

Heartland Consumers Power District

Independent Auditor's Reports and Financial Statements

December 31, 2017 and 2016



Heartland Consumers Power District

December 31, 2017 and 2016

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Independent Auditor's Report

Board of Directors
Heartland Consumers Power District
Madison, South Dakota

We have audited the accompanying financial statements of Heartland Consumers Power District (the District), as of and for the years ended December 31, 2017 and 2016, and the related notes to the financial statements, which collectively comprise the District'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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Heartland Consumers Power District as of December 31, 2017 and 2016, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and the pension information as listed in the table of contents 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 audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the District's basic financial statements. The schedules of transmission operation and maintenance expenses and of administrative and general expenses as listed in the table of contents, are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The schedules of transmission operation and maintenance expenses and of administrative and general expenses have not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on them.

BKD, LLP

Lincoln, Nebraska
April 9, 2018

MANAGEMENT'S DISCUSSION AND ANALYSIS

This discussion and analysis of Heartland Consumers Power District's (Heartland or HCPD) financial statements provides the reader an overview of the financial activities for 2017, 2016 and 2015. Heartland's financial statements are comprised of three components: (1) Management's Discussion and Analysis, (2) financial statements, and (3) notes to the financial statements. Please read this in conjunction with the audited financial statements and footnotes contained herein.

Overview of Financial Statements

The balance sheets present information on Heartland's assets and deferred outflows of resources, and liabilities and deferred inflows of resources, with the difference reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of Heartland is improving or deteriorating.

Heartland's overall financial position is summarized below (in thousands). This information is derived from the financial statements and records of Heartland.

	Net Position as of December 31,			Fiscal Year-to-Year Percentage Change	
	2017	2016	2015	From 2016 to 2017	From 2015 to 2016
Current assets	\$ 27,285	\$ 28,769	\$ 25,552	(5.2)%	12.6%
Capital assets, net	22,155	20,402	20,260	8.6%	0.7%
Other noncurrent assets	6,633	5,500	8,601	20.6%	(36.1)%
Total assets	<u>56,073</u>	<u>54,671</u>	<u>54,413</u>	<u>2.6%</u>	<u>0.5%</u>
Deferred outflows of resources	801	675	536	18.7%	(5.9)%
Total assets and deferred outflows of resources	<u>\$ 56,874</u>	<u>\$ 55,346</u>	<u>\$ 54,949</u>	<u>2.8%</u>	<u>0.7%</u>
Current liabilities	\$ 4,885	\$ 10,727	\$ 14,464	(54.5)%	(25.8)%
Noncurrent liabilities	9,867	5,650	12,667	74.6%	(55.4)%
Total liabilities	<u>14,752</u>	<u>16,377</u>	<u>27,131</u>	<u>(9.9)%</u>	<u>(39.6)%</u>
Deferred inflows of resources	1,914	1,776	426	7.8%	316.9%
Net investment in capital assets	16,855	12,250	4,789	37.6%	155.8%
Restricted for debt service	-	5,660	6,668	(100.0)%	(15.1)%
Restricted for pensions	-	-	370	—%	100.0%
Unrestricted	<u>23,353</u>	<u>19,283</u>	<u>15,565</u>	<u>21.1%</u>	<u>23.9%</u>
Total net position	<u>40,208</u>	<u>37,193</u>	<u>27,392</u>	<u>8.1%</u>	<u>35.8%</u>
Total liabilities, deferred inflows of resources and net position	<u>\$ 56,874</u>	<u>\$ 55,346</u>	<u>\$ 54,949</u>	<u>2.8%</u>	<u>0.7%</u>

Heartland's overall net position increased in 2017, 2016 and 2015 by \$3,015,031, \$9,801,428 and \$11,742,652, respectively.

The decrease in customer revenue in both 2017 and 2016 was a result of two of Heartland's long-term contracts ending June 30, 2016, with the most significant being Marshall, MN. Heartland received over 10 years advance notice of the contract termination. Generation and transmission facilities represent 95% of Heartland's total capital assets. The remaining 5% of capital assets includes Heartland's headquarters building, transportation equipment, and office equipment. The level of assets should remain reasonably stable until such time as Laramie River Station (LRS) requires substantial capital improvements.

The statements of revenues, expenses and changes in net position present information showing how Heartland's net position changed during the most recent fiscal year.

Heartland's results for the current and prior two years are summarized in the following table. This information is derived from the financial statements and records of Heartland.

Results of Operations

A summary of revenues and expenses is provided in the table that follows (in thousands except power sales).

	2017 Actual	2016 Actual	2015 Actual	Fiscal Year-to-Year Percentage Change	
				From 2016 to 2017	From 2015 to 2016
Power sales					
Customer energy (MWh)	425,050	637,252	855,651	(33.3)%	(25.5)%
Customer cumulative demand (kW)	762,089	1,085,799	1,433,896	(29.8)%	(24.3)%
Revenues					
Customer revenue	\$ 36,217	\$ 50,071	\$ 62,717	(27.7)%	(20.2)%
Contracted requirements revenue	15,455	17,893	12,609	(13.6)%	41.9%
Surplus sales revenue	4,098	2,557	2,976	60.3%	(14.1)%
Other operating revenue	1,899	4,041	969	(53.0)%	317.0%
Transfer for rate stabilization	-	(1,750)	-	100.0%	—%
Total operating revenue	<u>57,669</u>	<u>72,812</u>	<u>79,271</u>	<u>(20.8)%</u>	<u>(8.1)%</u>
Expenses					
LRS production & O&M	7,020	7,732	8,470	(9.2)%	(8.7)%
Cost of power	34,229	41,368	46,543	(17.3)%	(11.1)%
Transmission	7,544	6,400	5,439	17.9%	17.7%
Depreciation	1,073	1,323	1,242	(18.9)%	6.5%
Taxes	628	447	199	40.5%	124.6%
Administration and general	3,645	3,947	4,264	(7.7)%	(7.4)%
Amortization	203	1,108	203	(81.7)%	445.8%
Total operating expenses	<u>54,342</u>	<u>62,325</u>	<u>66,360</u>	<u>(12.8)%</u>	<u>(6.1)%</u>
Operating income	3,327	10,487	12,911	(68.3)%	(18.8)%
Total nonoperating expenses, net	<u>(312)</u>	<u>(686)</u>	<u>(1,168)</u>	<u>(54.5)%</u>	<u>(41.3)%</u>
Change in net position	3,015	9,801	11,743	(69.2)%	(16.5)%
Net position, beginning of year	<u>37,193</u>	<u>27,392</u>	<u>15,649</u>		
Net position, end of year	<u>\$ 40,208</u>	<u>\$ 37,193</u>	<u>\$ 27,392</u>		

Operating revenues include firm power sales to Heartland's wholesale rate customers, other contracted sales, short-term energy sales on the surplus market, and other revenues. Demand and energy sales for 2017 were 762 MW and 425,050 MWh, respectively. This reduction is from the customer contract ending June 30, 2016. Heartland's customer peak was 73.5 MW in 2017. Demand and energy sales for 2016 were 1,086 MW and 637,252 MWh, respectively. The 2016 peak demand of Heartland's long-term wholesale customers was 126.7 MW. Heartland's wholesale customer demand and energy sales for 2015 were 1,443 MW and 855,651 MWh, respectively. Heartland's wholesale customer peak demand for 2015 was 135.7 MW.

Heartland has other energy sales contracts, in addition to its wholesale customers. The contracted requirements revenue mitigates exposure to the surplus market for excess power and the contracts typically contain fixed pricing and quantities. Many of these contracts are unit contingent and Heartland is not required to provide replacement power. These revenues were less in 2017 due to more scheduled and unscheduled unit outages compared to 2016.

Surplus energy sales are the sales of energy produced by Heartland's resources in excess of the energy required by Heartland's customers and other contracts. These sales are considered short term and non-firm. The quantity of surplus energy and revenue is dependent upon multiple factors including availability of resources, customer and other contract requirements, and market and contractual pricing.

