	<u>(4,072,841)</u>	<u>-</u>	<u>(123,049,928)</u>
Station Two total	<u>\$ 53,897,976</u>	<u>\$ (1,002,586)</u>	<u>\$ -</u>	<u>\$ 52,895,390</u>
Total utility, plant, and equipment, net	<u>\$ 64,988,870</u>			<u>\$ 63,910,320</u>

Depreciation expense for the fiscal years ended May 31, 2014 and 2013 was \$5,085,827 and \$5,049,126 respectively.

6. Retirement Plans:

All Commission employees participate in the County Employees Retirement System (CERS), a multi-employer defined benefit retirement plan sponsored by the City of Henderson and administered by the Commonwealth of Kentucky. Under the plan, employees contribute 5% of their gross salary to the plan, while employees hired after July 1, 2009 contribute 6% of their salary. The Commission also contributes a percentage of the employee's gross salary to the plan. The Commission's contribution rate into the plan is determined on an annual basis by the Kentucky General Assembly.

Contributions and the related percentages for the previous three fiscal years ended were as follows:

<u>Fiscal year ended May 31</u>	<u>Amount</u>	<u>Matching Percentage</u>
2014	\$ 536,125	18.89%
2013	\$ 539,503	19.55%
2012	\$ 518,504	18.96%

A copy of the annual report for the County Employees Retirement System can be obtained from the County Employees Retirement System 1260 Louisville Road, Frankfort, Kentucky 40601, or by calling 1.502.564.4646.

7. Accounts Payable and Accrued Expenses:

Accounts payable and accrued expenses consisted of the following as of May 31, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Accounts payable and accrued expenses - Existing System	\$ 2,376,689	\$ 2,590,015
Accounts payable and accrued liabilities - Station Two	<u>2,685,538</u>	<u>2,758,785</u>
Total	<u>\$ 5,062,227</u>	<u>\$ 5,348,800</u>

8. Long-Term Debt-Revenue Bonds:

During the fiscal year ended May 31, 2012, the City of Henderson Utility Commission issued revenue bonds for the purpose of financing capital improvements throughout its system through two revenue bond series, *Electric System Revenue Bonds, Series 2011A* in the amount of \$11,350,000, and *Electric System Revenue Bonds, Series 2011 B*, in the amount of \$3,670,000.

The bond ordinance requires that certain accounts for each issue be established and held by a trustee as follows:

Debt Service Fund:

A monthly transfer of 1/12 of principal and 1/6 of the interest due is required to be deposited in the Debt Service Fund.

8. Long-Term Debt-Revenue Bonds, Continued:

Debt Service Reserve Fund:

A reserve account was established, so that as of any date of calculation, an amount equal to at least the highest amount of aggregate debt service, or an amount equal to 125% of the average aggregate debt service and an amount equal to 10% of the “proceeds” of the bonds with respect to all series is maintained by the Commission.

Series 2011A:

The Series 2011A bonds are secured by a pledge of the revenues of the City of Henderson, Kentucky Utility Commission. The Series 2011A Bonds are additionally secured by a debt service reserve and a non-foreclosable statutory mortgage lien on the System. The Series 2011A Bonds are also secured by a debt service reserve in an amount equal to the least of the maximum annual debt service on the Series 2011A Bonds. The proceeds from the sale of these bonds were used to retire the Bond Anticipation Note, Series 2008B in the amount of \$5,281,067, with the remaining proceeds to be used for capital improvements of the City’s electric transmission and distribution system, and at its Station Two generating station. Interest is due semi-annually on these obligations on December 1st and June 1st of each year.

It is the opinion from the City of Henderson, Kentucky Utility Commission’s bond counsel, that under existing laws, interest on the Series 2011A Bonds is not subject to income tax.

Optional Redemption Series 2011A:

The Series 2011A Bonds maturing on and after December 1, 2021, are subject to redemption by the City, at its option, before maturity on September 1, 2021, and on any date thereafter in whole or from time to time in part in any order of maturity (less than all of a single maturity to be selected by lot in such manner as the Trustee and Paying Agent may determine) at a redemption price equal to 100% of the principal amount thereof plus accrued interest to the redemption date.

Series 2011B:

The Series 2011B bonds are secured by a pledge of the revenues of the City of Henderson, Kentucky Utility Commission. The Series 2011B Bonds are additionally secured by a debt service reserve and a non-foreclosable statutory mortgage lien on the System. The Series 2011B Bonds are also secured by a debt service reserve in an amount equal to the least of the maximum annual debt service on the Series 2011B bonds. The proceeds from the sale of these bonds were used to retire the Bond Anticipation Note, Series 2008A and 2010A, in the amounts of \$3,500,000 and \$170,000, respectively. Interest is due semi-annually on these obligations on December 1st and June 1st of each year.

It is the opinion from the City of Henderson, Kentucky Utility Commission’s bond counsel, that under existing laws, interest on the Series 2011B bonds is not subject to income tax.

Optional Redemption Series 2011B:

The Series 2011B Bonds maturing on and after December 1, 2021, are subject to redemption by the City, at its option, before maturity on September 1, 2021, and on any date thereafter in whole or from time to time in part in any order of maturity (less than all of a single maturity to be selected by lot in such manner as the Trustee and Paying Agent may determine) at a redemption price equal to 100% of the principal amount thereof plus accrued interest to the redemption date.

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements

8. Long-Term Debt-Revenue Bonds, continued:

A summary of the long-term debt of the Commission is as follows:

	<u>2014</u>	<u>2013</u>
City of Henderson, Kentucky Utility Commission Series 2011A Revenue Bonds, secured by pledge of system revenues and non-forecloseable statutory lien, maturing December 1, 2031, annual principal payments range from \$420,000 to \$725,000 interest rates range from 2.5% to 4.5%.	\$ 10,495,000	\$ 10,930,000
City of Henderson, Kentucky Utility Commission Series 2011B Revenue Bonds, secured by pledge of system revenues and non-forecloseable statutory lien, maturing December 1, 2031, annual principal payments range from \$150,000 to \$245,000 interest rates range from 2.5% to 4.5%.	<u>3,370,000</u>	<u>3,520,000</u>
Total long term debt as of May 31, 2014	\$ 13,865,000	\$ 14,450,000
Less current portion due	<u>595,000</u>	<u>585,000</u>
Long term debt net of current portion	<u>\$ 13,270,000</u>	<u>\$ 13,865,000</u>

Future maturities of long-term debt for the next five years as of May 31, 2014 are as follows:

<u>Fiscal Year:</u>	<u>Series 2011A</u>			<u>Series 2011B</u>			<u>Total Debt Service</u>
	<u>Principal</u>	<u>Interest</u>	<u>Total</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>	
2015	\$ 445,000	\$ 385,931	\$ 830,931	\$ 150,000	\$ 104,856	\$ 254,856	\$ 1,085,787
2016	455,000	374,806	829,806	155,000	102,980	257,980	1,087,786
2017	465,000	363,430	828,430	155,000	101,044	256,044	1,084,474
2018	475,000	351,806	826,806	155,000	98,718	253,718	1,080,524
2019	490,000	339,930	829,930	160,000	95,618	255,618	1,085,548
2020-2024	2,685,000	1,459,046	4,144,046	870,000	415,386	1,285,386	5,429,432
2025-2029	3,210,000	920,888	4,130,888	1,020,000	262,841	1,282,841	5,413,729
2030-2032	<u>2,270,000</u>	<u>206,320</u>	<u>2,476,320</u>	<u>705,000</u>	<u>58,405</u>	<u>763,405</u>	<u>3,239,725</u>
	<u>\$ 10,495,000</u>	<u>\$ 4,402,157</u>	<u>\$ 14,897,157</u>	<u>\$ 3,370,000</u>	<u>\$ 1,239,848</u>	<u>\$ 4,609,848</u>	<u>\$ 19,507,005</u>

9. Asset Retirement Obligation:

Effective December 31, 2008, the Commission terminated operation of its Station One generation facility. The Commission is legally obligated to remove asbestos, lead paint, and other contaminants located there. Accordingly, a liability has been established in accordance with SFAS No. 143 *Accounting for Asset Retirement Obligations*.

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements

9. Asset Retirement Obligation, continued:

The following is a reconciliation of the aggregate retirement liability associated with the Commission's obligation to remove the contaminants:

	Asset Retirement Obligation
Balance as of June 1, 2013	\$ 1,430,771
Additional obligations incurred	-
Increase in present value of the obligation	-
Increase based on revised estimates of costs to dismantle and remove assets	-
Liabilities extinguished	-
Balance as of May 31, 2014	<u>\$ 1,430,771</u>

The Commission during July of 2014 opened bids to demolish and perform an environmental clean up of its Station One facility. Six contractors submitted bids ranging from \$216,000 to \$4.9 million, with one bidder offering to pay \$37,000 for the privilege as the firm will sell the scrap and equipment from the facility as well as remove the contamination. The Commission engaged this firm in September of 2014 and as of the date of this report, work is in progress to dismantle the facility and remove the contamination.

10. Discounted Internet and Broadband Services:

A summary of discounted internet and broadband services provided by the Commission to other governmental concerns is as follows:

<u>Governmental Organizations</u>	<u>2014</u>	<u>2013</u>
Henderson County GIS System	\$ 54,000	\$ 54,000
Henderson Water Utility	121,000	121,000
City of Henderson	201,000	201,000
Other organizations	2,000	2,000
	<u>\$ 378,000</u>	<u>\$ 378,000</u>

11. Concentration of Sales:

Three industrial customers of the Existing System accounted for sales in the amount of \$10.4 million (28% of Existing System sales), and \$11.7 million (31% of Existing System sales) for the fiscal years ended May 31, 2014 and 2013.

12. Emission Allowances:

Amendments to the Clean Air Act in 1990 established a system whereby emission allowances were created and allocated to generating units subject to Phase 1 of the emission restrictions. Station Two was allotted a total of 226,901 allowances through 1999 (one emission allowance represents the authorization to emit one ton of sulfur dioxide in a given year). The allowances are allocated between the Commission and the Station Two Operator based upon the Station Two capacity allocations. As of May 31, 2014 and 2013, there were remaining sulfur dioxide emission allowances valued at \$41,364 and \$28,697, respectively each year ended.

13. Related Party Transactions:

The Commission incurred the following transactions with the City of Henderson, Kentucky for the fiscal years ended May 31, 2014 and 2013:

Paid the City \$611,417 and \$582,583 each year, respectively, for data processing and other services related to billings and collections.

Paid the City \$1,244,724 and \$1,244,724 May 31, 2014 and 2013 of the fiscal years ended, respectively.

Paid the City \$585,286 and \$554,590 for participation in the City of Henderson's self-insured employee health insurance plan for the fiscal years ended May 31, 2014 and 2013 respectively. Risk is minimized in this area by the purchase of re-insurance for amounts in excess of the \$125,000 stop loss limit. Charges are based on estimated amounts determined by the City of Henderson's insurance coordinator as necessary to fund claims as they become due and payable.

Provided the City of Henderson with power for the fiscal years ended May 31, 2014 and 2013 in the amount of \$408,000 and \$288,000 respectively. The City of Henderson was also provided significantly reduced communication service fees totaling approximately \$201,000 for the fiscal years May 31, 2014 and 2013.

14. Commitments and Contingencies:

A. Southeastern Power Administration:

The Southeastern Power Administration (SEPA) has contracted with the Commission to provide it a total of 18,000 megawatt hours of hydroelectric power each year. The 18,000 megawatt hours represent approximately 3% of the Commission's annual megawatt hour requirements. Henderson Municipal Power & Light is restricted to not more than 12 megawatt hours during any hour, and not more than 2,640 megawatt hours during any month.

During the year ended May 31, 2014 and 2013, the Commission purchased power on the spot market and from SEPA to supply the needs of its customers. Purchased power from these sources for the fiscal year ended May 31, 2014 was \$745,191 and \$634,539 during 2013.

14. Commitments and Contingencies, continued:

B. Regulatory Compliance:

The North American Electric Reliability Corporation (NERC) adopted new electric system reliability standards for all electric utilities in the United States. NERC has adopted and began enforcement of the new standards effective June of 2007. The new standards have been approved by the Federal Energy Regulatory Commission (FERC). The Commission must comply with the new standards and will incur administrative expenses related to NERC compliance.

Federal air quality and emission standards have become more stringent. The current standards and proposed standards resulted in the cost of compliance being excessive to operate Station One. As a result of the new regulations, the Commission approved the cessation of operations at Station One on August 25, 2008, and Station One was taken out of service in December of 2008. As noted in Footnote 9, the plant is being dismantled as of the date of our report.

C. Unwind Transaction- Station Two:

In 1998, HMP&L, Big Rivers Electric Corporation, and Western Kentucky Energy Corporation entered into contracts for the operation of the HMP&L Station Two Power Plant and other Big Rivers Electric Corporation Generation Plants. On July 16, 2009, Big Rivers Electric Corporation and Western Kentucky Energy Corporation (E.ON) signed an agreement under which the original 1998 contracts are rescinded and operational control of the Station Two Power Plant returned to Big Rivers Electric Corporation.

D. Pending Litigation:

Big Rivers and HMP&L are currently involved in litigation concerning the Excess Henderson Energy at Station Two. The litigation was heard in the Henderson County Circuit Court and the judge assigned the dispute to arbitration. On May 30, 2012 the Arbitration Panel issued a final ruling in favor of HMP&L. Big Rivers filed a motion with the Appeals Court requesting that the Arbitration Panel's ruling be vacated and set aside. The Appeals Court issued a final ruling on May 30, 2014 in favor of HMP&L. On October 1, 2014 Big Rivers filed A Motion for Discretionary Review with the Supreme Court of Kentucky. This legal dispute may continue for several years.

In July 2012, HMP&L entered into litigation with the Kentucky Department of Labor related to the application of prevailing of wage rates at Station Two. The litigation went to trial in December 2012. The Circuit Court ruled in favor of the Labor Cabinet on May 24, 2013. HMP&L filed an appeal in the Kentucky Appeals Court, and oral arguments were heard September 24, 2014. HMP&L anticipates a ruling from the Appeals Court within the next six months.

15. Risk Management:

The Commission is exposed to various risks of loss related to torts, theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Commission carries commercial insurance for these types of risk of loss, including workers' compensation. Settled claims from these risks have not exceeded commercial insurance coverage in any of the past five fiscal years.

16. Amounts Due From Station Two Operator:

As of the fiscal years ended May 31, 2014 and 2013, the amount the Station Two Operator owed to the Commission, as part of the annual settlement, was \$1,155,650 and \$832,193, respectively.

17. Change in Accounting Principle:

For the fiscal year ended May 31, 2014, the Commission implemented GASB No. 65 *Items Previously Reported as Assets and Liabilities*. Under GASB No. 65 bond issuance costs are treated as an expense. Bond issuance costs were removed through a prior period adjust. The effect of the implementation of this standard was to reduce net assets as of May 31, 2013 by \$464,081.

18. Subsequent Events:

Subsequent events have been evaluated through October 15, 2014.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
COMBINING STATEMENT OF NET POSITION-BY SYSTEM
As of May 31, 2014 and 2013

	<u>May 31, 2014</u>				<u>May 31, 2013</u>			
	<u>Existing System</u>	<u>Station Two</u>	<u>Elimination</u>	<u>Total</u>	<u>Existing System</u>	<u>Station Two</u>	<u>Elimination</u>	<u>Total</u>
<u>Assets</u>								
<u>Current assets:</u>								
Cash and cash equivalents	\$ 1,311,067	\$ 52,559	\$ -	\$ 1,363,626	\$ 884,208	\$ 21,221	\$ -	\$ 905,429
Investment securities	17,869,158	-	-	17,869,158	19,936,287	-	-	19,936,287
Restricted cash equivalents and investments:								
Certificates of deposit and money market	1,690,383	-	-	1,690,383	3,092,383	-	-	3,092,383
Short-term U.S. Government securities	2,135,838	-	-	2,135,838	1,626,842	-	-	1,626,842
Accounts receivable, net of allowance for uncollectible	1,774,504	93,246	-	1,867,750	1,692,383	-	-	1,692,383
Accounts receivable-Station Two Operator	1,155,650	-	-	1,155,650	832,193	-	-	832,193
Accrued interest receivable	-	-	-	-	-	-	-	-
Accrued revenue	2,803,484	-	-	2,803,484	2,641,247	-	-	2,641,247
Inventory and supplies	2,468,637	2,531,969	-	5,000,606	3,274,431	2,758,785	-	6,033,216
Prepaid expenses	103,324	-	-	103,324	57,261	-	-	57,261
Total current assets	<u>31,312,045</u>	<u>2,677,774</u>	<u>-</u>	<u>33,989,819</u>	<u>34,037,235</u>	<u>2,780,006</u>	<u>-</u>	<u>36,817,241</u>
<u>Utility plant, net of accumulated depreciation</u>	<u>11,133,582</u>	<u>51,746,037</u>	<u>-</u>	<u>62,879,619</u>	<u>11,014,930</u>	<u>52,895,390</u>	<u>-</u>	<u>63,910,320</u>
<u>Other assets:</u>								
Investment in Station Two	31,058,999	-	(31,058,999)	-	31,058,999	-	(31,058,999)	-
Total assets	<u>\$ 73,504,626</u>	<u>\$ 54,423,811</u>	<u>\$ (31,058,999)</u>	<u>\$ 96,869,438</u>	<u>\$ 76,111,164</u>	<u>\$ 55,675,396</u>	<u>\$ (31,058,999)</u>	<u>\$100,727,561</u>

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
COMBINING STATEMENT OF NET POSITION-BY SYSTEM
As of May 31, 2014 and 2013

	<u>May 31, 2014</u>				<u>May 31, 2013</u>			
	<u>Existing System</u>	<u>Station Two</u>	<u>Elimination</u>	<u>Total</u>	<u>Existing System</u>	<u>Station Two</u>	<u>Elimination</u>	<u>Total</u>
<u>Liabilities and net assets:</u>								
<u>Current liabilities:</u>								
Accounts payable and accrued expenses	\$ 2,376,689	2,685,538	\$ -	\$ 5,062,227	\$ 2,590,015	\$ 2,758,785	\$ -	\$ 5,348,800
Accounts payable-Construction in progress - Station Two	-	2,564,544	-	2,564,544	-	2,688,919	-	2,688,919
Asset retirement obligation	1,430,771	-	-	1,430,771	1,430,771	-	-	1,430,771
Accounts payable-Station Two Operator	-	-	-	-	-	28,984	-	28,984
Current portion-bonds payable	595,000	-	-	595,000	585,000	-	-	585,000
Customer deposits	656,004	-	-	656,004	633,973	-	-	633,973
Total current liabilities	5,058,464	5,250,082	-	10,308,546	5,239,759	5,476,688	-	10,716,447
<u>Long-term debt:</u>								
Long-term portion of bonds payable	13,270,000	-	-	13,270,000	13,865,000	-	-	13,865,000
Bond anticipation notes	-	-	-	-	-	-	-	-
Total long-term liabilities	13,270,000	-	-	13,270,000	13,865,000	-	-	13,865,000
<u>Net position:</u>								
Unrestricted	23,022,360	(2,572,308)	-	20,450,052	22,469,251	(2,696,682)	-	19,772,569
Restricted per bond ordinance	3,826,221	-	-	3,826,221	6,913,225	-	-	6,913,225
Investment in plant assets, net of related debt	28,327,581	51,746,037	(31,058,999)	49,014,619	27,623,929	52,895,390	(31,058,999)	49,460,320
Total net position	55,176,162	49,173,729	(31,058,999)	73,290,892	57,006,405	50,198,708	(31,058,999)	76,146,114
Total liabilities and net position	\$ 73,504,626	\$ 54,423,811	\$ (31,058,999)	\$ 96,869,438	\$ 76,111,164	\$ 55,675,396	\$ (31,058,999)	\$100,727,561

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
COMBINING STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION-BY SYSTEM
For the fiscal years ended May 31, 2014 and 2013

	May 31, 2014				May 31, 2013			
	Existing System	Station Two	Elimination	Consolidated Total	Existing System	Station Two	Elimination	Consolidated Total
Operating Revenues:								
Sale of electricity	\$ 36,885,855	\$ 36,948,306	(14,393,292)	\$ 59,440,869	\$ 37,406,971	\$ 39,632,707	\$ (14,535,586)	\$ 62,504,092
Communication services	1,055,678	-	-	1,055,678	980,662	-	-	980,662
Other	294,882	-	-	294,882	556,333	-	-	556,333
Total Operating Revenues	38,236,415	36,948,306	(14,393,292)	60,791,429	38,943,966	39,632,707	(14,535,586)	64,041,087
Operating Expenses:								
Production of electricity	30,309,307	30,473,308	(14,393,292)	46,389,323	31,906,031	33,512,818	(14,535,586)	50,883,263
Operating, general and administrative	6,261,534	3,391,870	-	9,653,404	6,347,067	3,431,217	-	9,778,284
Depreciation	977,536	4,108,291	-	5,085,827	976,285	4,072,841	-	5,049,126
Total Operating Expenses	37,548,377	37,973,469	(14,393,292)	61,128,554	39,229,383	41,016,876	(14,535,586)	65,710,673
Income (Loss) from Operations	688,038	(1,025,163)	-	(337,125)	(285,417)	(1,384,169)	-	(1,669,586)
Interest Income (Expense):								
Other income (expense)	(62)	28	-	(34)	-	-	-	-
Investment income	22,712	156	-	22,868	29,325	377	-	29,702
Interest expense	(497,163)	-	-	(497,163)	(509,650)	-	-	(509,650)
Total Interest Income (Expense)	(474,513)	184	-	(474,295)	(480,325)	377	-	(479,948)
Income (Loss) Before Transfers	213,525	(1,024,979)	-	(811,454)	(765,742)	(1,383,792)	-	(2,149,534)
Non-operating Items:								
Station 1 Remediation	(13,044)	-	-	(13,044)	-	-	-	-
Gain on sale of emission allowances	-	-	-	-	-	53	-	53
Transfers to City of Henderson	(1,244,724)	-	-	(1,244,724)	(1,244,724)	-	-	(1,244,724)
Power furnished to City of Henderson	(408,000)	-	-	(408,000)	(288,000)	-	-	(288,000)
Communication services provided to the City of Henderson and local governmental agencies	(378,000)	-	-	(378,000)	(378,000)	-	-	(378,000)
Total non-operating Items	(2,043,768)	-	-	(2,043,768)	(1,910,724)	53	-	(1,910,671)
Increase (Decrease) in Net Position	(1,830,243)	(1,024,979)	-	(2,855,222)	(2,676,466)	(1,383,739)	-	(4,060,205)
Net Position, Beginning of Year	57,006,405	50,198,708	(31,058,999)	76,146,114	60,146,952	51,582,447	(31,058,999)	80,670,400
Cumulative effect of change in accounting principal-Adoption of GASB No.65	-	-	-	-	(464,081)	-	-	(464,081)
Net Position, End of Year	\$ 55,176,162	\$ 49,173,729	\$ (31,058,999)	\$ 73,290,892	\$ 57,006,405	\$ 50,198,708	\$ (31,058,999)	\$ 76,146,114

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
SUPPLEMENTAL SCHEDULE OF CHANGES IN NET POSITION -BY SYSTEM
For the fiscal years ended May 31, 2014 and 2013

	<u>Existing System</u>	<u>Station Two</u>			<u>Eliminations *</u>	<u>Total Net Assets</u>
		<u>Utility Commission</u>	<u>Big Rivers</u>	<u>Total Station Two</u>		
Beginning balance, June 1, 2012	\$ 60,146,952	\$ 18,037,703	\$ 33,544,744	\$ 51,582,447	\$ (31,058,999)	\$ 80,670,400
Cumulative effect of change in accounting Principal	(464,081)	-	-	-	-	(464,081)
Change in net position	<u>(2,676,466)</u>	<u>550,070</u>	<u>(1,933,809)</u>	<u>(1,383,739)</u>	<u>-</u>	<u>(4,060,205)</u>
Balance, May 31, 2013	\$ 57,006,405	\$ 18,587,773	\$ 31,610,935	\$ 50,198,708	\$ (31,058,999)	\$ 76,146,114
Change in net position	<u>(1,830,243)</u>	<u>908,830</u>	<u>(1,933,809)</u>	<u>(1,024,979)</u>	<u>-</u>	<u>(2,855,222)</u>
Balance May 31, 2014	<u>\$ 55,176,162</u>	<u>\$ 19,496,603</u>	<u>\$ 29,677,126</u>	<u>\$ 49,173,729</u>	<u>\$ (31,058,999)</u>	<u>\$ 73,290,892</u>

* Elimination of interest of Existing System in investment in the equity of Station Two.

Shown on the Statement of Net Position	<u>2014</u>	<u>2013</u>
Investment in Utility Plant and Equipment, net of related debt	\$ 20,450,052	\$ 19,772,569
Restricted per bond ordinance	3,826,221	6,913,225
Unrestricted	<u>49,014,619</u>	<u>49,460,320</u>
	<u>\$ 73,290,892</u>	<u>\$ 76,146,114</u>



Report on Internal Control Over Financial Reporting, Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Independent Auditors' Report

Members of the Board of Commissioners
City of Henderson, Kentucky Utility Commission
Henderson, 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 of America; the financial statements of the City of Henderson, Kentucky Utility Commission as of and for the year ended May 31, 2014, and have issued our report thereon dated October 15, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the City of Henderson, Kentucky Utility Commission's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City of Henderson, Kentucky Utility Commission's internal control. Accordingly, we do not express an opinion on the effectiveness of the City of Henderson, Kentucky Utility Commission's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or 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 the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in the internal control that might be significant deficiencies, or material weaknesses. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Henderson, Kentucky Utility Commission's financial statements are free of 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*.

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 result of that testing, and not to provide an opinion on the effectiveness of 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 report is not suitable for any other purpose.

A handwritten signature in black ink that reads "Myriad Co Group, LLC". The signature is written in a cursive, flowing style.

Henderson, Kentucky
October 15, 2014



**City of Henderson, Kentucky Utility Commission –
Henderson Municipal Power & Light**

Report on Audited Financial Statements

For the fiscal years ended May 31, 2015 and 2014

**Case No: 2019-00269
Attachment 1 to BREC 1-31
HMPL Audits 2011-2019**

Contents

	<u>Page(s)</u>
Management's Discussion and Analysis	1-12
Independent Auditors' Report	13-14
Basic Financial Statements:	
Statement of Net Position	15
Statement of Revenues, Expenses, and Changes in Net Position	16
Statement of Cash Flows	17
Statement of Cash Flows – Reconciliation of Net Cash Provided by Operations	18
Notes to the Financial Statements	19-35
Supplemental Information:	
Combining Statement of Net Position – By System	36-37
Combining Statement of Revenues, Expenses, and Changes in Net Position – By System	38
Supplemental Schedule of Changes in Net Position – By System	39
Schedule of the Commission's Proportionate Share of the Net Pension Liability	40
Schedule of Commission Contributions	41
Independent Auditors' Report on Internal Control Over Financial Reporting, Compliance and Other Matters Based on an Audit of Primary Government Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	42-43

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION- HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT'S DISCUSSION AND ANALYSIS

The City of Henderson, Kentucky Utility Commission (HMP&L) is in the business of providing electricity and internet communication services for residential, commercial, and industrial customers within the incorporated territory of the City of Henderson, Kentucky. The Commission also provides electricity and internet communication services to customers in a few areas outside of the incorporated territory of Henderson. The following discussion and analysis of HMP&L's financial performance provides an overview of the Utility's financial activities for fiscal year ended May 31, 2015.

Overview of the Financial Statements:

This annual financial report consists of three parts: 1) Management's Discussion and Analysis, 2) Financial Statements, and 3) Supplemental Additional Information. The Financial Statements also include notes that explain in more detail some of the information in the financial statements. The statements are followed by a section of supplemental information that further explains and supports the information in the basic financial statements. The Supplemental schedules present the financial position and results of operations for the Existing System and Station Two. The Consolidated Financial Statements report information about HMP&L using accounting methods similar to those used by private sector companies, except for the reporting of contributions in aid of construction, equity capital, and retained earnings. Refer to the Summary of Significant Accounting Policies in the footnotes to the Financial Statements relating to the adoption of Statement No. 34 of the Governmental Accounting Standard Board (GASB 34).

The Statement of Net Position, successor to the Balance Sheet, includes all of the Utility's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to HMP&L's creditors (liabilities). It also provides the basis for evaluating the capital structure of HMP&L and assessing the liquidity and financial flexibility of HMP&L.

All of the current year's revenues and expenses are accounted for in the Statement of Revenues, Expenses, and Changes in Net Position, successor to the Income Statement. This statement measures the success of the Utility's operations over the past year and can be used to determine whether the Utility has successfully recovered all of its costs through the sale of electricity, communications, and other charges, and has earned a reasonable profit, as well as maintained a sound financial position.

The final required financial statement is the Statement of Cash Flows. The primary purpose of this statement is to provide information about the Utility's cash receipts, cash payments, and net changes in cash resulting from operations, investing and financing activities, and it provides information on the sources and uses of cash and the changes in cash balances during the year.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Financial Statements:

- HMP&L's total assets decreased from \$96,869,438 at May 31, 2014 to \$93,317,404 at May 31, 2015. This decrease is primarily attributable to the decreased balances in investment securities and cash.
- Operating revenues for HMP&L Existing System decreased by approximately \$422,568 or 1.1% from \$38,236,415 to \$37,813,847. The decrease in Existing System sales was primarily due to decreased power demand over that of the previous year. Internet revenue increased by \$80,051.

Existing System:

	<u>2015</u>	<u>2014</u>	<u>Change</u>	<u>Percentage Change</u>
Sale of electricity	\$ 36,370	\$ 36,886	\$ (516)	-1%
Internet service	1,136	1,056	80	8%
Other	308	295	13	4%
 Total operating revenues	 <u>\$ 37,814</u>	 <u>\$ 38,237</u>	 <u>\$ (423)</u>	 <u>-1%</u>

Note: All amounts presented in thousands -000's omitted.

- Operating expenses for HMP&L Existing System increased by approximately \$788,097 or 2.1%. The following table represents the changes in the expenses for the Existing System:

Existing System:

	<u>2015</u>	<u>2014</u>	<u>Change</u>	<u>Percentage Change</u>
Sale of electricity	\$ 31,092	\$ 30,309	\$ 783	3%
Internet service	6,251	6,262	(11)	0%
Other	993	978	15	2%
 Total operating revenues	 <u>\$ 38,336</u>	 <u>\$ 37,549</u>	 <u>\$ 787</u>	 <u>2%</u>

Note: All amounts presented in thousands -000's omitted.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Financial Statements, continued:

- Operating revenues for Station Two increased approximately \$1,560,023 over that of the previous year. The Station Two Agreement is not designed to generate a profit for each of the participants in the venture, but rather to break-even on a cash flow basis. Operating expenses decreased for Station Two.

<u>Station Two</u>	<u>2015</u>	<u>2014</u>	<u>Change</u>
Sales- BREC	\$ 23,315	\$ 22,555	\$ 760
Sales- HMPL	15,194	14,393	801
Total Operating Revenue	<u>\$ 38,509</u>	<u>\$ 36,948</u>	<u>\$ 1,561</u>
<u>Expenses:</u>			
Production of electricity	\$ 35,173	\$ 33,865	\$ 1,308
Depreciation	4,077	4,108	(31)
Total Operating Expenses	<u>39,250</u>	<u>37,973</u>	<u>1,277</u>
Net income before transfers	<u>\$ (741)</u>	<u>\$ (1,025)</u>	<u>\$ 284</u>

Note: All amounts presented in thousands -000's omitted.

Upon the consolidation of the financial statements for each system, transactions between Henderson Municipal Power and Light and Station Two Operator are eliminated.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT’S DISCUSSION AND ANALYSIS**

Statement of Net Position:

Net position of HMP&L decreased by \$2,778,924 for the fiscal year ended May 31, 2015, while net position decreased by \$2,855,222 in the fiscal year ended May 31, 2014.

Investment securities decreased by \$2,986,707 over that of Fiscal Year 2014.

<u>Assets:</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
Cash and cash equivalents	\$ 504	\$ 1,364	\$ 905
Investment securities	15,078	18,064	19,936
Restricted assets	3,547	3,631	4,719
Accounts receivable-unbilled revenue	1,818	1,868	1,692
Accounts receivable-unbilled Station Two Operator	1,512	1,156	832
Accrued revenue	2,503	2,803	2,641
Inventories	5,046	5,001	6,033
Prepaid expenses	102	103	57
	<u>30,110</u>	<u>33,990</u>	<u>36,815</u>
Utility plant and equipment	62,733	62,880	6,390
Deferred outflow of resources	476	-	-
	<u>62,733</u>	<u>62,880</u>	<u>6,390</u>
Total assets and deferred outflows of resources	<u>\$ 93,319</u>	<u>\$ 96,870</u>	<u>\$ 43,205</u>

Note: All amounts presented in thousands -000's omitted.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT’S DISCUSSION AND ANALYSIS**

Statement of Net Position, continued:

Current liabilities decreased by \$488,110. Accounts payable and accrued expenses decreased \$384,095 over the previous year mainly due to normal variations in timing of payments.

A summary of the liabilities section of the Statement of Net Position is as follows:

<u>Liabilities</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
Accounts payable	\$ 4,678	\$ 5,062	\$ 5,349
Accounts payable-construction	3,410	2,565	2,689
Asset retirement obligation	381	1,431	1,431
Accounts payable			
Station Two Operator	90	-	29
Current portion bonds payable	605	595	585
Customer deposits	657	656	634
Total current liabilities	<u>9,821</u>	<u>10,309</u>	<u>10,717</u>
Unfunded pension liability	4,316	-	-
Long term bonds payable	12,665	13,270	13,865
Deferred inflows	446	-	-
Total liabilities	<u>\$ 27,248</u>	<u>\$ 23,579</u>	<u>\$ 24,582</u>

Note: All amounts presented in thousands -000's omitted.

Statement of Revenues, Expenses, and Changes in Net Position:

Operating Revenues for the entire entity increased by \$337,061 over that of the previous year. Sales for HMP&L Station Two increased by \$1,560,023 or 4.2% while Sales Existing System decreased by \$422,568 or 1.1%.

Operating Expenses increased by \$1.26 million. This was due to increased operating costs incurred with the operation of Station Two.

The Net Operating Loss of the Existing System, after interest expense and interest income, was \$963,102. Transfers were made to the City of Henderson in the amount of \$1.24 million for the fiscal year ended, the value of power furnished to the City of Henderson at no charge was \$465,769, and the value of communication services provided to the City of Henderson and other governmental agencies, at no charge, was \$378,000.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Statement of Revenues, Expenses, and Changes in Net Position, continued:

Station Two had a net operating loss of \$741,541; however, the loss relates primarily to depreciation expense which is a noncash item.

	<u>Existing System</u>	<u>Station Two</u>	<u>Total</u>
Income (loss) before transfers	\$ (963)	\$ (742)	\$ (1,705)
Non-operating items:			
Extraordinary item-Station One			
Removal	1,050	-	1,050
Station One Remediation	(36)	-	(36)
Transfer to City of Henderson	(1,245)	-	(1,245)
Communication services provided to the City of Henderson and other governmental agencies	(378)	-	(378)
Power furnished to City of Henderson	(466)	-	(466)
Change in net position	<u>\$ (2,038)</u>	<u>\$ (742)</u>	<u>\$ (2,780)</u>

Note: All amounts presented in thousands -000's omitted.

Statement of Cash Flows:

Cash generated from operating activities decreased by \$586,565 over the level from Fiscal Year 2014.

Cash Flows from non-capital financing activities include the funds transferred to the City of Henderson. For the fiscal year ended May 31, 2015, \$1.24 million was transferred.

Cash used by capital and related financing activities was \$6.06 million.

Cash and cash equivalents for the year, which consist primarily of checking and money market accounts of HMP&L, decreased by \$859,763.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Statement of Cash Flows, continued:

<u>Cash Flow Summary</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
Net cash generated by operations	\$ 3,331	\$ 3,918	\$ 4,849
Cash transferred to the City of Henderson	(1,245)	(1,245)	(1,245)
Net cash used by capital and related financing	(6,063)	(5,146)	(4,939)
Investing activities	3,117	2,931	854
Increase (decrease) in cash	<u>(860)</u>	<u>458</u>	<u>(481)</u>
Cash and cash equivalents, beginning of year	<u>1,364</u>	<u>906</u>	<u>1,387</u>
Cash and cash equivalents, end of year	<u><u>\$ 504</u></u>	<u><u>\$ 1,364</u></u>	<u><u>\$ 906</u></u>

Note: All amounts presented in thousands -000's omitted.

The following is a summary of cash and investment balances as of May 31, 2013, to 2015:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Cash and cash equivalents	\$ 504	\$ 1,364	\$ 905
Investments	15,078	18,064	19,936
Restricted investments	3,547	3,631	4,719
	<u><u>\$ 19,129</u></u>	<u><u>\$ 23,059</u></u>	<u><u>\$ 25,560</u></u>

Note: All amounts presented in thousands -000's omitted.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION- HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT'S DISCUSSION AND ANALYSIS

Capital Assets:

As noted in the footnotes to this report, HMP&L has 25,947 sulfur dioxide emission allowances from the Existing System and Station Two available as of May 31, 2015. The value of the allowances is not reflected in the financial statements due to the fact that the Commission has no cost basis in the allowances. The estimated current market value of these allowances at May 31, 2015, is approximately \$32,434.

Debt Administration:

HMP&L entered into two Bond Anticipation Notes with Fifth Third Bank on December 22, 2008, a non-taxable series 2008A in the amount of \$3,500,000 and a taxable series 2008B in the amount of \$9,000,000. The series 2008A was used for capital improvements to the City's retail electric system. The taxable series 2008B was used to make capital improvements to the City's Station Two generating plant. HMP&L entered into an additional Bond Anticipation Note with Fifth Third Bank on March 25, 2010, a non-taxable series 2010A in the amount of \$1,500,000. This note was repaid at the same time as the series 2008A note. In September of 2012 HMP&L issued Revenue Bonds in the amount of \$15,020,000 and retired all outstanding Bond Anticipation Notes.

On January 29, 2009, the City Commission approved an Ordinance increasing electric rates by 3.855 percent for all customer rate classifications. The purpose of the rate increase was to provide additional revenue to make the principal and interest payments on the short-term Bond Anticipation Notes and the long-term Bonds issued to replace the Bond Anticipation Notes. HMP&L set up a separate Bond Payment Account and, as of May 31, 2015, HMP&L had accrued \$1,286,260 for future principal and interest payments for the Bonds.

System Improvements and Replacement of Capital Assets:

During the period of June 1, 2014, through May 31, 2015, HMP&L made a number of improvements to the electric and communication facilities and replaced certain assets. The improvements to the facilities and asset replacements increased service reliability and extended the useful-life of certain existing assets.

During the FY2014-2015, HMP&L made \$801,442 in capital improvements and replacements in the Existing System and \$4,180,912 in capital improvements and replacements of Station Two.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT’S DISCUSSION AND ANALYSIS**

Electric Rates – Current and Future Increases:

On May 12, 2015, the Board of Commissioners of the City of Henderson, Kentucky, passed an ordinance approving and adopting the following schedule of electric rate increases:

	<u>Effective Date</u>	<u>Adjustment Percent Increase</u>
First Adjustment	July 1, 2015	5%
Second Adjustment	November 1, 2015	5%
Third Adjustment	May 1, 2016	5%
Fourth Adjustment	November 1, 2016	5%
Inflation Adjustment	Beginning January 1, 2017 and each January 1, thereafter	CPI*

*Consumer Price Index (CPI) – Adjustments will be made in accordance with the percentage changes in the US Department of Labor Consumer Price Index (CPI-U).

Station Two – Future Expenditures:

In 1998, HMP&L and Big Rivers Electric Corporation entered into contracts with Western Kentucky Energy Corporation for the operation of the HMP&L Station Two Power Plant and other Big Rivers Electric Corporation Power Plants. Big Rivers Electric Corporation and Western Kentucky Energy Corporation entered discussions in 2005 to unwind the original 1998 contracts and return operational control of the Station Two Power Plant and the other Plants to Big Rivers Electric Corporation. The Unwind Transaction closed on July 16, 2009, and Big Rivers, thereafter, resumed operation of the Station Two Power Plant. Big Rivers Electric Corporation has identified a number of facility upgrades and maintenance projects for the Station Two Power Plant. These Work Plans indicate HMP&L will incur an additional \$18 million to \$21 million in maintenance expenses in the future at Station Two.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION- HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT'S DISCUSSION AND ANALYSIS

Station Two – Future Expenditures, continued:

Big Rivers and HMP&L are currently involved in litigation concerning the Excess Henderson Energy at Station Two. The litigation was heard in the Henderson County Circuit Court and the judge assigned the dispute to arbitration. On May 30, 2012, the Arbitration Panel issued a final ruling in favor of HMP&L. Big Rivers filed a motion with the Appeals Court requesting that the Arbitration Panel's ruling be vacated and set aside. The Appeals Court issued a final ruling on May 30, 2014, in favor of HMP&L. On October 1, 2014, Big Rivers filed a Motion for Discretionary Review with the Supreme Court of Kentucky. On August 12, 2015, the Supreme Court of Kentucky denied the Motion for Discretionary Review. This legal dispute may continue for several years, however, HMP&L intends to claim damages beginning in July 2009.

In July 2012, HMP&L entered into litigation with the Kentucky Department of Labor related to the application of prevailing wage rates at Station Two. The litigation went to trial in the Henderson Circuit Court in December 2012. The Circuit Court ruled in favor of the Labor Cabinet on May 24, 2013. HMP&L filed an appeal in the Kentucky Appeals Court, and oral arguments were heard September 24, 2014. HMP&L is currently awaiting a ruling from the Appeals Court.

In past years, HMP&L has increased its reserve capacity at Station Two. The reserve capacity for FY 2014-2015 was 115 megawatts and HMP&L did not increase its reserve capacity for FY 2015-2016. HMP&L intends to keep the reserve capacity at 115 megawatts which is in line with the current HMP&L historical system peak demand. Each 5 megawatt increase in the reserved capacity will currently cost HMP&L approximately \$693,929/year. The actual cost of reserve capacity, however, is based upon the Station Two budget which varies each year.

Closing of Station One:

The Utility Commission considered Station One to no longer be a viable generating facility because of increasing federal and state restrictions for new air emissions and the increasing costs of maintenance and fuel for the facility. Therefore, Station One was closed effective December 31, 2008. Upon closing, Station One employed 13 full-time and 2 temporary personnel of which nine were placed internally, one was placed externally, one retired, three were laid off and one temporary employee was terminated. At the September 2014 Commission Meeting, the Utility Commission approved awarding the bid in the compensated amount of \$37,000 to National Salvage & Service Corporation to provide remedial actions, equipment removal, and demolition of the Station One Power Plant. Work began at the beginning of October 2014 and was completed in the second quarter of 2015.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION- HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT'S DISCUSSION AND ANALYSIS

Southeastern Power Administration (SEPA):

The Southeastern Power Administration (SEPA) has contracted with HMP&L to provide HMP&L a total of 18,000 megawatt hours of hydroelectric power each year. The 18,000 megawatt hours represent approximately 3 percent of HMP&L's annual megawatt hour requirements. HMP&L is restricted to not more than 12 megawatt hours during any one hour period. The hydroelectric power is provided from SEPA generation units on the Cumberland River System Project.

In the fall of 2006, SEPA informed all contract project participants that the Wolf Creek Dam near Jamestown, Kentucky, had been inspected and serious seepage problems existed in the earthen dam. The seepage problems at the dam date back to 1968 and the US Army Corp of Engineers implemented various repairs since that time; however, the seepage became critical to the safety of the Wolf Creek Dam and surrounding communities. In an effort to respond to these safety concerns and make the needed repairs to the dam, SEPA reduced and curtailed electric service to the contract project participants. This reduction and curtailment of SEPA electric service began in early 2007. The dam repairs were completed during 2014 and SEPA is currently in the process of allowing the basin to again fill with water. However, this area will take time to fill to its necessary level of water.

The SEPA Cumberland River Hydroelectric Power System may not return to normal operations for several more years.

Regulatory Compliance:

The North American Electric Reliability Corporation (NERC) adopted new electric system reliability standards for all electric utilities in the United States. NERC adopted and began enforcement of the new standards beginning in June 2007. The new standards were approved by the Federal Energy Regulatory Commission (FERC). HMP&L is required to comply with the new reliability standards and HMP&L will incur administrative expenses related to NERC compliance. HMP&L has established an internal committee to address NERC Reliability Standards. Also, HMP&L has retained an external consulting firm to assist, support, and facilitate HMP&L's compliance with NERC Reliability. In November 2008, the Southeastern Electric Reliability Council (SERC) audited HMP&L for compliance with NERC Reliability Standards. Subsequent to the November audit, a number of formal and informal discussions took place between HMP&L and SERC. HMP&L and SERC reached an agreement concerning non-compliance issues identified during the audit; and a final settlement agreement was approved. In November 2010, HMP&L hired a new Reliability Compliance Manager who is responsible for compliance with NERC Reliability Standards. SERC performed a compliance audit of HMP&L in March of 2014, evaluating the utility for compliance with 11 reliability requirements, as well as 3 infrastructure related items. This audit resulted in no findings, violations, or recommendations.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Regulatory Compliance, continued:

Federal air quality and emission standards continue to be increasingly more stringent. The current standards and proposed new standards will increase the cost of energy production at Station Two.

Transfer to the City of Henderson, Kentucky:

During the fiscal year 2014-2015, HMP&L's cash transfer to the City was \$1.24 million. HMP&L has budgeted this same level of cash transfer to the City for FY2015-2016 and subsequent budget periods. HMP&L also paid the City \$622,250 for internal service fees and HMP&L provided the City free electric service valued at \$465,769 and free communication services valued at \$378,000 annually. Excluding the annual fuel adjustment revenue and expense, the annual cash transfer payments, internal service fees, and value of the free electric and communication services represent 7.45 percent of gross electric revenue in fiscal year 2014-2015.



