

**OWENSBORO MUNICIPAL UTILITIES  
ELECTRIC LIGHT AND POWER SYSTEM  
&  
WATER WORKS SYSTEM  
FINANCIAL STATEMENTS  
& SUPPLEMENTARY INFORMATION  
Years Ended May 31, 2013 and 2012**

***(With Independent Auditor's Report Thereon)***

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## INDEPENDENT AUDITOR'S REPORT

City Utility Commission  
City of Owensboro, Kentucky

We have audited the accompanying financial statements of the Owensboro Municipal Utilities Electric Light and Power System (Electric System) of the City of Owensboro, Kentucky, as of and for the years ended May 31, 2013 and 2012, and the related notes to the 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 audit. We conducted our audit 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 the Owensboro Municipal Utilities Electric Light and Power System of the City of Owensboro, Kentucky, as of May 31, 2013 and 2012, and the changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

### **Emphasis of Matter**

As discussed in Note 1 to the financial statements, the financial statements present only the Electric System, an enterprise fund of the City of Owensboro, Kentucky, and do not purport to, and do not, present fairly the financial position of the City of Owensboro, Kentucky, as of May 31, 2013 and 2012, and the changes in its financial position or, where applicable, its cash flows, for the years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

### **Other Matters**

#### **Required Supplementary Information**

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 6 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 as a whole. The schedule of revenues and expenses is presented for purposes of additional analysis and is not a required part of the financial statements.

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

*Riney Hancock CPAs PSC*

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

Our discussion and analysis of the Owensboro Municipal Utilities Electric Light and Power System (Electric System) financial performance provides an overview of the Electric System's financial activities for the fiscal year ended May 31, 2013. Please read it in conjunction with the Electric System's financial statements, which begin on page 7.

### **Overview of the Financial Statements**

This annual report consists of three parts: Management's Discussion and Analysis, Financial Statements, and Supplementary Information.

Management's Discussion and Analysis (MD&A) serves as an introduction to the basic financial statements and supplementary information. The MD&A represents management's examination and analysis of the Electric System's financial condition and performance.

The financial statements report information using accounting methods similar to those used by private sector companies. The financial statements include a Statement of Net Position; a Statement of Revenues, Expenses, and Changes in Fund Net Position; a Statement of Cash Flows; and Notes to the Financial Statements.

The Statement of Net Position presents the financial position of the Electric System and thus provides information about the nature and amount of resources and obligations at year-end.

The Statement of Revenues, Expenses, and Changes in Fund Net Position presents the results of the business activities over the course of the fiscal year and information as to how the net position changed during the year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flow.

The Statement of Cash Flows presents changes in cash and cash equivalents resulting from operational, financing and investing activities. This statement presents cash receipts and cash disbursements information, without consideration of the earnings event or when an obligation arises.

The Notes to the Financial Statements provide required disclosures and other information that are essential to a full understanding of material data provided in the statements. The notes present information about the Electric System's accounting policies, significant account balances and activities, material risks, obligations, commitments, contingencies and subsequent events, if any.

## MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED

### Financial Summary

The following table summarizes the financial condition and operations of the Electric System for 2013 and 2012.

<b>Assets and Deferred Outflows of Resources</b>	<b><u>2013</u></b>	<b><u>2012</u></b>
Utility plant, net	\$ 174,639,040	\$ 182,018,739
Restricted assets	73,319,343	82,214,189
Current assets	37,091,387	32,508,325
Other noncurrent assets	10,353,929	8,236,901
Deferred outflows of resources	3,911,603	-
	<u>\$ 299,315,302</u>	<u>\$ 304,978,154</u>
 <b>Liabilities, Deferred Inflows of Resources, and Net Position</b>		
Net position		
Invested in capital assets, net	\$ 40,787,888	\$ 43,167,714
Restricted	39,009,725	42,507,183
Unrestricted	34,136,705	27,263,679
	<u>113,934,318</u>	<u>112,938,576</u>
Total net position	113,934,318	112,938,576
Long-term debt	141,054,874	152,908,973
Current liabilities	41,026,545	34,896,751
Other noncurrent liabilities	1,601,229	131,289
Deferred revenues	1,698,336	3,112,032
Deferred inflows of resources	-	990,533
	<u>\$ 299,315,302</u>	<u>\$ 304,978,154</u>
 <b>Revenues, Expenses and Changes in Fund Net Position</b>		
Operating revenues	\$ 142,294,779	\$ 141,474,209
Operating expenses	<u>123,056,364</u>	<u>126,034,149</u>
Operating income	<u>19,238,415</u>	<u>15,440,060</u>
Interest and debt expense	(10,472,877)	(11,228,701)
Interest and other income	<u>861,401</u>	<u>1,303,634</u>
Net nonoperating expenses	<u>(9,611,476)</u>	<u>(9,925,067)</u>
Income before special item and transfers	9,626,939	5,514,993
Special item -- gain on litigation settlement	-	3,679,667
Transfers out - dividends to City of Owensboro	<u>(8,631,197)</u>	<u>(8,365,863)</u>
Change in net position	<u>\$ 995,742</u>	<u>\$ 828,797</u>

## MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED

### FINANCIAL HIGHLIGHTS

- Net position increased by \$995,742 in 2013 versus \$828,797 in 2012 as the result of changes in operating revenues, operating expenses, interest and special items and transfers as discussed below.
- Operating revenues increased \$820,570, or 0.6%, in 2013 when compared to 2012. Wholesale revenues increased by \$1.5 million, or 2.7%, primarily as a result of increased sales volumes, due to increased generation at Elmer Smith Generating Station (ESGS). That increase was partially offset by a decrease in revenues from retail customers of \$762,882, or 1.0%, primarily due to a decrease in recovery of energy costs from retail customers through the energy cost adjustment. The adjustment provides for the Electric System to adjust charges to its retail customers for fluctuations in energy costs. Due to increased wholesale sales volumes, more energy cost was recovered from wholesale customers in 2013, thus reducing the recovery requirement from retail customers.
- Operating expenses in 2013 decreased \$3.0 million, or 2.4%, versus 2012, primarily as a result of decreases in production costs. Production costs decreased \$4.7 million, or 5.2%, primarily due to reductions in maintenance cost from no scheduled maintenance outages at ESGS in 2013. Partially offsetting the decline in maintenance costs was an increase in fuel costs due to increased power generation as a result of higher availability of the ESGS. Partially offsetting the decline in productions costs were increases in transmission and distribution of \$701,637, or 9.6%, due to transmission costs associated with the additional wholesale sales and other general cost increases, as well as an increase in depreciation of \$1.1 million, or 8.0%, primarily from additional depreciation of ESGS assets.
- Nonoperating revenues/expenses decreased by \$313,591, or 3.2%, in 2013 when compared to 2012. Interest expense decreased by \$755,824, or 6.7%, as a result of scheduled principal reduction on debt. Interest income decreased \$444,972, or 35.3%, primarily as a result of lower average interest rates on investments.
- Special items and transfers decreased as a result of a one-time litigation settlement of \$3.7 million in 2012 and an increase in dividend transfers to the City of Owensboro of \$265,334 in 2013, or 3.2%, due to increases in free services provided to the City.

## MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED

### CAPITAL ASSET AND DEBT ADMINISTRATION

#### Capital Assets

At the end of 2013, the Electric System had \$174.6 million invested in a broad range of assets, including power plant facilities and equipment, substation facilities and equipment, transformers, poles, wiring, street lighting, traffic signal equipment, communication equipment, fiber optic cable and equipment, buildings and other equipment. This represents a net decrease, after depreciation, of \$7.4 million over 2012, or 4.1%. Depreciation expense is the primary cause for the net decrease in capital assets. In addition to routine capital additions during 2013, OMU incurred \$1.3 million for boiler tube pendant replacement, \$1.1 million for various substation improvements and \$1.0 million for replacement of distribution and transmission system poles. The following table summarizes capital assets, net of accumulated depreciation, at the end of 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Production plant	\$ 109,109,471	\$ 118,868,327
Transmission plant	14,719,805	12,019,680
Distribution plant	32,107,192	32,381,840
General plant	7,544,537	6,565,549
Unclassified plant and construction in progress	<u>11,158,035</u>	<u>12,183,343</u>
	<u>\$ 174,639,040</u>	<u>\$ 182,018,739</u>

#### Debt

At the end of 2013, the Electric System had \$158.6 million in bonds outstanding versus \$170.3 million in 2012, for a decrease of 6.9%. As there was no new debt issued during 2013, this decrease is due to scheduled bond payments.