The operating expenses fluctuated in some areas. Production expenses (the cost for coal, transportation, and operations and maintenance at Laramie River Station (LRS)) decreased by 9.2% and 8.7% in 2017 and 2016, respectively. The largest reason for the decrease was a reduction in generation. LRS unit 1 had a long outages for environmental improvements in both 2017 and 2016.

Heartland purchases power, in addition to its ownership share in LRS, to meet the total contract resource obligations to its customers. The purchased power contracts include base-load resources, renewable generation facilities, market purchases, and additional capacity purchases required to comply with the resource reserve requirements for maintaining regional reliability.

Heartland is a member of Public Power Generation Agency (PPGA), an interlocal agency created under Nebraska statute to build WEC2, a 220 megawatt coal-fired project near Hastings, Nebraska. Heartland's participation in PPGA is for 80 megawatts. PPGA financed construction of WEC2 directly, rather than obtaining funding from its members. Heartland has a contract with Hastings Utilities for an additional share of WEC2. This contract decreases annually. Heartland also has a contract with North Iowa Municipal Electric Cooperative Association (NIMECA) in which NIMECA purchases output of WEC2 for the life of the unit. NIMECA's contract includes all owners' costs and increases annually until 2019. The combination of the Hastings Utilities contract reduction and the NIMECA contract increases resulted in reduced cost of power in 2017 and 2016. Also attributing to the reduction in the cost of power was a short-term power supply contract that corresponded with the end date of Marshall's contract in 2016.

The nonoperating revenues/expenses include interest on bonds, investment income, and amortization of costs recoverable from future billings.

Heartland made principal payments of \$5,600,000 on its Electric System Second Lien Revenue Bonds, Series 2011 in 2017, and also paid down \$600,000 on its operating line related to the previously outstanding Electric System Second Lien Revenue Note, Series 2010. Heartland called the Electric System Second Lien Revenue Note, Series 2010, in 2015 and the remaining balance was moved to Heartland's line of credit. This allowed Heartland to take advantage of the lower short-term interest rates on the line of credit compared to the 4.29% of the Series 2010 Note.

Fitch assigned an underlying rating of A- to Heartland and Moody's assigned A3.

Contact Information

This financial report is designed to provide a general overview of Heartland's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to Micheal Malone, P.O. Box 248, Madison, SD 57042.

Heartland Consumers Power District

Balance Sheets

December 31, 2017 and 2016

Assets and Deferred Outflows of Resources

	<u>2017</u>	<u>2016</u>
Current Assets		
Cash and cash equivalents	\$ 10,052,900	\$ 7,965,003
Restricted cash and cash equivalents	-	5,810,693
Short-term investments	4,649,471	1,977,173
Accounts receivable	7,240,446	7,777,416
Notes receivable, current portion	581,330	435,732
Plant operation assets	4,715,107	4,769,254
Prepaid expenses and other current assets	<u>45,428</u>	<u>33,279</u>
Total current assets	<u>27,284,682</u>	<u>28,768,550</u>
Noncurrent Assets		
Notes receivable, net of allowance of \$539,907 for 2017 and \$343,781 for 2016	4,233,487	2,743,898
Long-term investments	215,662	273,044
Capital assets, net	22,154,984	20,402,110
Costs recoverable from future billings	1,080,970	1,388,285
Net pension asset	7,850	-
Other noncurrent assets	<u>1,095,000</u>	<u>1,095,000</u>
Total noncurrent assets	<u>28,787,953</u>	<u>25,902,337</u>
Deferred Outflows of Resources		
Deferred outflows for pensions	<u>801,578</u>	<u>674,873</u>
Total assets and deferred outflows of resources	<u>\$ 56,874,213</u>	<u>\$ 55,345,760</u>

Liabilities, Deferred Inflows of Resources and Net Position

	2017	2016
Current Liabilities		
Current maturities of long-term debt	\$ 273,595	\$ 5,873,946
Accounts payable	4,275,336	4,197,886
Accrued expenses	331,732	500,361
Accrued interest payable	4,514	155,312
Total current liabilities	<u>4,885,177</u>	<u>10,727,505</u>
Noncurrent Liabilities		
Line of credit	5,300,000	2,300,000
Long-term debt, net	4,310,842	2,783,366
Net pension liability	-	296,707
Other noncurrent liabilities	256,443	269,750
Total noncurrent liabilities	<u>9,867,285</u>	<u>5,649,823</u>
Total liabilities	<u>14,752,462</u>	<u>16,377,328</u>
Deferred Inflows of Resources		
Deferred inflows for pensions	163,842	21,891
Reductions of future billings	1,750,000	1,753,663
Total deferred inflows of resources	<u>1,913,842</u>	<u>1,775,554</u>
Net Position		
Net investment in capital assets	16,855,030	12,250,422
Restricted for debt service	-	5,659,735
Unrestricted	23,352,879	19,282,721
Total net position	<u>40,207,909</u>	<u>37,192,878</u>
Total liabilities, deferred inflows of resources and net position	<u>\$ 56,874,213</u>	<u>\$ 55,345,760</u>

Heartland Consumers Power District
Statements of Revenues, Expenses and
Changes in Net Position
Years Ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Operating Revenues		
Customer requirements	\$ 36,217,321	\$ 50,070,249
Other contracted requirements	15,455,330	17,893,259
Surplus sales revenue	4,098,323	2,557,198
Other operating revenue	1,898,491	4,041,568
Transfer for rate stabilization	-	(1,750,000)
Total operating revenues	<u>57,669,465</u>	<u>72,812,274</u>
Operating Expenses		
Cost of power	41,248,568	49,099,837
Depreciation and amortization	1,275,897	2,430,760
Transmission	7,544,266	6,400,660
Other	4,274,014	4,394,270
Total operating expenses	<u>54,342,745</u>	<u>62,325,527</u>
Operating Income	<u>3,326,720</u>	<u>10,486,747</u>
Nonoperating Revenues (Expenses)		
Investment income	197,498	133,171
Interest expense	(74,081)	(386,639)
Amortization expense	(54,253)	(238,825)
Other	(380,853)	(193,026)
Net nonoperating expenses	<u>(311,689)</u>	<u>(685,319)</u>
Change in Net Position	3,015,031	9,801,428
Net Position, Beginning of Year	<u>37,192,878</u>	<u>27,391,450</u>
Net Position, End of Year	<u><u>\$ 40,207,909</u></u>	<u><u>\$ 37,192,878</u></u>

Heartland Consumers Power District
Statements of Cash Flows
Years Ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Operating Activities		
Receipts from customers	\$ 36,459,241	\$ 51,349,152
Receipts from others	21,747,194	23,518,676
Payments to suppliers	(51,321,654)	(63,773,731)
Payments to employees	(1,782,428)	(1,422,534)
Net cash provided by operating activities	<u>5,102,353</u>	<u>9,671,563</u>
Noncapital Financing Activities		
Proceeds from issuance of promissory notes	1,782,486	225,000
Payments on promissory notes	(255,361)	(273,851)
Other nonoperating payments	(184,727)	(176,020)
Net cash provided by (used in) noncapital financing activities	<u>1,342,398</u>	<u>(224,871)</u>
Capital and Related Financing Activities		
Advances on revolving line of credit	3,600,000	-
Payments on revolving line of credit	(600,000)	(1,700,000)
Purchase of capital assets	(3,077,819)	(1,365,219)
Payments on revenue bonds and notes	(5,600,000)	(5,750,000)
Interest paid	(224,878)	(488,147)
Net cash used in capital and related financing activities	<u>(5,902,697)</u>	<u>(9,303,366)</u>
Investing Activities		
Proceeds from sales and maturities of investment securities	2,057,358	7,183,717
Purchases of investment securities	(4,674,402)	(4,756,393)
Issuance of notes receivable	(2,745,000)	(436,407)
Repayments of notes receivable	913,687	483,903
Investment income received	183,507	175,184
Net cash provided by (used in) investing activities	<u>(4,264,850)</u>	<u>2,650,004</u>
Change in Cash and Cash Equivalents	(3,722,796)	2,793,330
Cash and Cash Equivalents, Beginning of Year	<u>13,775,696</u>	<u>10,982,366</u>
Cash and Cash Equivalents, End of Year	<u>\$ 10,052,900</u>	<u>\$ 13,775,696</u>
Composition of Cash and Cash Equivalents		
Cash and cash equivalents	\$ 10,052,900	\$ 7,965,003
Restricted cash and cash equivalents	-	5,810,693
Total	<u>\$ 10,052,900</u>	<u>\$ 13,775,696</u>