INDEPENDENT AUDITORS' REPORT

To the Board of Commissioners
City of Henderson, Kentucky
Utility Commission
Henderson, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the City of Henderson, Kentucky Utility Commission (Commission), a component unit of the City of Henderson, Kentucky, as of and for the years ended May 31, 2015 and 2014, and the related notes to the financial statements, which collectively comprise the Commission'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 opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of 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 auditors' 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 opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Commission as of May 31, 2015 and 2014, and the changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management Discussion and Analysis on pages 1 through 12 and the Schedules of the Commission's Proportionate Share of the Net Pension Liability and Contributions to the County Employees' Retirement System on pages 40 and 41 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 opinions on the financial statements that collectively comprise the City of Henderson, Kentucky Utility Commission's basic financial statements. The combining financial statements on pages 36 through 39 are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining financial statements are the responsibility of management and were derived from and relate 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 combining financial statements are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Implementation of New Accounting Standards

As disclosed in Note 2 to the financial statements, the City of Henderson, Kentucky Utility Commission implemented GASB Statement No. 68, *Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27*, and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date - an amendment of GASB No. 68*, during the fiscal year ended May 31, 2015.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report on our consideration of the City of Henderson, Kentucky Utility Commission's internal control over financial reporting and 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 the 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 City of Henderson, Kentucky Utility Commission's internal control over reporting and compliance.



Henderson, Kentucky
September 29, 2015

City of Henderson, Kentucky Utility Commission
Statement of Net Position
As of May 31, 2015 and 2014

<u>Assets:</u>	<u>2015</u>	<u>2014</u>
<u>Current assets:</u>		
Cash and cash equivalents	\$ 503,863	\$ 1,363,626
Investments - unrestricted	15,077,575	18,064,282
Investments - restricted	3,546,581	3,631,097
Accounts receivable, net of allowance for uncollectibles	1,817,864	1,867,750
Accounts receivable, Station Two Operator	1,511,787	1,155,650
Accrued revenue	2,502,950	2,803,484
Inventory and supplies	5,045,596	5,000,606
Prepaid expenses	101,748	103,324
Total current assets	<u>30,107,964</u>	<u>33,989,819</u>
<u>Utility plant and equipment:</u>		
Utility plant, net of accumulated depreciation	<u>62,733,307</u>	<u>62,879,619</u>
Total assets	<u>92,841,271</u>	<u>96,869,438</u>
<u>Deferred outflows of resources:</u>		
Deferred outflows of resources	<u>476,133</u>	<u>-</u>
Total deferred outflows of resources	<u>476,133</u>	<u>-</u>
Total assets and deferred outflows of resources	<u>\$ 93,317,404</u>	<u>\$ 96,869,438</u>
<u>Liabilities and net assets:</u>		
<u>Liabilities:</u>		
<u>Current liabilities:</u>		
Accounts payable and accrued expenses	\$ 4,678,132	\$ 5,062,227
Accounts payable-Construction in progress Station Two	3,409,854	2,564,544
Accounts payable-Station Two Operator	89,530	-
Current portion-bonds payable	610,000	595,000
Asset retirement obligation	380,771	1,430,771
Customer deposits	657,149	656,004
Total current liabilities	<u>9,825,436</u>	<u>10,308,546</u>
<u>Long-term liabilities:</u>		
Long-term portion bonds payable	12,660,000	13,270,000
Unfunded pension liability	4,316,000	-
Total long-term liabilities	<u>16,976,000</u>	<u>13,270,000</u>
Total liabilities	<u>26,801,436</u>	<u>23,578,546</u>
<u>Deferred inflows of resources:</u>		
Deferred inflows of resources	<u>446,000</u>	<u>-</u>
Total deferred inflows of resources	<u>446,000</u>	<u>-</u>
<u>Net position:</u>		
Unrestricted	13,060,080	20,450,052
Restricted per bond ordinance	3,546,581	3,826,221
Investment in plant assets, net of related debt	49,463,307	49,014,619
Total net position	<u>66,069,968</u>	<u>73,290,892</u>
Total liabilities, deferred inflows of resources, and net position	<u>\$ 93,317,404</u>	<u>\$ 96,869,438</u>

The accompanying notes are an integral part of these financial statements.

City of Henderson, Kentucky Utility Commission
Statement of Revenues, Expenses, and Changes in Net Position
For the fiscal years ended May 31, 2015 and 2014

<u>Operating revenues:</u>	<u>2015</u>	<u>2014</u>
Sale of electricity-Existing System	\$ 36,369,893	\$ 36,885,855
Sale of electricity-Station Two	23,314,643	22,555,014
Communication services	1,135,729	1,055,678
Other	308,225	294,882
Total operating revenues	<u>61,128,490</u>	<u>60,791,429</u>
<u>Operating expenses:</u>		
Production of electricity	47,458,745	46,389,323
Operating expenses	9,863,618	9,653,404
Depreciation	5,070,479	5,085,827
Total operating expenses	<u>62,392,842</u>	<u>61,128,554</u>
Income (loss) from operations	<u>(1,264,352)</u>	<u>(337,125)</u>
<u>Interest income (expense):</u>		
Investment income	45,819	22,834
Interest expense	(486,110)	(497,163)
Total interest income (expense)	<u>(440,291)</u>	<u>(474,329)</u>
Income (loss) before transfers	<u>(1,704,643)</u>	<u>(811,454)</u>
<u>Non-operating items:</u>		
Station One Remediation	(35,788)	(13,044)
Transfers to City of Henderson	(1,244,724)	(1,244,724)
Power furnished to City of Henderson	(465,769)	(408,000)
Communication services provided to the City of Henderson and other local government agencies	(378,000)	(378,000)
Total non-operating items	<u>(2,124,281)</u>	<u>(2,043,768)</u>
<u>Extraordinary item:</u>		
Extraordinary gain on disposal of plant one	<u>1,050,000</u>	<u>-</u>
Change in net position	(2,778,924)	(2,855,222)
Cumulative effect of change in accounting principle - adoption of Governmental Accounting Standards Board Statement No. 68	(4,442,000)	-
Net position, beginning of year	73,290,892	76,146,114
Net position, end of year	<u>\$ 66,069,968</u>	<u>\$ 73,290,892</u>

The accompanying notes are an integral part of these financial statements.

City of Henderson, Kentucky Utility Commission
Statement of Cash Flows
For the fiscal years ended May 31, 2015 and 2014

	2015	2014
<u>Cash flows from operating activities:</u>		
Receipts from customers	\$ 61,123,918	\$ 61,013,117
Payments to suppliers and employees	(57,792,535)	(57,095,169)
Net cash provided by operating activities	3,331,383	3,917,948
<u>Cash flows from non-capital financing activities:</u>		
Distributions to the City of Henderson	(1,244,724)	(1,244,724)
Net cash used by non-capital financing activities	(1,244,724)	(1,244,724)
<u>Cash flows from capital and related financing activities:</u>		
Acquisition and construction of capital assets	(4,982,354)	(4,063,445)
Principal payments on long-term debt	(595,000)	(585,000)
Interest payments on long-term debt	(486,110)	(497,163)
Net cash used by capital and related financing activities	(6,063,464)	(5,145,608)
<u>Cash flows from investing activities:</u>		
Proceeds from sale and maturities of investments	6,887,972	6,666,416
Investment income	50,536	22,834
Purchases of investment securities	(3,821,466)	(3,758,669)
Net cash provided by investing activities	3,117,042	2,930,581
Increase (decrease) in cash and cash equivalents	(859,763)	458,197
Cash and cash equivalents, beginning of year	1,363,626	905,429
Cash and cash equivalents, end of year	\$ 503,863	\$ 1,363,626

The accompanying notes are an integral part of these financial statements.

City of Henderson, Kentucky Utility Commission
Statement of Cash Flows-Reconciliation of Net Cash Provided by Operations
For the fiscal years ended May 31, 2015 and 2014

	2015	2014
<u>Operating activities:</u>		
Operating income (loss)	\$ (1,264,352)	\$ (337,125)
<u>Adjustments to reconcile operating income</u>		
<u>(loss) to net cash provided by operations:</u>		
Depreciation	5,070,479	5,085,827
Power furnished to the City of Henderson	(465,769)	(408,000)
Communication services provided at no charge	(378,000)	(378,000)
<u>Changes in operating assets and liabilities:</u>		
Accounts receivable	49,886	(175,367)
Due from Station Two Operator	(356,137)	(323,457)
Accrued revenue	300,534	(162,237)
Inventory and supplies	(44,990)	1,032,610
Prepaid expenses and other assets	1,576	(46,063)
Accounts payable and accrued expenses	(384,095)	(286,573)
Accounts payable-construction	845,310	(124,375)
Customer deposits	1,145	22,031
Due to Station Two Operator and other items	(44,204)	18,677
	\$ 3,331,383	\$ 3,917,948
Net cash provided by operating activities	\$ 3,331,383	\$ 3,917,948

The accompanying notes are an integral part of these financial statements.

1. Organization and Contracts:

The City of Henderson Utility Commission is organized under the provisions of Section 96.530 of the Kentucky Revised Statutes to operate, manage, and control the Henderson Municipal Power & Light System. The members of the Utility Commission are appointed by the Mayor and are approved by the City Commissioners of the City of Henderson, Kentucky (City). The Mayor and the City Commission authorize all rates and bond issues of the Utility Commission. As a municipal entity, the Utility Commission is exempt from all federal and state income taxes. Certain real estate utilized by the Utility Commission is owned by the City of Henderson.

The Utility Commission operates the “Existing System” and pursuant to certain contracts and agreements described as follows, reserves power from “Station Two” which is owned by the Commission, and currently operated by Big Rivers Electric Corporation (Big Rivers), pursuant to various lease, assignment, and other agreements between the parties.

The Commission provides retail electric service to the residents of the City of Henderson within its service territory. The Commission also provided wholesale electricity to Big Rivers through July 18, 1998 and subsequently to an affiliate of LG&E Energy Corporation. LG&E was purchased by Powergen in 2000 and thereafter acquired by E.ON. Effective July 16, 2009, Big Rivers resumed its role as operator of Station Two as part of the “Unwind Transaction.”

The Commission entered into certain contracts with Big Rivers relating to Station Two, as follows:

A. Power Plant Construction and Operation Agreement:

Under this agreement, Big Rivers agreed to furnish certain construction and start-up services for which it was paid out-of-pocket expenses plus overhead allowances and operate Station Two upon completion for which the Station Two Operator is paid reasonable expenditures allocable to the operation and maintenance of Station Two, as defined in the agreement. The original agreement was amended to include an option to extend through the useful operating life of Station Two. Big Rivers exercised this option in 1998.

B. Power Sales Contract:

Under this agreement, the Station Two Operator purchases all of the Station Two capacity in excess of the City of Henderson’s requirements. Payments for capacity purchased by the Station Two Operator are made monthly based on the portion of Station Two capacity allocated to the Station Two Operator compared to the total monthly Station Two capacity costs as defined in the agreement. The original agreement was executed in 1970 and extended through 2023. During 1993, the agreement was amended to include an option to extend through the useful operating life of Station Two. Big Rivers exercised this option in 1998.

C. Joint Facilities Agreement:

This agreement provides for the continuing joint use by the Commission and Station Two Operator of certain auxiliary facilities presently owned and used by the Station Two Operator at its generating station and of auxiliary facilities provided by the Commission in connection with the construction of Station Two, which is located adjacent to the generating station and also operated by the Station Two Operator.

1. Organization and Contracts, continued:

Power sales to the Station Two Operator under the agreement amounted to \$23,314,643 and \$22,555,014 for the fiscal years ended May 31, 2015 and 2014, respectively.

In connection with the negotiations related to the funding and construction of the Flue Gas Desulfurization System (FGD System) Station Two various aforementioned contracts were amended effective May 31, 1993. Significant provisions of the amendments include:

- The total capacity of Station Two, a factor in determining various Station Two cost allocations, was reduced as a result of the power required to operate the FGD System.
- FGD System costs, up to the amount of proceeds from the sale of Emission Allowances, will be borne in the same proportion as the Emission Allowances are allocated. Additional FGD System costs will be borne in proportion to the new capacity allocation as determined by the contract amendments.
- The Commission will reimburse the Station Two Operator for certain allocated costs of the existing Big Rivers' FGD System to be jointly used by the Station Two Operator and Station Two based upon an allocation formula defined in the amendments.

Amounts charged by the Station Two Operator as reasonable expenditures allocable to the operation and maintenance of Station Two are subject to review and approval by the Commission. Differences, if any, between amounts originally charged as allocable by the Station Two Operator and amounts accepted by the Utility Commission are recorded when a final determination of such amounts is made. Operating revenues and expenses would be reduced by any amount subsequently determined not to be allocable to Station Two.

Station Two became commercially operable and construction was substantially completed during 1974.

2. Summary of Significant Accounting Policies:

The Commission is a component unit of the City of Henderson, Kentucky (the primary government), due to its financial accountability to the City Commission.

The financial statements of the Commission have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the fund's principal ongoing operations. The principal operating revenues of the Commission are charges to customers for electric and communications sales and service.

Operating expenses for the Commission include the cost of power and services, administrative expenses, and depreciation. All other revenues and expenses not meeting this definition are classified as non-operating items.

2. **Summary of Significant Accounting Policies, continued:**

New Accounting Pronouncements:

The Commission implemented the Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27*, and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date - an amendment of GASB No. 68*. The provisions of these statements are effective for financial statements for fiscal years beginning after June 15, 2014, with earlier implementation encouraged. The implementation of GASB Statements No. 68 and 71 resulted in a cumulative effect of change in accounting principle which reduced the net position of the Commission by \$4,442,000. Additionally, implementation of the new GASB statements also resulted in the recording of related deferred outflows and inflows of resources, and unfunded pension liability, which is further discussed in Note 6.

Statement of Net Position:

The Statement of Net Position is designed to display the financial position of the Commission. The Commission's fund equity is reported as a net position, which is presented in three categories defined as follows:

- **Net invested in capital assets-** This component of net position consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- **Restricted-** This component of net position consists of constraints placed on net position use through external constraints imposed by creditors through debt covenants.
- **Unrestricted-** This component of net position consists of the remainder of net position that does not meet the definition of restricted or invested in capital assets, net of related debt.

Statement of Revenues, Expenses, and Changes in Net Position:

The Statement of Revenues, Expenses, and Changes in Net Position is the operating statement for proprietary funds. Revenues are reported by major source. This statement distinguishes between operating and non-operating revenues and expenses, and presents a separate subtotal for operating revenues, operating expenses, and operating income. The more significant of the Commission's accounting policies are described below:

A. Cash and Cash Equivalents:

Cash and cash equivalents consist of certificates of deposit and repurchase agreements with an original maturity of three months or less from the date of purchase. The carrying amount of each of these instruments approximates fair value.

B. Investment Securities:

Investments are recorded at fair value based on quoted market prices. Any gains or losses are reflected in the statement of revenues, expenses, and changes in net assets in accordance with GASB No.31, "Accounting and Reporting For Certain Investments and For Internal Investment Pools." Kentucky Revised Statute 66.480 limits the types of securities that a municipal entity may invest in to obligations of the United States Treasury and its agencies, certain Federal securities, repurchase agreements, commercial bank certificates of deposit, and the Commonwealth of Kentucky Investment Pool.

2. **Summary of Significant Accounting Policies, continued:**

C. **Accounts Receivable and Unbilled Revenue:**

The Commission has entered into an agreement with the City of Henderson to perform its billing and collection services. All monies due to the Utility Commission are collected and deposited in the City of Henderson's Utility Clearing Fund and are remitted to the Utility Commission on a weekly basis. The amount included in accounts receivable due from the Utility Clearing Fund was \$2,008,255 and \$1,868,911 as of May 31, 2015 and 2014, respectively.

D. **Inventory:**

The fuel and lime inventory is stated at cost using the first-in-first-out method. Materials and supplies are stated at the weighted average cost.

E. **Utility Plant and Equipment:**

The utility plant is carried at cost, which includes interest capitalized, aggregating \$15,342,300, which was capitalized during the period of construction. No interest was capitalized during the fiscal years ended May 31, 2015 and 2014. The Commission's policy for determining the useful lives of its utility plant and equipment is as follows:

Production plant and structures	33 ½	years
Transmission and distribution	25	years
Automotive equipment	6	years
Wireless internet equipment	5	years
Other equipment	10	years

F. **Use of Estimates:**

The preparation of financial statements in conformity with generally accepted accounting principles requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at May 31, 2015 and 2014, as well as revenues and expenses for the years then ended. Actual results could differ from the estimates and assumptions used.

G. **Compensated Absences:**

Employees of the Commission are entitled to paid vacations and sick-leave. The Commission's policy is to recognize these costs when earned under the accrual method of accounting in accordance with GASB No.16 "Accounting For Compensated Absences."

H. **Pensions:**

In the component unit financial statements of the City of Henderson, Kentucky Utility Commission, retirement plans (pensions) are required to be recognized and disclosed using the accrual basis of accounting (Refer to Note 6).

2. Summary of Significant Accounting Policies, continued:

H. Pensions, continued:

In general, the Commission recognizes a net pension liability, which represents the Commission's proportionate share of the excess of the total pension liability over the fiduciary net position reflected in the actuarial report provided by the Commonwealth of Kentucky's County Employees Retirement System (CERS). The net pension liability is measured as of the Commission's prior fiscal year end. Changes in the net pension liability that are recorded as deferred inflows of resources or deferred outflows of resources (that arise from changes in actuarial assumptions or other inputs and differences between expected or actual experience) are amortized over the weighted average remaining service life of all participants in the pension plan and are recorded as a component of pension expenses beginning with the period in which they are incurred.

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions and pension expense, information about the fiduciary net position of the County Employees' Retirement System (CERS), and additions to/deductions from CERS' 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 recorded at fair value.

Projected earnings on pension investments are recognized as a component of pension expense. Differences between projected and actual investment earnings are reported as deferred inflows of resources or deferred outflows of resources and amortized as a component of pension expense on a closed basis over a five year period beginning with the period in which the difference occurred. Each subsequent year will incorporate an additional closed basis five year period of recognition.

I. Emission Allowances:

The Commission does not record the value of emission allowances granted by the Environmental Protection Agency for sulfur dioxide and nitrous oxide on its financial statements as there is no cost basis in these allowances.

3. Cash and Cash Equivalents:

As of May 31, 2015, the City of Henderson, Kentucky Utility Commission maintained deposits with several local financial institutions. Of the bank balance, all was insured by the Federal Depositor's Insurance Corporation and excess of FDIC was secured by pledged United States Government securities.

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements

4. Investment Securities:

Investments are included in the Statement of Net Position under the caption "Investments-restricted/unrestricted." A summary of investments held by the City of Henderson, Kentucky Utility Commission along with the scheduled maturities is presented below:

<u>Investment Type:</u>	<u>Fair Value</u>	<u>Less Than One Year</u>	<u>One to Five Years</u>	<u>Six to Ten Years</u>
<u>May 31, 2015:</u>				
<u>Unrestricted Investments:</u>				
U.S. Treasury Bills	\$ 12,092,142	\$ 12,092,142	\$ -	\$ -
Certificate of Deposits and Money Markets	2,985,433	2,985,433	-	-
Total Unrestricted Investments	<u>\$ 15,077,575</u>	<u>\$ 15,077,575</u>	<u>\$ -</u>	<u>\$ -</u>
<u>Restricted Per Bond Ordinance:</u>				
Certificate of Deposit and Money Markets	\$ 3,546,581	\$ 3,446,581	\$ 100,000	\$ -
Total Restricted Investments	<u>\$ 3,546,581</u>	<u>\$ 3,446,581</u>	<u>\$ 100,000</u>	<u>\$ -</u>
<u>May 31, 2014:</u>	<u>Fair Value</u>	<u>Less Than One Year</u>	<u>One to Five Years</u>	<u>Six to Ten Years</u>
<u>Unrestricted Investments:</u>				
U.S. Treasury Bills	\$ 12,590,114	\$ 12,590,114	\$ -	\$ -
Certificate of Deposits and Money Markets	5,474,168	5,474,168	-	-
Total Unrestricted Investments	<u>\$ 18,064,282</u>	<u>\$ 18,064,282</u>	<u>\$ -</u>	<u>\$ -</u>
<u>Restricted Per Bond Ordinance:</u>				
Certificate of Deposit and Money Markets	\$ 3,631,097	\$ 3,631,097	\$ -	\$ -
Total Restricted Investments	<u>\$ 3,631,097</u>	<u>\$ 3,631,097</u>	<u>\$ -</u>	<u>\$ -</u>

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements

Restricted Assets consisted of the following:

	<u>2015</u>	<u>2014</u>
Operation and maintenance reserve	\$ 100,000	\$ 100,000
Debt Service Reserve	2,886,586	2,983,480
Debt Service Sinking Fund	559,995	547,617
Total restricted assets	<u>\$ 3,546,581</u>	<u>\$ 3,631,097</u>

4. Investment Securities, continued:

A. Interest Rate Risk:

The City of Henderson, Kentucky Utility Commission has a formal investment policy that limits investment maturities as a means to manage its exposure to fair value losses resulting from increasing interest rates.

B. Credit Risk:

The City of Henderson, Kentucky Utility Commission limits its investments to those allowed by Kentucky Revised Statute 66.480. Kentucky Revised Statute 66.480 limits investments to U.S. Government Treasury and Agency securities, certificates of deposit, securities issued by a state or local government rated in one of the three highest categories by a nationally recognized credit agency.

C. Custodial Credit Risk:

Custodial credit risk is the risk that in the event of the failure of the counterparty, The City of Henderson, Kentucky Utility Commission will not be able to recover the value of its investments, or collateral securities that are in the possession of the outside party. All investments of the Commission, with the exception of certificates of deposit, consist of unregistered and uninsured securities held by the Commission's trustee in their trust department not in the name of the Commission.

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements

5. Utility Plant and Equipment:

Utility plant and equipment consisted of the following as of May 31, 2015 and 2014:

<u>May 31, 2015:</u>	Beginning			Ending
<u>Existing System:</u>	Balance	Additions	Deletions	Balance
Vehicles	\$ 2,377,843	\$ 40,000	\$ (112,971)	\$ 2,304,872
Transmission plant	9,252,583	19,475	(628)	9,271,430
Distribution plant	26,010,178	629,952	(4,060)	26,636,070
Land and land rights	1,235,451	-	-	1,235,451
Telecommunications, internet, and fiber optics	5,781,525	112,015	-	5,893,540
General plant	11,065,881	-	(10,994,478)	71,403
	<u>55,723,461</u>	<u>801,442</u>	<u>(11,112,137)</u>	<u>45,412,766</u>
Accumulated depreciation:				
Asset retirement obligation	-	-	-	-
Accumulated depreciation	(44,589,879)	(993,336)	11,053,950	(34,529,265)
Existing System total	<u>\$ 11,133,582</u>	<u>\$ (191,894)</u>	<u>\$ (58,187)</u>	<u>\$ 10,883,501</u>
<u>Station Two:</u>				
General plant	\$ 178,904,256	\$ 4,180,912	\$ -	\$ 183,085,168
Accumulated depreciation	(127,158,219)	(4,077,143)	-	(131,235,362)
Station Two total	<u>\$ 51,746,037</u>	<u>\$ 103,769</u>	<u>\$ -</u>	<u>\$ 51,849,806</u>
Total utility, plant, and equipment, net	<u>\$ 62,879,619</u>			<u>\$ 62,733,307</u>
<u>May 31, 2014</u>	Beginning			Ending
<u>Existing System:</u>	Balance	Additions	Deletions	Balance
Vehicles	\$ 2,357,155	\$ 20,688	\$ -	\$ 2,377,843
Asset retirement obligation	296,793	-	(296,793)	-
Transmission plant	9,171,183	82,106	(706)	9,252,583
Distribution plant	25,136,574	893,438	(19,834)	26,010,178
Land and land rights	1,235,451	-	-	1,235,451
Telecommunications, internet, and fiber optics	5,686,706	102,017	(7,198)	5,781,525
General plant	11,065,881	-	-	11,065,881
	<u>54,949,743</u>	<u>1,098,249</u>	<u>(324,531)</u>	<u>55,723,461</u>
Accumulated depreciation:				
Asset retirement obligation	(286,483)	-	286,483	-
Accumulated depreciation	(43,648,330)	(977,536)	35,987	(44,589,879)
Existing System total	<u>\$ 11,014,930</u>	<u>\$ 120,713</u>	<u>\$ (2,061)</u>	<u>\$ 11,133,582</u>
<u>Station Two:</u>				
General plant	\$ 175,945,318	\$ 2,958,938	\$ -	\$ 178,904,256
Accumulated depreciation	(123,049,928)	(4,108,291)	-	(127,158,219)
Station Two total	<u>\$ 52,895,390</u>	<u>\$ (1,149,353)</u>	<u>\$ -</u>	<u>\$ 51,746,037</u>
Total utility, plant, and equipment, net	<u>\$ 63,910,320</u>			<u>\$ 62,879,619</u>

Depreciation expense for the fiscal years ended May 31, 2015 and 2014 was \$5,070,479 and \$5,085,827 respectively.

6. Retirement Plans:

General Information about the Pension Plan

Plan description: All Commission employees participate in the County Employees' Retirement System (CERS), a multi-employer, cost sharing, defined benefit plan administered by the Board of Trustees of Kentucky Retirement Systems. Kentucky Retirement Systems issues a publicly available financial report that includes financial statements and supplementary information for CERS. That report can be obtained at <https://kyret.ky.gov>.

Benefits provided: CERS provides retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living adjustments (COLA) are provided at the discretion of the State legislature. Kentucky Revised Statute 61.645 assigns the authority to establish and amend benefit provisions to the Kentucky Retirement Systems Board of Trustees.

Contributions: Plan members participating in CERS on or before August 31, 2008, are required to contribute 5% of the annual creditable compensation. For plan members who began participating in CERS on or after September 1, 2008, the contribution rate is 6%. The Commission is required to contribute at an actuarially determined rate. As of May 31, 2015, the Commission's required contribution rate was 17.67% of annual covered payroll. The contribution requirements of plan members and the Commission are established and may be amended by the Kentucky Retirement Systems Board of Trustees. Contributions to CERS from the Commission were \$519,661 for the year ended May 31, 2015.

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

At May 31, 2015, the Commission reported a liability of \$4,316,000 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2014, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Commission's proportion of the net pension liability was based on a projection of the Commission's long-term share of contributions to the pension plan relative to the projected contributions of all participating employers, actuarially determined. At June 30, 2014, the Commission's proportion was 0.123175%.

For the year ended May 31, 2015, the Commission recognized pension expense of \$320,000. At May 31, 2015, the Commission reported deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Net difference between projected and actual investment earnings on pension plan investments	\$ -	\$ 446,000
Commission contributions subsequent to the measurement date	<u>476,133</u>	<u>-</u>
Total	<u>\$ 476,133</u>	<u>\$ 446,000</u>

6. Retirement Plans, continued:

\$476,133 reported as deferred outflows of resources related to pensions resulting from Commission contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended May 31, 2016. Other amounts reported as deferred inflows of resources related to pensions will be recognized in pension expense as follows:

<u>Year ended May 31:</u>	Deferred Inflow Amounts
2016	\$ (111,500)
2017	(111,500)
2018	(111,500)
2019	(111,500)
Thereafter	-
Totals	<u>\$ (446,000)</u>

Actuarial assumptions: The total pension liability in the June 30, 2014 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.5%
Salary increases	4.5%, average, including inflation
Investment rate of return	7.75%, net of pension plan expense, including inflation

The rates of mortality for the period after service retirement are determined according to the 1983 Group Annuity Mortality Table for all retired members and beneficiaries as of June 30, 2006 and the 1994 Group Annuity Mortality Table for all other members. The Group Annuity Mortality Table set forward 5 years is used for the period after disability retirement.

The actuarial assumptions used in the June 30, 2014 valuation were based on the results of an actuarial experience study for the period July 1, 2005 - June 30, 2008.

The long-term expected return on plan assets is reviewed as part of the regular experience studies prepared every five years for Kentucky Retirement Systems. The most recent analysis, performed for the period covering fiscal years 2005 through 2008, is outlined in a report dated August 25, 2009. 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 assumption is intended to be a long-term assumption and is not expected to change absent a significant change in the asset allocation, a change in the inflation assumption, or a fundamental change in the market that alters expected returns in future years.

6. Retirement Plans, continued:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-Term Expected Real Rate of Return</u>
Domestic Equity	30%	8.45%
International Equity	22%	8.85%
Emerging Market Equity	5%	10.50%
Private Equity	7%	11.25%
Real Estate	5%	7.00%
Core US Fixed Income	10%	5.25%
High Yield US Fixed Income	5%	7.25%
Non US Fixed Income	5%	5.50%
Commodities	5%	7.75%
TIPS	5%	5.00%
Cash	1%	3.25%
Total	100%	

Discount rate: The discount rate used to measure the total pension liability was 7.75%. The projection of cash flows used to determine the discount rate assumed that contributions from plan members and employers will be made at statutory contribution rates. Projected inflows from investment earnings were calculated using the long-term assumed investment return of 7.75%. The long-term assumed investment rate of return was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the Commission's proportionate share of the net pension liability to changes in the discount rate: The following presents the Commission's proportionate share of the net pension liability calculated using the discount rate of 7.75%, as well as what the Commission's proportionate share of the net pension liability would be if it were calculated using a discount rate that is one percentage point lower (6.75%) or one percentage point higher (8.75%) than the current rate:

	1% Decrease (6.75%)	Current Discount Rate (7.75%)	1% Increase (8.75%)
Commission's proportionate share of the net pension liability as of May 31, 2015	<u>\$ 5,258,000</u>	<u>\$ 3,996,000</u>	<u>\$ 2,880,000</u>

Pension plan fiduciary net position: Detailed information about the pension plan's fiduciary net position is available in the separately issued financial statements.

A copy of the annual report for the County Employees' Retirement System can be obtained from the County Employees' Retirement System 1260 Louisville Road, Frankfort, Kentucky 40601, or by calling 1.502.564.4646.

7. Accounts Payable and Accrued Expenses:

Accounts payable and accrued expenses consisted of the following as of May 31, 2015 and 2014:

	<u>2015</u>	<u>2014</u>
Accounts payable and accrued expenses - Existing System	\$ 2,251,327	\$ 2,376,689
Accounts payable and accrued liabilities - Station Two	<u>2,426,805</u>	<u>2,685,538</u>
Total	<u>\$ 4,678,132</u>	<u>\$ 5,062,227</u>

8. Long-Term Debt-Revenue Bonds:

During the fiscal year ended May 31, 2012, the City of Henderson, Kentucky Utility Commission issued revenue bonds for the purpose of financing capital improvements throughout its system through two revenue bond series, *Electric System Revenue Bonds, Series 2011A* in the amount of \$11,350,000, and *Electric System Revenue Bonds, Series 2011 B*, in the amount of \$3,670,000.

The bond ordinance requires that certain accounts for each issue be established and held by a trustee as follows:

Debt Service Fund:

A monthly transfer of 1/12 of principal and 1/6 of the interest due is required to be deposited in the Debt Service Fund.

Debt Service Reserve Fund:

A reserve account was established, so that as of any date of calculation, an amount equal to at least the highest amount of aggregate debt service, or an amount equal to 125% of the average aggregate debt service and an amount equal to 10% of the “proceeds” of the bonds with respect to all series is maintained by the Commission.

Series 2011A:

The Series 2011A bonds are secured by a pledge of the revenues of the City of Henderson, Kentucky Utility Commission. The Series 2011A Bonds are additionally secured by a debt service reserve and a non-foreclosable statutory mortgage lien on the System. The Series 2011A Bonds are also secured by a debt service reserve in an amount equal to the least of the maximum annual debt service on the Series 2011A Bonds. The proceeds from the sale of these bonds were used to retire the Bond Anticipation Note, Series 2008B in the amount of \$5,281,067, with the remaining proceeds to be used for capital improvements of the City’s electric transmission and distribution system, and at its Station Two generating station. Interest is due semi-annually on these obligations on December 1st and June 1st of each year.

It is the opinion from the City of Henderson, Kentucky Utility Commission’s bond counsel, that under existing laws, interest on the Series 2011A Bonds is not subject to income tax.

8. Long-Term Debt-Revenue Bonds, continued:

Optional Redemption Series 2011A:

The Series 2011A Bonds maturing on and after December 1, 2021, are subject to redemption by the City, at its option, before maturity on September 1, 2021, and on any date thereafter in whole or from time to time in part in any order of maturity (less than all of a single maturity to be selected by lot in such manner as the Trustee and Paying Agent may determine) at a redemption price equal to 100% of the principal amount thereof plus accrued interest to the redemption date.

Series 2011B:

The Series 2011B bonds are secured by a pledge of the revenues of the City of Henderson, Kentucky Utility Commission. The Series 2011B Bonds are additionally secured by a debt service reserve and a non-foreclosable statutory mortgage lien on the System. The Series 2011B Bonds are also secured by a debt service reserve in an amount equal to the least of the maximum annual debt service on the Series 2011B bonds. The proceeds from the sale of these bonds were used to retire the Bond Anticipation Note, Series 2008A and 2010A, in the amounts of \$3,500,000 and \$170,000, respectively. Interest is due semi-annually on these obligations on December 1st and June 1st of each year.

It is the opinion from the City of Henderson, Kentucky Utility Commission's bond counsel, that under existing laws, interest on the Series 2011B bonds is not subject to income tax.

Optional Redemption Series 2011B:

The Series 2011B Bonds maturing on and after December 1, 2021, are subject to redemption by the Commission, at its option, before maturity on September 1, 2021, and on any date thereafter in whole or from time to time in part in any order of maturity (less than all of a single maturity to be selected by lot in such manner as the Trustee and Paying Agent may determine) at a redemption price equal to 100% of the principal amount thereof plus accrued interest to the redemption date.

A summary of the long-term debt of the Commission is as follows:

	<u>2015</u>	<u>2014</u>
City of Henderson, Kentucky Utility Commission Series 2011A Revenue Bonds, secured by pledge of system revenues and non-forecloseable statutory lien, maturing December 1, 2031, annual principal payments range from \$420,000 to \$725,000 interest rates range from 2.5% to 4.5%.	\$ 10,050,000	\$ 10,495,000
City of Henderson, Kentucky Utility Commission Series 2011B Revenue Bonds, secured by pledge of system revenues and non-forecloseable statutory lien, maturing December 1, 2031, annual principal payments range from \$150,000 to \$245,000 interest rates range from 2.5% to 4.5%.	<u>3,220,000</u>	<u>3,370,000</u>
Total long-term debt as of May 31, 2015	\$ 13,270,000	\$ 13,865,000
Less current portion due	<u>(610,000)</u>	<u>(595,000)</u>
Long-term debt, net of current portion	<u>\$ 12,660,000</u>	<u>\$ 13,270,000</u>

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements

8. Long-Term Debt-Revenue Bonds, continued:

Future maturities of long-term debt for the next five years as of May 31, 2015 are as follows:

Fiscal Year:	Series 2011A			Series 2011B			Total Debt Service
	Principal	Interest	Total	Principal	Interest	Total	
2016	\$ 455,000	\$ 374,806	\$ 829,806	\$ 155,000	\$ 102,982	\$ 257,982	\$ 1,087,788
2017	465,000	363,432	828,432	155,000	101,044	256,044	1,084,476
2018	475,000	351,806	826,806	155,000	98,718	253,718	1,080,524
2019	490,000	339,932	829,932	160,000	95,618	255,618	1,085,550
2020	505,000	325,232	830,232	165,000	92,098	257,098	1,087,330
2021-2025	2,775,000	1,368,014	4,143,014	895,000	356,741	1,251,741	5,394,755
2026-2030	3,340,000	787,948	4,127,948	1,055,000	243,731	1,298,731	5,426,679
2031-2033	1,545,000	105,076	1,650,076	480,000	44,066	524,066	2,174,142
	<u>\$ 10,050,000</u>	<u>\$ 4,016,246</u>	<u>\$ 14,066,246</u>	<u>\$ 3,220,000</u>	<u>\$ 1,134,998</u>	<u>\$ 4,354,998</u>	<u>\$ 18,421,244</u>

9. Asset Retirement Obligation:

Effective December 31, 2008, the Commission terminated operation of its Station One generation facility. The Commission is legally obligated to remove asbestos, lead paint, and other contaminants located there. Accordingly, a liability has been established in accordance with SFAS No. 143 *Accounting for Asset Retirement Obligations*.

The following is a reconciliation of the aggregate retirement liability associated with the Commission's obligation to remove the contaminants:

	Asset Retirement Obligation
Balance as of June 1, 2014	\$ 1,430,771
Additional obligations incurred	-
Increase in present value of the obligation	-
Increase based on revised estimates of costs to dismantle and remove assets	-
Liabilities extinguished	<u>(1,050,000)</u>
Balance as of May 31, 2015	<u>\$ 380,771</u>

During July of 2014, the Commission opened bids to demolish and perform an environmental clean up of its Station One facility. Six contractors submitted bids ranging from \$216,000 to \$4.9 million, with one bidder offering to pay \$37,000 for the privilege as the firm will sell the scrap and equipment from the facility as well as remove the contamination. The Commission engaged this firm in September of 2014 and as of May 31, 2015 the facility and the related liability had been removed.

10. Discounted Internet and Broadband Services:

A summary of discounted internet and broadband services provided by the Commission to other governmental concerns is as follows:

<u>Governmental Organizations</u>	<u>2015</u>	<u>2014</u>
Henderson County GIS System	\$ 54,000	\$ 54,000
Henderson Water Utility	121,000	121,000
City of Henderson	201,000	201,000
Other organizations	2,000	2,000
	<u>\$ 378,000</u>	<u>\$ 378,000</u>

11. Concentration of Sales:

Three industrial customers of the Existing System accounted for sales in the amount of \$10.9 million (29% of Existing System sales), and \$10.4 million (28% of Existing System sales) for the fiscal years ended May 31, 2015 and 2014.

12. Emission Allowances:

Amendments to the Clean Air Act in 1990 established a system whereby emission allowances were created and allocated to generating units subject to Phase 1 of the emission restrictions. Station Two was allotted a total of 226,901 allowances through 1999 (one emission allowance represents the authorization to emit one ton of sulfur dioxide in a given year). The allowances are allocated between the Commission and the Station Two Operator based upon the Station Two capacity allocations. As of May 31, 2015 and 2014, there were remaining sulfur dioxide emission allowances valued at \$32,434 and \$41,364, respectively each year ended.

13. Related Party Transactions:

The Commission incurred the following transactions with the City of Henderson, Kentucky for the fiscal years ended May 31, 2015 and 2014:

Paid the City \$622,250 and \$611,417 each year, respectively, for data processing and other services related to billings and collections.

Paid the City \$1,244,724 and \$1,244,724 May 31, 2015 and 2014 of the fiscal years ended, respectively.

Paid the City \$627,178 and \$585,286 for participation in the City of Henderson's self-insured employee health insurance plan for the fiscal years ended May 31, 2015 and 2014 respectively. Risk is minimized in this area by the purchase of re-insurance for amounts in excess of the \$125,000 stop loss limit. Charges are based on estimated amounts determined by the City of Henderson's insurance coordinator as necessary to fund claims as they become due and payable.

Provided the City of Henderson with power for the fiscal years ended May 31, 2015 and 2014 in the amount of \$465,769 and \$408,000 respectively. The City of Henderson was also provided significantly reduced communication service fees totaling approximately \$201,000 for the fiscal years May 31, 2015 and 2014.

14. Commitments and Contingencies:

A. Southeastern Power Administration:

The Southeastern Power Administration (SEPA) has contracted with the Commission to provide it a total of 18,000 megawatt hours of hydroelectric power each year. The 18,000 megawatt hours represent approximately 3% of the Commission's annual megawatt hour requirements. Henderson Municipal Power & Light is restricted to not more than 12 megawatt hours during any hour, and not more than 2,640 megawatt hours during any month. During the year ended May 31, 2015 and 2014, the Commission purchased power on the spot market and from SEPA to supply the needs of its customers. Purchased power from these sources for the fiscal year ended May 31, 2015 was \$527,522 and \$745,191 during 2014.

B. Regulatory Compliance:

The North American Electric Reliability Corporation (NERC) adopted new electric system reliability standards for all electric utilities in the United States. NERC has adopted and began enforcement of the new standards effective June of 2007. The new standards have been approved by the Federal Energy Regulatory Commission (FERC). The Commission must comply with the new standards and will incur administrative expenses related to NERC compliance. Federal air quality and emission standards have become more stringent. The current standards and proposed standards resulted in the cost of compliance being excessive to operate Station One. As a result of the new regulations, the Commission approved the cessation of operations at Station One on August 25, 2008, and Station One was taken out of service in December of 2008, and razed during the fiscal year ended May 31, 2015.

C. Unwind Transaction- Station Two:

In 1998, HMP&L, Big Rivers Electric Corporation, and Western Kentucky Energy Corporation entered into contracts for the operation of the HMP&L Station Two Power Plant and other Big Rivers Electric Corporation Generation Plants. On July 16, 2009, Big Rivers Electric Corporation and Western Kentucky Energy Corporation (E.ON) signed an agreement under which the original 1998 contracts are rescinded and operational control of the Station Two Power Plant returned to Big Rivers Electric Corporation.

D. Pending Litigation:

Big Rivers and HMP&L are currently involved in litigation concerning the Excess Henderson Energy at Station Two. The litigation was heard in the Henderson County Circuit Court and the judge assigned the dispute to arbitration. On May 30, 2012 the Arbitration Panel issued a final ruling in favor of HMP&L. Big Rivers filed a motion with the Appeals Court requesting that the Arbitration Panel's ruling be vacated and set aside. The Appeals Court issued a final ruling on May 30, 2014 in favor of HMP&L. On October 1, 2014 Big Rivers filed a Motion for Discretionary Review with the Supreme Court of Kentucky. This legal dispute may continue for several years.

In July 2012, HMP&L entered into litigation with the Kentucky Department of Labor related to the application of prevailing of wage rates at Station Two. The litigation went to trial in December 2012. The Circuit Court ruled in favor of the Labor Cabinet on May 24, 2013. HMP&L filed an appeal in the Kentucky Appeals Court, and oral arguments were heard September 24, 2014. HMP&L anticipates a ruling from the Appeals Court within the next six months.

15. Risk Management:

The Commission is exposed to various risks of loss related to torts, theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Commission carries commercial insurance for these types of risk of loss, including workers' compensation. Settled claims from these risks have not exceeded commercial insurance coverage in any of the past five fiscal years.

16. Amounts Due From Station Two Operator:

As of the fiscal years ended May 31, 2015 and 2014, the amount the Station Two Operator owed to the Commission, as part of the annual settlement, was \$1,511,787 and \$1,155,650, respectively.