Heartland Consumers Power District
Statements of Cash Flows - Continued
Years Ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Reconciliation of Operating Income to Net Cash		
Provided by Operating Activities		
Operating income	\$ 3,326,720	\$ 10,486,747
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation and amortization	1,275,897	2,430,760
Amortization of advance payment received under energy purchase contract	-	(1,191,877)
Changes in balance sheet operating items		
Accounts receivable	536,970	305,554
Plant operation assets	54,147	(1,209,165)
Prepaid expenses and other assets	50,728	(665,175)
Net pension asset (liability)	(304,557)	666,712
Deferred outflows for pensions	(126,705)	(245,450)
Accounts payable	329,138	(2,450,289)
Accrued liabilities	(181,936)	122,637
Deferred inflows for pensions	141,951	(328,891)
Deferred inflows for rate stabilization	-	1,750,000
Net Cash Provided by Operating Activities	<u>\$ 5,102,353</u>	<u>\$ 9,671,563</u>
Supplemental Cash Flows Information		
Capital asset acquisitions included in accounts payable	\$ -	\$ 251,688
Increase in allowance for notes receivable	\$ 196,126	\$ 17,007

Heartland Consumers Power District

Notes to Financial Statements

December 31, 2017 and 2016

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Heartland Consumers Power District (Heartland) is a public corporation and a political subdivision of the State of South Dakota created under the Consumers Power District Law for the purpose of supplying electric energy. Heartland is empowered by the Consumers Power District Law to finance, own, and operate, either singly or jointly with others and anywhere within or without the boundaries of Heartland or the State of South Dakota, any electric light and power plants, lines, and systems or interest therein for the generation and transmission of electric power and energy. Heartland has firm power customers in the four-state region of Minnesota, Kansas, Iowa and South Dakota.

Rates for wholesale electric service are set by the Heartland Board of Directors. Neither the South Dakota Public Utilities Commission nor any other commission has jurisdiction over Heartland with respect to Heartland's rates and charges for power sales to its customers.

Reporting Entity

In evaluating how to define the entity for financial reporting purposes, management has considered all potential component units for which financial accountability may exist. The determination of financial accountability includes consideration of a number of criteria, including: (1) Heartland's ability to appoint a voting majority of another entity's governing body and to impose its will on that entity, (2) the potential for that entity to provide specific financial benefits to or impose specific financial burdens on Heartland and (3) the entity's fiscal dependency on Heartland. Based upon the above criteria, Heartland has determined that it has no reportable component units.

Basis of Accounting

Heartland's activities are accounted for on the flow of economic resources measurement focus and use the accrual basis of accounting. Heartland's accounting records are maintained in accordance with accounting principles generally accepted in the United States of America for regulated utilities and generally follow the Uniform System of Accounts for Public Utilities and Licenses prescribed by the Federal Energy Regulatory Commission (FERC). Heartland prepares its financial statements as a business-type activity in conformity with applicable pronouncements of the Governmental Accounting Standards Board (GASB).

Heartland's accounting policies also follow the regulated operations provisions of GASB Statement No. 62, which permits an entity with cost-based rates to defer certain costs or income that would otherwise be recognized when incurred to the extent that the rate-regulated entity is recovering or expects to recover such amounts in rates charged to its customers. This method includes the philosophy that debt service requirements, as opposed to depreciation or amortization, are a cost for rate making purposes.

Heartland Consumers Power District

Notes to Financial Statements

December 31, 2017 and 2016

Note 1: Nature of Operations and Summary of Significant Accounting Policies - Continued

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and deferred inflows and outflows of resources and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues, expenses and other changes in net position during the reporting period. Actual results may differ from those estimates.

Cash Equivalents

Heartland considers all highly liquid investments with an original maturity of three months or less at the date of purchase to be cash equivalents. At December 31, 2017 and 2016, cash equivalents consisted of money market funds.

Investments and Investment Income

Investments in money market mutual funds are carried at cost, which approximates fair value. Investments in U.S. Treasury securities and U.S. agency obligations are carried at fair value. Fair value is determined based on quoted market prices or yields currently available on comparable securities of issuers with similar credit ratings.

Investment income consists of interest income and realized and unrealized gains and losses.

Accounts and Notes Receivable

Accounts receivable are stated at the amount billed to customers. Accounts receivable are ordinarily due 20 days after the issuance of the invoice. Delinquent receivables are charged off as they are deemed uncollectible. Management does not believe an allowance for doubtful accounts is necessary for accounts receivable at December 31, 2017 and 2016, as there were no delinquent accounts. Notes receivable relate to Heartland's economic development program (see Note 3), and amounts due generally follow amortization schedules contained within the related note agreements. Management has established an allowance for doubtful accounts for notes receivable of \$539,907 and \$343,781 at December 31, 2017 and 2016, respectively.

Plant Operation Assets

The operation of the Laramie River Station (LRS) requires the establishment of certain operating assets, primarily fuel inventories, supplies, and operating cash. These assets are managed by the operating agent for LRS and are stated at cost.

Heartland Consumers Power District
Notes to Financial Statements
December 31, 2017 and 2016

Note 1: Nature of Operations and Summary of Significant Accounting Policies - Continued

Capital Assets

Capital assets are recorded at cost at the date of acquisition. Depreciation is computed using the straight-line method over the estimated useful life of each asset, which is normally 20 - 30 years for utility plant, 5 - 10 years for vehicles, furniture, and various office equipment and 40 years for buildings.

Compensated Absences

Employees earn vacation days at varying rates depending on years of service. In the event of termination, an employee is reimbursed for accumulated vacation time. Expense and the related liability are recognized when earned and vacation benefits are redeemable as time off or in cash. Employees earn sick leave at the rate of approximately one day per month. Upon normal retirement, an employee can use any accumulated sick time to pay for certain qualified medical expenses. Expense and the related liability for sick leave benefits are recognized when earned to the extent the employee is expected to realize the benefit in cash determined using the termination payment method. Compensated absences expected to be used during the next fiscal year are classified as a current liability in accrued expenses. The remaining balance is reflected as a noncurrent liability.

Regulated Operations

Rates for Heartland's regulated operations are established and approved by the Board of Directors. Heartland applies the regulated operations provisions of GASB Statement No. 62, which provide for the deferral of expenses which are expected to be recovered through customer rates over some future period (costs recoverable from future billings) and reductions in earnings to cover future expenditures (reductions of future billings). Costs recoverable from future billings are primarily comprised of charges incurred in relation to Heartland's bond issuances and costs incurred by Heartland for initial payments made on long-term capacity contracts. These costs are being amortized in future rate periods when such costs are included in the revenue requirements to establish electric rates. Reductions of future billings are comprised of the unrealized net gains on investments and a Board approved transfer for rate stabilization.

Pensions

For purposes of measuring the net pension asset and liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension revenue and expense, information about the fiduciary net position of the South Dakota Retirement System (SDRS) and additions to/deductions from SDRS's fiduciary net position have been determined on the same basis as they are reported by SDRS. Heartland's contributions and net pension asset and liability are recognized on the accrual basis of accounting.

Heartland Consumers Power District

Notes to Financial Statements

December 31, 2017 and 2016

Note 1: Nature of Operations and Summary of Significant Accounting Policies - Continued

Net Position Classification

Net position is required to be classified into three components – net investment in capital assets; restricted; and unrestricted. These classifications are defined as follows:

Net investment in capital assets - This component of net position consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt are included in this component of net position. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of net investment in capital assets.

Restricted - This component of net position consists of constraints placed on net position use through external constraints imposed by creditors (such as through debt covenants), contributors, or law or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

Unrestricted - This component of net position consists of the net amount of the assets, liabilities and deferred inflows and outflows of resources that do not meet the definition of “restricted” or “net investment in capital assets.”

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

Classification of Revenues

Operating revenues and expenses generally result from providing services in connection with Heartland’s ongoing operations. The principal operating revenues are charges to customers for services. Operating expenses include the cost of service, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Taxes

Heartland is exempt from federal income taxes as it is a political subdivision of the state of South Dakota. Heartland may be subject to franchise taxes in states in which it operates. Tax expense was \$1,960 and \$3,880 in 2017 and 2016, respectively.

Heartland Consumers Power District
Notes to Financial Statements
December 31, 2017 and 2016

Note 2: Deposits, Investments and Investment Return

Heartland's investing is performed in accordance with the investment policy adopted by its Board of Directors and applicable state statutes. Heartland may invest in certificates of deposit, time deposits, repurchase agreements, and various U.S. Treasury securities and U.S. agency obligations.

Deposits

State statutes require banks either to give bond or to pledge government securities to Heartland in the amount of Heartland's deposits. Heartland's cash deposits, including certificates of deposit, are insured up to \$250,000 by the Federal Deposit Insurance Corporation (FDIC). Any cash deposits or certificates of deposit in excess of the \$250,000 FDIC limits are covered by collateral held in a Federal Reserve Bank pledge account or by an agent for Heartland and thus, no custodial risk exists. No legal opinion has been obtained regarding the enforceability of any collateral arrangements.

Investments

At December 31, 2017 and 2016, Heartland had the following investments and maturities:

	Carrying Value	Maturities in Years			Credit Ratings (Moody's)
		Less Than 1	1-5	6-10	
December 31, 2017					
Money market mutual funds	\$ 8,660,744	\$ 8,660,744	\$ -	\$ -	Aaa-mf
U.S. Treasury securities	4,675,044	4,675,044	-	-	N/A
U.S. agency obligations	190,089	-	-	190,089	Aaa
	<u>\$ 13,525,877</u>	<u>\$ 13,335,788</u>	<u>\$ -</u>	<u>\$ 190,089</u>	
December 31, 2016					
Money market mutual funds	\$ 12,257,085	\$ 12,257,085	\$ -	\$ -	Aaa-mf
U.S. Treasury securities	2,002,110	-	2,002,110	-	N/A
U.S. agency obligations	248,107	-	-	248,107	Aaa
	<u>\$ 14,507,302</u>	<u>\$ 12,257,085</u>	<u>\$ 2,002,110</u>	<u>\$ 248,107</u>	

Disclosures About Fair Value of Assets and Liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities

Heartland Consumers Power District
Notes to Financial Statements
December 31, 2017 and 2016

Note 2: Deposits, Investments and Investment Return - Continued

Disclosures About Fair Value of Assets and Liabilities - Continued

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities

Level 3 Unobservable inputs supported by little or no market activity and are significant to the fair value of the assets or liabilities

Heartland's investments in money market mutual funds are carried at cost and thus are not included within the fair value hierarchy. Heartland's investments in U.S. Treasury securities and U.S. agency obligations are measured at fair value on a recurring basis, and are classified within Level 2 of the fair value hierarchy at December 31, 2017 and 2016.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Heartland's investment policy provides limitations on the maturities of the various types of investments as a means of managing its exposure to fair value losses arising from interest rate fluctuations.

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Heartland's investment policy establishes requirements for all investment securities to be in compliance with ratings established in bond indentures, for which substantially all investments are held.

Custodial Credit Risk

For an investment, custodial credit risk is the risk that, in the event of a failure of the counterparty, Heartland would not be able to recover the value of its investment securities that are in the possession of an outside party. Heartland's investments in U.S. agency obligations are held in a book entry system in an account designated as a customer account at the Federal Reserve and the custodian's internal records identify Heartland as owner.

Heartland Consumers Power District

Notes to Financial Statements

December 31, 2017 and 2016

Note 2: Deposits, Investments and Investment Return - Continued

Concentration of Credit Risk

Concentration of credit risk is the risk associated with the amount of investments Heartland has with any one issuer that exceeds 5% or more of its total investments. Investments issued or explicitly guaranteed by the U.S. Government are excluded from this requirement. Heartland's investment policy limits the amount of its investment portfolio that may be invested in any one issuer, other than U.S. government securities, to 10%. No investments at December 31, 2017 or 2016 exceeded 5%.

Summary of Carrying Values

The carrying values of deposits and investments shown above are included in the balance sheets at December 31, 2017 and 2016 as follows:

	<u>2017</u>	<u>2016</u>
Carrying value		
Deposits	\$ 1,392,156	\$ 1,518,611
Investments	<u>13,525,877</u>	<u>14,507,302</u>
	<u>\$ 14,918,033</u>	<u>\$ 16,025,913</u>

Included in the following balance sheet captions:

	<u>2017</u>	<u>2016</u>
Current Assets		
Cash and cash equivalents		
Operating funds	\$ 352,987	\$ 545,812
General reserve funds	8,510,584	3,715,507
Revolving loan fund program accounts	1,189,216	1,122,798
Rate stabilization fund	<u>113</u>	<u>2,580,886</u>
Total	<u>10,052,900</u>	<u>7,965,003</u>
Restricted cash and cash equivalents		
Energy efficiency and incentive grant fund	-	59,730
Debt service funds	<u>-</u>	<u>5,750,963</u>
Total	<u>-</u>	<u>5,810,693</u>
Short-term investments - rate stabilization fund	<u>4,649,471</u>	<u>1,977,173</u>
Noncurrent Assets		
Long-term investments - rate stabilization fund	<u>215,662</u>	<u>273,044</u>
	<u>\$ 14,918,033</u>	<u>\$ 16,025,913</u>

Heartland Consumers Power District
Notes to Financial Statements
December 31, 2017 and 2016

Note 2: Deposits, Investments and Investment Return - Continued

Investment Return

Investment return for the years ended December 31, 2017 and 2016 consisted of interest income and realized gains of \$120,380 and \$92,257, respectively. Unrealized gains and losses on restricted investments are deferred and reported as reductions of future billings shown as a deferred inflow of resources in accordance with the regulated operations provisions of GASB Statement No. 62.

Note 3: Notes Receivable

Type of Notes	2017				Due Within One Year
	January 1,	Additions	Reductions	December 31,	
4.0% to 4.5% notes in connection with Heartland's economic development program, payable in annual installments through December 2018	\$ 139,835	\$ -	\$ 6,963	\$ 132,872	\$ -
3.0% to 5.0% notes in connection with the Intermediary Relending Program Promissory Note (see Note 13), due in monthly installments through September 2027	1,126,035	1,595,000	540,663	2,180,372	262,867
0.0% to 3.0% notes in connection with the Rural Economic Development Loan Agreement and Rural Economic Development Grant Agreement (see Note 13), due in monthly installments through November 2028	2,257,541	1,150,000	366,061	3,041,480	318,463
Allowance for notes receivable	(343,781)	(196,126)	-	(539,907)	-
Total notes receivable, net	\$ 3,179,630	\$ 2,548,874	\$ 913,687	\$ 4,814,817	\$ 581,330

Heartland Consumers Power District
Notes to Financial Statements
December 31, 2017 and 2016

Note 3: Notes Receivable - Continued

Type of Notes	2016				Due Within One Year
	January 1,	Additions	Reductions	December 31,	
4.0% to 4.5% notes in connection with Heartland's economic development program, payable in annual installments through December 2018	\$ 161,218	\$ 2,657	\$ 24,040	\$ 139,835	\$ 9,461
3.0% to 6.25% notes in connection with the Intermediary Relending Program Promissory Note (see Note 13), due in monthly installments through January 2024	842,593	433,750	150,308	1,126,035	116,715
Interest-free notes in connection with the Rural Economic Development Loan Agreement and Rural Economic Development Grant Agreement (see Note 13), due in monthly installments through November 2028	2,567,096	-	309,555	2,257,541	309,556
Allowance for notes receivable	(326,774)	(17,007)	-	(343,781)	-
Total notes receivable, net	<u>\$ 3,244,133</u>	<u>\$ 419,400</u>	<u>\$ 483,903</u>	<u>\$ 3,179,630</u>	<u>\$ 435,732</u>

Interest income on these notes totaled \$77,118 and \$40,914 for 2017 and 2016, respectively, and is included within investment income on the statements of revenues, expenses and changes in net position.