17. Subsequent Events:

Subsequent events have been evaluated through September 29, 2015, the date these financial statements were available to be issued.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
COMBINING STATEMENT OF NET POSITION-BY SYSTEM
As of May 31, 2015 and 2014

	May 31, 2015				May 31, 2014			
	Existing System	Station Two	Elimination	Total	Existing System	Station Two	Elimination	Total
Assets:								
<u>Current assets:</u>								
Cash and cash equivalents	\$ 292,979	\$ 210,884	\$ -	\$ 503,863	\$ 1,311,067	\$ 52,559	\$ -	\$ 1,363,626
Investments - unrestricted	15,077,575	-	-	15,077,575	18,064,282	-	-	18,064,282
Investments - restricted	3,546,581	-	-	3,546,581	3,631,097	-	-	3,631,097
Accounts receivable, net of allowance for uncollectibles	1,817,864	-	-	1,817,864	1,774,504	93,246	-	1,867,750
Accounts receivable-Station Two Operator	1,511,787	-	-	1,511,787	1,155,650	-	-	1,155,650
Accrued revenue	2,502,950	-	-	2,502,950	2,803,484	-	-	2,803,484
Inventory and supplies	2,747,909	2,297,687	-	5,045,596	2,468,637	2,531,969	-	5,000,606
Prepaid expenses	101,748	-	-	101,748	103,324	-	-	103,324
Total current assets	27,599,393	2,508,571	-	30,107,964	31,312,045	2,677,774	-	33,989,819
<u>Utility plant, net of accumulated depreciation:</u>	10,883,501	51,849,806	-	62,733,307	11,133,582	51,746,037	-	62,879,619
<u>Other assets:</u>								
Investment in Station Two	31,058,999	-	(31,058,999)	-	31,058,999	-	(31,058,999)	-
Total assets	69,541,893	54,358,377	(31,058,999)	92,841,271	73,504,626	54,423,811	(31,058,999)	96,869,438
<u>Deferred outflows of resources:</u>								
Deferred outflows of resources	476,133	-	-	476,133	-	-	-	-
Total deferred outflows of resources	476,133	-	-	476,133	-	-	-	-
Total assets and deferred outflows of resources	\$ 70,018,026	\$ 54,358,377	\$ (31,058,999)	\$ 93,317,404	\$ 73,504,626	\$ 54,423,811	\$ (31,058,999)	\$ 96,869,438

See Independent Auditors' Report.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
COMBINING STATEMENT OF NET POSITION-BY SYSTEM
As of May 31, 2015 and 2014

	<u>May 31, 2015</u>				<u>May 31, 2014</u>			
	<u>Existing System</u>	<u>Station Two</u>	<u>Elimination</u>	<u>Total</u>	<u>Existing System</u>	<u>Station Two</u>	<u>Elimination</u>	<u>Total</u>
<u>Liabilities and net assets:</u>								
<u>Current liabilities:</u>								
Accounts payable and accrued expenses	\$ 2,251,327	\$ 2,426,805	\$ -	\$ 4,678,132	\$ 2,376,689	\$ 2,685,538	\$ -	\$ 5,062,227
Accounts payable-Construction in progress - Station Two	-	3,409,854	-	3,409,854	-	2,564,544	-	2,564,544
Asset retirement obligation	380,771	-	-	380,771	1,430,771	-	-	1,430,771
Accounts payable-Station Two Operator	-	89,530	-	89,530	-	-	-	-
Current portion-bonds payable	610,000	-	-	610,000	595,000	-	-	595,000
Customer deposits	657,149	-	-	657,149	656,004	-	-	656,004
Total current liabilities	3,899,247	5,926,189	-	9,825,436	5,058,464	5,250,082	-	10,308,546
<u>Long-term liabilities:</u>								
Long-term portion of bonds payable	12,660,000	-	-	12,660,000	13,270,000	-	-	13,270,000
Unfunded pension liability	4,316,000	-	-	4,316,000	-	-	-	-
Total long-term liabilities	16,976,000	-	-	16,976,000	13,270,000	-	-	13,270,000
Total liabilities	20,875,247	5,926,189	-	26,801,436	18,328,464	5,250,082	-	23,578,546
<u>Deferred inflows of resources:</u>								
Deferred inflows of resources	446,000	-	-	446,000	-	-	-	-
Total deferred inflows of resources	446,000	-	-	446,000	-	-	-	-
<u>Net position:</u>								
Unrestricted	16,477,698	(3,417,618)	-	13,060,080	23,022,360	(2,572,308)	-	20,450,052
Restricted per bond ordinance	3,546,581	-	-	3,546,581	3,826,221	-	-	3,826,221
Investment in plant assets, net of related debt	28,672,500	51,849,806	(31,058,999)	49,463,307	28,327,581	51,746,037	(31,058,999)	49,014,619
Total net position	48,696,779	48,432,188	(31,058,999)	66,069,968	55,176,162	49,173,729	(31,058,999)	73,290,892
Total liabilities, deferred inflows, and net position	\$ 70,018,026	\$ 54,358,377	\$ (31,058,999)	\$ 93,317,404	\$ 73,504,626	\$ 54,423,811	\$ (31,058,999)	\$ 96,869,438

See Independent Auditors' Report.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
COMBINING STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION-BY SYSTEM
For the fiscal years ended May 31, 2015 and 2014

	May 31, 2015				May 31, 2014			
	Existing System	Station Two	Elimination	Consolidated Total	Existing System	Station Two	Elimination	Consolidated Total
Operating Revenues:								
Sale of electricity	\$ 36,369,893	\$ 38,508,329	\$ (15,193,686)	\$ 59,684,536	\$ 36,885,855	\$ 36,948,306	\$ (14,393,292)	\$ 59,440,869
Communication services	1,135,729	-	-	1,135,729	1,055,678	-	-	1,055,678
Other	308,225	-	-	308,225	294,882	-	-	294,882
Total Operating Revenues	37,813,847	38,508,329	(15,193,686)	61,128,490	38,236,415	36,948,306	(14,393,292)	60,791,429
Operating Expenses:								
Production of electricity	31,091,864	31,560,567	(15,193,686)	47,458,745	30,309,307	30,473,308	(14,393,292)	46,389,323
Operating, general and administrative	6,251,274	3,612,344	-	9,863,618	6,261,534	3,391,870	-	9,653,404
Depreciation	993,336	4,077,143	-	5,070,479	977,536	4,108,291	-	5,085,827
Total Operating Expenses	38,336,474	39,250,054	(15,193,686)	62,392,842	37,548,377	37,973,469	(14,393,292)	61,128,554
Income (Loss) from Operations	(522,627)	(741,725)	-	(1,264,352)	688,038	(1,025,163)	-	(337,125)
Interest Income (Expense):								
Other income (expense)	(62)	21	-	(41)	(62)	28	-	(34)
Investment income	45,697	163	-	45,860	22,712	156	-	22,868
Interest expense	(486,110)	-	-	(486,110)	(497,163)	-	-	(497,163)
Total Interest Income (Expense)	(440,475)	184	-	(440,291)	(474,513)	184	-	(474,329)
Income (Loss) Before Transfers	(963,102)	(741,541)	-	(1,704,643)	213,525	(1,024,979)	-	(811,454)
Non-operating Items:								
Station 1 Remediation	(35,788)	-	-	(35,788)	(13,044)	-	-	(13,044)
Transfers to City of Henderson	(1,244,724)	-	-	(1,244,724)	(1,244,724)	-	-	(1,244,724)
Power furnished to City of Henderson	(465,769)	-	-	(465,769)	(408,000)	-	-	(408,000)
Communication services provided to the City of Henderson and local governmental agencies	(378,000)	-	-	(378,000)	(378,000)	-	-	(378,000)
Total Non-operating Items	(2,124,281)	-	-	(2,124,281)	(2,043,768)	-	-	(2,043,768)
Extraordinary Items:								
Extraordinary gain on disposal of plant one	1,050,000	-	-	1,050,000	-	-	-	-
Increase (Decrease) in Net Position	(2,037,383)	(741,541)	-	(2,778,924)	(1,830,243)	(1,024,979)	-	(2,855,222)
Cumulative effect of change in accounting principle - GASB 68 adoption	(4,442,000)	-	-	(4,442,000)	-	-	-	-
Net Position, Beginning of Year	55,176,162	49,173,729	(31,058,999)	73,290,892	57,006,405	50,198,708	(31,058,999)	76,146,114
Net Position, End of Year	\$ 48,696,779	\$ 48,432,188	\$ (31,058,999)	\$ 66,069,968	\$ 55,176,162	\$ 49,173,729	\$ (31,058,999)	\$ 73,290,892

See Independent Auditors' Report.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
SUPPLEMENTAL SCHEDULE OF CHANGES IN NET POSITION -BY SYSTEM
For the fiscal years ended May 31, 2015 and 2014

	<u>Existing System</u>	<u>Station Two</u>			<u>Eliminations *</u>	<u>Total Net Assets</u>
		<u>Utility Commission</u>	<u>Big Rivers</u>	<u>Total Station Two</u>		
Beginning balance, June 1, 2013	\$ 57,006,405	\$ 18,587,773	\$ 31,610,935	\$ 50,198,708	\$ (31,058,999)	\$ 76,146,114
Change in net position	(1,830,243)	908,830	(1,933,809)	(1,024,979)	-	(2,855,222)
Balance, May 31, 2014	\$ 55,176,162	\$ 19,496,603	\$ 29,677,126	\$ 49,173,729	\$ (31,058,999)	\$ 73,290,892
Change in net position	(2,037,383)	1,192,268	(1,933,809)	(741,541)	-	(2,778,924)
Cumulative effect of change in accounting principle - GASB 68 adoption	(4,442,000)	-	-	-	-	(4,442,000)
Balance May 31, 2015	<u>\$ 48,696,779</u>	<u>\$ 20,688,871</u>	<u>\$ 27,743,317</u>	<u>\$ 48,432,188</u>	<u>\$ (31,058,999)</u>	<u>\$ 66,069,968</u>

* Elimination of interest of Existing System in investment in the equity of Station Two.

Shown on the Statement of Net Position	<u>2015</u>	<u>2014</u>
Investment in Utility Plan and Equipment, net of related debt	\$ 49,463,307	\$ 49,014,619
Restricted per bond ordinance	3,546,581	3,826,221
Unrestricted	13,060,080	20,450,052
	<u>\$ 66,069,968</u>	<u>\$ 73,290,892</u>

See Independent Auditors' Report.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
SCHEDULE OF THE COMMISSION'S PROPORTIONATE SHARE OF THE NET
PENSION LIABILITY
County Employees' Retirement System
Last 10 Fiscal Years*

	<u>2015</u>
Commission's proportion of the net pension liability	0.123175%
Commission's proportionate share of the net pension liability	\$ 3,996,000
Commission's covered-employee payroll	\$ 2,940,922
Commission's proportionate share of the net pension liability as a percentage of its covered-employee payroll	135.88%
Plan fiduciary net position as a percentage of the total pension liability	66.80%

*Information prior to 2015 is not available.

See Independent Auditors' Report.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
SCHEDULE OF COMMISSION CONTRIBUTIONS
County Employees Retirement System
Last 10 Fiscal Years*

	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
Statutorily required contribution	\$ 519,661	\$ 536,125	\$ 539,503	\$ 518,504	\$ 459,118	\$ 420,197	\$ 435,888
Contributions in relation to the statutorily required contribution	<u>(519,661)</u>	<u>(536,125)</u>	<u>(539,503)</u>	<u>(518,504)</u>	<u>(459,118)</u>	<u>(420,197)</u>	<u>(435,888)</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Commission's covered-employee payroll	\$ 2,940,922	\$ 2,838,142	\$ 2,759,606	\$ 2,734,726	\$ 2,711,861	\$ 2,600,229	\$ 3,228,800
Contributions as a percentage of covered- employee payroll	17.67%	18.89%	19.55%	18.96%	16.93%	16.16%	13.50%

*Information prior to 2009 is not available.

See Independent Auditors' Report.



Report on Internal Control Over Financial Reporting, Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Independent Auditors' Report

Members of the Board of Commissioners
City of Henderson, Kentucky Utility Commission
Henderson, 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 of America; the financial statements of the City of Henderson, Kentucky Utility Commission as of and for the year ended May 31, 2015, and have issued our report thereon dated September 29, 2015.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the City of Henderson, Kentucky Utility Commission's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City of Henderson, Kentucky Utility Commission's internal control. Accordingly, we do not express an opinion on the effectiveness of the City of Henderson, Kentucky Utility Commission's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or 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 the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in the internal control that might be significant deficiencies, or material weaknesses. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

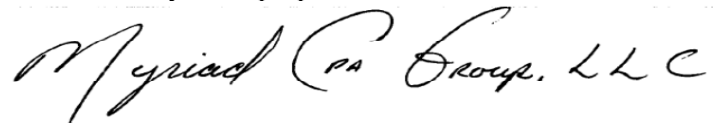
Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Henderson, Kentucky Utility Commission's financial statements are free of 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*.

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 result of that testing, and not to provide an opinion on the effectiveness of 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 report is not suitable for any other purpose.

A handwritten signature in black ink that reads "Myriad CPA Group, LLC". The signature is written in a cursive, flowing style.

Henderson, Kentucky
September 29, 2015



**City of Henderson, Kentucky Utility Commission –
Henderson Municipal Power & Light**

Report on Audited Financial Statements

For the fiscal years ended May 31, 2016 and 2015

**Case No: 2019-00269
Attachment 1 to BREC 1-31
HMPL Audits 2011-2019**

Contents

	<u>Page(s)</u>
Management's Discussion and Analysis	1-11
Independent Auditors' Report	12-13
Basic Financial Statements:	
Statement of Net Position	14
Statement of Revenues, Expenses, and Changes in Net Position	15
Statement of Cash Flows	16
Statement of Cash Flows – Reconciliation of Net Cash Provided by Operations	17
Notes to the Financial Statements	18-36
Supplemental Information:	
Combining Statement of Net Position – By System	37-38
Combining Statement of Revenues, Expenses, and Changes in Net Position – By System	39
Supplemental Schedule of Changes in Net Position – By System	40
Schedule of the Commission's Proportionate Share of the Net Pension Liability	41
Schedule of Commission Contributions	42
Notes to the Required Supplemental Information	43
Independent Auditors' Report on Internal Control Over Financial Reporting, Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	44-45

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION- HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT’S DISCUSSION AND ANALYSIS

The City of Henderson, Kentucky Utility Commission (HMP&L) is in the business of providing electricity and internet communication services for residential, commercial, and industrial customers within the incorporated territory of the City of Henderson, Kentucky. The Commission also provides electricity and internet communication services to customers in a few areas outside of the incorporated territory of Henderson. The following discussion and analysis of HMP&L’s financial performance provides an overview of the Utility’s financial activities for the fiscal year ended May 31, 2016.

Overview of the Financial Statements:

This annual financial report consists of three parts: 1) Management’s Discussion and Analysis, 2) Financial Statements, and 3) Supplemental Additional Information. The Financial Statements also include notes that explain in more detail some of the information in the financial statements. The statements are followed by a section of supplemental information that further explains and supports the information in the basic financial statements. The Supplemental schedules present the financial position and results of operations for the Existing System and Station Two. The Consolidated Financial Statements report information about HMP&L using accounting methods similar to those used by private sector companies, except for the reporting of contributions in aid of construction, equity capital, and retained earnings. Refer to the Summary of Significant Accounting Policies in the footnotes to the Financial Statements relating to the adoption of GASB No. 34 of the Governmental Accounting Standards Board (GASB 34).

The Statement of Net Position, successor to the Balance Sheet, includes all of the Utility’s assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to HMP&L’s creditors (liabilities). It also provides the basis for evaluating the capital structure of HMP&L and assessing the liquidity and financial flexibility of HMP&L.

All of the current year’s revenues and expenses are accounted for in the Statement of Revenues, Expenses, and Changes in Net Position, successor to the Income Statement. This statement measures the success of the Utility’s operations over the past year and can be used to determine whether the Utility has successfully recovered all of its costs through the sale of electricity, communications, and other charges, and has earned a reasonable profit, as well as maintained a sound financial position.

The final required financial statement is the Statement of Cash Flows. The primary purpose of this statement is to provide information about the Utility’s cash receipts, cash payments, and net changes in cash resulting from operations, investing and financing activities, and it provides information on the sources and uses of cash and the changes in cash balances during the year.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Financial Statements:

- HMP&L's total assets decreased from \$93,317,404 at May 31, 2015 to \$91,276,589 at May 31, 2016. This decrease is primarily attributable to the decreased balances in investment securities and utility plant and equipment.
- Operating revenues for HMP&L Existing System increased by approximately \$2,531,842 or 6.7% from \$37,813,847 to \$40,345,689. The increase in Existing System sales was primarily due to the adoption of a schedule of electric rate increases. Internet revenue increased by \$172,766 due to the increase in the number of commercial customers.

<u>Existing System:</u>	<u>2016</u>	<u>2015</u>	<u>Change</u>	<u>Percentage Change</u>
Sale of electricity	\$ 38,746	\$ 36,370	\$ 2,376	6.5%
Internet service	1,308	1,136	172	15.1%
Other	291	308	(17)	-5.5%
Total operating revenues	<u>\$ 40,345</u>	<u>\$ 37,814</u>	<u>\$ 2,531</u>	<u>6.7%</u>

Note: All amounts presented in thousands -000's omitted.

- Operating expenses for HMP&L Existing System decreased by approximately \$666,989 or 1.7%. The following table represents the changes in the expenses for the Existing System:

<u>Existing System:</u>	<u>2016</u>	<u>2015</u>	<u>Change</u>	<u>Percentage Change</u>
Production of electricity	\$ 30,268	\$ 31,092	\$ (824)	-2.7%
Other operating expenses	6,433	6,251	182	2.9%
Depreciation	969	993	(24)	-2.4%
Total operating expenses	<u>\$ 37,670</u>	<u>\$ 38,336</u>	<u>\$ (666)</u>	<u>-1.7%</u>

Note: All amounts presented in thousands -000's omitted.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT’S DISCUSSION AND ANALYSIS**

Financial Statements, continued:

- Operating revenues for Station Two decreased approximately \$4,698,947 over that of the previous year. The Station Two Agreement is not designed to generate a profit for each of the participants in the venture, but rather to break-even on a cash flow basis. Operating expenses decreased for Station Two.

<u>Station Two</u>	<u>2016</u>	<u>2015</u>	<u>Change</u>
Sales- BREC	\$ 19,895	\$ 23,315	\$ (3,420)
Sales- HMPL	13,915	15,194	(1,279)
Total Operating Revenue	<u>\$ 33,810</u>	<u>\$ 38,509</u>	<u>\$ (4,699)</u>
 <u>Expenses:</u>			
Production of electricity	\$ 30,290	\$ 35,173	\$ (4,883)
Depreciation	4,153	4,077	76
Total Operating Expenses	<u>34,443</u>	<u>39,250</u>	<u>(4,807)</u>
 Net income before transfers	 <u>\$ (633)</u>	 <u>\$ (741)</u>	 <u>\$ 108</u>

Upon the consolidation of the financial statements for each system, transactions between Henderson Municipal Power and Light and Station Two Operator are eliminated.

Statement of Net Position:

Net position of HMP&L increased by \$130,793 for the fiscal year ended May 31, 2016, while net position decreased by \$2,037,383 in the fiscal year ended May 31, 2015.

Investment securities decreased by \$1,839,899 over that of Fiscal Year 2015.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Statement of Net Position, continued:

Cash and cash equivalents decreased by \$64,407 for the fiscal year ended May 31, 2016, versus a decrease of \$859,763 at May 31, 2015, compared to the previous fiscal year end. A summary of the assets of the Commission for the previous three years is as follows:

<u>Assets:</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
Cash and cash equivalents	\$ 439	\$ 504	\$ 1,364
Investment securities	13,238	15,078	18,064
Restricted assets	3,500	3,547	3,631
Accounts receivable-unbilled revenue	2,249	1,818	1,868
Accounts receivable-unbilled Station Two Operator	2,589	1,512	1,156
Accrued revenue	2,791	2,503	2,803
Inventories	5,709	5,046	5,001
Prepaid expenses	61	102	103
	<u>30,576</u>	<u>30,110</u>	<u>33,990</u>
Utility plant and equipment	59,650	62,733	62,880
Deferred outflow of resources	<u>1,051</u>	<u>476</u>	<u>-</u>
Total assets and deferred outflows of resources	<u>\$ 91,277</u>	<u>\$ 93,319</u>	<u>\$ 96,870</u>

Note: All amounts presented in thousands -000's omitted.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT’S DISCUSSION AND ANALYSIS**

Statement of Net Position, continued:

Current liabilities decreased by \$1,545,276. Accounts payable and accrued expenses increased \$455,869 over the previous year mainly due to normal variations in timing of payments.

A summary of the liabilities section of the Statement of Net Position is as follows:

<u>Liabilities</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
Accounts payable	\$ 5,134	\$ 4,678	\$ 5,062
Accounts payable-construction	1,325	3,410	2,565
Asset retirement obligation	381	381	1,431
Accounts payable			
Station Two Operator	185	90	-
Current portion bonds payable	620	610	585
Customer deposits	645	657	656
Total current liabilities	<u>8,290</u>	<u>9,826</u>	<u>10,299</u>
Unfunded pension liability	5,379	4,316	-
Deferred outflows	-	446	-
Long term bonds payable	<u>12,040</u>	<u>12,660</u>	<u>13,280</u>
Total liabilities and deferred outflows	<u>\$ 25,709</u>	<u>\$ 27,248</u>	<u>\$ 23,579</u>

Note: All amounts presented in thousands -000's omitted.

Statement of Revenues, Expenses, and Changes in Net Position:

Operating Revenues for the entire entity decreased by \$888,070 over that of the previous year. Sales for HMP&L Station Two decreased by \$4,698,947 or 12.2% while Existing System sales increased by \$2,531,842 or 6.7%.

Operating Expenses decreased by \$4.2 million. This was due to the decreased operating costs incurred with the operation of Station Two.

The Net Operating Income of the HMP&L Existing System, after interest expense and interest income, was \$2,292,465. Transfers were made to the City of Henderson in the amount of \$1.24 million for the fiscal year ended May 31, 2016, the value of power furnished to the City of Henderson at no charge was \$430,776, and the value of communication services provided to the City of Henderson and other governmental agencies, at no charge, was \$475,392.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT’S DISCUSSION AND ANALYSIS**

Statement of Revenues, Expenses, and Changes in Net Position, continued:

Station Two had a net operating loss of \$633,306; however, the loss relates primarily to depreciation expense which is a noncash item.

	Existing System	Station Two	Total
Income (loss) before transfers	\$ 2,292	\$ (633)	\$ 1,659
Non-operating items:			
Station One Remediation	(10)	-	(10)
Transfer to City of Henderson	(1,245)	-	(1,245)
Communication services provided to the City of Henderson and other governmental agencies	(475)	-	(475)
Power furnished to City of Henderson	(431)	-	-
	<u>(431)</u>	<u>-</u>	<u>(431)</u>
Change in net position	<u>\$ 131</u>	<u>\$ (633)</u>	<u>\$ (502)</u>

Note: All amounts presented in thousands -000's omitted.

Statement of Cash Flows:

Cash generated from operating activities decreased by \$1,010,105 over the level from Fiscal Year 2015.

Cash Flows from non-capital financing activities is comprised of funds transferred to the City of Henderson. For the fiscal year ended May 31, 2016, \$1.24 million was transferred.

Cash used by capital and related financing activities was \$3.12 million.

Cash and cash equivalents for the year, which consist primarily of checking and money market accounts of HMP&L, decreased by \$64,407.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Statement of Cash Flows, continued:

The following is an abbreviated analysis of cash flows of HMP&L for the fiscal years ended May 31, 2014 to May 31, 2016:

Note: All amounts presented in thousands -000's omitted.

<u>Cash Flow Summary</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
Net cash generated by operations	\$ 2,327	\$ 3,331	\$ 3,918
Cash transferred to the City of Henderson	(1,245)	(1,245)	(1,245)
Net cash used by capital and related financing	(3,120)	(6,063)	(5,146)
Investing activities	<u>1,974</u>	<u>3,117</u>	<u>2,931</u>
Increase (decrease) in cash	(64)	(860)	458
Cash and cash equivalents, beginning of year	<u>503</u>	<u>1,363</u>	<u>905</u>
Cash and cash equivalents, end of year	<u>\$ 439</u>	<u>\$ 503</u>	<u>\$ 1,363</u>

Note: All amounts presented in thousands -000's omitted.

The following is a summary of cash and investment balances as of May 31, 2014, to May 31, 2016:

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Cash and cash equivalents	\$ 439	\$ 504	\$ 1,364
Investments	13,238	15,078	18,064
Restricted investments	<u>3,500</u>	<u>3,547</u>	<u>3,631</u>
	<u>\$ 17,177</u>	<u>\$ 19,129</u>	<u>\$ 23,059</u>

Note: All amounts presented in thousands -000's omitted.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION- HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT'S DISCUSSION AND ANALYSIS

Capital Assets:

As noted in the footnotes to this report, HMP&L had 25,947 sulfur dioxide emission allowances from the Existing System and Station Two available as of May 31, 2016. The value of the allowances is not reflected in the financial statements due to the fact that the Commission does not have a cost basis in the allowances. The estimated current market value of these allowances at May 31, 2016, was approximately \$25,947.

Debt Administration:

HMP&L entered into two Bond Anticipation Notes with Fifth Third Bank on December 22, 2008, a non-taxable series 2008A in the amount of \$3,500,000 and a taxable series 2008B in the amount of \$9,000,000. The series 2008A was used for capital improvements to the City's retail electric system. The taxable series 2008B was used to make capital improvements to the City's Station Two generating plant. HMP&L entered into an additional Bond Anticipation Note with Fifth Third Bank on March 25, 2010, a non-taxable series 2010A in the amount of \$1,500,000. This note was repaid at the same time as the series 2008A note. In September of 2012 HMP&L issued Revenue Bonds in the amount of \$15,020,000 and retired all outstanding Bond Anticipation Notes.

On January 29, 2009, the City Commission approved an Ordinance increasing electric rates by 3.855 percent for all customer rate classifications. The purpose of the rate increase was to provide additional revenue to make the principal and interest payments on the short-term Bond Anticipation Notes and the long-term Bonds issued to replace the Bond Anticipation Notes. HMP&L set up a separate Bond Payment Account and, as of May 31, 2016, HMP&L had accrued \$1,196,599 for future principal and interest payments for the Bonds.

System Improvements and Replacement of Capital Assets:

During the period of June 1, 2015, through May 31, 2016, HMP&L made a number of improvements to the electric and communication facilities and replaced certain assets. The improvements to the facilities and asset replacements increased service reliability and extended the useful-life of certain existing assets.

During the FY2015-2016, HMP&L made \$656,006 in capital improvements and replacements for the Existing System and \$1,435,171 in capital improvements and replacements for Station Two.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT’S DISCUSSION AND ANALYSIS**

Electric Rates – Current and Future Increases:

On May 12, 2015, the Board of Commissioners of the City of Henderson, Kentucky, passed an ordinance approving and adopting the following schedule of electric rate increases:

	<u>Effective Date</u>	<u>Adjustment Percent Increase</u>
First Adjustment	July 1, 2015	5%
Second Adjustment	November 1, 2015	5%
Third Adjustment	May 1, 2016	5%
Fourth Adjustment	November 1, 2016	5%
Inflation Adjustment	Beginning January 1, 2017 and each January 1, thereafter	CPI*

*Consumer Price Index (CPI) – Adjustments will be made in accordance with the percentage changes in the US Department of Labor Consumer Price Index (CPI-U).

Station Two – Future Expenditures:

In 1998, HMP&L and Big Rivers Electric Corporation entered into contracts with Western Kentucky Energy Corporation for the operation of the HMP&L Station Two Power Plant and other Big Rivers Electric Corporation Power Plants. Big Rivers Electric Corporation and Western Kentucky Energy Corporation entered discussions in 2005 to unwind the original 1998 contracts and return operational control of the Station Two Power Plant and the other Plants to Big Rivers Electric Corporation. The Unwind Transaction closed on July 16, 2009, and Big Rivers, thereafter, resumed operation of the Station Two Power Plant. Big Rivers Electric Corporation has identified a number of facility upgrades and maintenance projects for the Station Two Power Plant. Due to the aging of the Station Two Power Plant, there will continue to be ongoing maintenance and expenditures for capital projects.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION- HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT'S DISCUSSION AND ANALYSIS

Station Two – Future Expenditures, continued:

Big Rivers and HMP&L are currently involved in litigation concerning the Excess Henderson Energy at Station Two. The litigation was heard in the Henderson County Circuit Court and the judge assigned the dispute to arbitration. On May 30, 2012, the Arbitration Panel issued a final ruling in favor of HMP&L. Big Rivers filed a motion with the Appeals Court requesting that the Arbitration Panel's ruling be vacated and set aside. The Appeals Court issued a final ruling on May 30, 2014, in favor of HMP&L. On October 1, 2014, Big Rivers filed a Motion for Discretionary Review with the Supreme Court of Kentucky. On August 12, 2015, the Supreme Court of Kentucky denied the Motion for Discretionary Review. On February 12, 2016, HMP&L filed a claim for damages beginning in 2009. This legal dispute may continue for several years, however, HMP&L intends to claim damages beginning in July 2009.

In July of 2012, HMP&L entered into litigation with the Kentucky Department of Labor related to the application of prevailing wage rates at Station Two. The litigation went to trial in the Henderson Circuit Court in December 2012. The Circuit Court ruled in favor of the Labor Cabinet on May 24, 2013. HMP&L filed an appeal in the Kentucky Appeals Court, and oral arguments were heard September 24, 2014. On June 24, 2016, the Kentucky Appeals Court affirmed the order of the Henderson Circuit Court. HMP&L is currently appealing this decision.

It is important to note that the Energy and Prevailing Wage litigation should not have any adverse effects on the financial condition of HMP&L.

In past years, HMP&L has increased its reserve capacity at Station Two. The reserve capacity for FY 2015-2016 was 115 megawatts and HMP&L did not increase its reserve capacity for FY 2016-2017. HMP&L intends to keep the reserve capacity at 115 megawatts which is in line with the current HMP&L historical system peak demand. Each 5 megawatt increase in the reserved capacity will currently cost HMP&L approximately \$600,000 a year. The actual cost of reserve capacity, however, is based upon the Station Two budget which varies each year.

Southeastern Power Administration (SEPA):

The Southeastern Power Administration (SEPA) has contracted with HMP&L to provide HMP&L a total of 15,000 megawatt hours of hydroelectric power each year. The 15,000 megawatt hours represent approximately 2.5 percent of HMP&L's annual megawatt hour requirements. HMP&L is restricted to not more than 10 megawatt hours during any one hour period. The hydroelectric power is provided from SEPA generation units on the Cumberland River System Project.

In the fall of 2006, SEPA informed all contract project participants that the Wolf Creek Dam near Jamestown, Kentucky, had been inspected and serious seepage problems existed in the earthen dam. The seepage problems at the dam date back to 1968 and the US Army Corp of Engineers implemented various repairs since that time; however, the seepage became critical to the safety of the Wolf Creek Dam and

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION- HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT'S DISCUSSION AND ANALYSIS

Southeastern Power Administration (SEPA) continued:

surrounding communities. In an effort to respond to these safety concerns and make the needed repairs to the dam, SEPA reduced and curtailed electric service to the contract project participants. This reduction and curtailment of SEPA electric service began in early 2007. The dam repairs were completed during 2014 and SEPA is currently in the process of allowing the basin to again fill with water. However, the basin will take time to fill to its necessary level of water.

The SEPA Cumberland River Hydroelectric Power System may not return to normal operations for several more years.

Regulatory Compliance:

The North American Electric Reliability Corporation (NERC) adopted new electric system reliability standards for all electric utilities in the United States. NERC adopted and began enforcement of the new standards beginning in June 2007. The new standards were approved by the Federal Energy Regulatory Commission (FERC). HMP&L is required to comply with the new reliability standards and incurs administrative expenses related to NERC compliance.

In November 2008, the Southeastern Electric Reliability Council (SERC) audited HMP&L for compliance with NERC Reliability Standards. Subsequent to the November audit, a number of formal and informal discussions took place between HMP&L and SERC. HMP&L and SERC reached an agreement concerning non-compliance issues identified during the audit; and a final settlement agreement was approved. In November 2010, HMP&L hired a Reliability Compliance Manager who is responsible for compliance with NERC Reliability Standards. SERC performed a compliance audit of HMP&L in March of 2014, evaluating the utility for compliance with 11 reliability requirements, as well as 3 infrastructure related items. This audit resulted in no findings, violations, or recommendations.

Federal air quality and emission standards continue to be increasingly more stringent. The current standards and proposed new standards will increase the cost of energy production at Station Two.

Transfer to the City of Henderson, Kentucky:

During the fiscal year 2015-2016, HMP&L's cash transfer to the City was \$1.24 million. HMP&L has budgeted this same level of cash transfer to the City for the fiscal year 2016-2017 and subsequent budget periods. HMP&L also paid the City \$642,250 for internal service fees and HMP&L provided the City free electric service valued at \$430,776 and free communication services valued at \$475,392 annually. Excluding the annual fuel adjustment revenue and expense, the annual cash transfer payments, internal service fees, and value of the free electric and communication services represent 7.2 percent of gross electric revenue in fiscal year 2015-2016.

The financial statements of the Commission can be obtained via calling 270.826.2726 or by contacting the Commission directly at 100 Fifth Street, Henderson, Kentucky 42420.



INDEPENDENT AUDITORS' REPORT

Members of the Board of Commissioners
City of Henderson, Kentucky Utility Commission
Henderson, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the City of Henderson, Kentucky Utility Commission (Commission), a component unit of the City of Henderson, Kentucky, as of and for the years ended May 31, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the Commission'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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of 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 auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Commission as of May 31, 2016 and 2015, and the changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 1 through 11 and the Schedules of the Commission's Proportionate Share of the Net Pension Liability and Contributions to the County Employees' Retirement System on pages 41 and 42 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 opinions on the financial statements that collectively comprise the City of Henderson, Kentucky Utility Commission's basic financial statements. The combining financial statements on pages 37 through 40 are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining financial statements are the responsibility of management and were derived from and relate 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 combining financial statements are 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 on our consideration of the City of Henderson, Kentucky Utility Commission's internal control over financial reporting and 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 the 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 City of Henderson, Kentucky Utility Commission's internal control over reporting and compliance.

A handwritten signature in cursive script that reads "Myriad CPA Group, LLC". The signature is written in black ink and is positioned above the typed name of the firm.

Henderson, Kentucky
October 4, 2016

City of Henderson, Kentucky Utility Commission
Statements of Net Position
As of May 31, 2016 and 2015

	2016	2015
<u>Assets:</u>		
<u>Current assets:</u>		
Cash and cash equivalents	\$ 439,456	\$ 503,863
Investments - unrestricted	13,237,676	15,077,575
Investments - restricted	3,500,107	3,546,581
Accounts receivable, net of allowance for uncollectibles	2,248,646	1,817,864
Accounts receivable, Station Two Operator	2,588,760	1,511,787
Accrued revenue	2,790,719	2,502,950
Inventory and supplies	5,708,765	5,045,596
Prepaid expenses	60,935	101,748
	30,575,064	30,107,964
<u>Utility plant and equipment:</u>		
Utility plant, net of accumulated depreciation	59,650,423	62,733,307
	90,225,487	92,841,271
<u>Deferred outflows of resources:</u>		
Deferred outflows of resources	1,051,102	476,133
	1,051,102	476,133
	\$ 91,276,589	\$ 93,317,404
<u>Liabilities:</u>		
<u>Current liabilities:</u>		
Accounts payable and accrued expenses	\$ 5,134,001	\$ 4,678,132
Accounts payable-Construction in progress Station Two	1,325,221	3,409,854
Accounts payable-Station Two Operator	185,048	89,530
Current portion-bonds payable	620,000	610,000
Asset retirement obligation	380,771	380,771
Customer deposits	645,119	657,149
	8,290,160	9,825,436
<u>Long-term liabilities:</u>		
Long-term portion bonds payable	12,040,000	12,660,000
Unfunded pension liability	5,378,974	4,316,000
	17,418,974	16,976,000
	25,709,134	26,801,436
<u>Deferred inflows of resources:</u>		
Deferred inflows of resources	-	446,000
	-	446,000
<u>Net position:</u>		
Investment in plant assets, net of related debt	46,990,423	49,463,307
Restricted per bond ordinance	3,500,107	3,546,581
Unrestricted	15,076,925	13,060,080
	65,567,455	66,069,968
	\$ 91,276,589	\$ 93,317,404

The accompanying notes are an integral part of these financial statements.

City of Henderson, Kentucky Utility Commission
Statements of Revenues, Expenses, and Changes in Net Position
For the fiscal years ended May 31, 2016 and 2015

<u>Operating revenues:</u>	<u>2016</u>	<u>2015</u>
Sale of electricity-Existing System	\$ 38,746,429	\$ 36,369,893
Sale of electricity-Station Two	19,894,731	23,314,643
Communication services	1,308,495	1,135,729
Other	290,765	308,225
Total operating revenues	<u>60,240,420</u>	<u>61,128,490</u>
<u>Operating expenses:</u>		
Production of electricity	43,150,937	47,458,745
Operating expenses	9,924,724	9,863,618
Depreciation	5,122,049	5,070,479
Total operating expenses	<u>58,197,710</u>	<u>62,392,842</u>
Income (loss) from operations	<u>2,042,710</u>	<u>(1,264,352)</u>
<u>Interest income (expense):</u>		
Investment income	87,580	45,819
Interest expense	(471,131)	(486,110)
Total interest income (expense)	<u>(383,551)</u>	<u>(440,291)</u>
Income (loss) before non-operating items	<u>1,659,159</u>	<u>(1,704,643)</u>
<u>Non-operating items:</u>		
Station One Remediation	(10,780)	(35,788)
Transfers to the City of Henderson	(1,244,724)	(1,244,724)
Power furnished to the City of Henderson	(430,776)	(465,769)
Communication services provided to the City of Henderson and other local government agencies	(475,392)	(378,000)
Total non-operating items	<u>(2,161,672)</u>	<u>(2,124,281)</u>
<u>Extraordinary item:</u>		
Extraordinary gain on disposal of plant one	-	1,050,000
Change in net position	(502,513)	(2,778,924)
Cumulative effect of adoption of Governmental Accounting Standards Board Statement No. 68	-	(4,442,000)
Net position, beginning of year	66,069,968	73,290,892
Net position, end of year	<u>\$ 65,567,455</u>	<u>\$ 66,069,968</u>

The accompanying notes are an integral part of these financial statements.

City of Henderson, Kentucky Utility Commission
Statements of Cash Flows
For the fiscal years ended May 31, 2016 and 2015

	2016	2015
<u>Cash flows from operating activities:</u>		
Receipts from customers	\$ 58,432,866	\$ 61,123,918
Payments to suppliers and employees	(56,106,194)	(57,792,535)
Net cash provided by operating activities	2,326,672	3,331,383
<u>Cash flows from non-capital financing activities:</u>		
Distributions to the City of Henderson	(1,244,724)	(1,244,724)
Net cash used by non-capital financing activities	(1,244,724)	(1,244,724)
<u>Cash flows from capital and related financing activities:</u>		
Acquisition and construction of capital assets	(2,039,165)	(4,982,354)
Principal payments on long-term debt	(610,000)	(595,000)
Interest payments on long-term debt	(471,131)	(486,110)
Net cash used by capital and related financing activities	(3,120,296)	(6,063,464)
<u>Cash flows from investing activities:</u>		
Proceeds from sale and maturities of investments	5,499,322	6,887,972
Investment income	86,903	50,536
Purchases of investment securities	(3,612,284)	(3,821,466)
Net cash provided by investing activities	1,973,941	3,117,042
Increase (decrease) in cash and cash equivalents	(64,407)	(859,763)
Cash and cash equivalents, beginning of year	503,863	1,363,626
Cash and cash equivalents, end of year	\$ 439,456	\$ 503,863

The accompanying notes are an integral part of these financial statements.

City of Henderson, Kentucky Utility Commission
Statements of Cash Flows-Reconciliation of Net Cash Provided by Operations
For the fiscal years ended May 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
<u>Operating activities:</u>		
Operating income (loss)	\$ 2,042,710	\$ (1,264,352)
<u>Adjustments to reconcile operating income</u>		
<u>(loss) to net cash provided by operations:</u>		
Depreciation	5,122,049	5,070,479
Power furnished to the City of Henderson	(430,776)	(465,769)
Communication services provided at no charge	(475,392)	(378,000)
<u>Changes in operating assets and liabilities:</u>		
Accounts receivable	(430,782)	49,886
Due from Station Two Operator	(1,076,973)	(356,137)
Accrued revenue	(287,769)	300,534
Inventory and supplies	(663,169)	(44,990)
Prepaid expenses and other assets	40,813	1,576
Accounts payable and accrued expenses	455,869	(384,095)
Accounts payable-construction	(2,084,633)	845,310
GASB No. 68 items, net	42,005	-
Customer deposits	(12,030)	1,145
Other item	(10,768)	-
Due to Station Two Operator and other items	95,518	(44,204)
	<u>95,518</u>	<u>(44,204)</u>
Net cash provided by operating activities	<u>\$ 2,326,672</u>	<u>\$ 3,331,383</u>

The accompanying notes are an integral part of these financial statements.

1. Organization and Contracts:

The City of Henderson, Kentucky Utility Commission is organized under the provisions of Section 96.530 of the Kentucky Revised Statutes to operate, manage, and control the Henderson Municipal Power & Light System. The members of the Utility Commission are appointed by the Mayor and are approved by the City Commissioners of the City of Henderson, Kentucky (City). The Mayor and the City Commission authorize all rates and bond issues of the Utility Commission. As a municipal entity, the Utility Commission is exempt from all federal and state income taxes. Certain real estate utilized by the Utility Commission is owned by the City of Henderson.

The Utility Commission operates the “Existing System” and pursuant to certain contracts and agreements described as follows, reserves power from “Station Two” which is owned by the Commission, and currently operated by Big Rivers Electric Corporation (Big Rivers), pursuant to various lease, assignment, and other agreements between the parties.

The Commission provides retail electric service to the residents of the City of Henderson within its service territory. The Commission also provided wholesale electricity to Big Rivers through July 18, 1998 and subsequently to an affiliate of LG&E Energy Corporation. LG&E was purchased by Powergen in 2000 and thereafter acquired by E.ON. Effective July 16, 2009, Big Rivers resumed its role as operator of Station Two as part of the “Unwind Transaction.”

The Commission entered into certain contracts with Big Rivers relating to Station Two, as follows:

A. Power Plant Construction and Operation Agreement:

Under this agreement, Big Rivers agreed to furnish certain construction and start-up services for which it was paid out-of-pocket expenses plus overhead allowances and operate Station Two upon completion for which the Station Two Operator is paid reasonable expenditures allocable to the operation and maintenance of Station Two, as defined in the agreement. The original agreement was amended to include an option to extend through the useful operating life of Station Two. Big Rivers exercised this option in 1998.

B. Power Sales Contract:

Under this agreement, the Station Two Operator purchases all of the Station Two capacity in excess of the City of Henderson’s requirements. Payments for capacity purchased by the Station Two Operator are made monthly based on the portion of Station Two capacity allocated to the Station Two Operator compared to the total monthly Station Two capacity costs as defined in the agreement. The original agreement was executed in 1970 and extended through 2023. During 1993, the agreement was amended to include an option to extend through the useful operating life of Station Two. Big Rivers exercised this option in 1998.

C. Joint Facilities Agreement:

This agreement provides for the continuing joint use by the Commission and Station Two Operator of certain auxiliary facilities presently owned and used by the Station Two Operator at its generating station and of auxiliary facilities provided by the Commission in connection with the construction of Station Two, which is located adjacent to the generating station and also operated by the Station Two Operator.

1. Organization and Contracts, continued:

Power sales to the Station Two Operator under the agreement amounted to \$19,894,731 and \$23,314,643 for the fiscal years ended May 31, 2016 and 2015, respectively.

In connection with the negotiations related to the funding and construction of the Flue Gas Desulfurization System (FGD System) Station Two various aforementioned contracts were amended effective May 31, 1993. Significant provisions of the amendments include:

- The total capacity of Station Two, a factor in determining various Station Two cost allocations, was reduced as a result of the power required to operate the FGD System.
- FGD System costs, up to the amount of proceeds from the sale of Emission Allowances, will be borne in the same proportion as the Emission Allowances are allocated. Additional FGD System costs will be borne in proportion to the new capacity allocation as determined by the contract amendments.
- The Commission will reimburse the Station Two Operator for certain allocated costs of the existing Big Rivers' FGD System to be jointly used by the Station Two Operator and Station Two based upon an allocation formula defined in the amendments.

Amounts charged by the Station Two Operator as reasonable expenditures allocable to the operation and maintenance of Station Two are subject to review and approval by the Commission. Differences, if any, between amounts originally charged as allocable by the Station Two Operator and amounts accepted by the Utility Commission are recorded when a final determination of such amounts is made. Operating revenues and expenses would be reduced by any amount subsequently determined not to be allocable to Station Two.

Station Two became commercially operable and construction was substantially completed during 1974.

2. Summary of Significant Accounting Policies:

The Commission is a component unit of the City of Henderson, Kentucky (the primary government), due to its financial accountability to the City Commission.

The financial statements of the Commission have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the fund's principal ongoing operations. The principal operating revenues of the Commission are charges to customers for electric and communications sales and service.

Operating expenses for the Commission include the cost of power and services, administrative expenses, and depreciation. All other revenues and expenses not meeting this definition are classified as non-operating items.

2. **Summary of Significant Accounting Policies, continued:**

New Accounting Pronouncements:

The Commission implemented the Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27*, and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date - an amendment of GASB No. 68*. The provisions of these statements are effective for financial statements for fiscal years beginning after June 15, 2014, with earlier implementation encouraged. The implementation of GASB Statements No. 68 and 71 resulted in a cumulative effect of change in accounting principle which reduced the net position of the Commission by \$4,442,000. Additionally, implementation of the new GASB statements also resulted in the recording of related deferred outflows and inflows of resources, and unfunded pension liability, which is further discussed in Note 6.

Statement of Net Position:

The Statement of Net Position is designed to display the financial position of the Commission. The Commission's fund equity is reported as a net position, which is presented in three categories defined as follows:

- **Net invested plant assets net of related debt-** This component of net position consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- **Restricted-** This component of net position consists of constraints placed on net position use through external constraints imposed by creditors through debt covenants.
- **Unrestricted-** This component of net position consists of the remainder of net position that does not meet the definition of restricted or invested in plant assets, net of related debt.

Statement of Revenues, Expenses, and Changes in Net Position:

The Statement of Revenues, Expenses, and Changes in Net Position is the operating statement for proprietary funds. Revenues are reported by major source. This statement distinguishes between operating and non-operating revenues and expenses, and presents a separate subtotal for operating revenues, operating expenses, and operating income. The more significant of the Commission's accounting policies are described below:

A. Cash and Cash Equivalents:

Cash and cash equivalents consist of certificates of deposit and repurchase agreements with an original maturity of three months or less from the date of purchase. The carrying amount of each of these instruments approximates fair value.

B. Investment Securities:

Investments are recorded at fair value based on quoted market prices. Any gains or losses are reflected in the statement of revenues, expenses, and changes in net assets in accordance with GASB No.31, *"Accounting and Reporting For Certain Investments and For Internal Investment Pools."* Kentucky Revised Statute 66.480 limits the types of securities that a municipal entity may invest in to obligations of the United States Treasury and its agencies, certain Federal securities, repurchase agreements, commercial bank certificates of deposit, and the Commonwealth of Kentucky Investment Pool.

2. **Summary of Significant Accounting Policies, continued:**

C. **Accounts Receivable and Unbilled Revenue:**

The Commission has entered into an agreement with the City of Henderson to perform its billing and collection services. All monies due to the Utility Commission are collected and deposited in the City of Henderson's Utility Clearing Fund and are remitted to the Utility Commission on a weekly basis. The amount included in accounts receivable due from the Utility Clearing Fund was \$2,578,169 and \$2,008,255 as of May 31, 2016 and 2015, respectively.

D. **Inventory:**

The fuel and lime inventory is stated at cost using the first-in-first-out method. Materials and supplies are stated at the weighted average cost.

E. **Utility Plant and Equipment:**

The utility plant is carried at cost, which includes interest aggregating \$15,342,300, which was capitalized during the period of construction. No interest was capitalized during the fiscal years ended May 31, 2016 and 2015. The Commission's policy for determining the useful lives of its utility plant and equipment is as follows:

Production plant and structures	33 ½	years
Transmission and distribution	25	years
Automotive equipment	6	years
Wireless internet equipment	5	years
Other equipment	10	years

F. **Use of Estimates:**

The preparation of financial statements in conformity with generally accepted accounting principles requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at May 31, 2016 and 2015, as well as revenues and expenses for the years then ended. Actual results could differ from the estimates and assumptions used.

G. **Compensated Absences:**

Employees of the Commission are entitled to paid vacations and sick-leave. The Commission's policy is to recognize these costs when earned under the accrual method of accounting in accordance with GASB No.16 "Accounting For Compensated Absences."

H. **Pensions:**

In the component unit financial statements of the City of Henderson, Kentucky Utility Commission, retirement plans (pensions) are required to be recognized and disclosed using the accrual basis of accounting (Refer to Note 6).

2. Summary of Significant Accounting Policies, continued:

H. Pensions, continued:

In general, the Commission recognizes a net pension liability, which represents the Commission's proportionate share of the excess of the total pension liability over the fiduciary net position reflected in the actuarial report provided by the Commonwealth of Kentucky's County Employees Retirement System (CERS). The net pension liability is measured as of the Commission's prior fiscal year end. Changes in the net pension liability that are recorded as deferred inflows of resources or deferred outflows of resources (that arise from changes in actuarial assumptions or other inputs and differences between expected or actual experience) are amortized over the weighted average remaining service life of all participants in the pension plan and are recorded as a component of pension expenses beginning with the period in which they are incurred.