Note 4: Capital Assets

Capital assets at December 31, 2017 and 2016 consisted of the following:

	2017	2016
Depreciable assets		
Missouri Basin Power Project	\$ 56,663,387	\$ 56,029,934
Transmission Project I (TP I)	1,085,293	1,085,293
Groton substation (TP III)	415,292	408,641
Heartland headquarters building	2,837,333	2,837,333
General plant	821,526	811,285
Total depreciable assets	<u>61,822,831</u>	<u>61,172,486</u>
Nondepreciable assets		
Land	80,402	80,402
Construction in progress	3,035,525	1,030,796
Total nondepreciable assets	<u>3,115,927</u>	<u>1,111,198</u>
	<u>\$ 64,938,758</u>	<u>\$ 62,283,684</u>

Heartland Consumers Power District
Notes to Financial Statements
December 31, 2017 and 2016

Note 4: Capital Assets - Continued

Capital assets activity for 2017 and 2016 was:

	2017				
	Beginning Balance	Additions	Retirements	Transfers	Ending Balance
Missouri Basin Power Project	\$ 56,029,934	\$ -	\$ (135,755)	\$ 769,208	\$ 56,663,387
Transmission Project I (TP I)	1,085,293	-	-	-	1,085,293
Groton substation (TP III)	408,641	6,651	-	-	415,292
Heartland headquarters building	2,837,333	-	-	-	2,837,333
General plant	811,285	45,543	(35,302)	-	821,526
Land	80,402	-	-	-	80,402
Construction in progress	1,030,796	2,773,937	-	(769,208)	3,035,525
Total capital assets	62,283,684	2,826,131	(171,057)	-	64,938,758
Less accumulated depreciation	(41,881,574)	(1,073,257)	171,057	-	(42,783,774)
Capital assets, net	<u>\$ 20,402,110</u>	<u>\$ 1,752,874</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 22,154,984</u>
	2016				
	Beginning Balance	Additions	Retirements	Transfers	Ending Balance
Missouri Basin Power Project	\$ 54,555,764	\$ 66,704	\$ (189,150)	\$ 1,596,616	\$ 56,029,934
Transmission Project I (TP I)	1,085,293	-	-	-	1,085,293
Transmission Project II (TP II)	6,752,305	-	(6,752,305)	-	-
Groton substation (TP III)	408,641	-	-	-	408,641
Heartland headquarters building	2,837,333	-	-	-	2,837,333
General plant	759,685	51,600	-	-	811,285
Land	80,402	-	-	-	80,402
Construction in progress	1,280,756	1,346,656	-	(1,596,616)	1,030,796
Total capital assets	67,760,179	1,464,960	(6,941,455)	-	62,283,684
Less accumulated depreciation	(47,499,907)	(1,323,122)	6,941,455	-	(41,881,574)
Capital assets, net	<u>\$ 20,260,272</u>	<u>\$ 141,838</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 20,402,110</u>

Heartland is a 24% of 75% (total of 18%) owner of TP I, which consists of approximately eight miles of 115 kv transmission line and associated switching equipment.

TP II consisted of 3 115/69 kv substations, certain improvements to three East River Electric Power Cooperative (East River) 69/12.5 kv substations, three microwave towers and associated facilities, and approximately 51 miles of additions to East River 115 kv and 69 kv transmission lines, the additions owned jointly by Heartland and East River as tenants in common. Heartland held a 99% ownership interest and East River a 1% ownership interest in those additions. East River has 100% use of this East River Section of TP II and purchased 100% of the total capacity of this section on a take-or-pay basis. In accordance with the terms of the agreement described in Note 7, East River executed its option to acquire Heartland's interest in TP II during 2016.

Heartland Consumers Power District

Notes to Financial Statements

December 31, 2017 and 2016

Note 4: Capital Assets - Continued

TP III consists of a 345/115 kv substation located near Groton, South Dakota; a 115 kv tie line between the Groton substation and the substation owned by Western Area Power Administration (WAPA); and a 115 kv circuit breaker in addition to the WAPA Groton substation for the termination of the tie line. Heartland owns a 3.9% share in TP III.

Heartland is also a 3% co-owner of the Missouri Basin Power Project, which includes Laramie River Station (LRS), a three-unit, 1,650 MW, coal-fired power supply station in eastern Wyoming, and a related transmission system.

Note 5: Credit Facilities

Line of Credit

In March 2015, Heartland entered into a revolving credit agreement with a financial institution that provides for borrowings up to \$25,000,000; secured by a subordinate lien on the revenues of Heartland's electric system. The agreement expires on March 23, 2018, and can be extended at the option of Heartland. Borrowings under the credit agreement bear interest at varying rates, and cannot exceed a maximum rate, as defined in the agreement (1.92% and 1.41% at December 31, 2017 and 2016, respectively). The agreement also provides for standby letters of credit, not to exceed \$5,000,000 in the aggregate. The amount available under Heartland's revolving credit agreement is reduced by the amount of any issued standby letters of credit. Heartland had outstanding borrowings of \$5,300,000 and \$2,300,000 on this line at December 31, 2017 and 2016, respectively. Heartland management has created an internal loan amortization schedule to document their intent of repayment of the outstanding balance on the line of credit by February 2019. This internal amortization schedule shows principal repayments of \$3,350,000 and \$1,950,000 in 2018 and 2019, respectively.

Letter of Credit

As financial security for Heartland's performance under certain financial transmission rights and transmission congestion rights in regional transmission organizations in which Heartland participates, Heartland has obtained a standby letter of credit for \$1.5 million at December 31, 2017 and 2016. The letter of credit expires September 30, 2018, and can be renewed for an additional one-year term.

Heartland Consumers Power District
Notes to Financial Statements
December 31, 2017 and 2016

Note 6: Long-term Liabilities

Long-term liabilities at December 31, 2017 consisted of the following:

Type of Debt	2017				Due Within One Year
	January 1,	Additions	Reductions	December 31,	
4.75-5.25% Electric System Second Lien Revenue Bonds, Series 2011, with interest payments due semi-annually and principal payments due on January 1, 2016 and 2017	\$ 5,600,000	\$ -	\$ 5,600,000	\$ -	\$ -
1.0% Intermediary Relending Program Promissory Note, due annually on October 16 with a final payment due October 16, 2036	573,283	-	26,105	547,178	26,366
1.0% Intermediary Relending Program Promissory Note, due annually on June 25 with a final payment due June 25, 2040	579,322	88,736	25,933	642,125	25,417
1.0% Intermediary Relending Program Promissory Note, due annually on November 10, beginning in 2020, with a final payment due November 10, 2046	225,000	693,750	-	918,750	-
0% Rural Economic Development Promissory Note, with principal payments due in monthly installments of \$6,852 through July 31, 2019	212,396	-	75,372	137,024	82,224
0% Rural Economic Development Promissory Note, with principal payments due in monthly installments of \$3,299 through April 30, 2031	567,307	-	36,289	531,018	39,588
0% Rural Economic Development Promissory Note, with principal payments due in monthly installments of \$8,333 through December 31, 2025	900,004	-	91,662	808,342	100,000
0% Rural Economic Development Promissory Note, with principal payments due in monthly installments of \$10,417, beginning in October 2019, through September 21, 2027	-	1,000,000	-	1,000,000	-
Total bonds and notes payable	8,657,312	1,782,486	5,855,361	4,584,437	273,595
Compensated absences	327,770	137,961	117,781	347,950	91,507
Total long-term liabilities	<u>\$ 8,985,082</u>	<u>\$ 1,920,447</u>	<u>\$ 5,973,142</u>	<u>\$ 4,932,387</u>	<u>\$ 365,102</u>