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions and pension expense, information about the fiduciary net position of the County Employees' Retirement System (CERS), and additions to/deductions from CERS' 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 recorded at fair value.

Projected earnings on pension investments are recognized as a component of pension expense. Differences between projected and actual investment earnings are reported as deferred inflows of resources or deferred outflows of resources and amortized as a component of pension expense on a closed basis over a five year period beginning with the period in which the difference occurred. Each subsequent year will incorporate an additional closed basis five year period of recognition.

I. Emission Allowances:

The Commission does not record the value of emission allowances granted by the Environmental Protection Agency for sulfur dioxide and nitrous oxide on its financial statements as there is no cost basis in these allowances.

3. Cash and Cash Equivalents:

As of May 31, 2016, the City of Henderson, Kentucky Utility Commission maintained deposits with several local financial institutions. Of the bank balance, all was insured by the Federal Depositor's Insurance Corporation and any amounts in excess of FDIC were secured by pledged United States Government securities.

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements

4. Investment Securities:

Investments are included in the Statement of Net Position under the caption "Investments-restricted/unrestricted." A summary of investments held by the City of Henderson, Kentucky Utility Commission along with the scheduled maturities is presented below:

<u>Investment Type:</u>	<u>Fair Value</u>	<u>Less Than One Year</u>	<u>One to Five Years</u>	<u>Six to Ten Years</u>
<u>May 31, 2016:</u>				
<u>Unrestricted Investments:</u>				
U.S. Treasury Bills	\$ 10,108,229	\$ 10,108,229	\$ -	\$ -
Certificate of Deposits and Money Markets	3,129,447	3,129,447	-	-
Total Unrestricted Investments	<u>\$ 13,237,676</u>	<u>\$ 13,237,676</u>	<u>\$ -</u>	<u>\$ -</u>
<u>Restricted Per Bond Ordinance:</u>				
Certificate of Deposit and Money Markets	\$ 3,500,107	\$ 3,400,107	\$ 100,000	\$ -
Total Restricted Investments	<u>\$ 3,500,107</u>	<u>\$ 3,400,107</u>	<u>\$ 100,000</u>	<u>\$ -</u>
<u>May 31, 2015:</u>	<u>Fair Value</u>	<u>Less Than One Year</u>	<u>One to Five Years</u>	<u>Six to Ten Years</u>
<u>Unrestricted Investments:</u>				
U.S. Treasury Bills	\$ 12,092,142	\$ 12,092,142	\$ -	\$ -
Certificate of Deposits and Money Markets	2,985,433	2,985,433	-	-
Total Unrestricted Investments	<u>\$ 15,077,575</u>	<u>\$ 15,077,575</u>	<u>\$ -</u>	<u>\$ -</u>
<u>Restricted Per Bond Ordinance:</u>				
Certificate of Deposit and Money Markets	\$ 3,546,581	\$ 3,446,581	\$ 100,000	\$ -
Total Restricted Investments	<u>\$ 3,546,581</u>	<u>\$ 3,446,581</u>	<u>\$ 100,000</u>	<u>\$ -</u>
<u>Restricted Assets consisted of the following:</u>			<u>2016</u>	<u>2015</u>
Operation and Maintenance Reserve			\$ 100,000	\$ 100,000
Debt Service Reserve			2,797,130	2,886,586
Debt Service Sinking Fund			602,977	559,995
Total restricted assets			<u>\$ 3,500,107</u>	<u>\$ 3,546,581</u>

4. Investment Securities, continued:

A. Interest Rate Risk:

The City of Henderson, Kentucky Utility Commission has a formal investment policy that limits investment maturities as a means to manage its exposure to fair value losses resulting from increasing interest rates.

B. Credit Risk:

The City of Henderson, Kentucky Utility Commission limits its investments to those allowed by Kentucky Revised Statute 66.480. Kentucky Revised Statute 66.480 limits investments to U.S. Government Treasury and Agency securities, certificates of deposit, securities issued by a state or local government rated in one of the three highest categories by a nationally recognized credit agency.

C. Custodial Credit Risk:

Custodial credit risk is the risk that in the event of the failure of the counterparty, the City of Henderson, Kentucky Utility Commission will not be able to recover the value of its investments, or collateral securities that are in the possession of the outside party. All investments of the Commission, with the exception of certificates of deposit, consist of unregistered and uninsured securities held by the Commission's trustee in their trust department not in the name of the Commission.

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements

5. Utility Plant and Equipment:

Utility plant and equipment consisted of the following as of May 31, 2016 and 2015:

<u>May 31, 2016:</u>	<u>Beginning</u>			<u>Ending</u>
<u>Existing System:</u>	<u>Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u>
Vehicles	\$ 2,304,872	\$ 88,741	\$ (268,456)	\$ 2,125,157
Transmission plant	9,271,430	120,441	(710,753)	8,681,118
Distribution plant	26,633,521	363,345	(342)	26,996,524
Land and land rights	1,235,451	-	-	1,235,451
Telecommunications, internet, and fiber optics	5,893,540	83,479	-	5,977,019
General plant	71,403	-	(17,053)	54,350
	<u>45,410,217</u>	<u>656,006</u>	<u>(996,604)</u>	<u>45,069,619</u>
Accumulated depreciation:				
Accumulated depreciation	<u>(34,526,716)</u>	<u>(968,937)</u>	<u>944,590</u>	<u>(34,551,063)</u>
Existing System total	<u>\$ 10,883,501</u>	<u>\$ (312,931)</u>	<u>\$ (52,014)</u>	<u>\$ 10,518,556</u>
<u>Station Two:</u>				
General plant	\$ 183,085,168	\$ 1,435,171	\$ -	\$ 184,520,339
Accumulated depreciation	<u>(131,235,362)</u>	<u>(4,153,110)</u>	<u>-</u>	<u>(135,388,472)</u>
Station Two total	<u>\$ 51,849,806</u>	<u>\$ (2,717,939)</u>	<u>\$ -</u>	<u>\$ 49,131,867</u>
Total utility, plant, and equipment, net	<u>\$ 62,733,307</u>			<u>\$ 59,650,423</u>
<u>May 31, 2015</u>	<u>Beginning</u>			<u>Ending</u>
<u>Existing System:</u>	<u>Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u>
Vehicles	\$ 2,377,843	\$ 40,000	\$ (112,971)	\$ 2,304,872
Transmission plant	9,252,583	19,475	(628)	9,271,430
Distribution plant	26,010,178	629,952	(6,609)	26,633,521
Land and land rights	1,235,451	-	-	1,235,451
Telecommunications, internet, and fiber optics	5,781,525	112,015	-	5,893,540
General plant	11,065,881	-	(10,994,478)	71,403
	<u>55,723,461</u>	<u>801,442</u>	<u>(11,114,686)</u>	<u>45,410,217</u>
Accumulated depreciation:				
Accumulated depreciation	<u>(44,589,879)</u>	<u>(993,336)</u>	<u>11,056,499</u>	<u>(34,526,716)</u>
Existing System total	<u>\$ 11,133,582</u>	<u>\$ (191,894)</u>	<u>\$ (58,187)</u>	<u>\$ 10,883,501</u>
<u>Station Two:</u>				
General plant	\$ 178,904,256	\$ 4,180,912	\$ -	\$ 183,085,168
Accumulated depreciation	<u>(127,158,219)</u>	<u>(4,077,143)</u>	<u>-</u>	<u>(131,235,362)</u>
Station Two total	<u>\$ 51,746,037</u>	<u>\$ 103,769</u>	<u>\$ -</u>	<u>\$ 51,849,806</u>
Total utility, plant, and equipment, net	<u>\$ 62,879,619</u>			<u>\$ 62,733,307</u>

Depreciation expense for the fiscal years ended May 31, 2016 and 2015 was \$5,122,049 and \$5,070,479 respectively.

6. **Retirement Plans:**

General Information about the Pension Plan

Plan description: All Commission employees participate in the County Employees' Retirement System (CERS), a multi-employer, cost sharing, defined benefit plan administered by the Board of Trustees of Kentucky Retirement Systems. Kentucky Retirement Systems issues a publicly available financial report that includes financial statements and supplementary information for CERS. That report can be obtained at <https://kyret.ky.gov>.

Benefits provided: CERS provides retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living adjustments (COLA) are provided at the discretion of the State legislature. Kentucky Revised Statute 61.645 assigns the authority to establish and amend benefit provisions to the Kentucky Retirement Systems Board of Trustees.

Contributions: Plan members participating in CERS on or before August 31, 2008, are required to contribute 5% of the annual creditable compensation. For plan members who began participating in CERS on or after September 1, 2008, the contribution rate is 6%. The Commission is required to contribute at an actuarially determined rate. As of May 31, 2016, the Commission's required contribution rate was 12.42% of annual covered payroll. The contribution requirements of plan members and the Commission are established and may be amended by the Kentucky Retirement Systems Board of Trustees. Contributions to CERS from the Commission were \$365,977 for the year ended May 31, 2016.

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

At May 31, 2016, the Commission reported a liability of \$5,378,974 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Commission's proportion of the net pension liability was based on a projection of the Commission's long-term share of contributions to the pension plan relative to the projected contributions of all participating employers, actuarially determined. At June 30, 2015, the Commission's proportion was 0.125106%.

For the year ended May 31, 2016, the Commission recognized pension expense of \$407,982. At May 31, 2016, the Commission reported deferred inflows of resources related to pensions from the following sources:

6. Retirement Plans, continued:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	\$ 44,701	\$ -
Changes of assumptions	542,411	-
Net difference between projected and actual investment earnings on pension plan investments	48,218	-
Changes in proportion and differences between Commission contributions and proportional share of contributions	49,794	-
Commission contributions subsequent to the measurement date	<u>365,977</u>	<u>-</u>
Total	<u>\$ 1,051,101</u>	<u>\$ -</u>

\$365,977 reported as deferred outflows of resources related to pensions resulting from Commission contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended May 31, 2017. Other amounts reported as deferred inflows of resources related to pensions will be recognized in pension expense as follows:

<u>Year ended May 31:</u>	<u>Amount</u>
2017	\$ 265,802
2018	265,802
2019	141,467
2020	12,053
2021	-
Thereafter	-

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

Inflation	3.25%
Salary increases	4.00%, average, including inflation
Investment rate of return	7.50%, net of pension plan expense, including inflation

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

6. Retirement Plans, continued:

beneficiaries, the mortality table used is the RP-2000 Combined Mortality Table projected with Scale BB to 2013 (set back one year for females). For disabled members, the RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (set back four 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, 2015 valuation were based on the results of an actuarial experience study for the period July 1, 2008 - June 30, 2013.

The long-term expected return on plan assets is reviewed as part of the regular experience studies prepared every five years for Kentucky Retirement Systems. 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 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 assumption is intended to be a long term assumption and is not expected to change absent a significant change in the asset allocation, a change in the inflation assumption, or a fundamental change in the market that alters expected returns in future years.

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Combined Equity	44%	5.4%
Combined Fixed Income	19%	1.5%
Real Return (Diversified Inflation Strategies)	10%	3.5%
Real Estate	5%	4.5%
Absolute Return (Diversified Hedge Funds)	10%	4.25%
Private Equity	10%	8.5%
Cash Equivalent	2%	-0.25%
Total	100%	

Discount rate: 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 28 year amortization period of the unfunded actuarial accrued liability. The discount rate determination does not use a municipal bond rate. Projected future benefit payments for all current plan members were projected through 2117.

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements

6. Retirement Plans, continued:

Sensitivity of the Commission's proportionate share of the net pension liability to changes in the discount rate: The following presents the Commission's proportionate share of the net pension liability calculated using the discount rate of 7.5%, as well as what the Commission's proportionate share of the net pension liability would be if it were calculated using a discount rate that is one percentage point lower (6.5%) or one percentage point higher (8.5%) than the current rate:

	1% Decrease (6.5%)	Current Discount Rate (7.5%)	1% Increase (8.5%)
Commission's proportionate share of the net pension liability as of May 31, 2016	<u>\$ 6,866,928</u>	<u>\$ 5,378,974</u>	<u>\$ 4,104,673</u>

Pension plan fiduciary net position: Detailed information about the pension plan's fiduciary net position is available in the separately issued financial statements.

A copy of the annual report for the County Employees' Retirement System can be obtained from the County Employees' Retirement System 1260 Louisville Road, Frankfort, Kentucky 40601, or by calling 1.502.564.4646.

Postemployment Healthcare Benefits

Plan description: In addition to the pension benefits described above, KRS provides postemployment healthcare benefits through the Kentucky Retirement Systems Insurance Fund (Insurance Fund). The Insurance Fund was established to provide hospital and medical insurance for those receiving benefits from the Kentucky Employees Retirement System (KERS), the County Employees Retirement System (CERS), and the State Police Retirement System (SPRS). The Insurance Fund pays a prescribed contribution for whole or partial payment of required premiums to purchase hospital and medical insurance. For the fiscal year ended June 30, 2015 (the date of the latest available information), insurance premiums withheld from benefit payments for these benefits from CERS were \$22.6 million and \$1.7 million for non-hazardous and hazardous employees, respectively. For the fiscal year ended June 30, 2014, insurance premiums withheld from benefit payments for those receiving benefits from CERS were \$24.2 million and \$1.9 million for non-hazardous and hazardous employees, respectively. The Insurance Fund pays the same proportion of hospital and medical insurance premiums for the spouse and dependents of retired hazardous employees killed in the line of duty. As of June 30, 2015, the Insurance Fund had 108,952 retirees and beneficiaries for whom benefits were available.

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

<u>Years of Service</u>	<u>% Paid by Insurance Fund</u>
20 or more	100%
15 - 19	75%
10 - 14	50%
4 - 9	25%
Less than 4	0%

6. Retirement Plans, continued:

As a result of House Bill 290 (2004 Kentucky General Assembly), medical insurance benefits are calculated differently for those who began participating on or after July 1, 2003. Once employees reach a minimum vesting period of ten 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 based on the retiree COLA, which is updated annually due to changes in the Consumer Price Index for all urban consumers. This benefit is not protected under the inviolable contract provisions of Kentucky Revised Statute 16.652, 61.692, and 78.852. The Kentucky General Assembly reserves the right to suspend or reduce this benefit if, in its judgment, the welfare of the Commonwealth so demands.

Funding policy: In prior years, the employer's required medical insurance contribution rate was being increased annually by a percentage that would result in advance-funding the medical liability on an actuarially determined basis using the entry age normal method within a 20 year period measured from 1987. In November 1992, the Board adopted a fixed percentage rate and suspended future increases under the current medical premium funding policy until the next experience study could be performed. In May 1996, the Board adopted a policy to increase the insurance contribution rate by the amount needed to achieve the target rate for full entry age normal funding within 20 years.

The Commission is required to contribute at an actuarially determined rate. As of May 31, 2016, 2015, and 2014, the Commission's required contribution rate was 4.64%, 4.92%, and 5.15%, respectively, of annual covered payroll. The contribution requirements of plan members and the Commission are established and may be amended by the Kentucky Retirement Systems Board of Trustees. Contributions to the Insurance Fund from the Commission were \$136,726, \$144,693, and \$146,164 for the years ended May 31, 2016, 2015, and 2014, respectively.

On August 6, 2012, the Board voted to cease self-funding of healthcare benefits for most Medicare eligible retirees. The Board elected to contract with Humana Insurance Company to provide healthcare benefits to retirees through a fully insured Medicare Advantage Plan. The Humana Medicare Advantage Plan became effective January 1, 2013.

7. Accounts Payable and Accrued Expenses:

Accounts payable and accrued expenses consisted of the following as of May 31, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Accounts payable and accrued expenses - Existing System	\$ 2,311,083	\$ 2,251,327
Accounts payable and accrued liabilities - Station Two	<u>2,822,918</u>	<u>2,426,805</u>
Total	<u>\$ 5,134,001</u>	<u>\$ 4,678,132</u>

8. Long-Term Debt-Revenue Bonds:

During the fiscal year ended May 31, 2012, the City of Henderson, Kentucky Utility Commission issued revenue bonds for the purpose of financing capital improvements throughout its system through two revenue bond series, *Electric System Revenue Bonds, Series 2011A* in the amount of \$11,350,000, and *Electric System Revenue Bonds, Series 2011 B*, in the amount of \$3,670,000.

The bond ordinance requires that certain accounts for each issue be established and held by a trustee as follows:

Debt Service Fund:

A monthly transfer of 1/12 of principal and 1/6 of the interest due is required to be deposited in the Debt Service Fund.

Debt Service Reserve Fund:

A reserve account was established, so that as of any date of calculation, an amount equal to at least the highest amount of aggregate debt service, or an amount equal to 125% of the average aggregate debt service and an amount equal to 10% of the “proceeds” of the bonds with respect to all series is maintained by the Commission.

Series 2011A:

The Series 2011A bonds are secured by a pledge of the revenues of the City of Henderson, Kentucky Utility Commission. The Series 2011A Bonds are additionally secured by a debt service reserve and a non-foreclosable statutory mortgage lien on the System. The Series 2011A Bonds are also secured by a debt service reserve in an amount equal to the least of the maximum annual debt service on the Series 2011A Bonds. The proceeds from the sale of these bonds were used to retire the Bond Anticipation Note, Series 2008B in the amount of \$5,281,067, with the remaining proceeds to be used for capital improvements of the City’s electric transmission and distribution system, and at its Station Two generating station. Interest is due semi-annually on these obligations on December 1st and June 1st of each year.

It is the opinion from the City of Henderson, Kentucky Utility Commission’s bond counsel, that under existing laws, interest on the Series 2011A Bonds is not subject to income tax.

Optional Redemption Series 2011A:

The Series 2011A Bonds maturing on and after December 1, 2021, are subject to redemption by the Commission, at its option, before maturity on September 1, 2021, and on any date thereafter in whole or from time to time in part in any order of maturity (less than all of a single maturity to be selected by lot in such manner as the Trustee and Paying Agent may determine) at a redemption price equal to 100% of the principal amount thereof plus accrued interest to the redemption date.

Series 2011B:

The Series 2011B bonds are secured by a pledge of the revenues of the City of Henderson, Kentucky Utility Commission. The Series 2011B Bonds are additionally secured by a debt service reserve and a non-foreclosable statutory mortgage lien on the System. The Series 2011B Bonds are also secured by a debt service reserve in an amount equal to the least of the maximum annual debt service on the Series 2011B bonds. The proceeds from the sale of these bonds were used to retire the Bond Anticipation Note, Series 2008A and 2010A, in the amounts of \$3,500,000 and \$170,000, respectively. Interest is due semi-annually on these obligations on December 1st and June 1st of each year.

It is the opinion from the City of Henderson, Kentucky Utility Commission’s bond counsel, that under existing laws, interest on the Series 2011B bonds is not subject to income tax.

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements

8. Long-Term Debt-Revenue Bonds, continued:

Optional Redemption Series 2011B:

The Series 2011B Bonds maturing on and after December 1, 2021, are subject to redemption by the Commission, at its option, before maturity on September 1, 2021, and on any date thereafter in whole or from time to time in part in any order of maturity (less than all of a single maturity to be selected by lot in such manner as the Trustee and Paying Agent may determine) at a redemption price equal to 100% of the principal amount thereof plus accrued interest to the redemption date.

A summary of the long-term debt of the Commission is as follows:

	<u>2016</u>	<u>2015</u>
City of Henderson, Kentucky Utility Commission Series 2011A Revenue Bonds, secured by pledge of system revenues and non-forecloseable statutory lien, maturing December 1, 2031, annual principal payments range from \$420,000 to \$725,000, interest rates range from 2.5% to 4.5%.	\$ 9,595,000	\$ 10,050,000
City of Henderson, Kentucky Utility Commission Series 2011B Revenue Bonds, secured by pledge of system revenues and non-forecloseable statutory lien, maturing December 1, 2031, annual principal payments range from \$150,000 to \$245,000, interest rates range from 2.5% to 4.5%.	<u>3,065,000</u>	<u>3,220,000</u>
Total long-term debt	\$ 12,660,000	\$ 13,270,000
Less current portion due	<u>(620,000)</u>	<u>(610,000)</u>
Long-term debt, net of current portion	<u>\$ 12,040,000</u>	<u>\$ 12,660,000</u>

Future maturities of long-term debt as of May 31, 2016 are as follows:

<u>Fiscal Year:</u>	<u>Series 2011A</u>			<u>Series 2011B</u>			<u>Total Debt Service</u>
	<u>Principal</u>	<u>Interest</u>	<u>Total</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>	
2017	\$ 465,000	\$ 363,432	\$ 828,432	\$ 155,000	\$ 101,044	\$ 256,044	\$ 1,084,476
2018	475,000	351,806	826,806	155,000	98,718	253,718	1,080,524
2019	490,000	339,932	829,932	160,000	95,618	255,618	1,085,550
2020	505,000	325,232	830,232	165,000	92,098	257,098	1,087,330
2021	520,000	310,082	830,082	170,000	88,138	258,138	1,088,220
2022-2026	2,870,000	1,268,324	4,138,324	920,000	362,116	1,282,116	5,420,440
2027-2031	3,480,000	647,082	4,127,082	1,095,000	184,238	1,279,238	5,406,320
2032-2033	<u>790,000</u>	<u>35,550</u>	<u>825,550</u>	<u>245,000</u>	<u>10,044</u>	<u>255,044</u>	<u>1,080,594</u>
	<u>\$ 9,595,000</u>	<u>\$ 3,641,440</u>	<u>\$ 13,236,440</u>	<u>\$ 3,065,000</u>	<u>\$ 1,032,014</u>	<u>\$ 4,097,014</u>	<u>\$ 17,333,454</u>

9. Asset Retirement Obligation:

Effective December 31, 2008, the Commission terminated operation of its Station One generation facility. The Commission is legally obligated to remove asbestos, lead paint, and other contaminants located there. Accordingly, a liability has been established in accordance with SFAS No. 143 *Accounting for Asset Retirement Obligations*.

The following is a reconciliation of the aggregate retirement liability associated with the Commission's obligation to remove the contaminants at Station Two:

	Asset Retirement Obligation
Balance as of June 1, 2015	\$ 380,771
Additional obligations incurred	-
Increase in present value of the obligation	-
Increase based on revised estimates of costs to dismantle and remove assets	-
Liabilities extinguished	-
Balance as of May 31, 2016	<u>\$ 380,771</u>

During July of 2014, the Commission opened bids to demolish and perform an environmental clean up of its Station One facility. Six contractors submitted bids ranging from \$216,000 to \$4.9 million, with one bidder offering to pay \$37,000 for the privilege as the firm will sell the scrap and equipment from the facility as well as remove the contamination. The Commission engaged this firm in September of 2014 and as of May 31, 2015 the facility and the related liability had been removed.

10. Discounted Internet and Broadband Services:

A summary of discounted internet and broadband services provided by the Commission to other governmental concerns is as follows:

<u>Governmental Organizations</u>	<u>2016</u>	<u>2015</u>
Henderson County GIS System	\$ 116,400	\$ 54,000
Henderson Water Utility	91,800	121,000
City of Henderson	265,500	201,000
Other organizations	1,692	2,000
	<u>\$ 475,392</u>	<u>\$ 378,000</u>

11. Concentration of Sales:

Three industrial customers of the Existing System accounted for sales in the amount of \$11.8 million (30% of Existing System sales), and \$10.9 million (29% of Existing System sales) for the fiscal years ended May 31, 2016 and 2015.

12. Emission Allowances:

Amendments to the Clean Air Act in 1990 established a system whereby emission allowances were created and allocated to generating units subject to Phase 1 of the emission restrictions. Station Two was allotted a total of 226,901 allowances through 1999 (one emission allowance represents the authorization to emit one ton of sulfur dioxide in a given year). The allowances are allocated between the Commission and the Station Two Operator based upon the Station Two capacity allocations. As of May 31, 2016 and 2015, there were remaining sulfur dioxide emission allowances valued at \$25,947 and \$32,434, respectively.

13. Related Party Transactions:

The Commission incurred the following transactions with the City of Henderson, Kentucky for the fiscal years ended May 31, 2016 and 2015:

Paid the City \$642,250 and \$622,250 each year, respectively, for data processing and other services related to billings and collections.

Paid the City \$1,244,724 and \$1,244,724 May 31, 2016 and 2015 of the fiscal years ended, respectively for payment in lieu of taxes..

Paid the City \$593,767 and \$564,043 for participation in the City of Henderson's self-insured employee health insurance plan for the fiscal years ended May 31, 2016 and 2015 respectively. Risk is minimized in this area by the purchase of re-insurance for amounts in excess of the \$125,000 stop loss limit. Charges are based on estimated amounts determined by the City of Henderson's insurance coordinator as necessary to fund claims as they become due and payable.

Provided the City of Henderson with power for the fiscal years ended May 31, 2016 and 2015 in the amount of \$430,776 and \$465,769 respectively. The City of Henderson was also provided significantly reduced communication service fees totaling approximately \$265,500 for the fiscal years May 31, 2016 and 2015.

14. Commitments and Contingencies:

A. Southeastern Power Administration:

The Southeastern Power Administration (SEPA) has contracted with the Commission to provide it a total of 15,000 megawatt hours of hydroelectric power each year. The 15,000 megawatt hours represent approximately 2.5% of the Commission's annual megawatt hour requirements. Henderson Municipal Power & Light is restricted to not more than 10 megawatt hours during any hour, and not more than 2,640 megawatt hours during any month. During the year ended May 31, 2016 and 2015, the Commission purchased power on the spot market and from SEPA to supply the needs of its customers. Purchased power from these sources for the fiscal year ended May 31, 2016 was \$623,099 and \$527,522 during 2015.

14. **Commitments and Contingencies, continued:**

B. Regulatory Compliance:

The North American Electric Reliability Corporation (NERC) adopted new electric system reliability standards for all electric utilities in the United States. NERC has adopted and began enforcement of the new standards effective June of 2007. The new standards have been approved by the Federal Energy Regulatory Commission (FERC). The Commission must comply with the new standards and will incur administrative expenses related to NERC compliance. Federal air quality and emission standards have become more stringent. The current standards and proposed standards resulted in the cost of compliance being excessive to operate Station One. As a result of the new regulations, the Commission approved the cessation of operations at Station One on August 25, 2008, and Station One was taken out of service in December of 2008, and razed during the fiscal year ended May 31, 2015.

C. Unwind Transaction- Station Two:

In 1998, HMP&L, Big Rivers Electric Corporation, and Western Kentucky Energy Corporation entered into contracts for the operation of the HMP&L Station Two Power Plant and other Big Rivers Electric Corporation Generation Plants. On July 16, 2009, Big Rivers Electric Corporation and Western Kentucky Energy Corporation (E.ON) signed an agreement under which the original 1998 contracts are rescinded and operational control of the Station Two Power Plant returned to Big Rivers Electric Corporation.

D. Pending Litigation:

In 1998, HMP&L and Big Rivers Electric Corporation entered into contracts with Western Kentucky Energy Corporation for the operation of the HMP&L Station Two Power Plant and other Big Rivers Electric Corporation Power Plants. Big Rivers Electric Corporation and Western Kentucky Energy Corporation entered discussions in 2005 to unwind the original 1998 contracts and return operational control of Henderson's Station Two Power Plant and other Plants to Big Rivers Electric Corporation. The Unwind Transaction closed on July 16, 2009, and Big Rivers, thereafter, resumed operation of the Station Two Power Plant. Big Rivers Electric Corporation has identified a number of facility upgrades and maintenance projects for the Station Two Power Plant. These Work Plans indicate HMP&L will incur an additional \$18 million to \$21 million in maintenance expenses in the future at Station Two.

Big Rivers and HMP&L are currently involved in ongoing litigation concerning HMP&L's Energy at Station Two. The initial litigation was heard in the Henderson County Circuit Court and the judge assigned the dispute to arbitration. On May 30, 2012, the Arbitration Panel issued a final ruling in favor of HMP&L. Big Rivers filed a motion with the Appeals Court requesting that the Arbitration Panel's ruling be vacated and set aside. The Appeals Court issued a final ruling on May 30, 2014, in favor of HMP&L. On October 1, 2014, Big Rivers filed A Motion for Discretionary Review with the Supreme Court of Kentucky. On August 12, 2015, the Supreme Court of Kentucky denied the Motion for Discretionary Review. On February 12, 2016, HMP&L filed a claim for damages beginning in July 2009. This legal dispute may continue for several years.

D. Pending Litigation, continued:

In July 2012, HMP&L entered into litigation with the Kentucky Department of Labor related to the application of prevailing wage rates at Station Two. The litigation went to trial in the Henderson Circuit Court in December 2012. The Circuit Court ruled in favor of the Labor Cabinet on May 24, 2013. HMP&L filed an appeal in the Kentucky Appeals Court, and oral arguments were heard September 24, 2014. On June 24, 2016, the Kentucky Appeals Court affirmed the order of the Henderson Circuit Court. HMP&L is currently appealing this decision; however, it is important to note that the Energy and Prevailing Wage litigation should not have any adverse affects, if any, on the financial status of HMP&L.

15. Risk Management:

The Commission is exposed to various risks of loss related to torts, theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Commission carries commercial insurance for these types of risk of loss, including workers' compensation. Settled claims from these risks have not exceeded commercial insurance coverage in any of the past five fiscal years.

16. Amounts Due From Station Two Operator:

As of the fiscal years ended May 31, 2016 and 2015, the amount the Station Two Operator owed to the Commission, as part of the annual settlement, was \$2,588,760 and \$1,511,787, respectively.

17. Subsequent Events:

Subsequent events have been evaluated through October 4, 2016, the date these financial statements were available to be issued.

a. Big Rivers Public Service Commission Filing:

Big Rivers has filed an application for a declaratory order with the Kentucky Public Service Commission, seeking approval of a plan to charge Henderson for variable costs associated with the generation of Excess Henderson Energy at the City's Station Two power plant. The City of Henderson and Henderson Utility Commission, d/b/a Henderson Municipal Power & Light, have intervened, claiming a special interest in the proceeding. Henderson has challenged the Commission's jurisdiction over what appears to be solely a matter of contract interpretation.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
COMBINING STATEMENTS OF NET POSITION-BY SYSTEM
As of May 31, 2016 and 2015

	<u>May 31, 2016</u>				<u>May 31, 2015</u>			
	<u>Existing System</u>	<u>Station Two</u>	<u>Elimination</u>	<u>Total</u>	<u>Existing System</u>	<u>Station Two</u>	<u>Elimination</u>	<u>Total</u>
<u>Assets:</u>								
<u>Current assets:</u>								
Cash and cash equivalents	\$ 130,059	\$ 309,397	\$ -	\$ 439,456	\$ 292,979	\$ 210,884	\$ -	\$ 503,863
Investments - unrestricted	13,237,676	-	-	13,237,676	15,077,575	-	-	15,077,575
Investments - restricted	3,500,107	-	-	3,500,107	3,546,581	-	-	3,546,581
Accounts receivable, net of allowance for uncollectibles	2,248,646	-	-	2,248,646	1,817,864	-	-	1,817,864
Accounts receivable-Station Two Operator	2,588,760	-	-	2,588,760	1,511,787	-	-	1,511,787
Accrued revenue	2,790,719	-	-	2,790,719	2,502,950	-	-	2,502,950
Inventory and supplies	3,017,960	2,690,805	-	5,708,765	2,747,909	2,297,687	-	5,045,596
Prepaid expenses	60,935	-	-	60,935	101,748	-	-	101,748
Total current assets	<u>27,574,862</u>	<u>3,000,202</u>	<u>-</u>	<u>30,575,064</u>	<u>27,599,393</u>	<u>2,508,571</u>	<u>-</u>	<u>30,107,964</u>
<u>Utility plant, net of accumulated depreciation:</u>	<u>10,518,556</u>	<u>49,131,867</u>	<u>-</u>	<u>59,650,423</u>	<u>10,883,501</u>	<u>51,849,806</u>	<u>-</u>	<u>62,733,307</u>
<u>Other assets:</u>								
Investment in Station Two	31,058,999	-	(31,058,999)	-	31,058,999	-	(31,058,999)	-
Total assets	<u>69,152,417</u>	<u>52,132,069</u>	<u>(31,058,999)</u>	<u>90,225,487</u>	<u>69,541,893</u>	<u>54,358,377</u>	<u>(31,058,999)</u>	<u>92,841,271</u>
<u>Deferred outflows of resources:</u>								
Deferred outflows of resources	1,051,102	-	-	1,051,102	476,133	-	-	476,133
Total deferred outflows of resources	<u>1,051,102</u>	<u>-</u>	<u>-</u>	<u>1,051,102</u>	<u>476,133</u>	<u>-</u>	<u>-</u>	<u>476,133</u>
Total assets and deferred outflows of resources	<u>\$ 70,203,519</u>	<u>\$ 52,132,069</u>	<u>\$ (31,058,999)</u>	<u>\$ 91,276,589</u>	<u>\$ 70,018,026</u>	<u>\$ 54,358,377</u>	<u>\$ (31,058,999)</u>	<u>\$ 93,317,404</u>

See Independent Auditors' Report.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
COMBINING STATEMENTS OF NET POSITION-BY SYSTEM
As of May 31, 2016 and 2015

	<u>May 31, 2016</u>				<u>May 31, 2015</u>			
	<u>Existing System</u>	<u>Station Two</u>	<u>Elimination</u>	<u>Total</u>	<u>Existing System</u>	<u>Station Two</u>	<u>Elimination</u>	<u>Total</u>
<u>Liabilities and net assets:</u>								
<u>Current liabilities:</u>								
Accounts payable and accrued expenses	\$ 2,311,083	\$ 2,822,918	\$ -	\$ 5,134,001	\$ 2,251,327	\$ 2,426,805	\$ -	\$ 4,678,132
Accounts payable-Construction in progress - Station Two	-	1,325,221	-	1,325,221	-	3,409,854	-	3,409,854
Asset retirement obligation	380,771	-	-	380,771	380,771	-	-	380,771
Accounts payable-Station Two Operator	-	185,048	-	185,048	-	89,530	-	89,530
Current portion-bonds payable	620,000	-	-	620,000	610,000	-	-	610,000
Customer deposits	645,119	-	-	645,119	657,149	-	-	657,149
Total current liabilities	3,956,973	4,333,187	-	8,290,160	3,899,247	5,926,189	-	9,825,436
<u>Long-term liabilities:</u>								
Long-term portion of bonds payable	12,040,000	-	-	12,040,000	12,660,000	-	-	12,660,000
Unfunded pension liability	5,378,974	-	-	5,378,974	4,316,000	-	-	4,316,000
Total long-term liabilities	17,418,974	-	-	17,418,974	16,976,000	-	-	16,976,000
Total liabilities	21,375,947	4,333,187	-	25,709,134	20,875,247	5,926,189	-	26,801,436
<u>Deferred inflows of resources:</u>								
Deferred inflows of resources	-	-	-	-	446,000	-	-	446,000
Total deferred inflows of resources	-	-	-	-	446,000	-	-	446,000
<u>Net position:</u>								
Investment in plant assets, net of related debt	28,917,555	49,131,867	(31,058,999)	46,990,423	16,477,698	(3,417,618)	-	13,060,080
Restricted per bond ordinance	3,500,107	-	-	3,500,107	3,546,581	-	-	3,546,581
Unrestricted	16,409,910	(1,332,985)	-	15,076,925	28,672,500	51,849,806	(31,058,999)	49,463,307
Total net position	48,827,572	47,798,882	(31,058,999)	65,567,455	48,696,779	48,432,188	(31,058,999)	66,069,968
Total liabilities, deferred inflows, and net position	\$ 70,203,519	\$ 52,132,069	\$ (31,058,999)	\$ 91,276,589	\$ 70,018,026	\$ 54,358,377	\$ (31,058,999)	\$ 93,317,404

See Independent Auditors' Report

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
COMBINING STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION-BY SYSTEM
For the fiscal years ended May 31, 2016 and 2015

	May 31, 2016				May 31, 2015			
	Existing System	Station Two	Elimination	Consolidated Total	Existing System	Station Two	Elimination	Consolidated Total
Operating Revenues:								
Sale of electricity	\$ 38,746,429	\$ 33,809,382	\$ (13,914,651)	\$ 58,641,160	\$ 36,369,893	\$ 38,508,329	\$ (15,193,686)	\$ 59,684,536
Communication services	1,308,495	-	-	1,308,495	1,135,729	-	-	1,135,729
Other	290,765	-	-	290,765	308,225	-	-	308,225
Total Operating Revenues	40,345,689	33,809,382	(13,914,651)	60,240,420	37,813,847	38,508,329	(15,193,686)	61,128,490
Operating Expenses:								
Production of electricity	30,267,805	26,797,783	(13,914,651)	43,150,937	31,091,864	31,560,567	(15,193,686)	47,458,745
Operating, general and administrative	6,432,741	3,491,983	-	9,924,724	6,251,274	3,612,344	-	9,863,618
Depreciation	968,939	4,153,110	-	5,122,049	993,336	4,077,143	-	5,070,479
Total Operating Expenses	37,669,485	34,442,876	(13,914,651)	58,197,710	38,336,474	39,250,054	(15,193,686)	62,392,842
Income (Loss) from Operations	2,676,204	(633,494)	-	2,042,710	(522,627)	(741,725)	-	(1,264,352)
Interest Income (Expense):								
Other income (expense)	-	12	-	12	(62)	21	-	(41)
Investment income	87,392	176	-	87,568	45,697	163	-	45,860
Interest expense	(471,131)	-	-	(471,131)	(486,110)	-	-	(486,110)
Total Interest Income (Expense)	(383,739)	188	-	(383,551)	(440,475)	184	-	(440,291)
Income (Loss) Before Transfers	2,292,465	(633,306)	-	1,659,159	(963,102)	(741,541)	-	(1,704,643)
Non-operating Items:								
Station 1 Remediation	(10,780)	-	-	(10,780)	(35,788)	-	-	(35,788)
Transfers to City of Henderson	(1,244,724)	-	-	(1,244,724)	(1,244,724)	-	-	(1,244,724)
Power furnished to City of Henderson	(430,776)	-	-	(430,776)	(465,769)	-	-	(465,769)
Communication services provided to the City of Henderson and local governmental agencies	(475,392)	-	-	(475,392)	(378,000)	-	-	(378,000)
Total Non-operating Items	(2,161,672)	-	-	(2,161,672)	(2,124,281)	-	-	(2,124,281)
Extraordinary Items:								
Extraordinary gain on disposal of plant one	-	-	-	-	1,050,000	-	-	1,050,000
Increase (Decrease) in Net Position	130,793	(633,306)	-	(502,513)	(2,037,383)	(741,541)	-	(2,778,924)
Cumulative effect of adoption of GASB 68	-	-	-	-	(4,442,000)	-	-	(4,442,000)
Net Position, Beginning of Year	48,696,779	48,432,188	(31,058,999)	66,069,968	55,176,162	49,173,729	(31,058,999)	73,290,892
Net Position, End of Year	\$ 48,827,572	\$ 47,798,882	\$ (31,058,999)	\$ 65,567,455	\$ 48,696,779	\$ 48,432,188	\$ (31,058,999)	\$ 66,069,968

See Independent Auditors' Report
39

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
SUPPLEMENTAL SCHEDULE OF CHANGES IN NET POSITION -BY SYSTEM
For the fiscal years ended May 31, 2016 and 2015

	<u>Existing System</u>	<u>Station Two</u>			<u>Eliminations *</u>	<u>Total Net Assets</u>
		<u>Utility Commission</u>	<u>Big Rivers</u>	<u>Total Station Two</u>		
Beginning balance, June 1, 2014	\$ 55,176,162	\$ 19,496,603	\$ 29,677,126	\$ 49,173,729	\$ (31,058,999)	\$ 73,290,892
Cumulative effect of adoption of GASB 68	(4,442,000)	-	-	-	-	(4,442,000)
Change in net position	<u>(2,037,383)</u>	<u>1,192,268</u>	<u>(1,933,809)</u>	<u>(741,541)</u>	<u>-</u>	<u>(2,778,924)</u>
Balance, May 31, 2015	48,696,779	20,688,871	27,743,317	48,432,188	(31,058,999)	66,069,968
Change in net position	130,793	1,300,503	(1,933,809)	(633,306)	-	(502,513)
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Balance May 31, 2016	<u>\$ 48,827,572</u>	<u>\$ 21,989,374</u>	<u>\$ 25,809,508</u>	<u>\$ 47,798,882</u>	<u>\$ (31,058,999)</u>	<u>\$ 65,567,455</u>

* Elimination of interest of Existing System in investment in the equity of Station Two.

As shown on the Statement of Net Position	<u>2016</u>	<u>2015</u>
Investment in Utility Plant and Equipment, net of related debt	\$ 46,990,423	\$ 49,463,307
Restricted per bond ordinance	3,500,107	3,546,581
Unrestricted	<u>15,076,925</u>	<u>13,060,080</u>
Net position, end of year	<u>\$ 65,567,455</u>	<u>\$ 66,069,968</u>

See Independent Auditors' Report

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
SCHEDULE OF THE COMMISSION'S PROPORTIONATE SHARE OF THE NET
PENSION LIABILITY
County Employees Retirement System
Last 10 Fiscal Years*

	<u>2016</u>	<u>2015</u>
Commission's proportion of the net pension liability	0.125106%	0.123175%
Commission's proportionate share of the net pension liability	\$ 5,378,974	\$ 3,996,000
Commission's covered-employee payroll	\$ 2,946,675	\$ 2,940,925
Commission's proportionate share of the net pension liability as a percentage of its covered-employee payroll	182.54%	135.88%
Plan fiduciary net position as a percentage of the total pension liability	59.97%	66.80%

*Information prior to 2015 is not available.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
SCHEDULE OF COMMISSION CONTRIBUTIONS
County Employees Retirement System
Last 10 Fiscal Years*

	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
Statutorily required contribution	\$ 365,977	\$ 374,968	\$ 389,961	\$ 348,262
Contributions in relation to the statutorily required contribution	<u>(365,977)</u>	<u>(374,968)</u>	<u>(389,961)</u>	<u>(348,262)</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Commission's covered-employee payroll	\$ 2,946,675	\$ 2,940,925	\$ 2,838,144	\$ 2,759,604
Contributions as a percentage of covered-employee payroll	12.42%	12.75%	13.74%	12.62%

*Information prior to 2013 is not available.

Notes to the Required Supplementary Information

For the fiscal year ended May 31, 2016

Changes of assumptions: The following changes in actuarial assumptions were made for amounts reported in fiscal year 2016:

	<u>Fiscal Year 2016</u>	<u>Prior Periods</u>
Inflation	3.25%	3.50%
Salary Increase	4.00%	4.50%
Investment Rate of Return	7.50%	7.75%

For amounts reported in fiscal year 2016, 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 one year for females). For disabled members, the RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (set back four years for males) is used for the period after disability retirement.

For periods prior to fiscal year 2016, the rates of mortality for the period after service retirement are according to the 1983 Group Annuity Mortality Table for all retired members and beneficiaries as of June 30, 2006 and the 1994 Group Annuity Mortality Table for all other members. The Group Annuity Mortality Table set forward 5 years is used for the period after disability retirement



**Independent Auditors' Report
on Internal Control Over Financial Reporting, Compliance and on Other Matters Based on an Audit of
Financial Statements Performed in Accordance with *Government Auditing Standards***

Members of the Board of Commissioners
City of Henderson, Kentucky Utility Commission
Henderson, 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 of America, the financial statements of the City of Henderson, Kentucky Utility Commission as of and for the year ended May 31, 2016, and have issued our report thereon dated October 4, 2016.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the City of Henderson, Kentucky Utility Commission's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City of Henderson, Kentucky Utility Commission's internal control. Accordingly, we do not express an opinion on the effectiveness of the City of Henderson, Kentucky Utility Commission's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or 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 the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in the internal control that might be significant deficiencies, or material weaknesses. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Henderson, Kentucky Utility Commission's financial statements are free of 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*.

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 result of that testing, and not to provide an opinion on the effectiveness of 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 report is not suitable for any other purpose.

Myriad CPA Group, LLC

Henderson, Kentucky
October 4, 2016



**City of Henderson, Kentucky Utility Commission –
Henderson Municipal Power & Light**

Report on Audited Financial Statements

For the fiscal years ended May 31, 2017 and 2016

**Case No: 2019-00269
Attachment 1 to BREC 1-31
HMPL Audits 2011-2019**

Contents

	<u>Page(s)</u>
Management's Discussion and Analysis	1-12
Independent Auditors' Report	13-14
Basic Financial Statements:	
Statements of Net Position	15
Statements of Revenues, Expenses, and Changes in Net Position	16
Statements of Cash Flows	17
Statements of Cash Flows – Reconciliation of Net Cash Provided by Operations	18
Notes to the Financial Statements	19-36
Supplemental Information:	
Combining Statements of Net Position – By System	37-38
Combining Statements of Revenues, Expenses, and Changes in Net Position – By System	39
Supplemental Schedule of Changes in Net Position – By System	40
Schedule of the Commission's Proportionate Share of the Net Pension Liability	41
Schedule of Commission Contributions	42
Independent Auditors' Report on Internal Control Over Financial Reporting, Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	43-44

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION- HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT'S DISCUSSION AND ANALYSIS

The City of Henderson, Kentucky Utility Commission (HMP&L) is in the business of providing electricity and internet communication services for residential, commercial, and industrial customers within the incorporated territory of the City of Henderson, Kentucky. The Commission also provides electricity and internet communication services to customers in a few areas outside of the incorporated territory of Henderson. The following discussion and analysis of HMP&L's financial performance provides an overview of the Utility's financial activities for fiscal year ended May 31, 2017.

Overview of the Financial Statements:

This annual financial report consists of three parts: 1) Management's Discussion and Analysis, 2) Financial Statements, and 3) Supplemental Additional Information. The Financial Statements also include notes that explain in more detail some of the information in the financial statements. The statements are followed by a section of supplemental information that further explains and supports the information in the basic financial statements. The Supplemental schedules present the financial position and results of operations for the Existing System and Station Two. The Consolidated Financial Statements report information about HMP&L using accounting methods similar to those used by private sector companies, except for the reporting of contributions in aid of construction, equity capital, and retained earnings. Refer to the Summary of Significant Accounting Policies in the footnotes to the Financial Statements relating to the adoption of Statement No. 34 of the Governmental Accounting Standard Board (GASB 34).

The Statement of Net Position, successor to the Balance Sheet, includes all of the Utility's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to HMP&L's creditors (liabilities). It also provides the basis for evaluating the capital structure of HMP&L and assessing the liquidity and financial flexibility of HMP&L.

All of the current year's revenues and expenses are accounted for in the Statement of Revenues, Expenses, and Changes in Net Position, successor to the Income Statement. This statement measures the success of the Utility's operations over the past year and can be used to determine whether the Utility has successfully recovered all of its costs through the sale of electricity, communications, and other charges, and has earned a reasonable return and maintained a sound financial position.

The final required financial statement is the Statement of Cash Flows. The primary purpose of this statement is to provide information about the Utility's cash receipts, cash payments, and net changes in cash resulting from operations, investing and financing activities, and it provides information on the sources and uses of cash and the changes in cash balances during the year.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Financial Statements:

- HMP&L's total assets increased from \$91,276,589 at May 31, 2016 to \$91,338,363 at May 31, 2017. This increase is primarily attributable to the increased balances in inventory and supplies.
- Operating revenues for HMP&L Existing System increased by approximately \$3,117,095 or 7.7% from \$40,345,689 to \$43,462,784. The increase in Existing System sales was primarily due to the adoption of a schedule of electric rate increases. Internet revenue decreased by \$183,747 due to the restructuring of internet offerings.

Existing System:

	<u>2017</u>	<u>2016</u>	<u>Change</u>	<u>Percentage Change</u>
Sale of electricity	\$ 41,658	\$ 38,746	\$ 2,912	7.5%
Internet service	1,125	1,308	(183)	-14.0%
Other	680	291	389	133.7%
Total operating revenues	<u>\$ 43,463</u>	<u>\$ 40,345</u>	<u>\$ 3,118</u>	<u>7.7%</u>

Note: All amounts presented in thousands -000's omitted.

- Operating expenses for HMP&L Existing System increased by approximately \$788,299 or 2.1%. The following table represents the changes in the expenses for the Existing System:

Existing System:

	<u>2017</u>	<u>2016</u>	<u>Change</u>	<u>Percentage Change</u>
Production of electricity	\$ 30,955	\$ 30,268	\$ 687	2.3%
Other operating expenses	6,609	6,433	176	2.7%
Depreciation	884	969	(85)	-8.8%
Total operating expenses	<u>\$ 38,448</u>	<u>\$ 37,670</u>	<u>\$ 778</u>	<u>2.1%</u>

Note: All amounts presented in thousands -000's omitted.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Financial Statements, continued:

- Operating revenues for Station Two increased approximately \$2,437,356 over that of the previous year. The Station Two Agreement is not designed to generate a profit for each of the participants in the venture, but rather to break-even on a cash flow basis. Operating expenses increased for Station Two.

<u>Station Two</u>	<u>2017</u>	<u>2016</u>	<u>Change</u>
Sales- BREC	\$ 23,657	\$ 19,895	\$ 3,762
Sales- HMPL	12,590	13,915	(1,325)
Total Operating Revenue	<u>\$ 36,247</u>	<u>\$ 33,810</u>	<u>\$ 2,437</u>
 <u>Expenses:</u>			
Production of electricity	\$ 35,215	\$ 30,290	\$ 4,925
Depreciation	4,108	4,153	(45)
Total Operating Expenses	<u>39,323</u>	<u>34,443</u>	<u>4,880</u>
 Net income before transfers	 <u>\$ (3,076)</u>	 <u>\$ (633)</u>	 <u>\$ (2,443)</u>

Note: All amounts presented in thousands -000's omitted.

Upon the consolidation of the financial statements for each system, transactions between Henderson Municipal Power and Light and Station Two Operator are eliminated.

Statement of Net Position:

Net position of the Existing System increased by \$2,760,285 for the fiscal year ended May 31, 2017, while net position increased by \$130,793 in the fiscal year ended May 31, 2016.

Investment securities decreased by \$1,494,048 from that of Fiscal Year 2016.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT’S DISCUSSION AND ANALYSIS**

Statement of Net Position, continued:

Cash and cash equivalents increased by \$1,908,855 for the fiscal year ended May 31, 2017, versus a decrease of \$64,407 at May 31, 2016, compared to the previous fiscal year ended.

A summary of the assets of the Commission for the previous three years is as follow:

<u>Assets:</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Cash and cash equivalents	\$ 2,348	\$ 439	\$ 504
Investment securities	12,922	13,238	15,078
Restricted assets	2,322	3,500	3,547
Accounts receivable-unbilled revenue	3,439	2,249	1,818
Accounts receivable-unbilled Station Two Operator	2,149	2,589	1,512
Accrued revenue	3,343	2,791	2,503
Inventories	6,748	5,709	5,046
Prepaid expenses	83	61	102
	<u>33,354</u>	<u>30,576</u>	<u>30,110</u>
Utility plant and equipment	56,663	59,650	62,733
Deferred outflow of resources	<u>1,322</u>	<u>1,051</u>	<u>476</u>
Total assets and deferred outflows of resources	<u>\$ 91,339</u>	<u>\$ 91,277</u>	<u>\$ 93,319</u>

Note: All amounts presented in thousands -000's omitted.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT’S DISCUSSION AND ANALYSIS**

Statement of Net Position, continued:

Current liabilities increased by \$302,283. Accounts payable and accrued expenses increased \$252,994 over the previous year mainly due to normal variations in timing of payments.

A summary of the liabilities section of the Statement of Net Position is as follows:

<u>Liabilities</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Accounts payable	\$ 5,387	\$ 5,134	\$ 4,678
Accounts payable-construction	1,542	1,325	3,410
Asset retirement obligation	381	381	381
Accounts payable			
Station Two Operator	-	185	90
Current portion bonds payable	630	620	610
Customer deposits	653	645	657
Total current liabilities	<u>8,593</u>	<u>8,290</u>	<u>9,826</u>
Unfunded pension liability	5,994	5,379	4,316
Deferred outflows	90	-	446
Long term bonds payable	11,410	12,040	12,660
Total liabilities and deferred outflows	<u>\$ 26,087</u>	<u>\$ 25,709</u>	<u>\$ 27,248</u>

Note: All amounts presented in thousands -000's omitted.

Statement of Revenues, Expenses, and Changes in Net Position:

Operating Revenues for the entire entity increased by \$6,879,599 over that of the previous year. Sales for HMP&L Station Two increased by \$2,437,356 or 7.2% while Existing System sales increased by \$3,117,095 or 7.7%.

Operating Expenses increased by \$6.98 million. This was due to increased operating costs incurred with the operation of Station Two.

The Net Operating Profit of the Existing System, after interest expense and interest income, was \$4,665,216. For the fiscal year ended, transfers were made to the City of Henderson in the amount of \$1.24 million, the value of power furnished to the City of Henderson at no charge was \$423,707, and the value of communication services provided to the City of Henderson and other governmental agencies at no charge, was \$237,000. This resulted in a total increase in net position of \$2,760,285.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT’S DISCUSSION AND ANALYSIS**

Statement of Revenues, Expenses, and Changes in Net Position, continued:

Station Two had a net operating loss of \$3,076,069; however, the loss relates primarily to depreciation expense which is a noncash item.

	<u>Existing System</u>	<u>Station Two</u>	<u>Total</u>
Income (loss) before transfers	\$ 4,665	\$ (3,076)	\$ 1,589
Non-operating items:			
Transfer to City of Henderson	(1,245)	-	(1,245)
Communication services provided to the City of Henderson and other governmental agencies	(237)	-	(237)
Power furnished to the City of Henderson	<u>(423)</u>	<u>-</u>	<u>(423)</u>
Change in net position	<u>\$ 2,760</u>	<u>\$ (3,076)</u>	<u>\$ (316)</u>

Note: All amounts presented in thousands -000's omitted.

Statement of Cash Flows:

Cash generated from operating activities increased by \$2,307,398 compared to the level from Fiscal Year 2016.

Cash Flows from non-capital financing activities is comprised of the funds transferred to the City of Henderson. For the fiscal year ended May 31, 2017, \$1.24 million was transferred.

Cash used by capital and related financing activities was \$3.08 million.

Cash provided by investing activities was \$1.6 million.

Cash and cash equivalents for the year, which consist primarily of checking and money market accounts of HMP&L, increased by \$1,908,855.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Statement of Cash Flows, continued:

The following is an abbreviated analysis of cash flows of HMP&L for the fiscal years ended May 31, 2015 to 2017:

<u>Cash Flow Summary</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Net cash generated by operations	\$ 4,634	\$ 2,327	\$ 3,331
Cash transferred to the City of Henderson	(1,245)	(1,245)	(1,245)
Net cash used by capital and related financing	(3,082)	(3,120)	(6,063)
Investing activities	<u>1,602</u>	<u>1,974</u>	<u>3,117</u>
Increase (decrease) in cash	1,909	(64)	(860)
 Cash and cash equivalents, beginning of year	 <u>439</u>	 <u>503</u>	 <u>1,363</u>
 Cash and cash equivalents, end of year	 <u>\$ 2,348</u>	 <u>\$ 439</u>	 <u>\$ 503</u>

Note: All amounts presented in thousands -000's omitted.

The following is a summary of cash and investment balances as of May 31, 2015 to 2017:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Cash and cash equivalents	\$ 2,348	\$ 439	\$ 504
Investments	12,922	13,238	15,078
Restricted investments	<u>2,322</u>	<u>3,500</u>	<u>3,547</u>
	<u>\$ 17,592</u>	<u>\$ 17,177</u>	<u>\$ 19,129</u>

Note: All amounts presented in thousands -000's omitted.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION- HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT'S DISCUSSION AND ANALYSIS

Capital Assets:

As noted in the footnotes to this report, HMP&L has a total of 2,667 sulfur dioxide, nitrous oxide, and ozone emission allowances, from the Existing System and Station Two available as of May 31, 2017. The value of the allowances is not reflected in the financial statements due to the fact that the Commission has no cost basis in the allowances. The estimated current market value of these allowances at May 31, 2017, is approximately \$35,094.

Debt Administration:

HMP&L entered into two Bond Anticipation Notes with Fifth Third Bank on December 22, 2008, a non-taxable series 2008A in the amount of \$3,500,000 and a taxable series 2008B in the amount of \$9,000,000. The series 2008A was used for capital improvements to the City's retail electric system. The taxable series 2008B was used to make capital improvements to the City's Station Two generating plant. HMP&L entered into an additional Bond Anticipation Note with Fifth Third Bank on March 25, 2010, a non-taxable series 2010A in the amount of \$1,500,000. This note was repaid at the same time as the series 2008A note. In September of 2012 HMP&L issued Revenue Bonds in the amount of \$15,020,000 and retired all outstanding Bond Anticipation Notes.

On January 29, 2009, the City Commission approved an Ordinance increasing electric rates by 3.855 % for all customer rate classifications. The purpose of the rate increase was to provide additional revenue to make the principal and interest payments on the short-term Bond Anticipation Notes and the long-term Bonds issued to replace the Bond Anticipation Notes. HMP&L set up a separate Bond Payment Account and, as of May 31, 2017, HMP&L had accrued \$1,237,150 for future principal and interest payments for the Bonds.

System Improvements and Replacement of Capital Assets:

During the period of June 1, 2016, through May 31, 2017, HMP&L made a number of improvements to the electric and communication facilities and replaced certain assets. The improvements to the facilities and asset replacements increased service reliability and extended the useful-life of certain existing assets.

During the Fiscal Year 2016-2017, HMP&L made \$756,077 in capital improvements and replacements in the Existing System and \$1,248,855 in capital improvements and replacements of Station Two.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION-
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT’S DISCUSSION AND ANALYSIS**

Electric Rates – Current and Future Increases:

On May 12, 2015, the Board of Commissioners of the City of Henderson, Kentucky, passed an ordinance approving and adopting the following schedule of electric rate increases:

	<u>Effective Date</u>	<u>Adjustment Percent Increase</u>
First Adjustment	July 1, 2015	5%
Second Adjustment	November 1, 2015	5%
Third Adjustment	May 1, 2016	5%
Fourth Adjustment	November 1, 2016	5%
Inflation Adjustment	Beginning January 1, 2017 and each January 1, thereafter	CPI*

*Consumer Price Index (CPI) – Adjustments will be made in accordance with the percentage changes in the US Department of Labor Consumer Price Index (CPI-U).

Employee Development:

HMP&L’s workforce has a large number of employees nearing retirement age- both management and lead line workers. In order to prepare for this, HMP&L has begun hiring more line workers under the Apprenticeship Program. This program allows line workers who have completed line workers school and/or have on the job training to join HMP&L. Upon hire, the apprentice line workers progress in a structured program- from Apprentice Line Worker I to Apprentice Line Worker IV (depending on experience and knowledge), and then subsequently to Journey Line Worker and potentially Crew Leader. Having this program allows HMP&L to plan for the future, as well as make sure all employees are progressing in a safe manner.

Station Two – Future Expenditures:

Big Rivers and HMP&L are currently involved in litigation concerning HMP&L’s claim for damages concerning surplus energy sales related to Station Two. This civil action involved a claim by HMP&L to recover monetary damages from Big Rivers Electric Corporation because of HMP&L’s inability to schedule its excess energy. An offer to settle all claims past, present and future, has been accepted by the parties, subject to approval of the settlement documents. As of the date of this report, the settlement documents have not been approved and executed by either party to this litigation.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION- HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT'S DISCUSSION AND ANALYSIS

Station Two – Future Expenditures, continued:

In July 2012, HMP&L entered into litigation with the Kentucky Department of Labor related to the application of prevailing wage rates at Station Two. The litigation went to trial in the Henderson Circuit Court in December 2012. The Circuit Court ruled in favor of the Labor Cabinet on May 24, 2013. HMP&L filed an appeal in the Kentucky Appeals Court, and oral arguments were heard September 24, 2014. On June 24, 2016, the Kentucky Appeals Court affirmed the order of the Henderson Circuit Court. HMP&L appealed this decision. Subsequently, on January 7, 2017, the Kentucky legislature repealed prevailing wage. HMP&L's litigation with the Kentucky Department of Labor related to the application of prevailing wage rates to Station Two, therefore, has been concluded.

In past years, HMP&L has increased its reserved capacity at Station Two. The reserve capacity for FY 2016-2017 was 115 megawatts and HMP&L did not increase its reserve capacity for FY 2017-2018. HMP&L intends to keep the reserve capacity around 115 megawatts which is in line with the recent HMP&L historical system peak demand. Each 5 megawatt increase in the reserved capacity will currently cost HMP&L approximately \$600,000/year. The actual cost of reserved capacity, however, is based upon the Station Two budget, which varies each year.

HMP&L has also begun the process of gathering information to determine the next steps for the future of the Station Two power plant. A preliminary Integrated Resource Plan (IRP) was finalized in July 2017, and presented to the Utility Commission. The IRP considered various options, such as continuing to run the two units as coal and complying with all environmental requirements, converting one or both units to natural gas, relying on the power market, integrating a peaking unit, and various other options. Upon receiving the IRP report, HMP&L started the process of evaluating the various options, and immediately began working towards completing another, more detailed IRP.

Southeastern Power Administration (SEPA):

The Southeastern Power Administration (SEPA) has contracted with HMP&L to provide HMP&L a total of 15,000 megawatt hours of hydroelectric power each year. The 15,000 megawatt hours represent approximately 2.5 percent of HMP&L's annual megawatt hour requirements. HMP&L is restricted to not more than 10 megawatt hours during any one hour period. The hydroelectric power is provided from SEPA generation units on the Cumberland River System Project.

In the fall of 2006, SEPA informed all contract project participants that the Wolf Creek Dam near Jamestown, Kentucky, had been inspected and serious seepage problems existed in the earthen dam. The seepage problems at the dam date back to 1968 and the US Army Corps of Engineers implemented various repairs since that time; however, the seepage became critical to the safety of the Wolf Creek Dam and surrounding communities. In an effort to respond to these safety concerns and make the needed repairs to the dam, SEPA reduced and curtailed electric service to the contract project participants. This reduction and curtailment of SEPA electric service began in early 2007.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION- HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT'S DISCUSSION AND ANALYSIS

Southeastern Power Administration (SEPA), Continued:

The dam repairs were completed during 2014 and the basin was allowed to fill to the necessary level of water.

The SEPA Cumberland River Hydroelectric Power System is continuing to be restored to its pre-construction conditions.

Regulatory Compliance:

The North American Electric Reliability Corporation (NERC) adopted new electric system reliability standards for all electric utilities in the United States. NERC adopted and began enforcement of the new standards beginning in June 2007. The new standards were approved by the Federal Energy Regulatory Commission (FERC). HMP&L is required to comply with the new reliability standards and HMP&L will incur administrative expenses related to NERC compliance.

In November 2008, the Southeastern Electric Reliability Council (SERC) audited HMP&L for compliance with NERC Reliability Standards. Subsequent to the November audit, a number of formal and informal discussions took place between HMP&L and SERC. HMP&L and SERC reached an agreement concerning non-compliance issues identified during the audit; and a final settlement agreement was approved. In November 2010, HMP&L hired a new Reliability Compliance Manager who is responsible for compliance with NERC Reliability Standards. SERC performed a compliance audit of HMP&L in March of 2014, evaluating the utility for compliance with 11 reliability requirements, as well as 3 infrastructure related items. This audit resulted in no findings, violations, or recommendations.

Federal air quality and emission standards continue to be increasingly more stringent. The current standards and proposed new standards will increase the cost of energy production at Station Two.

Transfers to City:

During the fiscal year 2016-2017, HMP&L's cash transfer to the City was \$1.24 million. HMP&L has budgeted this same level of cash transfer to the City for Fiscal Year 2017-2018 and subsequent budget periods. HMP&L also paid the City \$664,167 for internal service fees and HMP&L provided the City free electric service valued at \$423,207 and free communication services valued at \$237,000 for the 2016-2017 Fiscal Year. The annual cash transfer payments, internal service fees, and value of the free electric and communication services represent 6.2% of gross electric revenue in fiscal year 2016-2017.

Should additional information be needed inquiries can be directed to HMP&L at 100 Fifth Street, Henderson, Kentucky 42420. Contact via telephone at 270.826.2726.



INDEPENDENT AUDITORS' REPORT

To the Board of Commissioners
City of Henderson, Kentucky Utility Commission
Henderson, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the City of Henderson, Kentucky Utility Commission (Commission), a component unit of the City of Henderson, Kentucky, as of and for the years ended May 31, 2017 and 2016, and the related notes to the financial statements, which collectively comprise the Commission'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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of 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 auditors' 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 opinions.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Commission as of May 31, 2017 and 2016, and the changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management Discussion and Analysis on pages 1 through 12 and the Schedules of the Commission's Proportionate Share of the Net Pension Liability and Contributions to the County Employees' Retirement System on pages 41 and 42 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 opinions on the financial statements that collectively comprise the City of Henderson, Kentucky Utility Commission's basic financial statements. The combining financial statements on pages 37 through 40 are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining financial statements are the responsibility of management and were derived from and relate 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 combining financial statements are 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 11, 2017, on our consideration of the City of Henderson, Kentucky Utility Commission's internal control over financial reporting and 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 the 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 City of Henderson, Kentucky Utility Commission's internal control over reporting and compliance.

A handwritten signature in black ink that reads "Myriad CPA Group, LLC". The signature is written in a cursive, flowing style.

Henderson, Kentucky
October 11, 2017

City of Henderson, Kentucky Utility Commission
Statements of Net Position
As of May 31, 2017 and 2016

<u>Assets:</u>	<u>2017</u>	<u>2016</u>
<u>Current assets:</u>		
Cash and cash equivalents	\$ 2,348,311	\$ 439,456
Investments - unrestricted	12,921,612	13,237,676
Investments - restricted	2,322,123	3,500,107
Accounts receivable, net of allowance for uncollectibles	3,439,150	2,248,646
Accounts receivable, Station Two Operator	2,148,962	2,588,760
Accrued revenue	3,342,815	2,790,719
Inventory and supplies	6,747,640	5,708,765
Prepaid expenses	82,571	60,935
Total current assets	<u>33,353,184</u>	<u>30,575,064</u>
<u>Utility plant and equipment:</u>		
Utility plant, net of accumulated depreciation	<u>56,663,128</u>	<u>59,650,423</u>
Total assets	<u>90,016,312</u>	<u>90,225,487</u>
<u>Deferred outflows of resources:</u>		
Deferred outflows of resources	<u>1,322,051</u>	<u>1,051,102</u>
Total deferred outflows of resources	<u>1,322,051</u>	<u>1,051,102</u>
Total assets and deferred outflows of resources	<u>\$ 91,338,363</u>	<u>\$ 91,276,589</u>
<u>Liabilities:</u>		
<u>Current liabilities:</u>		
Accounts payable and accrued expenses	\$ 5,386,995	\$ 5,134,001
Accounts payable-Construction in progress Station Two	1,541,776	1,325,221
Accounts payable-Station Two Operator	-	185,048
Current portion-bonds payable	630,000	620,000
Asset retirement obligation	380,771	380,771
Customer deposits	652,901	645,119
Total current liabilities	<u>8,592,443</u>	<u>8,290,160</u>
<u>Long-term liabilities:</u>		
Long-term portion bonds payable	11,410,000	12,040,000
Unfunded pension liability	5,994,076	5,378,974
Total long-term liabilities	<u>17,404,076</u>	<u>17,418,974</u>
Total liabilities	<u>25,996,519</u>	<u>25,709,134</u>
<u>Deferred inflows of resources:</u>		
Deferred inflows of resources	<u>90,173</u>	<u>-</u>
Total deferred inflows of resources	<u>90,173</u>	<u>-</u>
<u>Net position:</u>		
Investment in plant assets, net of related debt	44,623,128	46,990,423
Restricted per bond ordinance	2,322,123	3,500,107
Unrestricted	18,306,420	15,076,925
Total net position	<u>65,251,671</u>	<u>65,567,455</u>
Total liabilities, deferred inflows of resources, and net position	<u>\$ 91,338,363</u>	<u>\$ 91,276,589</u>

The accompanying notes are an integral part of these financial statements.

City of Henderson, Kentucky Utility Commission
Statements of Revenues, Expenses, and Changes in Net Position
For the fiscal years ended May 31, 2017 and 2016

<u>Operating revenues:</u>	<u>2017</u>	<u>2016</u>
Sale of electricity-Existing System	\$ 41,658,367	\$ 38,746,429
Sale of electricity-Station Two	23,657,235	19,894,731
Communication services	1,124,748	1,308,495
Other	679,669	290,765
Total operating revenues	67,120,019	60,240,420
<u>Operating expenses:</u>		
Production of electricity	49,421,696	43,150,937
Operating expenses	10,767,342	9,924,724
Depreciation	4,992,227	5,122,049
Total operating expenses	65,181,265	58,197,710
Income (loss) from operations	1,938,754	2,042,710
<u>Interest income (expense):</u>		
Investment income	107,893	87,580
Interest expense	(457,500)	(471,131)
Total interest income (expense)	(349,607)	(383,551)
Income (loss) before non-operating items	1,589,147	1,659,159
<u>Non-operating items:</u>		
Station One Remediation	-	(10,780)
Transfers to the City of Henderson	(1,244,724)	(1,244,724)
Power furnished to the City of Henderson	(423,207)	(430,776)
Communication services provided to the City of Henderson and other local government agencies	(237,000)	(475,392)
Total non-operating items	(1,904,931)	(2,161,672)
Change in net position	(315,784)	(502,513)
Net position, beginning of year	65,567,455	66,069,968
Net position, end of year	\$ 65,251,671	\$ 65,567,455

The accompanying notes are an integral part of these financial statements.

City of Henderson, Kentucky Utility Commission
Statements of Cash Flows
For the fiscal years ended May 31, 2017 and 2016

	2017	2016
<u>Cash flows from operating activities:</u>		
Receipts from customers	\$ 66,306,257	\$ 58,432,866
Payments to suppliers and employees	(61,672,187)	(56,106,194)
Net cash provided by operating activities	4,634,070	2,326,672
<u>Cash flows from non-capital financing activities:</u>		
Distributions to the City of Henderson	(1,244,724)	(1,244,724)
Net cash used by non-capital financing activities	(1,244,724)	(1,244,724)
<u>Cash flows from capital and related financing activities:</u>		
Acquisition and construction of capital assets	(2,004,932)	(2,039,165)
Principal payments on long-term debt	(620,000)	(610,000)
Interest payments on long-term debt	(457,500)	(471,131)
Net cash used by capital and related financing activities	(3,082,432)	(3,120,296)
<u>Cash flows from investing activities:</u>		
Proceeds from sale and maturities of investments	7,010,865	5,499,322
Investment income	107,893	86,903
Purchases of investment securities	(5,516,817)	(3,612,284)
Net cash provided by investing activities	1,601,941	1,973,941
Increase (decrease) in cash and cash equivalents	1,908,855	(64,407)
Cash and cash equivalents, beginning of year	439,456	503,863
Cash and cash equivalents, end of year	\$ 2,348,311	\$ 439,456

The accompanying notes are an integral part of these financial statements.

City of Henderson, Kentucky Utility Commission
Statements of Cash Flows-Reconciliation of Net Cash Provided by Operations
For the fiscal years ended May 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
<u>Operating activities:</u>		
Operating income (loss)	\$ 1,938,754	\$ 2,042,710
<u>Adjustments to reconcile operating income</u>		
<u>(loss) to net cash provided by operations:</u>		
Depreciation	4,992,227	5,122,049
Power furnished to the City of Henderson	(423,207)	(430,776)
Communication services provided at no charge	(237,000)	(475,392)
<u>Changes in operating assets and liabilities:</u>		
Accounts receivable	(1,190,504)	(430,782)
Due from Station Two Operator	470,718	(1,076,973)
Accrued revenue	(552,096)	(287,769)
Inventory and supplies	(1,038,875)	(663,169)
Prepaid expenses and other assets	(21,636)	40,813
Accounts payable and accrued expenses	37,026	455,869
Accounts payable-construction	216,555	(2,084,633)
Unfunded pension liability-deferred inflows and outflows	434,326	42,005
Other items	-	(10,768)
Customer deposits	7,782	(12,030)
Due to Station Two Operator and other items	-	95,518
	<u> </u>	<u> </u>
Net cash provided by operating activities	<u>\$ 4,634,070</u>	<u>\$ 2,326,672</u>

The accompanying notes are an integral part of these financial statements.

1. Organization and Contracts:

The City of Henderson Utility Commission is organized under the provisions of Section 96.530 of the Kentucky Revised Statutes to operate, manage, and control the Henderson Municipal Power & Light System. The members of the Utility Commission are appointed by the Mayor and are approved by the City Commissioners of the City of Henderson, Kentucky (City). The Mayor and the City Commission authorize all rates and bond issues of the Utility Commission. As a municipal entity, the Utility Commission is exempt from all federal and state income taxes. Certain real estate utilized by the Utility Commission is owned by the City of Henderson.

The Utility Commission operates the “Existing System” and pursuant to certain contracts and agreements described as follows, reserves power from “Station Two” which is owned by the Commission, and currently operated by Big Rivers Electric Corporation (Big Rivers), pursuant to various lease, assignment, and other agreements between the parties.

The Commission provides retail electric service to the residents of the City of Henderson within its service territory. The Commission also provided wholesale electricity to Big Rivers through July 18, 1998 and subsequently to an affiliate of LG&E Energy Corporation. LG&E was purchased by Powergen in 2000 and thereafter acquired by E.ON. Effective July 16, 2009, Big Rivers resumed its role as operator of Station Two as part of the “Unwind Transaction.”

The Commission entered into certain contracts with Big Rivers relating to Station Two, as follows:

A. Power Plant Construction and Operation Agreement:

Under this agreement, Big Rivers agreed to furnish certain construction and start-up services for which it was paid out-of-pocket expenses plus overhead allowances and operate Station Two upon completion for which the Station Two Operator is paid reasonable expenditures allocable to the operation and maintenance of Station Two, as defined in the agreement. The original agreement was amended to include an option to extend through the useful operating life of Station Two. Big Rivers exercised this option in 1998.

B. Power Sales Contract:

Under this agreement, the Station Two Operator purchases all of the Station Two capacity in excess of the City of Henderson’s requirements. Payments for capacity purchased by the Station Two Operator are made monthly based on the portion of Station Two capacity allocated to the Station Two Operator compared to the total monthly Station Two capacity costs as defined in the agreement. The original agreement was executed in 1970 and extended through 2023. During 1993, the agreement was amended to include an option to extend through the useful operating life of Station Two. Big Rivers exercised this option in 1998.

C. Joint Facilities Agreement:

This agreement provides for the continuing joint use by the Commission and Station Two Operator of certain auxiliary facilities presently owned and used by the Station Two Operator at its generating station and of auxiliary facilities provided by the Commission in connection with the construction of Station Two, which is located adjacent to the generating station and also operated by the Station Two Operator.

1. Organization and Contracts, continued:

Power sales to the Station Two Operator under the agreement amounted to \$23,657,235 and \$19,894,731 for the fiscal years ended May 31, 2017 and 2016, respectively.

In connection with the negotiations related to the funding and construction of the Flue Gas Desulfurization System (FGD System) Station Two various aforementioned contracts were amended effective May 31, 1993. Significant provisions of the amendments include:

- The total capacity of Station Two, a factor in determining various Station Two cost allocations, was reduced as a result of the power required to operate the FGD System.
- FGD System costs, up to the amount of proceeds from the sale of Emission Allowances, will be borne in the same proportion as the Emission Allowances are allocated. Additional FGD System costs will be borne in proportion to the new capacity allocation as determined by the contract amendments.
- The Commission will reimburse the Station Two Operator for certain allocated costs of the existing Big Rivers' FGD System to be jointly used by the Station Two Operator and Station Two based upon an allocation formula defined in the amendments.

Amounts charged by the Station Two Operator as reasonable expenditures allocable to the operation and maintenance of Station Two are subject to review and approval by the Commission. Differences, if any, between amounts originally charged as allocable by the Station Two Operator and amounts accepted by the Utility Commission are recorded when a final determination of such amounts is made. Operating revenues and expenses would be reduced by any amount subsequently determined not to be allocable to Station Two.

Station Two became commercially operable and construction was substantially completed during 1974.

2. Summary of Significant Accounting Policies:

The Commission is a component unit of the City of Henderson, Kentucky (the primary government), due to its financial accountability to the City Commission.

The financial statements of the Commission have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the fund's principal ongoing operations. The principal operating revenues of the Commission are charges to customers for electric and communications sales and service.

Operating expenses for the Commission include the cost of power and services, administrative expenses, and depreciation. All other revenues and expenses not meeting this definition are classified as non-operating items.

2. **Summary of Significant Accounting Policies, continued:**

Statement of Net Position:

The Statement of Net Position is designed to display the financial position of the Commission. The Commission's fund equity is reported as a net position, which is presented in three categories defined as follows:

- **Net invested in capital assets-** This component of net position consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- **Restricted-** This component of net position consists of constraints placed on net position use through external constraints imposed by creditors through debt covenants.
- **Unrestricted-** This component of net position consists of the remainder of net position that does not meet the definition of restricted or invested in capital assets, net of related debt.

Statement of Revenues, Expenses, and Changes in Net Position:

The Statement of Revenues, Expenses, and Changes in Net Position is the operating statement for proprietary funds. Revenues are reported by major source. This statement distinguishes between operating and non-operating revenues and expenses, and presents a separate subtotal for operating revenues, operating expenses, and operating income. The more significant of the Commission's accounting policies are described below:

A. Cash and Cash Equivalents:

Cash and cash equivalents consist of certificates of deposit and repurchase agreements with an original maturity of three months or less from the date of purchase. The carrying amount of each of these instruments approximates fair value.

B. Investment Securities:

Investments are recorded at fair value based on quoted market prices. Any gains or losses are reflected in the statement of revenues, expenses, and changes in net assets in accordance with GASB No.31, "Accounting and Reporting For Certain Investments and For Internal Investment Pools." Kentucky Revised Statute 66.480 limits the types of securities that a municipal entity may invest in to obligations of the United States Treasury and its agencies, certain Federal securities, repurchase agreements, commercial bank certificates of deposit, and the Commonwealth of Kentucky Investment Pool.

2. **Summary of Significant Accounting Policies, continued:**

C. **Accounts Receivable and Unbilled Revenue:**

The Commission has entered into an agreement with the City of Henderson to perform its billing and collection services. All monies due to the Utility Commission are collected and deposited in the City of Henderson's Utility Clearing Fund and are remitted to the Utility Commission on a weekly basis. The amount included in accounts receivable due from the Utility Clearing Fund was \$3,144,595 and \$2,578,169 as of May 31, 2017 and 2016, respectively.

D. **Inventory:**

The fuel and lime inventory is stated at cost using the first-in-first-out method. Materials and supplies are stated at the weighted average cost.

E. **Utility Plant and Equipment:**

The utility plant is carried at cost, which includes interest capitalized, aggregating \$15,342,300, which was capitalized during the period of construction. No interest was capitalized during the fiscal years ended May 31, 2017 and 2016. The Commission's policy for determining the useful lives of its utility plant and equipment is as follows:

Production plant and structures	33 ½	years
Transmission and distribution	25	years
Automotive equipment	6	years
Wireless internet equipment	5	years
Other equipment	10	years

F. **Use of Estimates:**

The preparation of financial statements in conformity with generally accepted accounting principles requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at May 31, 2017 and 2016, as well as revenues and expenses for the years then ended. Actual results could differ from the estimates and assumptions used.

G. **Compensated Absences:**

Employees of the Commission are entitled to paid vacations and sick-leave. The Commission's policy is to recognize these costs when earned under the accrual method of accounting in accordance with GASB No.16 "Accounting For Compensated Absences."

H. **Pensions:**

In the component unit financial statements of the City of Henderson, Kentucky Utility Commission, retirement plans (pensions) are required to be recognized and disclosed using the accrual basis of accounting (Refer to Note 6).

2. Summary of Significant Accounting Policies, continued:

H. Pensions, continued:

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions and pension expense, information about the fiduciary net position of the County Employees' Retirement System (CERS), and additions to/deductions from CERS' 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 recorded at fair value.

I. Emission Allowances:

The Commission does not record the value of emission allowances granted by the Environmental Protection Agency for sulfur dioxide and nitrous oxide on its financial statements as there is no cost basis in these allowances.

3. Cash and Cash Equivalents:

As of May 31, 2017, the City of Henderson, Kentucky Utility Commission maintained deposits with several local financial institutions. Of the bank balance, all was insured by the Federal Depositor's Insurance Corporation and any amounts in excess of FDIC coverage were secured by pledged United States Government securities.

4. Investment Securities:

Investments are included in the Statement of Net Position under the caption "Investments-restricted/unrestricted." A summary of investments held by the City of Henderson, Kentucky Utility Commission along with the scheduled maturities is presented below:

<u>Investment Type:</u>	<u>Fair Value</u>	<u>Less Than One Year</u>	<u>One to Five Years</u>	<u>Six to Ten Years</u>
<u>May 31, 2017:</u>				
<u>Unrestricted Investments:</u>				
U.S. Treasury Bills	\$ 10,108,549	\$ 10,108,549	\$ -	\$ -
Certificate of Deposit and Money Markets	2,813,063	2,813,063	-	-
Total Unrestricted Investments	<u>\$ 12,921,612</u>	<u>\$ 12,921,612</u>	<u>\$ -</u>	<u>\$ -</u>
<u>Restricted Per Bond Ordinance:</u>				
Certificate of Deposit and Money Markets	\$ 2,322,123	\$ 2,322,123	\$ -	\$ -
Total Restricted Investments	<u>\$ 2,322,123</u>	<u>\$ 2,322,123</u>	<u>\$ -</u>	<u>\$ -</u>

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements

4. Investment Securities, continued:

<u>May 31, 2016:</u>	<u>Fair Value</u>	<u>Less Than One Year</u>	<u>One to Five Years</u>	<u>Six to Ten Years</u>
<u>Unrestricted Investments:</u>				
U.S. Treasury Bills	\$ 10,108,229	\$ 10,108,229	\$ -	\$ -
Certificate of Deposit and Money Markets	3,129,447	3,129,447	-	-
Total Unrestricted Investments	<u>\$ 13,237,676</u>	<u>\$ 13,237,676</u>	<u>\$ -</u>	<u>\$ -</u>

Restricted Per Bond Ordinance:

Certificate of Deposit and Money Markets	\$ 3,500,107	\$ 3,400,107	\$ 100,000	\$ -
Total Restricted Investments	<u>\$ 3,500,107</u>	<u>\$ 3,400,107</u>	<u>\$ 100,000</u>	<u>\$ -</u>

Restricted Assets consisted of the following:

	<u>2017</u>	<u>2016</u>
Operation and Maintenance Reserve	\$ 100,000	\$ 100,000
Debt Service Reserve	1,612,734	2,797,130
Debt Service Sinking Fund	609,399	602,977
Total restricted assets	<u>\$ 2,322,133</u>	<u>\$ 3,500,107</u>

A. Interest Rate Risk:

The City of Henderson, Kentucky Utility Commission has a formal investment policy that limits investment maturities as a means to manage its exposure to fair value losses resulting from increasing interest rates.

B. Credit Risk:

The City of Henderson, Kentucky Utility Commission limits its investments to those allowed by Kentucky Revised Statute 66.480. Kentucky Revised Statute 66.480 limits investments to U.S. Government Treasury and Agency securities, certificates of deposit, securities issued by a state or local government rated in one of the three highest categories by a nationally recognized credit agency.

C. Custodial Credit Risk:

Custodial credit risk is the risk that in the event of the failure of the counterparty, The City of Henderson, Kentucky Utility Commission will not be able to recover the value of its investments, or collateral securities that are in the possession of the outside party. All investments of the Commission, with the exception of certificates of deposit, consist of unregistered and uninsured securities held by the Commission's trustee in their trust department not in the name of the Commission.

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements

5. Utility Plant and Equipment:

Utility plant and equipment consisted of the following as of May 31, 2017 and 2016:

<u>May 31, 2017:</u>				
<u>Existing System:</u>	<u>Beginning</u>		<u>Deletions</u>	<u>Ending</u>
	<u>Balance</u>	<u>Additions</u>		<u>Balance</u>
Vehicles	\$ 2,125,157	\$ 84,434	\$ (21,148)	\$ 2,188,443
Transmission plant	8,681,118	32,831	-	8,713,949
Distribution plant	26,996,524	493,283	(4,474)	27,485,333
Land and land rights	1,235,451	-	-	1,235,451
Telecommunications, internet, and fiber optics	5,977,019	145,529	(25,564)	6,096,984
General plant	54,350	-	-	54,350
	<u>45,069,619</u>	<u>756,077</u>	<u>(51,186)</u>	<u>45,774,510</u>
Accumulated depreciation	<u>(34,551,063)</u>	<u>(883,859)</u>	<u>51,186</u>	<u>(35,383,736)</u>
Existing System total	<u>\$ 10,518,556</u>	<u>\$ (127,782)</u>	<u>\$ -</u>	<u>\$ 10,390,774</u>
<u>Station Two:</u>				
General plant	\$ 184,520,339	\$ 1,248,855	\$ -	\$ 185,769,194
Accumulated depreciation	<u>(135,388,472)</u>	<u>(4,108,368)</u>	<u>-</u>	<u>(139,496,840)</u>
Station Two total	<u>\$ 49,131,867</u>	<u>\$ (2,859,513)</u>	<u>\$ -</u>	<u>\$ 46,272,354</u>
Total utility, plant, and equipment, net	<u>\$ 59,650,423</u>			<u>\$ 56,663,128</u>
<u>May 31, 2016</u>				
<u>Existing System:</u>	<u>Beginning</u>		<u>Deletions</u>	<u>Ending</u>
	<u>Balance</u>	<u>Additions</u>		<u>Balance</u>
Vehicles	\$ 2,304,872	\$ 88,741	\$ (268,456)	\$ 2,125,157
Transmission plant	9,271,430	120,441	(710,753)	8,681,118
Distribution plant	26,633,521	363,345	(342)	26,996,524
Land and land rights	1,235,451	-	-	1,235,451
Telecommunications, internet, and fiber optics	5,893,540	83,479	-	5,977,019
General plant	71,403	-	(17,053)	54,350
	<u>45,410,217</u>	<u>656,006</u>	<u>(996,604)</u>	<u>45,069,619</u>
Accumulated depreciation	<u>(34,526,716)</u>	<u>(968,937)</u>	<u>944,590</u>	<u>(34,551,063)</u>
Existing System total	<u>\$ 10,883,501</u>	<u>\$ (312,931)</u>	<u>\$ (52,014)</u>	<u>\$ 10,518,556</u>
<u>Station Two:</u>				
General plant	\$ 183,085,168	\$ 1,435,171	\$ -	\$ 184,520,339
Accumulated depreciation	<u>(131,235,362)</u>	<u>(4,153,110)</u>	<u>-</u>	<u>(135,388,472)</u>
Station Two total	<u>\$ 51,849,806</u>	<u>\$ (2,717,939)</u>	<u>\$ -</u>	<u>\$ 49,131,867</u>
Total utility, plant, and equipment, net	<u>\$ 62,733,307</u>			<u>\$ 59,650,423</u>

Depreciation expense for the fiscal years ended May 31, 2017 and 2016 was \$4,992,227 and \$5,122,049 respectively.

6. **Retirement Plans:**

General Information about the Pension Plan

Plan description: All Commission employees participate in the County Employees' Retirement System (CERS), a multi-employer, cost sharing, defined benefit plan administered by the Board of Trustees of Kentucky Retirement Systems. Kentucky Retirement Systems issues a publicly available financial report that includes financial statements and supplementary information for CERS. That report can be obtained at <https://kyret.ky.gov>.

Benefits provided: CERS provides retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living adjustments (COLA) are provided at the discretion of the State legislature. Kentucky Revised Statute 61.645 assigns the authority to establish and amend benefit provisions to the Kentucky Retirement Systems Board of Trustees.

Contributions: Plan members participating in CERS on or before August 31, 2008, are required to contribute 5% of the annual creditable compensation. For plan members who began participating in CERS on or after September 1, 2008, the contribution rate is 6%. The Commission is required to contribute at an actuarially determined rate. As of May 31, 2017, the Commission's required contribution rate was 13.95% of annual covered payroll. The contribution requirements of plan members and the Commission are established and may be amended by the Kentucky Retirement Systems Board of Trustees. Contributions to CERS from the Commission were \$384,888 for the year ended May 31, 2017.

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

At May 31, 2017, the Commission reported a liability of \$5,994,076 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2016, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2015. The Commission's proportion of the net pension liability was based on a projection of the Commission's long-term share of contributions to the pension plan relative to the projected contributions of all participating employers, actuarially determined. At June 30, 2016, the Commission's proportion was 0.121741%.

For the year ended May 31, 2017, the Commission recognized pension expense of \$819,214. At May 31, 2017, the Commission reported deferred outflows and inflows of resources related to pensions from the following sources:

6. Retirement Plans, continued:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	\$ 26,169	\$ -
Changes of assumptions	317,534	-
Net difference between projected and actual investment earnings on pension plan investments	563,504	-
Changes in proportion and differences between Commission contributions and proportional share of contributions	29,956	90,173
Commission contributions subsequent to the measurement date	<u>384,888</u>	<u>-</u>
Total	<u>\$ 1,322,051</u>	<u>\$ 90,173</u>

The \$384,888 reported as deferred outflows of resources related to pensions resulting from Commission contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended May 31, 2018. Other amounts reported as deferred inflows of resources related to pensions will be recognized in pension expense as follows:

<u>Year ended May 31:</u>	<u>Amount</u>
2018	\$ 321,436
2019	197,101
2020	203,588
2021	124,865
2022	-
Thereafter	-

Actuarial assumptions: The total pension liability in the June 30, 2016 actuarial valuation was determined using standard roll-forward techniques, using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.25%
Salary increases	4.0%, average, including inflation
Investment rate of return	7.50%, net of pension plan expense, including inflation

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 one year for females). For disabled members, the RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (set back four years for males) is used for the period after disability

6. Retirement Plans, continued:

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, 2015 valuation were based on the results of an actuarial experience study for the period July 1, 2008 - June 30, 2013.

The long-term expected return on plan assets is reviewed as part of the regular experience studies prepared every five years for Kentucky Retirement Systems. The most recent analysis, performed for the period covering fiscal years 2008 through 2013, is outlined in a report dated December 3, 2015. Several factors are considered in evaluating the 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 assumption is intended to be a long term assumption and is not expected to change absent a significant change in the asset allocation, a change in the inflation assumption, or a fundamental change in the market that alters expected returns in future years.

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Combined Equity	44%	5.4%
Combined Fixed Income	19%	1.5%
Real Return (Diversified Inflation Strategies)	10%	3.5%
Real Estate	5%	4.5%
Absolute Return (Diversified Hedge Funds)	10%	4.25%
Private Equity	10%	8.5%
Cash Equivalent	2%	-0.25%
Total	100%	

Discount rate: The projection of cash flows used to determine the discount rate assumed that local employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 27 year amortization period of the unfunded actuarial accrued liability. The discount rate determination does not use a municipal bond rate. Projected future benefit payments for all current plan members were projected through 2117.

Sensitivity of the Commission's proportionate share of the net pension liability to changes in the discount rate: The following presents the Commission's proportionate share of the net pension liability calculated using the discount rate of 7.5%, as well as what the Commission's proportionate share of the net pension liability would be if it were calculated using a discount rate the is one percentage point lower (6.5%) or one percentage point higher (8.5%) than the current rate:

6. Retirement Plans, continued:

	<u>1% Decrease (6.5%)</u>	<u>Current Discount Rate (7.5%)</u>	<u>1% Increase (8.5%)</u>
Commission's proportionate share of the net pension liability as of May 31, 2017	<u>\$ 7,469,589</u>	<u>\$ 5,994,076</u>	<u>\$ 4,729,267</u>

Pension plan fiduciary net position: Detailed information about the pension plan's fiduciary net position is available in the separately issued Kentucky Retirement Systems financial report.