Heartland Consumers Power District
Notes to Financial Statements
December 31, 2017 and 2016

Note 6: Long-term Liabilities - Continued

Long-term liabilities at December 31, 2016 consisted of the following:

Type of Debt	2016				Due Within One Year
	January 1,	Additions	Reductions	December 31,	
4.75-5.25% Electric System Second Lien Revenue Bonds, Series 2011, with interest payments due semi-annually and principal payments due on January 1, 2016 and 2017	\$ 11,350,000	\$ -	\$ 5,750,000	\$ 5,600,000	\$ 5,600,000
1.0% Intermediary Relending Program Promissory Note, due annually on October 16 with a final payment due October 16, 2036	599,130	-	25,847	573,283	26,105
1.0% Intermediary Relending Program Promissory Note, due annually on June 25 with a final payment due June 25, 2040	605,518	-	26,196	579,322	26,029
1.0% Intermediary Relending Program Promissory Note, due annually on November 10, beginning in 2020, with a final payment due November 10, 2046	-	225,000	-	225,000	-
0% Rural Economic Development Promissory Note, with principal payments due in monthly installments of \$6,852 through July 31, 2019	294,620	-	82,224	212,396	82,224
0% Rural Economic Development Promissory Note, with principal payments due in monthly installments of \$3,299 through April 30, 2031	606,895	-	39,588	567,307	39,588
0% Rural Economic Development Promissory Note, with principal payments due in monthly installments of \$8,333 through December 31, 2025	1,000,000	-	99,996	900,004	100,000
Total bonds and notes payable	14,456,163	225,000	6,023,851	8,657,312	5,873,946
Compensated absences	327,804	99,682	99,716	327,770	82,572
Total long-term liabilities	<u>\$ 14,783,967</u>	<u>\$ 324,682</u>	<u>\$ 6,123,567</u>	<u>\$ 8,985,082</u>	<u>\$ 5,956,518</u>

Heartland Consumers Power District
Notes to Financial Statements
December 31, 2017 and 2016

Note 6: Long-term Liabilities - Continued

Debt service requirements at December 31, 2017 are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2018	\$ 273,595	\$ 19,847	\$ 293,442
2019	271,103	20,563	291,666
2020	350,649	20,065	370,714
2021	351,535	19,179	370,714
2022	352,405	18,309	370,714
2023-2027	1,544,101	78,222	1,622,323
2028-2032	607,316	55,153	662,469
2033-2037	466,375	30,892	497,267
2038-2042	285,418	10,849	296,267
2043-2047	81,940	852	82,792
	<u>\$ 4,584,437</u>	<u>\$ 273,931</u>	<u>\$ 4,858,368</u>

Heartland has executed four credit agreements with two financial institutions, two for \$740,000 and two for \$1,000,000, which are renewed annually. The credit agreements allow Heartland to retain drawing capacity at least equal to the issued and outstanding amount of the Rural Economic Development Promissory Notes. There were no amounts outstanding under these credit agreements at December 31, 2017 and 2016.

The principal and interest on the revenue notes and bonds are payable solely from, and secured solely by, a pledge of and lien on: (1) the revenues of Heartland's electric system, subject to prior payments there from of operation and maintenance expense; (2) the proceeds of the sale of the notes or bonds; and (3) all accounts established under the Bond Resolution, including income, if any, from investments thereof. The debt was paid in full by Heartland in January 2017. Principal and interest for the current year and total operating revenues were \$5,747,000 and \$57,669,465, respectively.

Note 7: Power Sales Agreements

Heartland is a party to electric power sales agreements with municipalities in South Dakota, Minnesota, Kansas and Iowa, whereby Heartland has undertaken to provide primary power to and to supplement existing power sources of the parties. Rates are established annually by the Board of Directors. The majority of these agreements expire in 2040.

Heartland Consumers Power District
Notes to Financial Statements
December 31, 2017 and 2016

Note 7: Power Sales Agreements – Continued

Heartland had a power sales agreement with Northern Electric Cooperative, Inc. (Northern) to provide supplemental electric service to a small portion of Northern's service area under the same terms and conditions as the agreements with Heartland's municipal customers. This agreement expired in 2016. Heartland also has power sales agreements with the State of South Dakota to provide service to various state institutions.

Heartland had an agreement with East River Electric Power Cooperative whereby East River will pay approximately 95% of the operating expenses of TP II on a take-or-pay basis. The payments were set to underwrite the cost of debt service on the associated bonds along with Heartland's overhead expenses. East River operated and maintained the facilities at its own expense. The contract continued until 2016, at which time East River executed its option under the agreement and acquired Heartland's interest for \$1,000

Heartland entered into power sales agreements with Basin Electric Power Cooperative (Basin) whereby Heartland will sell and deliver approximately 50 MW of power to Basin through May 31, 2021. The agreements provide for a fixed energy rate throughout the term of the contracts.

Note 8: Commitments

Public Power Generation Agency (PPGA)

Heartland has entered into an agreement with other utilities, creating an interlocal, PPGA. In connection with PPGA, Heartland has also entered into a long-term participation power agreement whereby Heartland has agreed to share in the energy output of the Whelan Energy Center Unit 2, a 220 MW coal-fired power plant, which became commercially operational in May 2011. Heartland's commitment is for 36.36%, or 80 MW, of the output of the project, which extends to the later of the life of the project or January 2041, which represents the date of final maturity on the bonds issued by PPGA for the project.

Energy Purchase Contracts

Heartland entered into an energy purchase contract with a national energy company to purchase 30 MW of energy at a fixed price during the period of January 1, 2014 through June 30, 2016. In connection with the agreement, Heartland received a \$6,000,000 advance payment from the energy company in 2012. This advance payment was recorded as unearned revenue and was recognized over the term of the contract as a reduction of the cost of the power purchased under the agreement.

Heartland Consumers Power District

Notes to Financial Statements

December 31, 2017 and 2016

Note 9: Retirement Plans

Defined Benefit Plan

Plan Description

Heartland contributes to the South Dakota Retirement System (the Plan), which is a cost-sharing, multiple-employer, public employee retirement system, providing retirement, disability and survivors benefits. The Plan is a defined benefit plan covering all full-time employees of Heartland. Authority for establishing, administering and amending plan provisions are found in South Dakota Codified Law 3-12. In accordance with the provisions of GASB Statement No. 68, Heartland accounts for and reports its participation in the Plan, based on its calculated proportionate share of contributions to the Plan. The Plan issues a publicly available financial report that includes financial statements and required supplementary information for the Plan. That report may be obtained at <http://www.sdrs.sd.gov/publications/> or by writing the South Dakota Retirement System, P.O. Box 1098, Pierre, SD 57501-1098.

Contributions

Covered employees are required by state statute to contribute a percentage of their salary (6%) to the Plan, and Heartland is required to match the employee contribution. The contribution requirements of plan members and Heartland are established and may be amended by the Plan's board of trustees. Contributions made to the Plan by Heartland were \$107,920 and \$103,771 during 2017 and 2016, respectively, and were in accordance with statutory rates. The employees' contributions during 2017 and 2016 were \$88,534 and \$84,452, respectively, and were in accordance with statutory rates.

Benefits

The Plan provides retirement, disability, and survivor benefits based on an employer's membership class within the Plan. Heartland is a Class A member in the Plan. Class A members who retire after age 65 with three years of service are entitled to an unreduced annual retirement benefit. An unreduced annual retirement benefit is also available after age 55 for Class A members, where the sum of age and credited service is greater than or equal to 85. The annual increase in benefits payable is indexed to the consumer price index annually on July 1st, with further adjustments based on the funded status of the Plan. The right to receive benefits vests after three years of credited service.

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

At December 31, 2017, Heartland reported an asset of \$7,850 for its proportionate share of the collective net pension asset for the Plan. At December 31, 2016, Heartland reported a liability of \$296,707 for its proportionate share of the collective net pension liability for the Plan. The net pension asset and net pension liability were measured as of June 30, 2017 and 2016, respectively, and the total pension liability used to calculate these amounts was determined by an actuarial

Heartland Consumers Power District
Notes to Financial Statements
December 31, 2017 and 2016

Note 9: Pension Plan - Continued

Defined Benefit Plan - Continued

valuation as of those dates. Heartland's proportionate share of the net pension asset and net pension liability was based on Heartland's share of contributions to the Plan relative to all employer contributions to the Plan for the measurement period. At December 31, 2017 and 2016, Heartland's proportion was 0.086% and 0.088%, respectively.

For the years ended December 31, 2017 and 2016, Heartland recognized pension revenue of \$289,311 and pension expense of \$92,371, respectively. At December 31, 2017 and 2016, Heartland reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	December 31, 2017		December 31, 2016	
	Deferred Outflows of Resources	Deferred Inflows of Resources	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	\$ 125,778	\$ -	\$ 103,290	\$ -
Net difference between projected and actual earnings on pension plan investments	-	150,923	330,039	-
Changes of assumptions	609,500	-	177,714	-
Change in Heartland's proportionate share	-	12,919	-	21,891
Heartland contributions subsequent to the measurement date	<u>66,300</u>	<u>-</u>	<u>63,830</u>	<u>-</u>
Total	<u>\$ 801,578</u>	<u>\$ 163,842</u>	<u>\$ 674,873</u>	<u>\$ 21,891</u>

The deferred outflows of resources related to pensions resulting from Heartland contributions subsequent to the measurement date will be recognized as a reduction of pension expense in the fiscal year ending December 31, 2018. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year Ending December 31,	
2018	\$ 149,521
2019	262,127
2020	195,631
2021	<u>(35,843)</u>
	<u>\$ 571,436</u>

Heartland Consumers Power District
Notes to Financial Statements
December 31, 2017 and 2016

Note 9: Pension Plan - Continued

Defined Benefit Plan - Continued

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

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

Inflation	2017 - 2.25%
	2016 - 3.25%
Salary increases	2017 - 6.50% at entry to 3.0% after 25 years of service
	2016 - 5.83% at entry to 3.87% after 30 years of service
Discount rate	2017 - 6.50%, net of pension plan investment expense
	2016 - 7.50%, net of pension plan investment expense

Mortality rates for the June 30, 2017 actuarial valuation were based on the RP-2014 Mortality Table, projected generationally with Scale MP-2016. Mortality rates for the June 30, 2016 actuarial valuation were based on the RP-2000 Mortality Table, projected generally with Scale BB and with rates reduced to fit recent experience.

The actuarial assumptions used in the June 30, 2017 and 2016 valuations were based on the results of an actuarial experience study, which covered the five-year period ending June 30, 2011.

The long-term expected rate of return on pension plan investments was determined using a method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are 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 by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class as of December 31, 2017 and 2016, are summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Global Equity	58.0%	4.8%
Fixed Income	30.0%	1.8%
Real Estate	10.0%	4.6%
Cash	2.0%	0.7%
Total	<u>100.0%</u>	

Heartland Consumers Power District
Notes to Financial Statements
December 31, 2017 and 2016

Note 9: Pension Plan - Continued

Defined Benefit Plan - Continued

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

Discount rate – The discount rate used to measure the total pension liability in 2017 and 2016 was 6.50% and 7.50%, respectively. The projection of cash flows used to determine the discount rate assumed that contributions from plan members will be made at the current contribution rate, and that contributions from employers will be made at contractually required rates. Based on those assumptions, the pension plan’s fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of Heartland’s proportionate share of the net pension (asset) liability to changes in the discount rate – The following presents Heartland’s proportionate share of the net pension (asset) liability calculated using the discount rate of 6.50%, as well as what Heartland’s proportionate share of the net pension (asset) liability would be if it were calculated using a discount rate that is one percentage point lower (5.50%) or one percentage point higher (7.50%) than the current rate.

	1% Decrease (5.50%)	Current Discount Rate (6.50%)	1% Increase (7.50%)
Heartland's proportionate share of the net pension (asset) liability December 31, 2017	\$ 1,437,718	\$ (7,850)	\$ (1,185,012)

Pension Plan Fiduciary Net Position

Detailed information about the pension plan’s fiduciary net position is available in the separately issued South Dakota Retirement System financial report.

Defined Contribution Plan

In addition to the above retirement plan, Heartland has a savings plan with the National Rural Electric Cooperative Association, which is a defined contribution plan. Employees are eligible to participate in this plan after one month of service. The National Rural Electric Cooperative Association board of directors has the authority to establish and amend provisions to the plan. Heartland matches up to 4% of participating employees’ salaries; employees must contribute a minimum of 1% of their salaries. The contributions made by, and related expense of, Heartland for the years ended December 31, 2017 and 2016 were \$60,611 and \$57,691, respectively. No forfeitures were used to reduce Heartland’s contributions during 2017 and 2016. The contributions made by Heartland employees for the years ended December 31, 2017 and 2016 were \$92,281 and \$85,966, respectively.

Heartland Consumers Power District
Notes to Financial Statements
December 31, 2017 and 2016

Note 10: Significant Estimates and Concentrations

Major Customers

Sales to one and two customers were approximately 20% and 37%, respectively, of total operating revenues for the years ended December 31, 2017 and 2016, respectively. Approximately 34% and 38% of total accounts receivable were owed from three customers at December 31, 2017 and 2016, respectively.

Proposed Environmental Standards

In June 1999, the Environmental Protection Agency (EPA) issued final regulations for a Regional Haze Program. The purpose of the regulations is to improve visibility in the form of reduced regional haze in 156 national parks and wilderness areas across the country. The EPA's claim is that haze is formed, in part, from emissions of SO₂ (sulfur dioxide) and NO₂ (nitrogen dioxide). Heartland is impacted by these regulations through its co-ownership of Laramie River Station (LRS) in Wyoming.

As part of the EPA's Clean Air Act regulations, each state is required to submit a state implementation plan (SIP) identifying the emission control technology proposed to comply with the Regional Haze Program. The State of Wyoming submitted its SIP to the EPA in 2011, which included plans for LRS. In January 2014, the EPA issued their final ruling on this SIP, requiring installation of selective catalytic reduction (SCR) NO₂ removal technology for five coal plants in Wyoming, including the three units at LRS. Negotiations continued through 2016 until a tentative agreement was reached late in 2016. The agreement would require LRS to install non-SCR technology on two units and SCR technology on one unit, which results in significant cost savings over installing SCR technology on all three units. Although initial estimates of these costs have been calculated, the level of regulatory and legal uncertainty related to these facilities makes it impractical to quantify the specific potential financial impacts at this time.

Note 11: Risk Management

Heartland 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 others; and natural disasters. Heartland carries commercially available insurance, subject to certain limits and deductibles, to reduce the financial impact for claims arising from such matters. Claims have not exceeded this commercial coverage in any of the three preceding years.