Postemployment Healthcare Benefits

Plan description: In addition to the pension benefits described above, KRS provides postemployment healthcare benefits through the Kentucky Retirement Systems Insurance Fund (Insurance Fund). The Insurance Fund was established to provide hospital and medical insurance for those receiving benefits the Kentucky Employees Retirement System (KERS), the County Employees Retirement System (CERS), and the State Police Retirement System (SPRS). The Insurance Fund pays a prescribed contribution for whole or partial payment of required premiums to purchase hospital and medical insurance. For the fiscal year ended June 30, 2016 (the date of the latest available information), insurance premiums withheld from benefit payments for these benefits from CERS were \$22.6 million and \$2.2 million for non-hazardous and hazardous employees, respectively. For the fiscal year ended June 30, 2015, insurance premiums withheld from benefit payments for those receiving benefits from CERS were \$22.6 million and \$1.7 million for non-hazardous and hazardous employees, respectively. The Insurance Fund pays the same proportion of hospital and medical insurance premiums for the spouse and dependents of retired hazardous employees killed in the line of duty. As of June 30, 2016, the Insurance Fund had 113,280 retirees and beneficiaries for whom benefits were available.

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

<u>Years of Service</u>	<u>% Paid by Insurance Fund</u>
20 or more	100%
15 - 19	75%
10 - 14	50%
4 - 9	25%
Less than 4	0%

As a result of House Bill 290 (2004 Kentucky General Assembly), medical insurance benefits are calculated differently for those who began participating on or after July 1, 2003. Once employees reach a minimum vesting period of ten 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 based on the retiree COLA, which is updated annually due to changes in the Consumer Price Index for all urban consumers. This benefit is not protected under

6. Retirement Plans, continued:

the inviolable contract provisions of Kentucky Revised Statute 16.652, 61.692, and 78.852. The Kentucky General Assembly reserves the right to suspend or reduce this benefit if, in its judgment, the welfare of the Commonwealth so demands

Funding policy: In prior years, the employer's required medical insurance contribution rate was being increased annually by a percentage that would result in advance-funding the medical liability on an actuarially determined basis using the entry age normal method within a 20 year period measured from 1987. In November 1992, the Board adopted a fixed percentage rate and suspended future increases under the current medical premium funding policy until the next experience study could be performed. In May 1996, the Board adopted a policy to increase the insurance contribution rate by the amount needed to achieve the target rate for full entry age normal funding within 20 years.

The Commission is required to contribute at an actuarially determined rate. As of May 31, 2017, 2016, and 2015, the Commission's required contribution rate was 4.73%, 4.64%, and 4.92%, respectively, of annual covered payroll. The contribution requirements of plan members and the Commission are established and may be amended by the Kentucky Retirement Systems Board of Trustees. Contributions to the Insurance Fund from the Commission were \$130,504, \$136,726, and \$144,693 for the years ended May 31, 2017, 2016, and 2015, respectively.

On August 6, 2012, the Board voted to cease self-funding of healthcare benefits for most Medicare eligible retirees. The Board elected to contract with Humana Insurance Company to provide healthcare benefits to retirees through a fully insured Medicare Advantage Plan. The Humana Medicare Advantage Plan became effective January 1, 2013.

A copy of the annual report for the County Employees' Retirement System can be obtained from the County Employees' Retirement System 1260 Louisville Road, Frankfort, Kentucky 40601, or by calling 1.502.564.4646.

7. Accounts Payable and Accrued Expenses:

Accounts payable and accrued expenses consisted of the following as of May 31, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Accounts payable and accrued expenses - Existing System	\$ 2,125,648	\$ 2,311,083
Accounts payable and accrued liabilities - Station Two	<u>3,261,347</u>	<u>2,822,918</u>
Total	<u>\$ 5,386,995</u>	<u>\$ 5,134,001</u>

8. Long-Term Debt-Revenue Bonds:

During the fiscal year ended May 31, 2012, the City of Henderson, Kentucky Utility Commission issued revenue bonds for the purpose of financing capital improvements throughout its system through two revenue bond series, *Electric System Revenue Bonds, Series 2011A* in the amount of \$11,350,000, and *Electric System Revenue Bonds, Series 2011 B*, in the amount of \$3,670,000.

The bond ordinance requires that certain accounts for each issue be established and held by a trustee as follows:

Debt Service Fund:

A monthly transfer of 1/12 of principal and 1/6 of the interest due is required to be deposited in the Debt Service Fund.

Debt Service Reserve Fund:

A reserve account was established, so that as of any date of calculation, an amount equal to at least the highest amount of aggregate debt service, or an amount equal to 125% of the average aggregate debt service and an amount equal to 10% of the “proceeds” of the bonds with respect to all series is maintained by the Commission.

Series 2011A:

The Series 2011A bonds are secured by a pledge of the revenues of the City of Henderson, Kentucky Utility Commission. The Series 2011A Bonds are additionally secured by a debt service reserve and a non-foreclosable statutory mortgage lien on the System. The Series 2011A Bonds are also secured by a debt service reserve in an amount equal to the least of the maximum annual debt service on the Series 2011A Bonds. The proceeds from the sale of these bonds were used to retire the Bond Anticipation Note, Series 2008B in the amount of \$5,281,067, with the remaining proceeds to be used for capital improvements of the City’s electric transmission and distribution system, and at its Station Two generating station. Interest is due semi-annually on these obligations on December 1st and June 1st of each year.

It is the opinion from the City of Henderson, Kentucky Utility Commission’s bond counsel, that under existing laws, interest on the Series 2011A Bonds is not subject to income tax.

Optional Redemption Series 2011A:

The Series 2011A Bonds maturing on and after December 1, 2021, are subject to redemption by the City, at its option, before maturity on September 1, 2021, and on any date thereafter in whole or from time to time in part in any order of maturity (less than all of a single maturity to be selected by lot in such manner as the Trustee and Paying Agent may determine) at a redemption price equal to 100% of the principal amount thereof plus accrued interest to the redemption date.

Series 2011B:

The Series 2011B bonds are secured by a pledge of the revenues of the City of Henderson, Kentucky Utility Commission. The Series 2011B Bonds are additionally secured by a debt service reserve and a non-foreclosable statutory mortgage lien on the System. The Series 2011B Bonds are also secured by a debt service reserve in an amount equal to the least of the maximum annual debt service on the Series 2011B bonds. The proceeds from the sale of these bonds were used to retire the Bond Anticipation Note, Series 2008A and 2010A, in the amounts of \$3,500,000 and \$170,000, respectively. Interest is due semi-annually on these obligations on December 1st and June 1st of each year.

It is the opinion from the City of Henderson, Kentucky Utility Commission’s bond counsel, that under existing laws, interest on the Series 2011B bonds is not subject to income tax.

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements

8. Long-Term Debt-Revenue Bonds, continued:

Optional Redemption Series 2011B:

The Series 2011B Bonds maturing on and after December 1, 2021, are subject to redemption by the Commission, at its option, before maturity on September 1, 2021, and on any date thereafter in whole or from time to time in part in any order of maturity (less than all of a single maturity to be selected by lot in such manner as the Trustee and Paying Agent may determine) at a redemption price equal to 100% of the principal amount thereof plus accrued interest to the redemption date.

A summary of the long-term debt of the Commission is as follows:

	<u>2017</u>	<u>2016</u>
City of Henderson, Kentucky Utility Commission Series 2011A Revenue Bonds, secured by pledge of system revenues and non-forecloseable statutory lien, maturing December 1, 2031, annual principal payments range from \$420,000 to \$725,000, interest rates range from 2.5% to 4.5%.	\$ 9,130,000	\$ 9,595,000
City of Henderson, Kentucky Utility Commission Series 2011B Revenue Bonds, secured by pledge of system revenues and non-forecloseable statutory lien, maturing December 1, 2031, annual principal payments range from \$150,000 to \$245,000, interest rates range from 2.5% to 4.5%.	<u>2,910,000</u>	<u>3,065,000</u>
Total long-term debt	\$ 12,040,000	\$ 12,660,000
Less current portion due	<u>(630,000)</u>	<u>(620,000)</u>
Long-term debt, net of current portion	<u>\$ 11,410,000</u>	<u>\$ 12,040,000</u>

Future maturities of long-term debt for the next five years as of May 31, 2017 are as follows:

<u>Fiscal Year:</u>	<u>Series 2011A</u>			<u>Series 2011B</u>			<u>Total Debt Service</u>
	<u>Principal</u>	<u>Interest</u>	<u>Total</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>	
2018	\$ 475,000	\$ 351,806	\$ 826,806	\$ 155,000	\$ 98,718	\$ 253,718	\$ 1,080,524
2019	490,000	339,932	829,932	160,000	95,618	255,618	1,085,550
2020	505,000	325,232	830,232	165,000	92,098	257,098	1,087,330
2021	520,000	310,082	830,082	170,000	88,138	258,138	1,088,220
2022-2026	2,870,000	1,268,324	4,138,324	920,000	362,116	1,282,116	5,420,440
2027-2031	3,480,000	647,082	4,127,082	1,095,000	184,238	1,279,238	5,406,320
2032-2033	790,000	35,550	825,550	245,000	10,044	255,044	1,080,594
	<u>\$ 9,130,000</u>	<u>\$ 3,278,008</u>	<u>\$ 12,408,008</u>	<u>\$ 2,910,000</u>	<u>\$ 930,970</u>	<u>\$ 3,840,970</u>	<u>\$ 16,248,978</u>

9. Asset Retirement Obligation:

Effective December 31, 2008, the Commission terminated operation of its Station One generation facility. The Commission is legally obligated to remove asbestos, lead paint, and other contaminants located there. Accordingly, a liability has been established in accordance with SFAS No. 143 *Accounting for Asset Retirement Obligations*.

The following is a reconciliation of the aggregate retirement liability associated with the Commission's obligation to remove the contaminants:

	Asset Retirement Obligation
Balance as of June 1, 2016	\$ 380,771
Additional obligations incurred	-
Increase in present value of the obligation	-
Increase based on revised estimates of costs to dismantle and remove assets	-
Liabilities extinguished	-
Balance as of May 31, 2017	<u>\$ 380,771</u>

10. Discounted Internet and Broadband Services:

A summary of discounted internet and broadband services provided by the Commission to other governmental concerns is as follows:

<u>Governmental Organizations</u>	<u>2017</u>	<u>2016</u>
Henderson County GIS System	\$ 116,400	\$ 116,400
Henderson Water Utility	-	91,800
City of Henderson	120,600	265,500
Other organizations	-	1,692
	<u>\$ 237,000</u>	<u>\$ 475,392</u>

For the fiscal year ended May 31, 2017, the Henderson Water Utility was charged for their communication services.

11. Concentration of Sales:

Three industrial customers of the Existing System accounted for sales in the amount of \$12.6 million (30% of Existing System sales), and \$11.8 million (30% of Existing System sales) for the fiscal years ended May 31, 2017 and 2016.

12. Emission Allowances:

Amendments to the Clean Air Act in 1990 established a system whereby emission allowances were created and allocated to generating units subject to Phase 1 of the emission restrictions. Station Two was allocated a total of 226,901 allowances through 1999 (one emission allowance represents the authorization to emit one ton of sulfur dioxide in a given year). The allowances are allocated between the Commission and the Station Two Operator based upon the Station Two capacity allocations. As of May 31, 2017 and 2016, there were remaining a total of 2,667 sulfur dioxide, nitrous oxide, and ozone emission allowances valued at \$35,094 and \$25,947, respectively.

13. Related Party Transactions:

The Commission incurred the following transactions with the City of Henderson, Kentucky for the fiscal years ended May 31, 2017 and 2016:

Paid the City \$664,167 and \$642,250 each year, respectively, for data processing and other services related to billings and collections.

Paid the City \$1,244,724 and \$1,244,724 each year, respectively, for payment in lieu of taxes.

Paid the City \$561,149 and \$593,767 for participation in the City of Henderson's self-insured employee health insurance plan for the fiscal years ended May 31, 2017 and 2016 respectively. Risk is minimized in this area by the purchase of re-insurance for amounts in excess of the \$125,000 stop loss limit. Charges are based on estimated amounts determined by the City of Henderson's insurance coordinator as necessary to fund claims as they become due and payable.

Provided the City of Henderson with power for the fiscal years ended May 31, 2017 and 2016 in the amount of \$423,207 and \$430,776 respectively. The City of Henderson was also provided significantly reduced communication service fees totaling approximately \$120,600 and \$265,500 for the fiscal years May 31, 2017 and 2016, respectively.

14. Commitments and Contingencies:

A. Southeastern Power Administration:

The Southeastern Power Administration (SEPA) has contracted with the Commission to provide it a total of 15,000 megawatt hours of hydroelectric power each year. The 15,000 megawatt hours represent approximately 2.5% of the Commission's annual megawatt hour requirements. Henderson Municipal Power & Light is restricted to not more than 10 megawatt hours during any hour, and not more than 2,640 megawatt hours during any month. During the year ended May 31, 2017 and 2016, the Commission purchased power on the spot market and from SEPA to supply the needs of its customers. Purchased power from these sources for the fiscal year ended May 31, 2017 was \$583,803 and \$623,099 during 2016.

B. Regulatory Compliance:

The North American Electric Reliability Corporation (NERC) adopted new electric system reliability standards for all electric utilities in the United States. NERC has adopted and began enforcement of the new standards effective June of 2007. The new standards have been approved by the Federal Energy Regulatory Commission (FERC). The Commission must comply with the new standards and will incur administrative expenses related to NERC compliance. Federal air quality and emission standards have become more stringent. The current standards and proposed standards resulted in the cost of compliance being excessive to operate Station One. As a result of the new regulations, the

Commission approved the cessation of operations at Station One on August 25, 2008, and Station One was taken out of service in December of 2008, and razed during the fiscal year ended May 31, 2015.

14. Commitments and Contingencies, continued:

C. Unwind Transaction- Station Two:

In 1998, HMP&L, Big Rivers Electric Corporation, and Western Kentucky Energy Corporation entered into contracts for the operation of the HMP&L Station Two Power Plant and other Big Rivers Electric Corporation Generation Plants. On July 16, 2009, Big Rivers Electric Corporation and Western Kentucky Energy Corporation (E.ON) signed an agreement under which the original 1998 contracts are rescinded and operational control of the Station Two Power Plant returned to Big Rivers Electric Corporation.

D. Pending Litigation:

On January 7, 2017, the Kentucky legislature repealed prevailing wage. HMP&L's litigation with the Kentucky Department of Labor related to the application of prevailing wage rates to Station Two, therefore, has been concluded.

Big Rivers and HMP&L are currently involved in litigation concerning HMP&L's claim for damages concerning surplus energy sales related to Station Two. This civil action involved a claim by HMP&L to recover monetary damages from Big Rivers Electric Corporation because of HMP&L inability to schedule its excess energy. An offer to settle all claims past, present and future, has been accepted by the parties, subject to approval of the settlement documents. As of the date of this report, the settlement documents have not been approved and executed by either party to this litigation.

15. Risk Management:

The Commission is exposed to various risks of loss related to torts, theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Commission carries commercial insurance for these types of risk of loss, including workers' compensation. Settled claims from these risks have not exceeded commercial insurance coverage in any of the past five fiscal years.

16. Amounts Due From Station Two Operator:

As of the fiscal years ended May 31, 2017 and 2016, the amount the Station Two Operator owed to the Commission, as part of the annual settlement, was \$2,118,042 and \$2,588,760, respectively.

17. Subsequent Events:

Subsequent events have been evaluated through October 11, 2017, the date these financial statements were available to be issued.

Excess Energy Settlement:

Subsequent to the fiscal year ended May 31, 2017, Western Kentucky Energy Corporation offered to pay on behalf of Big Rivers Electric Corporation to the Commission the sum of \$6,250,000 to settle all claims, past and future, between the parties concerning the excess energy sales related to Station Two. This offer also settles the dispute brought by the Civil Action No.09-CI-00693, Big Rivers versus The City of

Henderson, Kentucky and the City of Henderson Utility Commission. In this civil action, the Commission was seeking to recover monetary damages from

17. Subsequent Events, continued:

Excess Energy Settlement continued:

Big Rivers Electric Corporation as a result of the Commission not being able to schedule its excess energy, and denying the Commission access to the reserved generation capacity associated with the excess energy. As of the date of this report, no formal actions have been taken by either party to the litigation.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
COMBINING STATEMENTS OF NET POSITION-BY SYSTEM
As of May 31, 2017 and 2016

	<u>May 31, 2017</u>				<u>May 31, 2016</u>			
	<u>Existing System</u>	<u>Station Two</u>	<u>Elimination</u>	<u>Total</u>	<u>Existing System</u>	<u>Station Two</u>	<u>Elimination</u>	<u>Total</u>
<u>Assets:</u>								
<u>Current assets:</u>								
Cash and cash equivalents	\$ 2,246,818	\$ 101,493	\$ -	\$ 2,348,311	\$ 130,059	\$ 309,397	\$ -	\$ 439,456
Investments - unrestricted	12,921,612	-	-	12,921,612	13,237,676	-	-	13,237,676
Investments - restricted	2,322,123	-	-	2,322,123	3,500,107	-	-	3,500,107
Accounts receivable, net of allowance for uncollectibles	3,439,150	-	-	3,439,150	2,248,646	-	-	2,248,646
Accounts receivable-Station Two Operator	2,118,042	30,920	-	2,148,962	2,588,760	-	-	2,588,760
Accrued revenue	3,342,815	-	-	3,342,815	2,790,719	-	-	2,790,719
Inventory and supplies	3,626,471	3,121,169	-	6,747,640	3,017,960	2,690,805	-	5,708,765
Prepaid expenses	82,571	-	-	82,571	60,935	-	-	60,935
Total current assets	<u>30,099,602</u>	<u>3,253,582</u>	<u>-</u>	<u>33,353,184</u>	<u>27,574,862</u>	<u>3,000,202</u>	<u>-</u>	<u>30,575,064</u>
<u>Utility plant, net of accumulated depreciation:</u>	<u>10,390,774</u>	<u>46,272,354</u>	<u>-</u>	<u>56,663,128</u>	<u>10,518,556</u>	<u>49,131,867</u>	<u>-</u>	<u>59,650,423</u>
<u>Other assets:</u>								
Investment in Station Two	31,058,999	-	(31,058,999)	-	31,058,999	-	(31,058,999)	-
Total assets	<u>71,549,375</u>	<u>49,525,936</u>	<u>(31,058,999)</u>	<u>90,016,312</u>	<u>69,152,417</u>	<u>52,132,069</u>	<u>(31,058,999)</u>	<u>90,225,487</u>
<u>Deferred outflows of resources:</u>								
Deferred outflows of resources	1,322,051	-	-	1,322,051	1,051,102	-	-	1,051,102
Total deferred outflows of resources	<u>1,322,051</u>	<u>-</u>	<u>-</u>	<u>1,322,051</u>	<u>1,051,102</u>	<u>-</u>	<u>-</u>	<u>1,051,102</u>
Total assets and deferred outflows of resources	<u>\$ 72,871,426</u>	<u>\$ 49,525,936</u>	<u>\$ (31,058,999)</u>	<u>\$ 91,338,363</u>	<u>\$ 70,203,519</u>	<u>\$ 52,132,069</u>	<u>\$ (31,058,999)</u>	<u>\$ 91,276,589</u>

See Independent Auditors' Report.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
COMBINING STATEMENTS OF NET POSITION-BY SYSTEM
As of May 31, 2017 and 2016

	May 31, 2017				May 31, 2016			
	Existing System	Station Two	Elimination	Total	Existing System	Station Two	Elimination	Total
<u>Liabilities and net assets:</u>								
<u>Current liabilities:</u>								
Accounts payable and accrued expenses	\$ 2,125,648	\$ 3,261,347	\$ -	\$ 5,386,995	\$ 2,311,083	\$ 2,822,918	\$ -	\$ 5,134,001
Accounts payable-Construction in progress - Station Two	-	1,541,776	-	1,541,776	-	1,325,221	-	1,325,221
Asset retirement obligation	380,771	-	-	380,771	380,771	-	-	380,771
Accounts payable-Station Two Operator	-	-	-	-	-	185,048	-	185,048
Current portion-bonds payable	630,000	-	-	630,000	620,000	-	-	620,000
Customer deposits	652,901	-	-	652,901	645,119	-	-	645,119
Total current liabilities	3,789,320	4,803,123	-	8,592,443	3,956,973	4,333,187	-	8,290,160
<u>Long-term liabilities:</u>								
Long-term portion of bonds payable	11,410,000	-	-	11,410,000	12,040,000	-	-	12,040,000
Unfunded pension liability	5,994,076	-	-	5,994,076	5,378,974	-	-	5,378,974
Total long-term liabilities	17,404,076	-	-	17,404,076	17,418,974	-	-	17,418,974
Total liabilities	21,193,396	4,803,123	-	25,996,519	21,375,947	4,333,187	-	25,709,134
<u>Deferred inflows of resources:</u>								
Deferred inflows of resources	90,173	-	-	90,173	-	-	-	-
Total deferred inflows of resources	90,173	-	-	90,173	-	-	-	-
<u>Net position:</u>								
Investment in plant assets, net of related debt	29,409,773	46,272,354	(31,058,999)	44,623,128	28,917,555	49,131,867	(31,058,999)	46,990,423
Restricted per bond ordinance	2,322,123	-	-	2,322,123	3,500,107	-	-	3,500,107
Unrestricted	19,855,961	(1,549,541)	-	18,306,420	16,409,910	(1,332,985)	-	15,076,925
Total net position	51,587,857	44,722,813	(31,058,999)	65,251,671	48,827,572	47,798,882	(31,058,999)	65,567,455
Total liabilities, deferred inflows, and net position	\$ 72,871,426	\$ 49,525,936	\$ (31,058,999)	\$ 91,338,363	\$ 70,203,519	\$ 52,132,069	\$ (31,058,999)	\$ 91,276,589

See Independent Auditors' Report.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
COMBINING STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION-BY SYSTEM
For the fiscal years ended May 31, 2017 and 2016

	May 31, 2017				May 31, 2016			
	Existing System	Station Two	Elimination	Consolidated Total	Existing System	Station Two	Elimination	Consolidated Total
Operating Revenues:								
Sale of electricity	\$ 41,658,367	\$ 36,246,738	\$ (12,589,503)	\$ 65,315,602	\$ 38,746,429	\$ 33,809,382	\$ (13,914,651)	\$ 58,641,160
Communication services	1,124,748	-	-	1,124,748	1,308,495	-	-	1,308,495
Other	679,669	-	-	679,669	290,765	-	-	290,765
Total Operating Revenues	43,462,784	36,246,738	(12,589,503)	67,120,019	40,345,689	33,809,382	(13,914,651)	60,240,420
Operating Expenses:								
Production of electricity	30,954,963	31,056,236	(12,589,503)	49,421,696	30,267,805	26,797,783	(13,914,651)	43,150,937
Operating, general and administrative	6,608,962	4,158,380	-	10,767,342	6,432,741	3,491,983	-	9,924,724
Depreciation	883,859	4,108,368	-	4,992,227	968,939	4,153,110	-	5,122,049
Total Operating Expenses	38,447,784	39,322,984	(12,589,503)	65,181,265	37,669,485	34,442,876	(13,914,651)	58,197,710
Income (Loss) from Operations	5,015,000	(3,076,246)	-	1,938,754	2,676,204	(633,494)	-	2,042,710
Interest Income (Expense):								
Other income (expense)	-	11	-	11	-	12	-	12
Investment income	107,716	166	-	107,882	87,392	176	-	87,568
Interest expense	(457,500)	-	-	(457,500)	(471,131)	-	-	(471,131)
Total Interest Income (Expense)	(349,784)	177	-	(349,607)	(383,739)	188	-	(383,551)
Income (Loss) Before Transfers	4,665,216	(3,076,069)	-	1,589,147	2,292,465	(633,306)	-	1,659,159
Non-operating Items:								
Station 1 Remediation	-	-	-	-	(10,780)	-	-	(10,780)
Transfers to City of Henderson	(1,244,724)	-	-	(1,244,724)	(1,244,724)	-	-	(1,244,724)
Power furnished to City of Henderson	(423,207)	-	-	(423,207)	(430,776)	-	-	(430,776)
Communication services provided to the City of Henderson and local governmental agencies	(237,000)	-	-	(237,000)	(475,392)	-	-	(475,392)
Total Non-operating Items	(1,904,931)	-	-	(1,904,931)	(2,161,672)	-	-	(2,161,672)
Increase (Decrease) in Net Position	2,760,285	(3,076,069)	-	(315,784)	130,793	(633,306)	-	(502,513)
Net Position, Beginning of Year	48,827,572	47,798,882	(31,058,999)	65,567,455	48,696,779	48,432,188	(31,058,999)	66,069,968
Net Position, End of Year	\$ 51,587,857	\$ 44,722,813	\$ (31,058,999)	\$ 65,251,671	\$ 48,827,572	\$ 47,798,882	\$ (31,058,999)	\$ 65,567,455

See Independent Auditors' Report.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
SUPPLEMENTAL SCHEDULE OF CHANGES IN NET POSITION - BY SYSTEM
For the fiscal years ended May 31, 2017 and 2016

	<u>Existing System</u>	<u>Station Two</u>			<u>Eliminations *</u>	<u>Total Net Assets</u>
		<u>Utility Commission</u>	<u>Big Rivers</u>	<u>Total Station Two</u>		
Beginning balance, June 1, 2015	\$ 48,696,779	\$ 20,688,871	\$ 27,743,317	\$ 48,432,188	\$ (31,058,999)	\$ 66,069,968
Change in net position	<u>130,793</u>	<u>1,300,503</u>	<u>(1,933,809)</u>	<u>(633,306)</u>	<u>-</u>	<u>(502,513)</u>
Balance, May 31, 2016	48,827,572	21,989,374	25,809,508	47,798,882	(31,058,999)	65,567,455
Change in net position	<u>2,760,285</u>	<u>(1,190,095)</u>	<u>(1,885,974)</u>	<u>(3,076,069)</u>	<u>-</u>	<u>(315,784)</u>
Balance May 31, 2017	<u>\$ 51,587,857</u>	<u>\$ 20,799,279</u>	<u>\$ 23,923,534</u>	<u>\$ 44,722,813</u>	<u>\$ (31,058,999)</u>	<u>\$ 65,251,671</u>

* Elimination of interest of Existing System in investment in the equity of Station Two.

As shown on the Statement of Net Position	<u>2017</u>	<u>2016</u>
Investment in Utility Plant and Equipment, net of related debt	\$ 44,623,128	\$ 46,990,423
Restricted per bond ordinance	2,322,123	3,500,107
Unrestricted	<u>18,306,420</u>	<u>15,076,925</u>
Net position, end of year	<u>\$ 65,251,671</u>	<u>\$ 65,567,455</u>

See Independent Auditors' Report.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
SCHEDULE OF THE COMMISSION'S PROPORTIONATE SHARE
OF THE NET PENSION LIABILITY
County Employees Retirement System
As of the Measurement Date for the Last Three Years*

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Commission's proportion of the net pension liability	0.121741%	0.125106%	0.123175%
Commission's proportionate share of the net pension liability	\$ 5,994,076	\$ 5,378,974	\$ 3,996,000
Commission's covered-employee payroll	\$ 2,759,054	\$ 2,946,675	\$ 2,940,925
Commission's proportionate share of the net pension liability as a percentage of its covered-employee payroll	217.25%	182.54%	135.88%
Plan fiduciary net position as a percentage of the total pension liability	55.50%	59.97%	66.80%

*This table will present ten years of information as it becomes available.

See Independent Auditors' Report.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION
SCHEDULE OF COMMISSION CONTRIBUTIONS
County Employees Retirement System
For the Last Three Fiscal Years*

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Statutorily required contribution	\$ 384,888	\$ 365,977	\$ 374,968
Contributions in relation to the statutorily required contribution	<u>(384,888)</u>	<u>(365,977)</u>	<u>(374,968)</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Commission's covered-employee payroll	\$ 2,759,054	\$ 2,946,675	\$ 2,940,925
Contributions as a percentage of covered-employee payroll	13.95%	12.42%	12.75%

*This table will present ten years of information as it becomes available.

See Independent Auditors' Report.



Report on Internal Control Over Financial Reporting, Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Independent Auditors' Report

Members of the Board of Commissioners
City of Henderson, Kentucky Utility Commission
Henderson, 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 of America; the financial statements of the City of Henderson, Kentucky Utility Commission as of and for the year ended May 31, 2017, and have issued our report thereon dated October 11, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the City of Henderson, Kentucky Utility Commission's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City of Henderson, Kentucky Utility Commission's internal control. Accordingly, we do not express an opinion on the effectiveness of the City of Henderson, Kentucky Utility Commission's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or 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 the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in the internal control that might be significant deficiencies, or material weaknesses. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Henderson, Kentucky Utility Commission's financial statements are free of 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*.

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 result of that testing, and not to provide an opinion on the effectiveness of 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 report is not suitable for any other purpose.

Myriad Co Group, LLC

Henderson, Kentucky
October 11, 2017

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION –
HENDERSON MUNICIPAL POWER & LIGHT**

**FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION**

MAY 31, 2018 AND 2017

**Case No: 2019-00269
Attachment 1 to BREC 1-31
HMPL Audits 2011-2019**

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION –
HENDERSON MUNICIPAL POWER & LIGHT
TABLE OF CONTENTS**

Financial Section

Independent Auditor’s Report	1
Management’s Discussion and Analysis	3

Basic Financial Statements:

Statements of Net Position	13
Statements of Revenues, Expenses, and Changes in Net Position	14
Statements of Cash Flows	15
Statements of Cash Flows – Reconciliation of Net Cash Provided by Operations	16
Notes to the Financial Statements	17

Required Supplementary Information:

Schedule of the Commission’s Proportionate Share of the Collective Net Pension Liability	39
Schedule of the Commission’s Contributions to the Pension Plan	40
Schedule of the Commission’s Proportionate Share of the Collective Net OPEB Liability	41
Schedule of the Commission’s Contributions to the OPEB Plan	42
Notes to the Required Supplementary Information	43

Other Supplementary Information:

Combining Statements of Net Position – By System	44
Combining Statements of Revenues, Expenses, and Changes in Net Position – By System	46
Supplemental Schedule of Changes in Net Position – By System	47

Other Reporting Required by *Government Auditing Standards*

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 <i>Government Auditing Standards</i>	48
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INDEPENDENT AUDITOR'S REPORT

To the Board of Commissioners
City of Henderson, Kentucky Utility Commission
Henderson, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the City of Henderson, Kentucky Utility Commission (Commission), a component unit of the City of Henderson, Kentucky, as of and for the years ended May 31, 2018 and 2017, and the related notes to the financial statements, which collectively comprise the Commission'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.

Auditor's 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 of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Commission as of May 31, 2018 and 2017, and the changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in Note 2 to the financial statements, during the fiscal year ended May 31, 2018, the Commission adopted new accounting guidance, GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* and GASB Statement No. 82, *Pensions Issues*. Our opinion is not modified with respect to this matter.

As discussed in Note 9 to the financial statements, during the fiscal year ended May 31, 2018, management became aware of an asset retirement obligation that resulted in a prior period adjustment to net position. 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 discussion and analysis on pages 3 through 12 and the schedules of the Commission's proportionate share of the collective net pension and OPEB liabilities and contributions to the pension and OPEB plans on pages 39 through 43 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 City of Henderson, Kentucky Utility Commission's basic financial statements. The combining financial statements on pages 44 through 47 are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining financial statements are the responsibility of management and were derived from and relate 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 combining financial statements are 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 November 1, 2018 on our consideration of the City of Henderson, Kentucky Utility Commission's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of 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 City of Henderson, Kentucky Utility Commission's internal control over reporting and compliance.

Alexander Thompson Arnold PLLC

Henderson, Kentucky
November 1, 2018

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION – HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT’S DISCUSSION AND ANALYSIS

The City of Henderson, Kentucky Utility Commission (HMP&L) is in the business of providing electricity and internet communication services for residential, commercial, and industrial customers within the incorporated territory of the City of Henderson, Kentucky. The Commission also provides electricity and internet communication services to customers in a few areas outside of the incorporated territory of Henderson. The following discussion and analysis of HMP&L’s financial performance provides an overview of the Utility’s financial activities for fiscal year ended May 31, 2018.

Overview of the Financial Statements:

This annual financial report consists of three parts: 1) Management’s Discussion and Analysis, 2) Financial Statements, and 3) Supplemental Additional Information. The Financial Statements also include notes that explain in more detail some of the information in the financial statements. The statements are followed by a section of supplemental information that further explains and supports the information in the basic financial statements. The Supplemental schedules present the financial position and results of operations for the Existing System and Station Two. The Consolidated Financial Statements report information about HMP&L using accounting methods similar to those used by private sector companies, except for the reporting of contributions in aid of construction, equity capital, and retained earnings. Refer to the Summary of Significant Accounting Policies in the footnotes to the Financial Statements relating to the adoption of Statement No. 34 of the Governmental Accounting Standard Board (GASB 34).

The Statement of Net Position, successor to the Balance Sheet, includes all of the Utility’s assets and liabilities, deferred outflows and inflows, and provides information about the nature and amounts of investments in resources (assets) and the obligations to HMP&L’s creditors (liabilities). It also provides the basis for evaluating the capital structure of HMP&L and assessing the liquidity and financial flexibility of HMP&L.

All of the current year’s revenues and expenses are accounted for in the Statement of Revenues, Expenses, and Changes in Net Position, successor to the Income Statement. This statement measures the success of the Utility’s operations over the past year and can be used to determine whether the Utility has successfully recovered all of its costs through the sale of electricity, communications, and other charges, and has earned a reasonable return and maintained a sound financial position.

The final required financial statement is the Statement of Cash Flows. The primary purpose of this statement is to provide information about the Utility’s cash receipts, cash payments, and net changes in cash resulting from operations, investing and financing activities, and it provides information on the sources and uses of cash and the changes in cash balances during the year.

Financial Statements:

- HMP&L’s total assets and deferred outflows of resources increased from \$91,338,363 at May 31, 2017 to \$100,476,196 at May 31, 2018. This increase is primarily attributable to the increased balances in cash, inventory and supplies, and deferred outflows of resources.
- Operating revenues for HMP&L Existing System increased by approximately \$1,940,145, or 4.5% from \$43,462,784 to \$45,402,929. The increase in Existing System sales was primarily due to the adoption of a schedule of electric rate increases. Internet-Fiber revenue decreased by \$28,614, or 2.6%.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION – HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT’S DISCUSSION AND ANALYSIS

Financial Statements, continued:

<u>Existing System:</u>	<u>2018</u>	<u>2017</u>	<u>Change</u>	<u>Percentage Change</u>
Sale of electricity	\$ 43,837	\$ 41,658	\$ 2,179	5.2%
Internet service	1,096	1,125	(29)	-2.6%
Other	470	680	(210)	-30.9%
Total operating revenues	<u>\$ 45,403</u>	<u>\$ 43,463</u>	<u>\$ 1,940</u>	<u>4.5%</u>

Note: All amounts presented in thousands -000's omitted.

- Operating expenses for HMP&L Existing System increased by approximately \$1,454,283 or 3.8%. The following table represents the changes in the expenses for the Existing System:

<u>Existing System:</u>	<u>2018</u>	<u>2017</u>	<u>Change</u>	<u>Percentage Change</u>
Production of electricity	\$ 31,425	\$ 30,955	\$ 470	1.5%
Other operating expenses	7,567	6,609	958	14.5%
Depreciation	910	884	26	2.9%
Total operating expenses	<u>\$ 39,902</u>	<u>\$ 38,448</u>	<u>\$ 1,454</u>	<u>3.8%</u>

Note: All amounts presented in thousands -000's omitted.

- Operating revenues for Station Two decreased approximately \$5.6 million over that of the previous year due to the plant being placed into Economic Dispatch and power being purchased on the open market. The Station Two Agreement is not designed to generate a profit for each of the participants in the venture, but rather to break-even on a cash flow basis. Operating expenses decreased for Station Two by \$6.2 million.

<u>Station Two</u>	<u>2018</u>	<u>2017</u>	<u>Change</u>
Sales- BREC	\$ 18,461	\$ 23,657	\$ (5,196)
Sales- HMPL	12,140	12,590	(450)
Total Operating Revenue	<u>\$ 30,601</u>	<u>\$ 36,247</u>	<u>\$ (5,646)</u>

<u>Expenses:</u>			
Production of electricity	\$ 25,120	\$ 31,056	\$ (5,936)
Operating-General and administrative	3,821	\$ 4,158	(337)
Depreciation	4,140	4,108	32
Total Operating Expenses	<u>33,081</u>	<u>39,322</u>	<u>(6,241)</u>
Net income before transfers	<u>\$ (2,480)</u>	<u>\$ (3,075)</u>	<u>\$ 595</u>

Note: All amounts presented in thousands -000's omitted.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION – HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT’S DISCUSSION AND ANALYSIS

Statement of Net Position:

- Upon the consolidation of the financial statements for each system, transactions between Henderson Municipal Power and Light and Station Two Operator are eliminated.

Net position of the Existing System increased by \$9,503,136 for the fiscal year ended May 31, 2018, and \$7,641,694 after the effects of the cumulative change in accounting principle and prior period adjustment, while net position increased by \$2,760,285 in the fiscal year ended May 31, 2017.

Investment securities decreased by \$1,082,580 from that of Fiscal Year 2017.

Cash and cash equivalents increased by \$8,537,693 for the fiscal year ended May 31, 2018, versus an increase of \$1,908,855 at May 31, 2017, compared to the previous fiscal year ended.

A summary of the assets and deferred outflows of resources of the Commission for the previous three years is as follows:

<u>Assets:</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>
Cash and cash equivalents	\$ 10,886	\$ 2,348	\$ 439
Investment securities	11,803	12,922	13,238
Restricted assets	2,358	2,322	3,500
Accounts receivable-unbilled revenue	2,830	3,439	2,249
Accounts receivable-unbilled Station Two Operator	2,952	2,149	2,589
Accrued revenue	3,994	3,343	2,791
Inventories	9,021	6,748	5,709
Prepaid expenses	70	83	61
Total current assets	<u>43,914</u>	<u>33,354</u>	<u>30,576</u>
Utility plant and equipment	53,686	56,663	59,650
Asset retirement obligation	547	-	-
Total assets	<u>54,233</u>	<u>56,663</u>	<u>59,650</u>
Deferred outflow of resources	<u>2,329</u>	<u>1,322</u>	<u>1,051</u>
Total assets and deferred outflows of resources	<u>\$ 100,476</u>	<u>\$ 91,339</u>	<u>\$ 91,277</u>

Note: All amounts presented in thousands -000's omitted.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION –
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT’S DISCUSSION AND ANALYSIS**

Statement of Net Position, continued:

Current liabilities increased by \$398,935. Accounts payable and accrued expenses increased \$1,693,245 over the previous year mainly due to normal variations in timing of payments.

A summary of the liabilities and deferred inflows of the Statement of Net Position is as follows:

<u>Liabilities</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>
Accounts payable	\$ 6,826	\$ 5,132	\$ 5,134
Accounts payable-construction	201	1,542	1,325
Accounts payable			
Station Two Operator	-	-	185
Current portion bonds payable	650	630	620
Customer deposits	679	653	645
Total current liabilities	<u>8,356</u>	<u>7,957</u>	<u>7,909</u>
Compensated absences	267	254	-
Asset retirement obligation	1,327	381	381
Unfunded pension liability	6,464	5,994	5,379
Unfunded post employment benefits	2,220	-	-
Long term bonds payable	10,760	11,410	12,040
Total liabilities	<u>21,038</u>	<u>18,039</u>	<u>17,800</u>
Deferred inflows	665	90	-
Total liabilities and deferred inflows	<u>\$ 21,703</u>	<u>\$ 18,129</u>	<u>\$ 17,800</u>

Note: All amounts presented in thousands -000's omitted.

Statement of Revenues, Expenses, and Changes in Net Position:

Operating Revenues for the entire entity decreased by \$3,255,685 over that of the previous year. Sales for HMP&L Station Two decreased by \$5,644,892 or 15.6% while Existing System sales increased by \$2,179,062 or 5.2%.

Operating Expenses decreased by \$4.3 million. This was due to decreased operating costs incurred with Station Two.

The Net Operating Income of the Existing System, after interest expense and interest income, was \$5,253,941. For the fiscal year ended, transfers were made to the City of Henderson in the amount of \$1.24 million, the value of power furnished to the City of Henderson at no charge was \$581,349, and the value of communication services provided to the City of Henderson and other governmental agencies at no charge, was \$174,732. A settlement resulting from litigation related to the excess energy issue at Station Two of \$6.25 million was received. This resulted in a total increase in net position of \$9,503,136, before the effect of the cumulative effect of change in accounting principle related to GASB No.75 and the prior period adjustment related to the asset retirement obligation, resulting in an increase in net position of the Existing System of \$7,641,694.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION –
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT’S DISCUSSION AND ANALYSIS**

Statement of Revenues, Expenses, and Changes in Net Position, continued:

Station Two had a net operating loss of \$2,478,486; however, the loss relates primarily to depreciation expense which is a noncash item.

	Existing System	Station Two	Total
Income (loss) before transfers	\$ 5,253	\$ (2,478)	\$ 2,775
Non-operating items:			
Excess energy settlement	6,250	-	6,250
Transfer to City of Henderson	(1,244)	-	(1,244)
Communication services provided to the City of Henderson and other governmental agencies	(175)	-	(175)
Power furnished to the City of Henderson	(581)	-	(581)
Change in net position	<u>\$ 9,503</u>	<u>\$ (2,478)</u>	<u>\$ 7,025</u>

Note: All amounts presented in thousands -000's omitted.

Statement of Cash Flows:

Cash generated from operating activities increased by \$7,015,311 compared to the level from Fiscal Year 2017.

Cash Flows from non-capital financing activities is comprised of the funds transferred to the City of Henderson. For the fiscal year ended May 31, 2018, \$1.24 million was transferred.

Cash used by capital and related financing activities was \$3.15 million.

Cash provided by investing activities was \$1.3 million.

Cash and cash equivalents for the year, which consist primarily of checking and money market accounts of HMP&L, increased by \$8,537,693.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION –
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT’S DISCUSSION AND ANALYSIS**

Statement of Cash Flows, continued:

The following is an abbreviated analysis of cash flows of HMP&L for the fiscal years ended May 31, 2016 to 2018:

<u>Cash Flow Summary</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>
Net cash generated by operations	\$ 11,649	\$ 4,634	\$ 2,327
Cash transferred to the City of Henderson	(1,245)	(1,245)	(1,245)
Net cash used by capital and related financing	(3,146)	(3,082)	(3,120)
Provided by Investing activities	<u>1,279</u>	<u>1,602</u>	<u>1,974</u>
Increase (decrease) in cash	8,537	1,909	(64)
Cash and cash equivalents, beginning of year	<u>2,348</u>	<u>439</u>	<u>503</u>
Cash and cash equivalents, end of year	<u><u>\$ 10,885</u></u>	<u><u>\$ 2,348</u></u>	<u><u>\$ 439</u></u>

Note: All amounts presented in thousands -000's omitted.

The following is a summary of cash and investment balances as of May 31, 2016 to 2018:

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Cash and cash equivalents	\$ 10,885	\$ 2,348	\$ 439
Investments	11,803	12,922	13,238
Restricted investments	<u>2,358</u>	<u>2,322</u>	<u>3,500</u>
	<u><u>\$ 25,046</u></u>	<u><u>\$ 17,592</u></u>	<u><u>\$ 17,177</u></u>

Note: All amounts presented in thousands -000's omitted.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION – HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT’S DISCUSSION AND ANALYSIS

Capital Assets:

During the period of June 1, 2017, through May 31, 2018, HMP&L made a number of improvements to the electric and communication facilities and replaced certain assets. The improvements to the facilities and asset replacements increased service reliability and extended the useful-life of certain existing assets.

During the Fiscal Year 2017-2018, HMP&L made \$1,608,454 in capital improvements and replacements in the Existing System and \$321,056 in capital improvements and replacements of Station Two.

As noted in the footnotes to this report, HMP&L has a total of 550 sulfur dioxide, nitrous oxide, and ozone emission allowances, from the Existing System and Station Two available for fiscal year 2018-19. The value of the allowances is not reflected in the financial statements due to the fact that the Commission has no cost basis in the allowances. The estimated current market value of these allowances at May 31, 2018, is approximately \$1,237.

Debt Administration:

HMP&L entered into two Bond Anticipation Notes with Fifth Third Bank on December 22, 2008, a non-taxable series 2008A in the amount of \$3,500,000 and a taxable series 2008B in the amount of \$9,000,000. The series 2008A was used for capital improvements to the City’s retail electric system. The taxable series 2008B was used to make capital improvements to the City’s Station Two generating plant. HMP&L entered into an additional Bond Anticipation Note with Fifth Third Bank on March 25, 2010, a non-taxable series 2010A in the amount of \$1,500,000. This note was repaid at the same time as the Series 2008A note. In September of 2012 HMP&L issued Revenue Bonds in the amount of \$15,020,000 and retired all outstanding Bond Anticipation Notes. Total outstanding debt of the Commission was \$10,760,000 as of May 31, 2018.

On January 29, 2009, the City Commission approved an Ordinance increasing electric rates by 3.855 % for all customer rate classifications. The purpose of the rate increase was to provide additional revenue to make the principal and interest payments on the short-term Bond Anticipation Notes and the long-term Bonds issued to replace the Bond Anticipation Notes. HMP&L set up a separate Bond Payment Account and, as of May 31, 2018, HMP&L had accrued \$1,331,734 for future principal and interest payments for the Bonds.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION – HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT’S DISCUSSION AND ANALYSIS

Electric Rates – Current and Future Increases:

On May 12, 2015, the Board of Commissioners of the City of Henderson, Kentucky, passed an ordinance approving and adopting the following schedule of electric rate increases:

	<u>Effective Date</u>	<u>Adjustment Percent Increase</u>
First Adjustment	July 1, 2015	5%
Second Adjustment	November 1, 2015	5%
Third Adjustment	May 1, 2016	5%
Fourth Adjustment	November 1, 2016	5%
Inflation Adjustment	Beginning January 1, 2017 and each January 1, thereafter	CPI*

*Consumer Price Index (CPI) – Adjustments will be made in accordance with the percentage changes in the US Department of Labor Consumer Price Index (CPI-U).

The January 1, 2017 CPI adjustment was 1.6%; however, the CPI adjustment for January 1, 2018 was not approved by the City of Henderson, Kentucky Board of Commissioners.

Employee Development:

HMP&L’s workforce has a large number of employees nearing retirement age- both management and lead line workers. In order to prepare for this, HMP&L has begun hiring more line workers under the Apprenticeship Program. This program allows line workers who have completed line workers school and/or have on the job training to join HMP&L. Upon hire, the apprentice line workers progress in a structured program- from Apprentice Line Worker I to Apprentice Line Worker IV (depending on experience and knowledge), and then subsequently to Journey Line Worker and potentially Crew Leader. Having this program allows HMP&L to plan for the future, as well as make sure all employees are progressing in a safe manner.

Station Two – Settlement Excess Energy Litigation:

Big Rivers and HMP&L were involved in litigation concerning HMP&L’s claim for damages concerning surplus energy sales related to Station Two. This civil action involved a claim by HMP&L to recover monetary damages from Big Rivers Electric Corporation because of HMP&L’s inability to schedule its excess energy. An offer to settle all claims past, present and future, was accepted by the parties, and \$6.25 million was received on January 5, 2018. 1) The City of Henderson, Kentucky Utility Board of Commissioners approved allocating the settlement proceeds as follows: \$2 million is to be rebated to its customers which will be reflected in the fuel adjustment portion of their bill; 2) A Low-Income Relief Fund of \$1 million was established to be used to assist low income individuals having difficulty paying their power bills; 3) \$1.625 million was placed into an investment account;4) \$1.625 million was placed into unrestricted reserves.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION – HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT’S DISCUSSION AND ANALYSIS

Station Two – Future Expenditures:

In past years, HMP&L has increased its reserved capacity at Station Two. The reserve capacity for FY 2017-2018 was 115 megawatts and HMP&L did not increase its reserve capacity for FY 2018-2019. HMP&L intends to keep the reserve capacity around 115 megawatts which is in line with the recent HMP&L historical system peak demand. Each 5 megawatt increase in the reserved capacity will currently cost HMP&L approximately \$600,000/year. The actual cost of reserved capacity, however, is based upon the Station Two budget, which varies each year.

HMP&L has also begun the process of gathering information to determine the next steps for the future of the Station Two power plant. A preliminary Integrated Resource Plan (IRP) was finalized in July 2017, and presented to the Utility Commission. The IRP considered various options, such as continuing to run the two units as coal and complying with all environmental requirements, converting one or both units to natural gas, relying on the power market, integrating a peaking unit, and various other options. Upon receiving the IRP report, HMP&L started the process of evaluating the various options, and completed another, more detailed IRP in April of 2018. This IRP suggested that energy and capacity market purchases, either through managed contracts or on the open market, was the most economical option for HMP&L customers rather than continue to general power from Station Two.

The Commission is in the process of gathering bids through a request for proposal (RFP) that was released in August of 2018. The RFP is for energy and capacity beginning June 1, 2019. The RFP requests proposals for an all-requirements type contract, as well as a managed portfolio option. The Commission intends to finalize the contract with the chosen bidder in March of 2019.

Southeastern Power Administration (SEPA):

The Southeastern Power Administration (SEPA) has contracted with HMP&L to provide HMP&L a total of 15,000 megawatt hours of hydroelectric power each year. The 15,000 megawatt hours represent approximately 2.5 percent of HMP&L's annual megawatt hour requirements. HMP&L is restricted to not more than 10 megawatt hours during any one hour period. The hydroelectric power is provided from SEPA generation units on the Cumberland River System Project.

In the fall of 2006, SEPA informed all contract project participants that the Wolf Creek Dam near Jamestown, Kentucky, had been inspected and serious seepage problems existed in the earthen dam. The seepage problems at the dam date back to 1968 and the US Army Corps of Engineers implemented various repairs since that time; however, the seepage became critical to the safety of the Wolf Creek Dam and surrounding communities. In an effort to respond to these safety concerns and make the needed repairs to the dam, SEPA reduced and curtailed electric service to the contract project participants. This reduction and curtailment of SEPA electric service began in early 2007.

The dam repairs were completed during 2014 and the basin was allowed to fill to the necessary level of water. The SEPA Cumberland River Hydroelectric Power System is continuing to be restored to its pre-construction conditions.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION – HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT’S DISCUSSION AND ANALYSIS

Regulatory Compliance:

The North American Electric Reliability Corporation (NERC) adopted new electric system reliability standards for all electric utilities in the United States. NERC adopted and began enforcement of the new standards beginning in June 2007. The new standards were approved by the Federal Energy Regulatory Commission (FERC). HMP&L is required to comply with the new reliability standards and HMP&L will incur administrative expenses related to NERC compliance.

In November 2008, the Southeastern Electric Reliability Council (SERC) audited HMP&L for compliance with NERC Reliability Standards. Subsequent to the November audit, a number of formal and informal discussions took place between HMP&L and SERC. HMP&L and SERC reached an agreement concerning non-compliance issues identified during the audit; and a final settlement agreement was approved. In November 2010, HMP&L hired a new Reliability Compliance Manager who is responsible for compliance with NERC Reliability Standards. SERC performed a compliance audit of HMP&L in March of 2014, evaluating the utility for compliance with 11 reliability requirements, as well as 3 infrastructure related items. This audit resulted in no findings, violations, or recommendations.

Federal air quality and emission standards continue to be increasingly more stringent. The current standards and proposed new standards will increase the cost of energy production at Station Two.

Transfers to City:

During the fiscal year 2017-2018, HMP&L’s cash transfer to the City was \$1.24 million. HMP&L has budgeted this same level of cash transfer to the City for Fiscal Year 2018-2019 and subsequent budget periods. HMP&L also paid the City \$676,500 for internal service fees and HMP&L provided the City free electric service valued at \$581,349 and free communication services valued at \$174,732 for the 2017-2018 Fiscal Year. The annual cash transfer payments, internal service fees, and value of the free electric and communication services represent 6.1% of gross electric revenue in fiscal year 2017-2018.

Should additional information be needed inquiries can be directed to HMP&L at 100 Fifth Street, Henderson, Kentucky 42420. Contact via telephone at 270.826.2726.

**City of Henderson, Kentucky Utility Commission
Statements of Net Position
As of May 31, 2018 and 2017**

<u>Assets:</u>	<u>2018</u>	<u>2017</u>
<u>Current assets:</u>		
Cash and cash equivalents	\$ 10,886,004	\$ 2,348,311
Investments - unrestricted	11,802,770	12,921,612
Investments - restricted	2,358,385	2,322,123
Accounts receivable, net of allowance for uncollectibles	2,830,079	3,439,150
Accounts receivable, Station Two Operator	2,950,585	2,148,962
Accrued revenue	3,994,163	3,342,815
Inventory and supplies	9,021,192	6,747,640
Prepaid expenses	70,355	82,571
Total current assets	43,913,533	33,353,184
<u>Utility plant and equipment:</u>		
Utility plant, net of accumulated depreciation	53,685,796	56,663,128
<u>Other Assets</u>		
Asset retirement obligation, net of accumulated amortization	547,445	-
Total Assets	98,146,774	90,016,312
<u>Deferred outflows of resources:</u>		
Deferred outflows of resources	2,329,422	1,322,051
Total assets and deferred outflows of resources	\$100,476,196	\$ 91,338,363
<u>Liabilities:</u>		
<u>Current liabilities:</u>		
Accounts payable and accrued expenses	\$ 6,826,151	\$ 5,132,906
Accounts payable-Construction in progress Station Two	201,264	1,541,776
Current portion-bonds payable	650,000	630,000
Customer deposits	679,103	652,901
Total current liabilities	8,356,518	7,957,583
<u>Long-term liabilities:</u>		
Accrued compensated absences	267,413	254,089
Long-term portion bonds payable	10,760,000	11,410,000
Asset retirement obligation	1,327,136	380,771
Net pension liability	6,464,451	5,994,076
Net Other post-employment benefits liability	2,220,242	-
Total long-term liabilities	21,039,242	18,038,936
Total liabilities	29,395,760	25,996,519
<u>Deferred inflows of resources:</u>		
Deferred inflows of resources	665,557	90,173
<u>Net position:</u>		
Net investment in capital assets	42,275,796	44,623,128
Restricted per bond ordinance	2,358,385	2,322,123
Unrestricted	25,780,698	18,306,420
Total net position	70,414,879	65,251,671
Total liabilities, deferred inflows of resources, and net position	\$100,476,196	\$ 91,338,363

The accompanying notes are an integral part of these financial statements.

City of Henderson, Kentucky Utility Commission
Statements of Revenues, Expenses, and Changes in Net Position
For the fiscal years ended May 31, 2018 and 2017

<u>Operating revenues:</u>	<u>2018</u>	<u>2017</u>
Sale of electricity-Existing System	\$ 43,837,429	\$ 41,658,367
Sale of electricity-Station Two	18,461,405	23,657,235
Communication services	1,096,134	1,124,748
Other	469,366	679,669
Total operating revenues	<u>63,864,334</u>	<u>67,120,019</u>
<u>Operating expenses:</u>		
Production of electricity	44,403,951	49,421,696
Operating expenses	11,388,052	10,767,342
Depreciation	5,050,104	4,992,227
Total operating expenses	<u>60,842,107</u>	<u>65,181,265</u>
Income from operations	<u>3,022,227</u>	<u>1,938,754</u>
<u>Interest income (expense):</u>		
Investment income	196,266	107,894
Interest expense	(443,038)	(457,500)
Total interest income (expense)	<u>(246,772)</u>	<u>(349,606)</u>
Income before non-operating items	<u>2,775,455</u>	<u>1,589,148</u>
<u>Non-operating items:</u>		
Station Two-Excess Energy Settlement	6,250,000	-
Transfers to the City of Henderson	(1,244,724)	(1,244,724)
Power furnished to the City of Henderson	(581,349)	(423,207)
Communication services provided to the City of Henderson and other local government agencies	(174,732)	(237,000)
Total non-operating items	<u>4,249,195</u>	<u>(1,904,931)</u>
Change in net position	7,024,650	(315,783)
Cumulative effect of change in accounting principle - adoption of Governmental Accounting Standards Board Statement No. 75	(1,600,373)	-
Prior period adjustment-asset retirement obligation	(261,069)	-
Net position, beginning of year	65,251,671	65,567,454
Net position, end of year	<u>\$ 70,414,879</u>	<u>\$ 65,251,671</u>

The accompanying notes are an integral part of these financial statements.

City of Henderson, Kentucky Utility Commission
Statements of Cash Flows
For the fiscal years ended May 31, 2018 and 2017

	2018	2017
<u>Cash flows from operating activities:</u>		
Receipts from customers	\$ 70,776,030	\$ 66,306,257
Payments to suppliers and vendors	(54,499,649)	(56,830,114)
Payments to employees	(4,627,000)	(4,842,073)
Net cash provided by operating activities	11,649,381	4,634,070
<u>Cash flows from non-capital financing activities:</u>		
Distributions to the City of Henderson	(1,244,724)	(1,244,724)
Net cash used by non-capital financing activities	(1,244,724)	(1,244,724)
<u>Cash flows from capital and related financing activities:</u>		
Acquisition and construction of capital assets	(2,072,772)	(2,004,932)
Principal payments on long-term debt	(630,000)	(620,000)
Interest payments on long-term debt	(443,038)	(457,500)
Net cash used by capital and related financing activities	(3,145,810)	(3,082,432)
<u>Cash flows from investing activities:</u>		
Proceeds from sale and maturities of investments	2,365,549	7,010,865
Investment income	222,326	107,893
Purchases of investment securities	(1,309,029)	(5,516,817)
Net cash provided by investing activities	1,278,846	1,601,941
Increase in cash and cash equivalents	8,537,693	1,908,855
Cash and cash equivalents, beginning of year	2,348,311	439,456
Cash and cash equivalents, end of year	\$ 10,886,004	\$ 2,348,311

The accompanying notes are an integral part of these financial statements.

City of Henderson, Kentucky Utility Commission
Statements of Cash Flows – Reconciliation of Net Cash Provided by Operations
For the fiscal years ended May 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
<u>Operating activities:</u>		
Operating income	\$ 3,022,227	\$ 1,938,754
<u>Adjustments to reconcile operating income</u>		
<u>(loss) to net cash provided by operations:</u>		
Depreciation	5,050,104	4,992,227
Excess energy settlement proceeds	6,250,000	-
Power furnished to the City of Henderson	(581,349)	(423,207)
Communication services provided at no charge	(174,732)	(237,000)
Cumulative effect of change in accounting principle	(1,600,373)	-
Prior period adjustment	(261,069)	-
<u>Changes in operating assets and liabilities:</u>		
Accounts receivable	609,071	(1,190,504)
Due from Station Two Operator	(801,623)	470,718
Accrued revenue	(651,348)	(552,096)
Inventory and supplies	(2,273,552)	(1,038,875)
Prepaid expenses and other assets	12,216	(21,636)
Accounts payable and accrued expenses	1,706,569	37,026
Accounts payable-construction	(1,340,512)	216,555
Net pension liability and Other post employment benefits- deferred inflows and outflows	2,258,630	434,326
Asset retirement obligation	398,920	-
Customer deposits	26,202	7,782
	<u>\$ 11,649,381</u>	<u>\$ 4,634,070</u>
<u>Supplemental Information</u>		
<u>Non-cash activity:</u>		
Power furnished to the City of Henderson	\$ 581,349	\$ 423,207
Communication services provided at no charge	174,732	237,000

The accompanying notes are an integral part of these financial statements.

1. Organization and Contracts:

The City of Henderson Utility Commission is organized under the provisions of Section 96.530 of the Kentucky Revised Statutes to operate, manage, and control the Henderson Municipal Power & Light System. The members of the Utility Commission are appointed by the Mayor and are approved by the City Commissioners of the City of Henderson, Kentucky (City). The Mayor and the City Commission authorize all rates and bond issues of the Utility Commission. As a municipal entity, the Utility Commission is exempt from all federal and state income taxes. Certain real estate utilized by the Utility Commission is owned by the City of Henderson.

The Utility Commission operates the "Existing System" and pursuant to certain contracts and agreements described as follows, reserves power from "Station Two" which is owned by the Commission, and currently operated by Big Rivers Electric Corporation (Big Rivers), pursuant to various lease, assignment, and other agreements between the parties.

The Commission provides retail electric service to the residents of the City of Henderson within its service territory. The Commission also provided wholesale electricity to Big Rivers through July 18, 1998 and subsequently to an affiliate of LG&E Energy Corporation. LG&E was purchased by Powergen in 2000 and thereafter acquired by E.ON. Effective July 16, 2009, Big Rivers resumed its role as operator of Station Two as part of the "Unwind Transaction."

The Commission entered into certain contracts with Big Rivers relating to Station Two, as follows:

A. Power Plant Construction and Operation Agreement:

Under this agreement, Big Rivers agreed to furnish certain construction and start-up services for which it was paid out-of-pocket expenses plus overhead allowances and operate Station Two upon completion for which the Station Two Operator is paid reasonable expenditures allocable to the operation and maintenance of Station Two, as defined in the agreement. The original agreement was amended to include an option to extend through the useful operating life of Station Two. Big Rivers exercised this option in 1998.

B. Power Sales Contract:

Under this agreement, the Station Two Operator purchases all of the Station Two capacity in excess of the City of Henderson's requirements. Payments for capacity purchased by the Station Two Operator are made monthly based on the portion of Station Two capacity allocated to the Station Two Operator compared to the total monthly Station Two capacity costs as defined in the agreement. The original agreement was executed in 1970 and extended through 2023. During 1993, the agreement was amended to include an option to extend through the useful operating life of Station Two. Big Rivers exercised this option in 1998.

C. Joint Facilities Agreement:

This agreement provides for the continuing joint use by the Commission and Station Two Operator of certain auxiliary facilities presently owned and used by the Station Two Operator at its generating station and of auxiliary facilities provided by the Commission in connection with the construction of Station Two, which is located adjacent to the generating station and also operated by the Station Two Operator.

1. Organization and Contracts, continued:

Power sales to the Station Two Operator under the agreement amounted to \$18,461,405 and \$23,657,235 for the fiscal years ended May 31, 2018 and 2017, respectively.

In connection with the negotiations related to the funding and construction of the Flue Gas Desulfurization System (FGD System) Station Two various aforementioned contracts were amended effective May 31, 1993. Significant provisions of the amendments include:

- The total capacity of Station Two, a factor in determining various Station Two cost allocations, was reduced as a result of the power required to operate the FGD System.
- FGD System costs, up to the amount of proceeds from the sale of Emission Allowances, will be borne in the same proportion as the Emission Allowances are allocated. Additional FGD System costs will be borne in proportion to the new capacity allocation as determined by the contract amendments.
- The Commission will reimburse the Station Two Operator for certain allocated costs of the existing Big Rivers' FGD System to be jointly used by the Station Two Operator and Station Two based upon an allocation formula defined in the amendments.

Amounts charged by the Station Two Operator as reasonable expenditures allocable to the operation and maintenance of Station Two are subject to review and approval by the Commission. Differences, if any, between amounts originally charged as allocable by the Station Two Operator and amounts accepted by the Utility Commission are recorded when a final determination of such amounts is made. Operating revenues and expenses would be reduced by any amount subsequently determined not to be allocable to Station Two.

Station Two became commercially operable and construction was substantially completed during 1974.

2. Summary of Significant Accounting Policies:

The Commission is a component unit of the City of Henderson, Kentucky (the primary government), due to its financial accountability to the City Commission.

The financial statements of the Commission have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the fund's principal ongoing operations. The principal operating revenues of the Commission are charges to customers for electric and communications sales and service.

Operating expenses for the Commission include the cost of power and services, administrative expenses, and depreciation. All other revenues and expenses not meeting this definition are classified as non-operating items.

2. **Summary of Significant Accounting Policies, continued:**

Statement of Net Position:

The Statement of Net Position is designed to display the financial position of the Commission. The Commission's fund equity is reported as a net position, which is presented in three categories defined as follows:

- **Net investment in capital assets-** This component of net position consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- **Restricted-** This component of net position consists of constraints placed on net position use through external constraints imposed by creditors through debt covenants.
- **Unrestricted-** This component of net position consists of the remainder of net position that does not meet the definition of restricted or invested in capital assets, net of related debt.

Statement of Revenues, Expenses, and Changes in Net Position:

The Statement of Revenues, Expenses, and Changes in Net Position is the operating statement for proprietary funds. Revenues are reported by major source. This statement distinguishes between operating and non-operating revenues and expenses, and presents a separate subtotal for operating revenues, operating expenses, and operating income. The more significant of the Commission's accounting policies are described below:

A. Cash and Cash Equivalents:

Cash and cash equivalents consist of certificates of deposit and repurchase agreements with an original maturity of three months or less from the date of purchase. The carrying amount of each of these instruments approximates fair value.

B. Investment Securities:

Investments are recorded at fair value based on quoted market prices. Any gains or losses are reflected in the statement of revenues, expenses, and changes in net assets in accordance with GASB No. 31, "Accounting and Reporting For Certain Investments and For Internal Investment Pools." Kentucky Revised Statute 66.480 limits the types of securities that a municipal entity may invest in to obligations of the United States Treasury and its agencies, certain Federal securities, repurchase agreements, commercial bank certificates of deposit, and the Commonwealth of Kentucky Investment Pool.

2. Summary of Significant Accounting Policies, continued:

C. Accounts Receivable and Unbilled Revenue:

The Commission has entered into an agreement with the City of Henderson to perform its billing and collection services. All monies due to the Utility Commission are collected and deposited in the City of Henderson’s Utility Clearing Fund and are remitted to the Utility Commission on a weekly basis. The amount included in accounts receivable due from the Utility Clearing Fund was \$2,335,956 and \$3,144,595 as of May 31, 2018 and 2017, respectively. The allowance for uncollectible amounts was \$170,925 and \$48,063 for the fiscal years ended May 31, 2018

D. Inventory:

The fuel and lime inventory is stated at cost using the first-in-first-out method. Materials and supplies are stated at the weighted average cost.

E. Utility Plant and Equipment:

The utility plant is carried at cost, which includes capitalized interest, aggregating \$15,342,300, which was capitalized during the period of construction. No interest was capitalized during the fiscal years ended May 31, 2018 and 2017. The Commission capitalizes all items in excess of \$1,000. The Commission’s policy for determining the useful lives of its utility plant and equipment is as follows:

Production plant and structures	33 ½	years
Transmission and distribution	25	years
Automotive equipment	6	years
Wireless internet equipment	5	years
Other equipment	10	years

F. Use of Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at May 31, 2018 and 2017, as well as revenues and expenses for the years then ended. Actual results could differ from the estimates and assumptions used.

G. Compensated Absences:

Employees of the Commission are entitled to paid vacations and sick-leave. The Commission’s policy is to recognize these costs when earned under the accrual method of accounting in accordance with GASB No.16 “Accounting for Compensated Absences.”

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Compensated Absences	\$ 453,730	\$ 74,268	\$ (51,924)	\$ 476,074

Current portion (included in accounts payable and accrued expenses)	\$ 208,661
Long-term portion	267,413
	<u>\$ 476,074</u>

2. Summary of Significant Accounting Policies, continued:

H. New Accounting Pronouncements:

The Commission implemented Governmental Accounting Standards Board (GASB) Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* and GASB Statement No. 82, *Pensions Issues*. The provisions of these statements are effective for financial statements for fiscal years beginning after June 15, 2017. The implementation of GASB Statements No. 75 and 82 resulted in a cumulative effect of change in accounting principle which reduced the net position of the Commission by \$1,600,373. Additionally, implementation of the new GASB statements also resulted in the recording of related deferred outflows and inflows of resources and OPEB liability which is further discussed in Note 6.

I. Pensions:

In the component unit financial statements of the City of Henderson, Kentucky Utility Commission, retirement plans (pensions) are required to be recognized and disclosed using the accrual basis of accounting (Refer to Note 6).

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions and pension expense, information about the fiduciary net position of the County Employees' Retirement System (CERS), and additions to/deductions from CERS' 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 recorded at fair value.

J. Postemployment Benefits Other Than Pensions (OPEB):

In the component unit financial statements of the City of Henderson, Kentucky Utility Commission, postemployment benefits other than pensions (OPEB) are required to be recognized and disclosed using the accrual basis of accounting (Refer to Note 6).

For purposes of measuring the net OPEB liability, deferred outflows of resources and deferred inflows of resources related to OPEB, and OPEB expense, information about the fiduciary net position of the County Employees' Retirement System (CERS) and additions to/deductions from CERS' 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.

K. Emission Allowances:

The Commission does not record the value of emission allowances granted by the Environmental Protection Agency for sulfur dioxide and nitrous oxide on its financial statements as there is no cost basis in these allowances.

L. Bond Issuance Costs:

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

City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements-May 31, 2018

3. Cash and Cash Equivalents:

As of May 31, 2018 and 2017, the City of Henderson, Kentucky Utility Commission maintained deposits with several local financial institutions. Of the bank balance, all was insured by the Federal Deposit Insurance Corporation and any amounts in excess of FDIC coverage were secured by pledged United States Government securities.

4. Investment Securities:

Investments are included in the Statement of Net Position under the caption "Investments-restricted/unrestricted." A summary of investments held by the City of Henderson, Kentucky Utility Commission along with the scheduled maturities is presented below:

<u>Investment Type:</u>	<u>Fair Value</u>	<u>Less Than One Year</u>	<u>One to Five Years</u>	<u>Six to Ten Years</u>
<u>May 31, 2018</u>				
<u>Unrestricted Investments:</u>				
U.S. Treasury Bills	\$ 10,212,213	\$ 10,212,213	\$ -	\$ -
Certificate of Deposit and Money Markets	1,590,557	1,590,557	-	-
Total Unrestricted Investments	<u>\$ 11,802,770</u>	<u>\$ 11,802,770</u>	<u>\$ -</u>	<u>\$ -</u>

<u>Restricted Per Bond Ordinance:</u>				
Certificate of Deposit and Money Markets	\$ 2,358,385	\$ 2,358,385	\$ -	\$ -
Total Restricted Investments	<u>\$ 2,358,385</u>	<u>\$ 2,358,385</u>	<u>\$ -</u>	<u>\$ -</u>

<u>May 31, 2017</u>	<u>Fair Value</u>	<u>Less Than One Year</u>	<u>One to Five Years</u>	<u>Six to Ten Years</u>
<u>Unrestricted Investments:</u>				
U.S. Treasury Bills	\$ 10,108,549	\$ 10,108,549	\$ -	\$ -
Certificate of Deposit and Money Markets	2,813,063	2,813,063	-	-
Total Unrestricted Investments	<u>\$ 12,921,612</u>	<u>\$ 12,921,612</u>	<u>\$ -</u>	<u>\$ -</u>

<u>Restricted Per Bond Ordinance:</u>				
Certificate of Deposit and Money Markets	\$ 2,322,123	\$ 2,322,123	\$ -	\$ -
Total Restricted Investments	<u>\$ 2,322,123</u>	<u>\$ 2,322,123</u>	<u>\$ -</u>	<u>\$ -</u>

<u>Restricted Assets consisted of the following:</u>	<u>2018</u>	<u>2017</u>
Operation and Maintenance Reserve	\$ 600,000	\$ 600,000
Debt Service Reserve	1,088,868	1,112,724
Debt Service Sinking Fund	669,517	609,399
Total restricted assets	<u>\$ 2,358,385</u>	<u>\$ 2,322,123</u>

A. Interest Rate Risk:

The City of Henderson, Kentucky Utility Commission has a formal investment policy that limits investment maturities as a means to manage its exposure to fair value losses resulting from increasing interest rates.

4. Investment Securities, continued:

B. Credit Risk:

The City of Henderson, Kentucky Utility Commission limits its investments to those allowed by Kentucky Revised Statute 66.480. Kentucky Revised Statute 66.480 limits investments to U.S. Government Treasury and Agency securities, certificates of deposit, securities issued by a state or local government rated in one of the three highest categories by a nationally recognized credit agency.

C. Custodial Credit Risk:

Custodial credit risk is the risk that in the event of the failure of the counterparty, The City of Henderson, Kentucky Utility Commission will not be able to recover the value of its investments, or collateral securities that are in the possession of the outside party. All investments of the Commission, with the exception of certificates of deposit, consist of unregistered and uninsured securities held by the Commission's trustee in their trust department not in the name of the Commission.

5. Utility Plant and Equipment:

Utility plant and equipment consisted of the following as of May 31, 2018 and 2017:

<u>May 31, 2018</u>				<u>Ending</u>
<u>Existing System:</u>	<u>Beginning</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u>
	<u>Balance</u>			
Vehicles	\$ 2,188,443	\$ 381,479	\$ (175,129)	\$ 2,394,793
Transmission plant	8,713,949	38,553	-	8,752,502
Distribution plant	27,485,333	556,712	-	28,042,045
Land and land rights	1,235,451	53,100	-	1,288,551
Telecommunications, internet, and fiber optics	6,096,984	479,881	(679)	6,576,186
General plant	54,350	98,729	-	153,079
	<u>45,774,510</u>	<u>1,608,454</u>	<u>(175,808)</u>	<u>47,207,156</u>
Accumulated depreciation	<u>(35,383,736)</u>	<u>(910,049)</u>	<u>319,070</u>	<u>(35,974,715)</u>
Existing System total	<u>\$ 10,390,774</u>	<u>\$ 698,405</u>	<u>\$ 143,262</u>	<u>\$ 11,232,441</u>
<u>Station Two:</u>				
General plant	\$ 185,769,194	\$ 321,056	\$ -	\$ 186,090,250
Accumulated depreciation	<u>(139,496,840)</u>	<u>(4,140,055)</u>	<u>-</u>	<u>(143,636,895)</u>
Station Two total	<u>\$ 46,272,354</u>	<u>\$(3,818,999)</u>	<u>\$ -</u>	<u>\$ 42,453,355</u>
Total utility, plant, and equipment, net	<u>\$ 56,663,128</u>			<u>\$ 53,685,796</u>

5. **Utility Plant and Equipment, continued:**

<u>May 31, 2017</u>	<u>Beginning</u>			<u>Ending</u>
<u>Existing System:</u>	<u>Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u>
Vehicles	\$ 2,125,157	\$ 84,434	\$ (21,148)	\$ 2,188,443
Transmission plant	8,681,118	32,831	-	8,713,949
Distribution plant	26,996,524	493,283	(4,474)	27,485,333
Land and land rights	1,235,451	-	-	1,235,451
Telecommunications, internet, and fiber optics	5,977,019	145,529	(25,564)	6,096,984
General plant	54,350	-	-	54,350
	<u>45,069,619</u>	<u>756,077</u>	<u>(51,186)</u>	<u>45,774,510</u>
Accumulated depreciation	<u>(34,551,063)</u>	<u>(883,859)</u>	<u>51,186</u>	<u>(35,383,736)</u>
Existing System total	<u>\$ 10,518,556</u>	<u>\$ (127,782)</u>	<u>\$ -</u>	<u>\$ 10,390,774</u>
 <u>Station Two:</u>				
General plant	\$ 184,520,339	\$ 1,248,855	\$ -	\$ 185,769,194
Accumulated depreciation	<u>(135,388,472)</u>	<u>(4,108,368)</u>	<u>-</u>	<u>(139,496,840)</u>
Station Two total	<u>\$ 49,131,867</u>	<u>\$ (2,859,513)</u>	<u>\$ -</u>	<u>\$ 46,272,354</u>
Total utility, plant, and equipment, net	<u>\$ 59,650,423</u>			<u>\$ 56,663,128</u>

Depreciation expense for the fiscal years ended May 31, 2018 and 2017 was \$5,050,104 and \$4,992,227 respectively.

6. **Retirement Plans:**

General Information about the Pension Plan

Plan description: All eligible Commission employees participate in the County Employees' Retirement System (CERS), a cost-sharing, multiple-employer defined benefit plan administered by the Board of Trustees of Kentucky Retirement Systems. CERS consists of two plans – Non-Hazardous and Hazardous. Commission employees participate in the Non-Hazardous plan only. Kentucky Retirement Systems issues a publicly available financial report that includes financial statements and supplementary information for CERS. That report can be obtained at <https://kyret.ky.gov>.

Benefits provided: CERS provides retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Kentucky Revised Statute 61.645 assigns the authority to establish and amend benefit provisions to the Kentucky Retirement Systems Board of Trustees.

6. Retirement Plans, continued:

Cost of Living Adjustment (COLA): Prior to July 1, 2009, COLAs were provided annually equal to the percentage increase in the annual average of the consumer price index for all urban consumers for the most recent calendar year, not to exceed 5% in any plan year. After July 1, 2009, the COLAs were limited to 1.50%. No COLA has been granted since July 1, 2011.

Contributions: Tier 1 plan members, who began participating prior to September 1, 2008, are required to contribute 5% of their annual creditable compensation. These members are classified in the Tier 1 structure of benefits. Interest is paid each June 30 on members' accounts at a rate of 2.5%. If a member terminates employment and applies to take a refund, the member is entitled to a full refund of contributions and interest.

Tier 2 plan members, who began participating on, or after, September 1, 2008, and before January 1, 2014, are required to contribute 6% of their annual creditable compensation, while 1% of these contributions are deposited to an account created for the payment of health insurance benefits under 25 USC Section 401(h) in the Pension Fund. These members are classified in the Tier 2 structure of benefits. Interest is paid each June 30 on members' accounts at a rate of 2.5%. If a member terminates employment and applies to take a refund, the member is entitled to a full refund of contributions and interest; however, the 1% contribution to the 401(h) account is non-refundable and is forfeited.

Tier 3 plan members, who began participating on, or after, January 1, 2014, are required to contribute to the Cash Balance Plan. The Cash Balance Plan is known as a hybrid plan because it has characteristics of both a defined benefit plan and a defined contribution plan. Members in the plan contribute a set percentage of their salary each month to their own account. Members contribute 5% of their annual creditable compensation, and an additional 1% to the health insurance fund (401(h) account) which is not credited to the member's account and is not refundable. The employer contribution rate is set annually by the Kentucky Retirement System Board of Trustees based on an actuarial valuation. The employer contributes a set percentage of the member's salary. Each month, when employer contributions are received, an employer pay credit is deposited to the member's account. A member's account is credited with a 4% employer pay credit. The employer pay credit represents a portion of the employer contribution.

Interest is paid into the Tier 3 member's account. The account currently earns 4% interest credit on the member's account balance as of June 30 of the previous year. The member's account may be credited with additional interest if the system's five-year Geometric Average Net Investment Return (GANIR) exceeded 4%. If the member was actively employed and participating in the fiscal year, and if the system's GANIR for the previous five years exceeds 4%, then the member's account will be credited with 75% of the amount of the returns over 4% on the account balance as of June 30 of the previous year (Upside Sharing Interest). The Upside Sharing Interest is credited to both the member contribution balance and Employer Pay Credit Balance.

The Commission is required to contribute at an actuarially determined rate. As of May 31, 2018, the Commission's required contribution rate was 14.48% of annual covered payroll. The contribution requirements of plan members and the Commission are established and may be amended by the Kentucky Retirement Systems Board of Trustees. Contributions to CERS from the Commission were \$439,750 for the year ended May 31, 2018.

6. Retirement Plans, continued:

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

At May 31, 2018, the Commission reported a liability of \$6,464,451 for its proportionate share of the collective net pension liability. The collective net pension liability was measured as of June 30, 2017, and the total pension liability used to calculate the collective net pension liability was determined by an actuarial valuation as of June 30, 2016 and rolled-forward using generally accepted actuarial principles. The Commission's proportion of the collective net pension liability was based on a projection of the Commission's long-term share of contributions to the pension plan relative to the projected contributions of all participating employers, actuarially determined. At June 30, 2017, the Commission's proportion was 0.110441%, which was a decrease of 0.011300% from its proportion measured as of June 30, 2016.

For the year ended May 31, 2018, the Commission recognized pension expense of \$960,604. At May 31, 2018, the Commission reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	\$ 8,018	\$ 164,095
Changes of assumptions	1,192,866	-
Net difference between projected and actual investment earnings on pension plan investments	79,958	-
Changes in proportion and differences between Commission contributions and proportional share of contributions	10,118	385,216
Commission contributions subsequent to the measurement date	<u>439,750</u>	<u>-</u>
Total	<u>\$ 1,730,710</u>	<u>\$ 549,311</u>

Of the total amount reported as deferred outflows of resources related to pensions, \$439,750 resulting from Commission contributions subsequent to the measurement date and before the end of the fiscal year will be included as a reduction of the collective net pension liability in the year ended May 31, 2019. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in the Commission's pension expense as follows:

<u>Year ended May 31:</u>	<u>Amount</u>
2019	\$ 333,825
2020	340,464
2021	150,366
2022	(83,006)
2023	-
Thereafter	-

6. Retirement Plans, continued:

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

Inflation	2.30%
Payroll Growth	2.00%
Investment Rate of Return	6.25%, including inflation

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 one year for females). For disabled members, the RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (set back four years for males) is used for the period after disability retirement.

The actuarial assumptions used in the June 30, 2017 valuation were based on the results of an actuarial experience study for the period July 1, 2008 - June 30, 2013.

In July 2017, Kentucky Retirement Systems approved new asset allocations and, after reviewing capital market assumptions from eight leading investment and/or consulting firms, lowered the assumed rate of return from 7.50% to 6.25% to more realistically reflect the need to reduce volatility and increase the liquidity of the investments. Target asset allocations are summarized below.

Asset Class	Target Allocation
U.S. Equity	25.60%
International Equity	25.20%
Global Fixed	6.80%
Credit Fixed	7.20%
Real Return	8.00%
Private Equity	10.00%
Real Estate	5.00%
Absolute Return	10.00%
Cash Equivalent	2.20%
Total	100%

Discount rate: The projection of cash flows used to determine the discount rate of 6.25% assumed that local employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 26 year (closed) amortization period of the unfunded actuarial accrued liability. The discount rate determination does not use a municipal bond rate.

Sensitivity of the Commission's proportionate share of the collective net pension liability to changes in the discount rate: The following presents the Commission's proportionate share of the collective net pension liability calculated using the discount rate of 6.25%, as well as what the Commission's proportionate share of the collective net pension liability would be if it were calculated using a discount rate that is one percentage point lower (5.25%) or one percentage point higher (7.25%) than the current rate:

6. Retirement Plans, continued:

	<u>1.00% Decrease (5.25%)</u>	<u>Current Discount Rate (6.25%)</u>	<u>1.00% Increase (7.25)</u>
Commission's proportionate share of the collective net pension liability	<u>\$ 8,153,070</u>	<u>\$ 6,464,451</u>	<u>\$ 5,051,934</u>

Pension plan fiduciary net position: Detailed information about the pension plan's fiduciary net position is available in the separately issued Kentucky Retirement Systems financial report.

Postemployment Benefits Other Than Pensions (OPEB)

General Information about the OPEB Plan

Plan description: In addition to the pension benefits described above, Kentucky Retirement Systems provides postemployment healthcare benefits through the Kentucky Retirement Systems Insurance Fund (Insurance Fund). The Insurance Fund was established to provide hospital and medical insurance for those receiving benefits from the Kentucky Employees' Retirement System (KERS), the County Employees' Retirement System (CERS), and the State Police Retirement System (SPRS). Eligible non-Medicare retirees are covered by the Department of Employee Insurance (DEI) plans. Kentucky Retirement Systems submits the premium payments to DEI. The Board contracts with Humana to provide health care benefits to eligible Medicare retirees through a Medicare Advantage Plan.

Benefits Provided: The Insurance Fund pays a prescribed contribution for whole or partial payment of required premiums to purchase hospital and medical insurance. For the fiscal year ended June 30, 2017 (the date of the latest available information), insurance premiums withheld from benefit payments for members of CERS were \$22.9 million and \$2.7 million for non-hazardous and hazardous employees, respectively. For the fiscal year ended June 30, 2016, insurance premiums withheld from benefit payments for members of CERS were \$22.6 million and \$2.2 million for non-hazardous and hazardous employees, respectively. The Insurance Fund pays the same proportion of hospital and medical insurance premiums for the spouse and dependents of retired hazardous employees killed in the line of duty.

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

<u>Years of Service</u>	<u>% Paid by Insurance Fund</u>
20 or more	100%
15 - 19	75%
10 - 14	50%
4 - 9	25%
Less than 4	0%

6. Retirement Plans, continued:

As a result of House Bill 290 (2004 Kentucky General Assembly), medical insurance benefits are calculated differently for those who began participating on or after July 1, 2003. Once employees reach a minimum vesting period of ten 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 Kentucky Revised Statute 16.652, 61.692, and 78.852. The Kentucky General Assembly reserves the right to suspend or reduce this benefit if, in its judgment, the welfare of the Commonwealth so demands.

Contributions: The Commission is required to contribute at an actuarially determined rate. As of May 31, 2018, the Commission's required contribution rate was 4.70% of annual covered payroll. The contribution requirements of plan members and the Commission are established and may be amended by the Kentucky Retirement Systems Board of Trustees. Contributions to the Insurance Fund from the Commission were \$142,736 for the year ended May 31, 2018. As described above, Tier 2 and Tier 3 employees contribute 1% of their annual creditable compensation to the Insurance Fund; Tier 1 employees are not required to contribute.

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

At May 31, 2018, the Commission reported a liability of \$2,220,242 for its proportionate share of the collective net OPEB liability. The collective net OPEB liability was measured as of June 30, 2017, and the total OPEB liability used to calculate the collective net OPEB liability was determined by an actuarial valuation as of June 30, 2016 and rolled-forward using generally accepted actuarial principles. The Commission's proportion of the collective net OPEB liability was based on a projection of the Commission's long-term share of contributions to the OPEB plan relative to the projected contributions of all participating employers, actuarially determined. At June 30, 2017, the Commission's proportion was 0.110441%.

6. Retirement Plans, continued:

For the year ended May 31, 2018, the Commission recognized OPEB expense of \$280,139. At May 31, 2018, the Commission reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	\$ -	\$ 6,167
Changes of assumptions	483,111	-
Net difference between projected and actual investment earnings on pension plan investments	-	104,927
Changes in proportion and differences between Commission contributions and proportional share of contributions	-	5,152
Commission contributions subsequent to the measurement date	115,601	-
Total	<u>\$ 598,712</u>	<u>\$ 116,246</u>

Of the total amount reported as deferred outflows of resources related to OPEB, \$115,601 resulting from Commission contributions subsequent to the measurement date and before the end of the fiscal year will be included as a reduction of the collective net OPEB liability in the year ended May 31, 2019. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to OPEB will be recognized in the Commission's OPEB expense as follows:

<u>Year ended May 31:</u>	<u>Amount</u>
2019	\$ 63,122
2020	63,122
2021	63,122
2022	63,122
2023	89,354
Thereafter	25,023

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

Inflation	2.30%
Payroll Growth	2.00%
Investment Rate of Return	6.25%, including inflation
Healthcare 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.
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.

6. Retirement Plans, continued:

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 one year for females). For disabled members, the RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (set back four years for males) is used for the period after disability retirement.

The actuarial assumptions used in the June 30, 2017 valuation were based on the results of an actuarial experience study for the period July 1, 2008 - June 30, 2013.

In July 2017, Kentucky Retirement Systems approved new asset allocations and, after reviewing capital market assumptions from eight leading investment and/or consulting firms, lowered the assumed rate of return from 7.50% to 6.25% to more realistically reflect the need to reduce volatility and increase the liquidity of the investments. Target asset allocations are summarized below.

Asset Class	Target Allocation
U.S. Equity	26.50%
International Equity	26.50%
Global Fixed	6.00%
Credit Fixed	6.00%
Real Return	8.00%
Private Equity	10.00%
Real Estate	5.00%
Absolute Return	10.00%
Cash Equivalent	2.00%
Total	100%

The fully-insured premiums Kentucky Retirement Systems pays for the CERS Health Insurance Plan are blended rates based on the combined experience of active and retired members. Because the average cost of providing health care benefits to retirees under age 65 is higher than the average cost of providing health care benefits to active employees, there is an implicit employer subsidy for the non-Medicare eligible retirees. GASB 75 requires that the liability associated with this implicit subsidy be included in the calculation of the total OPEB liability.

Discount rate: The projection of cash flows used to determine the discount rate of 5.84% assumed that local employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 26 year (closed) amortization period of the unfunded actuarial accrued liability. The discount rate determination used an expected rate of return of 6.25%, and a municipal bond rate of 3.56%, as reported in Fidelity Index's "20-Year Municipal GO AA Index" as of June 30, 2017. 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 was included in the calculation of the system's actuarially determined contributions, and any cost associated with the implicit subsidy will not be paid out of the system's trusts. Therefore, the municipal bond rate was applied to future expected benefit payments associated with the implicit subsidy.

6. Retirement Plans, continued:

Sensitivity of the Commission's proportionate share of the collective net OPEB liability to changes in the discount rate: The following presents the Commission's proportionate share of the collective net OPEB liability calculated using the discount rate of 5.84%, as well as what the Commission's proportionate share of the collective net OPEB liability would be if it were calculated using a discount rate that is one percentage point lower (4.84%) or one percentage point higher (6.84%) than the current rate:

	1.00% Decrease (4.84%)	Current Discount Rate (5.84%)	1.00% Increase (6.84)
Commission's proportionate share of the collective net OPEB liability	\$ 2,825,135	\$ 2,220,242	\$ 1,716,876

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

	1.00% Decrease	Healthcare Cost Trend Rate	1.00% Increase
Commission's proportionate share of the collective net OPEB liability	\$ 1,703,040	\$ 2,220,242	\$ 2,892,574

OPEB plan fiduciary net position: Detailed information about the OPEB plan's fiduciary net position is available in the separately issued Kentucky Retirement Systems financial report.

7. Accounts Payable and Accrued Expenses:

Accounts payable and accrued expenses consisted of the following as of May 31, 2018 and 2017:

	2018	2017
Accounts payable and accrued expenses - Existing System	\$ 3,418,730	\$ 1,871,559
Accounts payable and accrued liabilities - Station Two	3,407,421	3,261,347
Total	\$ 6,826,151	\$ 5,132,906

8. Long-Term Debt – Revenue Bonds:

During the fiscal year ended May 31, 2012, the City of Henderson, Kentucky Utility Commission issued revenue bonds for the purpose of financing capital improvements throughout its system through two revenue bond series, *Electric System Revenue Bonds, Series 2011A* in the amount of \$11,350,000, and *Electric System Revenue Bonds, Series 2011 B*, in the amount of \$3,670,000.

The bond ordinance requires that certain accounts for each issue be established and held by a trustee as follows:

Debt Service Fund:

A monthly transfer of 1/12 of principal and 1/6 of the interest due is required to be deposited in the Debt Service Fund.

Debt Service Reserve Fund:

A reserve account was established, so that as of any date of calculation, an amount equal to at least the highest amount of aggregate debt service, or an amount equal to 125% of the average aggregate debt service and an amount equal to 10% of the “proceeds” of the bonds with respect to all series is maintained by the Commission.

Series 2011A:

The Series 2011A bonds are secured by a pledge of the revenues of the City of Henderson, Kentucky Utility Commission. The Series 2011A Bonds are additionally secured by a debt service reserve and a non-foreclosable statutory mortgage lien on the System. The Series 2011A Bonds are also secured by a debt service reserve in an amount equal to the least of the maximum annual debt service on the Series 2011A Bonds. The proceeds from the sale of these bonds were used to retire the Bond Anticipation Note, Series 2008B in the amount of \$5,281,067, with the remaining proceeds to be used for capital improvements of the City’s electric transmission and distribution system, and at its Station Two generating station. Interest is due semi-annually on these obligations on December 1st and June 1st of each year.

It is the opinion from the City of Henderson, Kentucky Utility Commission’s bond counsel, that under existing laws, interest on the Series 2011A Bonds is not subject to income tax.