Heartland Consumers Power District

Notes to Financial Statements

December 31, 2017 and 2016

Note 12: Statutory Reporting Requirement

Section 3 of Chapter 49-38 of the South Dakota Codified Laws requires that certain information be set forth in the annual reports of consumer power districts. Additional information, as required, is as shown below:

	<u>2017</u>	<u>2016</u>
Employees (unaudited)	12	12
Total salaries	\$ 1,506,831	\$ 1,422,500
Maintenance expense	\$ 326,624	\$ 220,820
Total kilowatt hours sold (unaudited)	956,328,108	1,282,757,118

Note 13: Segment Information

In accordance with the provisions of the Intermediary Relending Program Loan Agreements, Rural Economic Development Loan Agreement and Rural Economic Development Grant Agreement, Heartland is required to create and maintain a revolving loan fund. Heartland administers this revolving loan fund as a division within its Heartland operations. Condensed 2017 and 2016 financial information for the revolving loan fund is presented below:

Condensed Balance Sheet

	<u>2017</u>	<u>2016</u>
Current assets	\$ 1,775,976	\$ 1,551,824
Other assets	4,233,487	2,613,527
Total assets	<u>\$ 6,009,463</u>	<u>\$ 4,165,351</u>
Liabilities		
Current liabilities	\$ 283,110	\$ 278,623
Noncurrent liabilities	4,310,842	2,783,367
Total liabilities	4,593,952	3,061,990
Net Position	1,415,511	1,103,361
Total liabilities and net position	<u>\$ 6,009,463</u>	<u>\$ 4,165,351</u>

Heartland Consumers Power District

Notes to Financial Statements

December 31, 2017 and 2016

Note 13: Segment Information - Continued

Condensed Statement of Revenues, Expenses and Changes in Net Position

	<u>2017</u>	<u>2016</u>
Nonoperating revenues (expenses)		
Investment income	\$ 75,288	\$ 37,871
Interest expense	(19,746)	(12,017)
Bad debt expense	(63,260)	(17,007)
Other	(17,645)	(20,448)
Capital contributions	<u>337,513</u>	<u>-</u>
Increase (Decrease) in Net Position	312,150	(11,601)
Net Position, Beginning of Year	<u>1,103,361</u>	<u>1,114,962</u>
Net Position, End of Year	<u>\$ 1,415,511</u>	<u>\$ 1,103,361</u>

Condensed Statement of Cash Flows

Net cash provided by (used in)		
Noncapital financing activities	\$ 1,489,895	\$ (80,608)
Investing activities	<u>(1,423,477)</u>	<u>63,114</u>
Increase (Decrease) in Cash	66,418	(17,494)
Beginning of year	<u>1,122,798</u>	<u>1,140,292</u>
End of year	<u>\$ 1,189,216</u>	<u>\$ 1,122,798</u>

Required Supplementary Information

Heartland Consumers Power District
Schedule of Heartland's Proportionate Share of the Net Pension Asset (Liability)
South Dakota Retirement System
December 31, 2017

	2017	2016	2015	2014
Heartland's proportion of the net pension asset (liability)	0.086%	0.088%	0.087%	0.097%
Heartland's proportionate share of the net pension asset (liability)	\$ 7,850	\$ (296,707)	\$ 370,005	\$ 697,294
Heartland's covered payroll	\$ 1,458,085	\$ 1,394,520	\$ 1,390,734	\$ 1,404,232
Heartland's proportionate share of the net pension asset (liability) as a percentage of its covered payroll	0.54%	-21.28%	26.61%	49.66%
Plan fiduciary net position as a percentage of the total pension liability	100.10%	96.89%	104.10%	107.29%

Note: This schedule is presented to illustrate the requirement to show information for 10 years. However, until a full 10-year trend is compiled, Heartland will present information for only those years for which information is available. Information presented in this schedule has been determined as of Heartland's measurement date (June 30) of the collective net pension asset (liability) in accordance with GASB 68.

Heartland Consumers Power District
Schedule of Heartland's Contributions
South Dakota Retirement System
December 31, 2017

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
Statutorily required contribution	\$ 107,920	\$ 103,771	\$ 99,453	\$ 97,153
Contributions in relation to the statutorily required contribution	<u>(107,920)</u>	<u>(103,771)</u>	<u>(99,453)</u>	<u>(97,153)</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Heartland's covered payroll	\$ 1,506,831	\$ 1,422,500	\$ 1,377,344	\$ 1,414,132
Contributions as a percentage of covered payroll	7.16%	7.29%	7.22%	6.87%

Note: This schedule is presented to illustrate the requirement to show information for 10 years. However, until a full 10-year trend is compiled, the Heartland will present information for only those years for which information is available. Information presented in this schedule has been determined as of Heartland's most recent fiscal year-end (December 31) in accordance with GASB 68.

Other Information

Heartland Consumers Power District
Schedule of Transmission Operation and Maintenance Expenses
FERC Uniform System of Accounts Classification
Year Ended December 31, 2017

	Amount
Operation	
560 – Operation Supervision and Engineering	\$ 55,399
561 – Load Dispatching	-
561.1 – Load Dispatch – Reliability	-
561.2 – Load Dispatch – Monitor and Operate Transmission System	-
561.3 – Load Dispatch – Transmission Service and Scheduling	-
561.4 – Scheduling, System Control and Dispatch Services	-
561.5 – Reliability, Planning and Standards Development	-
561.6 – Transmission Service Studies	-
561.7 – Generation Interconnection Studies	-
561.8 – Reliability, Planning and Standards Development Service	-
562 – Station Expenses	24,959
563 – Overhead Lines Expenses	26,182
564 – Underground Lines Expenses	-
565 – Transmission of Electricity by Others	7,284,775
566 – Miscellaneous Transmission Expenses	23,254
567 – Rents	-
Total Operation Expense	7,414,569
Maintenance	
568 – Maintenance Supervision and Engineering	-
569 – Maintenance of Structures	-
569.1 – Maintenance of Computer Hardware	-
569.2 – Maintenance of Computer Software	-
569.3 – Maintenance of Communication Equipment	-
569.4 – Maintenance of Miscellaneous Regional Transmission Plant	-
570 – Maintenance of Station Equipment	20,782
571 – Maintenance of Overhead Lines	37,843
572 – Maintenance of Underground Lines	-
573 – Maintenance of Miscellaneous Transmission Plant	71,072
Total Maintenance Expense	129,697
Total Transmission O&M Expense	\$ 7,544,266

Heartland Consumers Power District
Schedule of Administrative and General Expenses
FERC Uniform System of Accounts Classification
Year Ended December 31, 2017

	Amount
Customer Accounts Expenses	
901 – Supervision	\$ -
902 – Meter Reading Expenses	-
903 – Customer Records and Collection Expenses	-
904 – Uncollectible Accounts	-
905 – Miscellaneous Customer Accounts Expenses	-
	-
Total Customer Accounts Expense	-
Customer Service and Informational Expenses	
907 – Supervision	231,170
908 – Customer Assistance Expenses	308,550
909 – Informational and Instructional Expenses	-
910 – Miscellaneous Customer Service and Informational Expenses	-
	-
Total Customer Service and Informational Expenses	539,720
Sales Expenses	
911 – Supervision	-
912 – Demonstrating and Selling Expenses	-
913 – Advertising Expenses	-
916 – Miscellaneous Sales Expenses	-
	-
Sales Expenses	-
Administrative and General Expenses	
920 – Administrative and General Salaries	1,284,085
921 – Office Supplies and Expenses	170,179
922 – Administrative Expenses Transferred Credit	-
923 – Outside Services Employed	405,136
924 – Property Insurance	7,182
925 – Injuries and Damages	14,772
926 – Employee Pension and Benefits	123,395
927 – Franchise Requirements	-
928 – Regulatory Commission Expenses	22,249
929 – Duplicate Charges Credit	-
930.1 – General Advertising Expenses	36,858
930.2 – Miscellaneous General Expenses	738,918
931 – Rents	-
935 – Maintenance of General Plant	196,927
	196,927
Administrative and General Expenses	\$ 2,999,701