Optional Redemption Series 2011A:

The Series 2011A Bonds maturing on and after December 1, 2021, are subject to redemption by the City, at its option, before maturity on September 1, 2021, and on any date thereafter in whole or from time to time in part in any order of maturity (less than all of a single maturity to be selected by lot in such manner as the Trustee and Paying Agent may determine) at a redemption price equal to 100% of the principal amount thereof plus accrued interest to the redemption date.

Series 2011B:

The Series 2011B bonds are secured by a pledge of the revenues of the City of Henderson, Kentucky Utility Commission. The Series 2011B Bonds are additionally secured by a debt service reserve and a non-foreclosable statutory mortgage lien on the System. The Series 2011B Bonds are also secured by a debt service reserve in an amount equal to the least of the maximum annual debt service on the Series 2011B bonds. The proceeds from the sale of these bonds were used to retire the Bond Anticipation Note, Series 2008A and 2010A, in the amounts of \$3,500,000 and \$170,000, respectively. Interest is due semi-annually on these obligations on December 1st and June 1st of each year.

**City of Henderson, Kentucky Utility Commission
Notes to the Financial Statements-May 31, 2018**

8. Long-Term Debt – Revenue Bonds, continued:

It is the opinion from the City of Henderson, Kentucky Utility Commission’s bond counsel, that under existing laws, interest on the Series 2011B bonds is not subject to income tax.

Optional Redemption Series 2011B:

The Series 2011B Bonds maturing on and after December 1, 2021, are subject to redemption by the Commission, at its option, before maturity on September 1, 2021, and on any date thereafter in whole or from time to time in part in any order of maturity (less than all of a single maturity to be selected by lot in such manner as the Trustee and Paying Agent may determine) at a redemption price equal to 100% of the principal amount thereof plus accrued interest to the redemption date.

A summary of the long-term debt of the Commission is as follows:

	<u>2018</u>	<u>2017</u>
City of Henderson, Kentucky Utility Commission Series 2011A Revenue Bonds, secured by pledge of system revenues and non-forecloseable statutory lien, maturing December 1, 2031, annual principal payments range from \$420,000 to \$725,000, interest rates range from 2.5% to 4.5%.	\$ 8,655,000	\$ 9,130,000
City of Henderson, Kentucky Utility Commission Series 2011B Revenue Bonds, secured by pledge of system revenues and non-forecloseable statutory lien, maturing December 1, 2031, annual principal payments range from \$150,000 to \$245,000, interest rates range from 2.5% to 4.5%.	<u>2,755,000</u>	<u>2,910,000</u>
Total long-term debt	\$ 11,410,000	\$ 12,040,000
Less current portion due	<u>(650,000)</u>	<u>(630,000)</u>
Long-term debt, net of current portion	<u>\$ 10,760,000</u>	<u>\$ 11,410,000</u>

Future maturities of long-term debt as of May 31, 2018 are as follows:

Fiscal Year:	Series 2011A			Series 2011B			Total
	Principal	Interest	Total	Principal	Interest	Total	Debt Service
2019	\$ 490,000	\$ 339,932	\$ 829,932	\$ 160,000	\$ 95,648	\$ 255,648	\$ 1,085,580
2020	505,000	325,230	830,230	165,000	92,098	257,098	1,087,328
2021	520,000	310,081	830,081	165,000	88,138	253,138	1,083,219
2022	535,000	293,181	828,181	175,000	83,634	258,634	1,086,815
2023	555,000	274,991	829,991	180,000	78,603	258,603	1,088,594
2024-2028	3,085,000	1,045,327	4,130,327	985,000	298,278	1,283,278	5,413,605
2029-2032	2,965,000	337,446	3,302,446	925,000	95,885	1,020,885	4,323,331
	<u>\$ 8,655,000</u>	<u>\$ 2,926,188</u>	<u>\$ 10,751,256</u>	<u>\$ 2,755,000</u>	<u>\$ 832,284</u>	<u>\$ 3,587,284</u>	<u>\$ 15,168,472</u>

8. Long-Term Debt – Revenue Bonds, continued:

The following is a summary of activity as it relates to long-term debt:

<u>May 31, 2018</u>	Beginning Balance	Additions	Payments	Ending Balance
Series 2011A	\$ 9,150,000	\$ -	\$ (495,000)	\$ 8,655,000
Series 2011B	2,890,000	-	(135,000)	2,755,000
	<u>\$ 12,040,000</u>	<u>\$ -</u>	<u>\$ (630,000)</u>	<u>\$ 11,410,000</u>
<u>May 31, 2017</u>				
Series 2011A	\$ 9,640,000	\$ -	\$ (490,000)	\$ 9,150,000
Series 2011B	3,020,000	-	(130,000)	2,890,000
	<u>\$ 12,660,000</u>	<u>\$ -</u>	<u>\$ (620,000)</u>	<u>\$ 12,040,000</u>

9. Asset Retirement Obligation:

The Commission is legally obligated to remove asbestos, lead paint, and other contaminants located at the Station Two facility. Accordingly, a liability has been established in accordance with SFAS No. 143 *Accounting for Asset Retirement Obligations*. During the fiscal year ended May 31, 2018, management became aware of an asset retirement obligation related to an ash pond located at the Station Two facility. The corresponding asset and liability was recorded in the financials resulting in a prior period adjustment to net position in the amount of \$261,069.

The following is a reconciliation of the aggregate asset retirement liability associated with the Commission's obligation to remove the contaminants:

	Asset Retirement Obligation
Balance as of June 1, 2017	\$ 380,771
Additional obligations incurred	853,838
Increase in present value of the obligation	40,138
Increase based on revised estimates of costs to dismantle and remove assets	52,389
Liabilities extinguished	-
Balance as of May 31, 2018	<u>\$ 1,327,136</u>

10. Discounted Internet and Broadband Services:

A summary of discounted internet and broadband services provided by the Commission to other governmental concerns for the fiscal years ending May 31, 2018 and 2017, respectively, is as follows:

<u>Governmental Organizations</u>	<u>2018</u>	<u>2017</u>
City of Henderson	\$ 138,732	\$ 120,600
Other organizations	36,000	116,400
	<u>\$ 174,732</u>	<u>\$ 237,000</u>

11. Concentration of Sales:

Three industrial customers of the Existing System accounted for sales in the amount of \$15.4 million (36% of Existing System sales), and \$12.6 million (30% of Existing System sales) for the fiscal years ended May 31, 2018 and 2017, respectively.

12. Emission Allowances:

Amendments to the Clean Air Act in 1990 established a system whereby emission allowances were created and allocated to generating units subject to Phase 1 of the emission restrictions. Station Two was allocated a total of 226,901 allowances through 1999 (one emission allowance represents the authorization to emit one ton of sulfur dioxide in a given year). The allowances are allocated between the Commission and the Station Two Operator based upon the Station Two capacity allocations. As of May 31, 2018 and 2017, there were remaining a total of 550 and 2,667 sulfur dioxide, nitrous oxide, and ozone emission allowances valued at \$1,237 and \$35,094, respectively.

13. Related Party Transactions:

The Commission incurred the following transactions with the City of Henderson, Kentucky for the fiscal years ended May 31, 2018 and 2017:

Paid the City \$676,500 and \$664,167 each year, respectively, for data processing and other services related to billings and collections.

Paid the City \$1,244,724 and \$1,244,724 each year, respectively, for payment in lieu of taxes.

Paid the City \$603,032 and \$561,149 for participation in the City of Henderson's self-insured employee health insurance plan for the fiscal years ended May 31, 2018 and 2017 respectively. Risk is minimized in this area by the purchase of re-insurance for amounts in excess of the \$125,000 stop loss limit. Charges are based on estimated amounts determined by the City of Henderson's insurance coordinator as necessary to fund claims as they become due and payable.

Provided the City of Henderson with power for the fiscal years ended May 31, 2018 and 2017 in the amount of \$581,349 and \$423,207 respectively. The City of Henderson was also provided significantly reduced communication service fees totaling approximately \$138,732 and \$120,600 for the fiscal years ended May 31, 2018 and 2017, respectively.

14. Commitments and Contingencies:

A. Southeastern Power Administration:

The Southeastern Power Administration (SEPA) has contracted with the Commission to provide it a total of 15,000 megawatt hours of hydroelectric power each year. The 15,000 megawatt hours represent approximately 2.5% of the Commission's annual megawatt hour requirements. Henderson Municipal Power & Light is restricted to not more than 10 megawatt hours during any hour, and not more than 2,640 megawatt hours during any month. During the fiscal years ended May 31, 2018 and 2017, the Commission purchased power on the spot market and from SEPA to supply the needs of its customers. Purchased power from these sources for the fiscal years ended May 31, 2018 and 2017 was \$601,655 and \$583,803, respectively.

14. Commitments and Contingencies, continued:

B. Regulatory Compliance:

The North American Electric Reliability Corporation (NERC) adopted new electric system reliability standards for all electric utilities in the United States. NERC has adopted and began enforcement of the new standards effective June of 2007. The new standards have been approved by the Federal Energy Regulatory Commission (FERC). The Commission must comply with the new standards and will incur administrative expenses related to NERC compliance. Federal air quality and emission standards have become more stringent.

C. Unwind Transaction – Station Two:

In 1998, HMP&L, Big Rivers Electric Corporation, and Western Kentucky Energy Corporation entered into contracts for the operation of the HMP&L Station Two Power Plant and other Big Rivers Electric Corporation Generation Plants. On July 16, 2009, Big Rivers Electric Corporation and Western Kentucky Energy Corporation (E.ON) signed an agreement under which the original 1998 contracts are rescinded and operational control of the Station Two Power Plant returned to Big Rivers Electric Corporation.

D. Pending Litigation:

On May 1, 2018, Big Rivers Electric Corp. filed an application with the Kentucky Public Service Commission for a declaratory order confirming Big Rivers' determination that the Station Two generating units are no longer capable of normal, continuous, reliable operation for the economically competitive production of electricity, and that the Station Two contracts had terminated on that date. On August 29, 2018, the Commission issued an order approving the termination of the contracts. The parties have agreed that Big Rivers will continue to operate Station Two under the terms of the contracts until the date production of electricity ceases, but in no event later than May 31, 2019. The parties are negotiating the terms of an agreement that would provide the City of Henderson and the City of Henderson, Kentucky Utility Commission, d/b/a Henderson Municipal Power & Light with a short-term power supply, and resolve all pending litigation, as well as issues related to the decommissioning process.

E. Station Two Engineering Study:

The City of Henderson, Kentucky Utility Commission, d/b/a Henderson Municipal Power & Light, engaged an engineering consultant to perform a study related to the continued viability of Station Two, and to determine the City of Henderson's future power needs. The study indicated that Station Two would require an immediate investment of \$50 million to meet maintenance and regulatory requirements. HMP&L subsequently issued a request for proposals to meet the city's long-term energy and capacity needs. Responses to the request for proposals are due no later than October 12, 2018. The utility has engaged a consultant to evaluate responsive proposals.

15. Risk Management:

The Commission is exposed to various risks of loss related to torts, theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Commission carries commercial insurance for these types of risk of loss, including workers' compensation. Settled claims from these risks have not exceeded commercial insurance coverage in any of the past five fiscal years.

16. Amounts Due From Station Two Operator(Big Rivers Electric Corporation):

As of the fiscal years ended May 31, 2018 and 2017, the amount Big Rivers Electric Corporation owed to the Commission, as part of the annual settlements, was \$2,950,585 and \$2,148,962, respectively.

17. Excess Energy Settlement:

During the fiscal year ended May 31, 2018, the Commission and Big Rivers Electric Corporation settled litigation related to the excess energy generated at Station Two. As a result of the settlement, Big Rivers paid the Commission \$6,250,000. It is the intention of the Commission to refund \$2 million of the settlement to its customers through the fuel adjustment over the course of the 2018-19 fiscal year. Additionally, management plans to utilize another \$1 million of the settlement to provide annual assistance to low income customers having difficulty paying their utility bill.

18. Subsequent Events:

Subsequent events have been evaluated through November 1, 2018, the date these financial statements were available to be issued.

a. Station Two:

In the near future, it is likely that the plant will be decommissioned. Utility Commission management is in the process of obtaining proposals for the supply of energy and capacity to meet the ongoing needs of the City and its inhabitants.

b. Excess Energy Settlement

Subsequent to the year end, in August of 2018, proceeds related to the Excess Energy Settlement in the amount of \$3.5 million were placed in an unrestricted bank account.

**City of Henderson, Kentucky Utility Commission
Schedule of the Commission's Proportionate Share of the Collective Net Pension Liability
County Employees' Retirement System Pension Plan
As of the Measurement Date for the Last Four Years***

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
Commission's proportion of the collective net pension liability	0.110441%	0.121741%	0.125106%	0.123175%
Commission's proportionate share of the collective net pension liability	\$ 6,464,451	\$ 5,994,076	\$ 5,378,974	\$ 3,996,000
Commission's covered-employee payroll	\$ 2,759,054	\$ 2,946,675	\$ 2,940,925	\$ 2,838,142
Commission's proportionate share of the collective net pension liability as a percentage of its covered-employee payroll	234.30%	203.42%	182.90%	140.80%
Plan fiduciary net position as a percentage of the total pension liability	53.30%	55.50%	59.97%	66.80%

*This table will present ten years of information as it becomes available.

**City of Henderson, Kentucky Utility Commission
Schedule of the Commission's Contributions to the Pension Plan
County Employees' Retirement System Pension Plan
For the Last Four Fiscal Years***

	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Statutorily required contribution	\$ 439,750	\$ 384,888	\$ 365,977	\$ 374,968
Contributions in relation to the statutorily required contribution	<u>(439,750)</u>	<u>(384,888)</u>	<u>(365,977)</u>	<u>(374,968)</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Commission's covered-employee payroll	\$ 3,036,948	\$ 2,759,054	\$ 2,946,675	\$ 2,940,925
Contributions as a percentage of covered-employee payroll	14.48%	13.95%	12.42%	12.75%

*This table will present ten years of information as it becomes available.

**City of Henderson, Kentucky Utility Commission
 Schedule of the Commission's Proportionate Share of the Collective Net OPEB Liability
 County Employees' Retirement System OPEB Plan
 As of the Measurement Date for the Last Year***

	2017
Commission's proportion of the collective net OPEB liability	0.110441%
Commission's proportionate share of the collective net OPEB liability	\$ 2,220,242
Commission's covered-employee payroll	\$ 2,759,054
Commission's proportionate share of the collective net OPEB liability as a percentage of its covered-employee payroll	80.47%
Plan fiduciary net position as a percentage of the total OPEB liability	52.40%

*This table will present ten years of information as it becomes available.

**City of Henderson, Kentucky Utility Commission
 Schedule of the Commission's Contributions to the OPEB Plan
 County Employees' Retirement System OPEB Plan
 For the Last Fiscal Year***

	2018
Statutorily required contribution	\$ 142,735
Contributions in relation to the statutorily required contribution	(142,735)
Contribution deficiency (excess)	\$ -
Commission's covered-employee payroll	\$ 3,036,915
Contributions as a percentage of covered-employee payroll	4.70%

*This table will present ten years of information as it becomes available.

City of Henderson, Kentucky Utility Commission
Notes to the Required Supplementary Information-May 31, 2018

Changes of assumptions: In the June 30, 2017 and 2015 actuarial valuations, the following changes in actuarial assumptions were made:

	<u>June 30, 2017</u>	<u>June 30, 2015</u>	<u>Prior Periods</u>
Inflation	2.30%	3.25%	3.50%
Payroll Growth	2.00%	4.00%	4.50%
Investment Rate of Return	6.25%	7.50%	7.75%

In the June 30, 2015 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 one year for females). For disabled members, the RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (set back four years for males) is used for the period after disability retirement.

For periods prior to the June 30, 2015 actuarial valuation, the rates of mortality for the period after service retirement are according to the 1983 Group Annuity Mortality Table for all retired members and beneficiaries as of June 30, 2006 and the 1994 Group Annuity Mortality Table for all other members. The Group Annuity Mortality Table set forward five years was used for the period after disability retirement.

**City of Henderson, Kentucky Utility Commission
Combining Statement of Net Position – By System
As of May 31, 2018 and 2017**

	May 31, 2018				May 31, 2017			
	Existing System	Station Two	Elimination	Total	Existing System	Station Two	Elimination	Total
Assets:								
Current assets:								
Cash and cash equivalents	\$ 10,805,387	\$ 80,617	\$ -	\$ 10,886,004	\$ 2,246,818	\$ 101,493	\$ -	\$ 2,348,311
Investments - unrestricted	11,802,770	-	-	11,802,770	12,921,612	-	-	12,921,612
Investments - restricted	2,358,385	-	-	2,358,385	2,322,123	-	-	2,322,123
Accounts receivable, net of allowance for uncollectibles	2,830,079	-	-	2,830,079	3,439,150	-	-	3,439,150
Accounts receivable-Station Two Operator	2,867,447	83,138	-	2,950,585	2,118,042	30,920	-	2,148,962
Accrued revenue	3,994,163	-	-	3,994,163	3,342,815	-	-	3,342,815
Inventory and supplies	5,785,290	3,235,902	-	9,021,192	3,626,471	3,121,169	-	6,747,640
Prepaid expenses	70,355	-	-	70,355	82,571	-	-	82,571
Total current assets	40,513,876	3,399,657	-	43,913,533	30,099,602	3,253,582	-	33,353,184
Utility plant, net of accumulated depreciation:	11,232,441	42,453,355	-	53,685,796	10,390,774	46,272,354	-	56,663,128
Other assets:								
Asset retirement obligation	547,445	-	-	547,445	-	-	-	-
Investment in Station Two	31,058,999	-	(31,058,999)	-	31,058,999	-	(31,058,999)	-
Total assets	83,352,761	45,853,012	(31,058,999)	98,146,774	71,549,375	49,525,936	(31,058,999)	90,016,312
Deferred outflows of resources:								
Deferred outflows of resources	2,329,422	-	-	2,329,422	1,322,051	-	-	1,322,051
Total deferred outflows of resources	2,329,422	-	-	2,329,422	1,322,051	-	-	1,322,051
Total assets and deferred outflows of resources	\$ 85,682,183	\$ 45,853,012	\$(31,058,999)	\$ 100,476,196	\$ 72,871,426	\$ 49,525,936	\$(31,058,999)	\$ 91,338,363

See Independent Auditor's Report

**City of Henderson, Kentucky Utility Commission
Combining Statements of Net Position – By System
As of May 31, 2018 and 2017**

	May 31, 2018				May 31, 2017			
	Existing System	Station Two	Elimination	Total	Existing System	Station Two	Elimination	Total
Liabilities and net assets:								
Current liabilities:								
Accounts payable and accrued expenses	\$ 3,418,730	\$ 3,407,421	\$ -	\$ 6,826,151	\$ 1,871,559	\$ 3,261,347	\$ -	\$ 5,132,906
Accounts payable-Construction in progress - Station Two	-	201,264	-	201,264	-	1,541,776	-	1,541,776
Current portion-bonds payable	650,000	-	-	650,000	630,000	-	-	630,000
Customer deposits	679,103	-	-	679,103	652,901	-	-	652,901
Total current liabilities	4,747,833	3,608,685	-	8,356,518	3,154,460	4,803,123	-	7,957,583
Long-term liabilities:								
Accrued compensated absences	267,413	-	-	267,413	254,089	-	-	254,089
Long- term portion of bonds payable	10,760,000	-	-	10,760,000	11,410,000	-	-	11,410,000
Asset retirement obligation	1,327,136	-	-	1,327,136	380,771	-	-	380,771
Net pension liability	6,464,451	-	-	6,464,451	5,994,076	-	-	5,994,076
Net Other post-employment benefits liability	2,220,242	-	-	2,220,242	-	-	-	-
Total long-term liabilities	21,039,242	-	-	21,039,242	18,038,936	-	-	18,038,936
Total liabilities	25,787,075	3,608,685	-	29,395,760	21,193,396	4,803,123	-	25,996,519
Deferred inflows of resources:								
Deferred inflows of resources	665,557	-	-	665,557	90,173	-	-	90,173
Total deferred inflows of resources	665,557	-	-	665,557	90,173	-	-	90,173
Net position:								
Net investment in capital assets	30,881,440	42,453,355	(31,058,999)	42,275,796	29,409,773	46,272,354	(31,058,999)	44,623,128
Restricted per bond ordinance	2,358,385	-	-	2,358,385	2,322,123	-	-	2,322,123
Unrestricted	25,989,726	(209,028)	-	25,780,698	19,855,961	(1,549,541)	-	18,306,420
Total net position	59,229,551	42,244,327	(31,058,999)	70,414,879	51,587,857	44,722,813	(31,058,999)	65,251,671
Total liabilities, deferred inflows, and net position	\$ 85,682,183	\$ 45,853,012	\$(31,058,999)	\$ 100,476,196	\$ 72,871,426	\$ 49,525,936	\$(31,058,999)	\$ 91,338,363

See Independent Auditor's Report

City of Henderson, Kentucky Utility Commission
Combining Statements of Revenues, Expenses, and Changes in Net Position – By System
For the fiscal years ended May 31, 2018 and 2017

	May 31, 2018				May 31, 2017			
	Existing System	Station	Elimination	Consolidated Total	Existing System	Station Two	Elimination	Consolidated Total
Operating Revenues:								
Sale of electricity	\$ 43,837,429	\$ 30,601,846	\$(12,140,441)	\$ 62,298,834	\$ 41,658,367	\$ 36,246,738	\$(12,589,503)	\$ 65,315,602
Communication services	1,096,134	-	-	1,096,134	1,124,748	-	-	1,124,748
Other	469,366	-	-	469,366	679,669	-	-	679,669
Total Operating Revenues	45,402,929	30,601,846	(12,140,441)	63,864,334	43,462,784	36,246,738	(12,589,503)	67,120,019
Operating Expenses:								
Production of electricity	31,424,690	25,119,702	(12,140,441)	44,403,951	30,954,963	31,056,236	(12,589,503)	49,421,696
Operating, general and administrative	7,567,328	3,820,724	-	11,388,052	6,608,962	4,158,380	-	10,767,342
Depreciation	910,049	4,140,055	-	5,050,104	883,859	4,108,368	-	4,992,227
Total Operating Expenses	39,902,067	33,080,481	(12,140,441)	60,842,107	38,447,784	39,322,984	(12,589,503)	65,181,265
Income (Loss) from Operations	5,500,862	(2,478,635)	-	3,022,227	5,015,000	(3,076,246)	-	1,938,754
Interest Income (Expense):								
Other income (expense)	-	13	-	13	-	13	-	13
Investment income	196,117	136	-	196,253	107,716	165	-	107,881
Interest expense	(443,038)	-	-	(443,038)	(457,500)	-	-	(457,500)
Total Interest Income (Expense)	(246,921)	149	-	(246,772)	(349,784)	178	-	(349,606)
Income (Loss) Before Transfers	5,253,941	(2,478,486)	-	2,775,455	4,665,216	(3,076,068)	-	1,589,148
Non-operating Items:								
Excess Energy Settlement Station Two	6,250,000	-	-	6,250,000	-	-	-	-
Transfers to City of Henderson	(1,244,724)	-	-	(1,244,724)	(1,244,724)	-	-	(1,244,724)
Power furnished to City of Henderson	(581,349)	-	-	(581,349)	(423,207)	-	-	(423,207)
Communication services provided to the City of Henderson and local governmental agencies	(174,732)	-	-	(174,732)	(237,000)	-	-	(237,000)
Total Non-operating Items	4,249,195	-	-	4,249,195	(1,904,931)	-	-	(1,904,931)
Increase (Decrease) in Net Position	9,503,136	(2,478,486)	-	7,024,650	2,760,285	(3,076,068)	-	(315,783)
Cumulative effect of change in accounting principle - GASB 75 adoption	(1,600,373)	-	-	(1,600,373)	-	-	-	-
Prior period adjustment for Asset Retirement Obligation	(261,069)	-	-	(261,069)	-	-	-	-
Net Position, Beginning of Year	51,587,857	44,722,813	(31,058,999)	65,251,671	48,827,572	47,798,881	(31,058,999)	65,567,454
Net Position, End of Year	\$ 59,229,551	\$ 42,244,327	\$(31,058,999)	\$ 70,414,879	\$ 51,587,857	\$ 44,722,813	\$(31,058,999)	\$ 65,251,671

**City of Henderson, Kentucky Utility Commission
Supplemental Schedule of Changes in Net Position – By System
For the fiscal years ended May 31, 2018 and 2017**

	Station Two				Eliminations *	Total Net Assets
	Existing System	Utility Commission	Big Rivers	Total Station Two		
Beginning balance, June 1, 2016	\$ 48,827,572	\$ 21,989,374	\$ 25,809,508	\$ 47,798,882	\$(31,058,999)	\$ 65,567,455
Change in net position	<u>2,760,285</u>	<u>(1,190,095)</u>	<u>(1,885,974)</u>	<u>(3,076,069)</u>	-	<u>(315,784)</u>
Balance, May 31, 2017	51,587,857	20,799,279	23,923,534	44,722,813	(31,058,999)	65,251,671
Change in net position	9,503,136	(592,512)	(1,885,974)	(2,478,486)	-	7,024,650
Prior period adjustment-asset retirement obligation	(261,069)	-	-	-	-	(261,069)
Cumulative effect of change in accounting principle - GASB 75 adoption	<u>(1,600,373)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(1,600,373)</u>
Balance May 31, 2018	<u>\$ 59,229,551</u>	<u>\$ 20,206,767</u>	<u>\$ 22,037,560</u>	<u>\$ 42,244,327</u>	<u>\$(31,058,999)</u>	<u>\$ 70,414,879</u>

* Elimination of interest of Existing System in investment in the equity of Station Two.

As shown on the Statement of Net Position	2018	2017
Net Investment in Capital Assets	\$ 42,275,796	\$ 44,623,128
Restricted per bond ordinance	2,358,385	2,322,123
Unrestricted	<u>25,780,698</u>	<u>18,306,420</u>
Net position, end of year	<u>\$ 70,414,879</u>	<u>\$ 65,251,671</u>

See Independent Auditor's Report



Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Members of the Board of Commissioners
City of Henderson, Kentucky Utility Commission
Henderson, 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 of America, the financial statements of the City of Henderson, Kentucky Utility Commission as of and for the year ended May 31, 2018, and have issued our report thereon dated November 1, 2018.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the City of Henderson, Kentucky Utility Commission's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City of Henderson, Kentucky Utility Commission's internal control. Accordingly, we do not express an opinion on the effectiveness of the City of Henderson, Kentucky Utility Commission's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or 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 the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in the internal control that might be significant deficiencies, or material weaknesses. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Henderson, Kentucky Utility Commission's financial statements are free of 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*.

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 result of that testing, and not to provide an opinion on the effectiveness of 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 report is not suitable for any other purpose.

Alexander Thompson Arnold PLLC

Henderson, Kentucky
November 1, 2018

**CITY OF HENDERSON, KENTUCKY UTILITY
COMMISSION –HENDERSON MUNICIPAL
POWER & LIGHT
FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION
MAY 31, 2019 AND 2018**

**Case No: 2019-00269
Attachment 1 to BREC 1-31
HMPL Audits 2011-2019**

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION –
HENDERSON MUNICIPAL POWER & LIGHT
TABLE OF CONTENTS**

Financial Section

Independent Auditor's Report	1
Management's Discussion and Analysis	3
Basic Financial Statements:	
Statements of Net Position	15
Statements of Revenues, Expenses, and Changes in Net Position	16
Statements of Cash Flows	17
Statements of Cash Flows – Reconciliation of Net Cash Provided by Operations	18
Notes to the Financial Statements	19
Required Supplementary Information:	
Schedule of the Commission's Proportionate Share of the Collective Net Pension Liability	42
Schedule of the Commission's Contributions to the Pension Plan	43
Schedule of the Commission's Proportionate Share of the Collective Net OPEB Liability	44
Schedule of the Commission's Contributions to the OPEB Plan	45
Notes to the Required Supplementary Information	46
Other Supplementary Information:	
Combining Statements of Net Position – By System	47
Combining Statements of Revenues, Expenses, and Changes in Net Position – By System	49
Supplemental Schedule of Changes in Net Position – By System	50
Other Reporting Required by <i>Government Auditing Standards</i>	
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 <i>Government Auditing Standards</i>	51



INDEPENDENT AUDITOR'S REPORT

To the Board of Commissioners
City of Henderson, Kentucky Utility Commission
Henderson, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the City of Henderson, Kentucky Utility Commission (Commission), a component unit of the City of Henderson, Kentucky, as of and for the years ended May 31, 2019 and 2018, and the related notes to the financial statements, which collectively comprise the Commission'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.

Auditor's 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 of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Commission as of May 31, 2019 and 2018, and the changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in Note 2 to the financial statements, during the fiscal year ended May 31, 2018, the Commission adopted new accounting guidance, GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* and GASB Statement No. 82, *Pensions Issues*. Our opinion is not modified with respect to this matter.

As discussed in Note 9 to the financial statements, during the fiscal year ended May 31, 2018, management became aware of an asset retirement obligation that resulted in a prior period adjustment to net position. 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 discussion and analysis on pages 3 through 14 and the schedules of the Commission's proportionate share of the collective net pension and OPEB liabilities, contributions to the pension and OPEB plans and the notes to the required supplementary information on pages 42 through 46 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 City of Henderson, Kentucky Utility Commission's basic financial statements. The combining financial statements on pages 47 through 50 are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining financial statements are the responsibility of management and were derived from and relate 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 combining financial statements are 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 September 23, 2019 on our consideration of the City of Henderson, Kentucky Utility Commission's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of 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 City of Henderson, Kentucky Utility Commission's internal control over reporting and compliance.

Alexander Thompson Arnold PLLC

Henderson, Kentucky
September 23, 2019

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION – HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT’S DISCUSSION AND ANALYSIS

The City of Henderson, Kentucky Utility Commission (HMP&L) is in the business of providing electricity and fiber services for residential, commercial, and industrial customers within the incorporated territory of the City of Henderson, Kentucky. The Commission also provides electricity and fiber services to customers in a few areas outside of the incorporated territory of Henderson. The following discussion and analysis of HMP&L’s financial performance provides an overview of the Utility’s financial activities for fiscal year ended May 31, 2019.

Overview of the Financial Statements:

This annual financial report consists of three parts: 1) Financial Section, 2) Other Supplemental Information, and 3) Other reporting required by *Governmental Auditing Standards*. The Financial Statements also include notes that explain some of the information in the financial statements in more detail. The statements are followed by a section of supplemental information that further explains and supports the information in the basic financial statements. The Supplemental schedules present the financial position and results of operations for the Existing System and Station Two. The Consolidated Financial Statements report information about HMP&L using accounting methods similar to those used by private sector companies, except for the reporting of contributions in aid of construction, equity capital, and retained earnings. Refer to the Summary of Significant Accounting Policies in the footnotes to the Financial Statements relating to the adoption of Statement No. 34 of the Governmental Accounting Standard Board (GASB 34).

The Statement of Net Position, successor to the Balance Sheet, includes all of the Utility’s assets, liabilities, and deferred outflows/inflows of resources and provides information about the nature and amounts of investments in resources (assets) and the obligations of HMP&L (liabilities). It also provides the basis for evaluating the capital structure and assessing the liquidity and financial flexibility of HMP&L.

All of the current audit year’s revenues and expenses are accounted for in the Statement of Revenues, Expenses, and Changes in Net Position, successor to the Income Statement. This statement measures the success of the Utility’s operations over the past year and can be used to determine whether the Utility has successfully recovered all of its costs through the sale of electricity, fiber, and other charges, has earned a reasonable return, and maintained a sound financial position.

The final required financial statement is the Statement of Cash Flows. The primary purpose of this statement is to provide information about the Utility’s cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. It also provides information on the sources and uses of cash and the changes in cash balances during the year.

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION – HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT’S DISCUSSION AND ANALYSIS

Financial Statements:

- HMP&L’s total assets and deferred outflow of resources decreased from \$100,476,196 at May 31, 2018 to \$56,671,864 at May 31, 2019. This decrease is primarily attributable to the decommissioning of Station Two.
- Operating revenues for HMP&L Existing System decreased by \$2,284,892, or 5%, from \$45,402,929 to \$43,118,037. The decrease in Existing System sales was primarily due to the decrease in electric consumption. Fiber and voice revenue increased by \$121,927.

<u>Existing System:</u>	<u>2019</u>	<u>2018</u>	<u>Change</u>	<u>Percentage</u> <u>Change</u>
Sale of electricity	\$ 41,336	\$ 43,837	\$ (2,501)	-5.7%
Internet service	1,218	1,096	122	11.1%
Other	564	470	94	20.0%
 Total operating revenues	 <u>\$ 43,118</u>	 <u>\$ 45,403</u>	 <u>\$ (2,285)</u>	 <u>-5.0%</u>

Note: All amounts presented in thousands -000's omitted.

- Operating expenses for HMP&L Existing System decreased by approximately \$1,414,733 or 3.5%. The decrease was primarily due to savings related to the change in power supply from the coal-fired generating plan to market purchases and bilateral agreements. The following table represents the changes in the expenses for the Existing System:

<u>Existing System:</u>	<u>2019</u>	<u>2018</u>	<u>Change</u>	<u>Percentage</u> <u>Change</u>
Production of electricity	\$ 28,249	\$ 31,425	\$ (3,176)	-10.1%
Other operating expenses	9,194	7,567	1,627	21.5%
Depreciation	1,044	910	134	14.8%
 Total operating expenses	 <u>\$ 38,487</u>	 <u>\$ 39,902</u>	 <u>\$ (1,415)</u>	 <u>-3.5%</u>

Note: All amounts presented in thousands -000's omitted.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION –
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT’S DISCUSSION AND ANALYSIS**

Financial Statements, continued:

- Operating revenues for Station Two decreased approximately \$14,159,663 compared to that of the previous year due to the plant being placed into Economic Dispatch, and then subsequently and power being purchased on the open market. The Station Two Agreement is not designed to generate a profit for each of the participants in the venture, but rather to break-even on a cash flow basis. Operating expenses decreased for Station Two as well.

<u>Station Two</u>	<u>2019</u>	<u>2018</u>	<u>Change</u>
Sales- BREC	\$ 8,278	\$ 18,461	\$ (10,183)
Sales- HMPL	8,164	12,140	(3,976)
Total Operating Revenue	<u>\$ 16,442</u>	<u>\$ 30,601</u>	<u>\$ (14,159)</u>
<u>Expenses:</u>			
Production of electricity	\$ 13,182	\$ 25,120	\$ (11,938)
Operating-General and administrative	2,264	3,821	(1,557)
Depreciation	4,080	4,140	(60)
Total Operating Expenses	<u>19,526</u>	<u>33,081</u>	<u>(13,555)</u>
Net income before transfers	<u>\$ (3,084)</u>	<u>\$ (2,480)</u>	<u>\$ (604)</u>

Note: All amounts presented in thousands -000's omitted.

Upon the consolidation of the financial statements for each system, transactions between Henderson Municipal Power and Light and Station Two Operator are eliminated.

Statement of Net Position:

Net position of the Existing System decreased by \$29,884,982 for the fiscal year ended May 31, 2019, while net position increased by \$9,503,136 in the fiscal year ended May 31, 2018.

Investment securities increased by \$1,510,102 compared to fiscal year 2018.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION –
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT’S DISCUSSION AND ANALYSIS**

Statement of Net Position, continued:

Cash and cash equivalents increased by \$1,504,088 for the fiscal year ended May 31, 2019, versus an increase of \$8,537,693 compared to the previous fiscal year ended. All assets related to the ownership and operation of Station Two have been removed due to decommissioning.

A summary of the assets and deferred outflows of the Commission for the previous three years is as follows:

<u>Assets:</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>
Cash and cash equivalents	\$ 12,390	\$ 10,886	\$ 2,348
Investment securities	13,152	11,803	12,922
Restricted assets	2,519	2,358	2,322
Accounts receivable-unbilled revenue	-	2,830	3,439
Accounts receivable-unbilled Station Two Operator	2,178	2,840	2,952
Accrued revenue	4,676	3,994	3,343
Inventories	289	9,021	6,748
Prepaid expenses	-	70	83
Total current assets	<u>41,439</u>	<u>43,914</u>	<u>33,354</u>
Utility plant and equipment	12,256	53,686	56,663
Asset retirement obligation	449	547	-
Total assets	<u>12,705</u>	<u>54,233</u>	<u>56,663</u>
Deferred outflow of resources	<u>2,528</u>	<u>2,329</u>	<u>1,322</u>
Total assets and deferred outflows of resources	<u>\$ 56,672</u>	<u>\$ 100,476</u>	<u>\$ 91,339</u>

Note: All amounts presented in thousands -000's omitted.

Current liabilities decreased by \$2,633,161. Accounts payable and accrued expenses increased \$2,503,869 over the previous year mainly due to normal variations in timing of payments.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION –
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT’S DISCUSSION AND ANALYSIS**

A summary of the liabilities and deferred inflows of the Statement of Net Position is as follows:

Liabilities	2019	2018	2017
Accounts payable	\$ 4,055	\$ 6,826	\$ 5,132
Accounts payable-construction	-	201	1,542
Current portion bonds payable	670	650	630
Customer deposits	701	679	653
Total current liabilities	5,426	8,356	7,957
Compensated absences	280	267	254
Asset retirement obligation	1,369	1,327	381
Net pension liability	7,243	6,464	5,994
Other post employment benefits	2,111	2,220	-
Long term bonds payable	10,090	10,760	11,410
Total liabilities	26,519	21,038	25,996
Deferred inflows	808	665	90
Total liabilities and deferred inflows	\$ 27,327	\$ 21,703	\$ 26,086

Note: All amounts presented in thousands -000's omitted.

Statement of Revenues, Expenses, and Changes in Net Position:

Operating Revenues for the entire entity decreased by \$12,468,590 over that of the previous year. Sales for HMP&L Station Two decreased by \$14,159,663 or 46.3 % while Existing System sales decreased by \$2,284,892 or 5.0%.

Operating Expenses decreased by \$13,554,126. This was due to decommissioning of Station Two.

Income from operations of the Existing System, after interest expense and interest income, was \$4,623,279. For the fiscal year ended, transfers were made to the City of Henderson in the amount of \$1,244,724, the value of power furnished to the City of Henderson at no charge was \$674,568, and the value of communication services provided to the City of Henderson and other governmental agencies at no charge, was \$168,120. The decommissioning of Station Two totaled \$32,420,849. This resulted in a total decrease in net position of \$29,884,982.

Station Two had a net operating loss of \$3,084,172, during its final eight months of operation.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION –
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT’S DISCUSSION AND ANALYSIS**

Statement of Revenues, Expenses, and Changes in Net Position, continued:

	<u>Existing System</u>	<u>Station Two</u>	<u>Eliminations</u>	<u>Total</u>
Income (loss) before transfers	\$ 4,623	\$ (3,084)	\$ -	\$ 1,539
Non-operating items:				
Decommissioning Station Two	(32,422)	(39,160)	31,059	(40,523)
Transfer to City of Henderson	(1,244)	-	-	(1,244)
Communication services provided to the City of Henderson and other governmental agencies	(168)	-	-	(168)
 Power furnished to the City of Henderson	 (674)	 -	 -	 (674)
 Change in net position	 <u>\$ (29,885)</u>	 <u>\$ (42,244)</u>	 <u>\$ 31,059</u>	 <u>\$ (41,070)</u>

Note: All amounts presented in thousands -000's omitted.

Statement of Cash Flows:

Cash generated from operating activities decreased by \$4,660,411 compared to the level from Fiscal Year 2018.

Cash Flows from non-capital financing activities is comprised of the funds transferred to the City of Henderson. For the fiscal year ended May 31, 2019, \$1.24 million was transferred.

Cash used by capital and related financing activities was \$3.2 million.

Cash used by investing activities was \$1.1 million.

Cash and cash equivalents for the year, which consist primarily of checking and money market accounts of HMP&L, increased by \$1,504,088.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION –
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT’S DISCUSSION AND ANALYSIS**

Statement of Cash Flows, continued:

The following is an abbreviated analysis of cash flows of HMP&L for the fiscal years ended May 31, 2017 to 2019:

<u>Cash Flow Summary</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>
Net cash generated by operations	\$ 6,988	\$ 11,649	\$ 4,634
Cash transferred to the City of Henderson	(1,245)	(1,245)	(1,245)
Net cash used by capital and related financing	(3,189)	(3,146)	(3,082)
Used by investing activities	<u>(1,049)</u>	<u>1,279</u>	<u>1,602</u>
Increase (decrease) in cash	1,505	8,537	1,909
 Cash and cash equivalents, beginning of year	 <u>10,885</u>	 <u>2,348</u>	 <u>439</u>
 Cash and cash equivalents, end of year	 <u>\$ 12,390</u>	 <u>\$ 10,885</u>	 <u>\$ 2,348</u>

Note: All amounts presented in thousands -000's omitted.

The following is a summary of cash and investment balances as of May 31, 2017 to 2019:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Cash and cash equivalents	\$ 12,390	\$ 10,885	\$ 2,348
Investments	12,345	11,803	12,922
Restricted investments	<u>2,518</u>	<u>2,358</u>	<u>2,322</u>
	<u>\$ 27,253</u>	<u>\$ 25,046</u>	<u>\$ 17,592</u>

Note: All amounts presented in thousands -000's omitted.

Debt Administration:

HMP&L entered into two Bond Anticipation Notes with Fifth Third Bank on December 22, 2008- a non-taxable series 2008A in the amount of \$3,500,000, and a taxable series 2008B in the amount of \$9,000,000. The series 2008A was used for capital improvements to the City’s retail electric system. The taxable series 2008B was used to make capital improvements to the City’s Station Two generating plant. HMP&L entered into an additional Bond Anticipation Note with Fifth Third Bank on March 25, 2010- a non-taxable series 2010A in the amount of \$1,500,000. This note was repaid at the same time as the series 2008A note. In September of 2012 HMP&L issued Revenue Bonds in the amount of \$15,020,000 and retired all outstanding Bond Anticipation Notes. The outstanding debt of the Commission was \$10,760,000 as of May 31, 2019.

**CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION –
HENDERSON MUNICIPAL POWER & LIGHT
MANAGEMENT’S DISCUSSION AND ANALYSIS**

Debt Administration, continued:

On January 29, 2009, the City Commission approved an Ordinance increasing electric rates by 3.855% for all customer rate classifications. The purpose of the rate increase was to provide additional revenue to make the principal and interest payments on the short-term Bond Anticipation Notes and the long-term Bonds issued to replace the Bond Anticipation Notes. HMP&L set up a separate Bond Payment Account and, as of May 31, 2019, HMP&L had accrued \$1,505,979 for future principal and interest payments for the Bonds.

System Improvements and Replacement of Capital Assets:

During the period of June 1, 2018, through May 31, 2019, HMP&L made a number of improvements to the electric and fiber facilities and replaced certain assets. The improvements to the facilities and asset replacements increased service reliability and extended the useful-life of certain existing assets.

During the 2018-2019 Fiscal Year, HMP&L made \$1,943,627 in capital improvements and replacements for Existing System and \$259,274 in capital improvements and replacements for Station Two.

Electric Rates – Current and Future Increases:

On May 12, 2015, the Board of Commissioners of the City of Henderson, Kentucky, passed an ordinance approving and adopting the following schedule of electric rate increases:

	<u>Effective Date</u>	<u>Adjustment Percent Increase</u>
First Adjustment	July 1, 2015	5%
Second Adjustment	November 1, 2015	5%
Third Adjustment	May 1, 2016	5%
Fourth Adjustment	November 1, 2016	5%
Inflation Adjustment	Beginning January 1, 2017 and each January 1, thereafter	CPI*

*Consumer Price Index (CPI) – Adjustments will be made in accordance with the percentage changes in the US Department of Labor Consumer Price Index (CPI-U).

CITY OF HENDERSON, KENTUCKY UTILITY COMMISSION – HENDERSON MUNICIPAL POWER & LIGHT MANAGEMENT’S DISCUSSION AND ANALYSIS

Electric Rates – Current and Future Increases, continued:

The January 1, 2017 CPI Adjustment was 1.6%. However, the January 1, 2018 CPI Adjustment was not approved by the City of Henderson, Kentucky Commission, and no further CPI increases or decreases have been presented to the Utility Commission or City Commission for approval.

In April of 2019, HMP&L conducted a Cost of Service Analysis with the assistance of consultants from GDS Associates. Since Station Two was being decommissioned and the power supply source was changing, HMP&L needed to restructure the rate schedules. This resulted in a revenue neutral rate restructuring that analyzed each customer class separately to ensure the same revenue level would be achieved for each class. The Fuel Adjustment was combined with base rates and a new Power Cost Adjustment (PCA), based on the Fiscal Year 2020 Budget, was developed. The PCA captures the increase or decrease in power costs for each month. This new rate structure better matches the current power supply arrangements of HMP&L.

Employee Development:

HMP&L’s workforce has a large number of employees nearing retirement age- both management and lead line workers. In order to prepare for this, HMP&L has begun hiring more line workers under the Apprenticeship Program. This program allows line workers who have completed line worker school and/or have on the job training to join HMP&L.

Upon hire, the apprentice line workers progress in a structured program- from Apprentice Line Worker I to Apprentice Line Worker IV (depending on experience and knowledge), and then subsequently to Journey Line Worker and potentially Crew Leader. Having this program allows HMP&L to plan for the future, as well as make sure all employees are progressing in a safe manner.

Station Two and Future Expenditures:

Big Rivers and HMP&L were involved in litigation concerning HMP&L’s claim for damages concerning surplus energy sales related to Station Two. This civil action involved a claim by HMP&L to recover monetary damages from Big Rivers Electric Corporation because of HMP&L’s inability to schedule its excess energy. An offer to settle all claims past, present and future, was accepted by the parties, and the \$6.25 million settlement was received on January 5, 2018. The City of Henderson, Kentucky Utility Commission decided to give back \$2 million to its customers through the Fuel Adjustment, establish a Low-Income Relief Fund of \$1 million, place \$1.625 million into an investment account, and place \$1.625 million into unrestricted reserves.

HMP&L decommissioned Station Two during Fiscal Year 2019. To arrive at this decision, a preliminary Integrated Resource Plan (IRP) was finalized in July 2017 and presented to the Utility Commission. The IRP considered various options, such as continuing to run the two units as coal and complying with all environmental requirements, converting one or both units