Subsequent to year end, the Electric System issued \$86 million in revenue and refunding bonds on June 25, 2013, to provide funding for various Electric System improvements and to refinance \$42.6 million of existing debt.

#### Outlook

We expect the 2014 net operating results to be comparable with 2013 results, with overall revenues and expenses remaining generally stable. Wholesale revenues are anticipated to decline as ESGS has two major maintenance outages scheduled in 2014, which are expected to result in decreased production volumes, leading to decreased surplus energy available for sale to wholesale customers. Revenues from retail customers are expected to increase, which will largely offset the decreased wholesale revenues. The expected increase in retail revenues is primarily due to OMU discontinuing billing credits associated with environmental costs at ESGS. Overall costs are also anticipated to remain stable in 2014. The maintenance outages schedule for ESGS will lead to increased maintenance costs. However, that cost increase will be largely offset by decreased fuel cost due to decreased energy production. Interest cost is also anticipated to decrease due to the June 2013 debt refinancing, as discussed above.

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**OWENSBORO MUNICIPAL UTILITIES  
ELECTRIC LIGHT AND POWER SYSTEM**

**STATEMENTS OF NET POSITION**

May 31, 2013 and 2012

<b>ASSETS AND DEFERRED OUTFLOWS OF RESOURCES</b>	<u>2013</u>	<u>2012</u>
Utility plant, net	\$ <u>174,639,040</u>	\$ <u>182,018,739</u>
Restricted assets	<u>73,319,343</u>	<u>82,214,189</u>
Current assets:		
Cash and cash equivalents	21,053,713	17,618,129
Receivables:		
Retail accounts receivable, less allowance for doubtful accounts of \$79,576 for 2013 and \$61,256 for 2012	7,527,748	9,271,853
Wholesale accounts receivable	3,458,839	1,036,777
City of Owensboro	703,267	8,163
Other	489,594	694,633
Materials and supplies	3,628,384	2,392,599
Prepayments	229,842	357,657
Other	<u>-</u>	<u>1,128,514</u>
Total current assets	<u>37,091,387</u>	<u>32,508,325</u>
Other noncurrent assets:		
Unamortized debt expense	1,309,385	1,410,162
Other	<u>9,044,544</u>	<u>6,826,739</u>
	<u>10,353,929</u>	<u>8,236,901</u>
Total assets	<u>295,403,699</u>	<u>304,978,154</u>
Deferred outflows of resources:		
Accumulated decrease in fair value of hedging derivatives	<u>3,911,603</u>	<u>-</u>
<b>Total assets and deferred outflows of resources</b>	<b>\$ <u>299,315,302</u></b>	<b>\$ <u>304,978,154</u></b>

**LIABILITIES, DEFERRED INFLOWS OF  
RESOURCES, AND NET POSITION**

	<u>2013</u>	<u>2012</u>
Net position:		
Net investment in capital assets	\$ 40,787,888	\$ 43,167,714
Restricted for capital projects	4,345,538	4,474,847
Restricted for debt service, net of related debt	16,687,320	15,835,372
Restricted for other purposes	17,976,867	22,196,964
Unrestricted	<u>34,136,705</u>	<u>27,263,679</u>
Total net position	<u>113,934,318</u>	<u>112,938,576</u>
Long-term debt	<u>141,054,874</u>	<u>152,908,973</u>
Current liabilities (payable from restricted assets):		
Current maturities of long-term debt	17,566,845	17,421,838
Accrued interest payable	1,633,485	1,694,508
Accounts payable	<u>6,541,058</u>	<u>4,862,820</u>
	<u>25,741,388</u>	<u>23,979,166</u>
Current liabilities (payable from current assets):		
Accounts payable	6,674,317	5,697,208
Other	<u>8,610,840</u>	<u>5,220,377</u>
	<u>15,285,157</u>	<u>10,917,585</u>
Total current liabilities	<u>41,026,545</u>	<u>34,896,751</u>
Other noncurrent liabilities	<u>1,601,229</u>	<u>131,289</u>
Deferred revenue	<u>1,698,336</u>	<u>3,112,032</u>
Commitments and contingencies (Note 9)		
Total liabilities	<u>185,380,984</u>	<u>191,049,045</u>
Deferred inflows of resources:		
Accumulated increase in fair value of hedging derivatives	<u>-</u>	<u>990,533</u>
<b>Total liabilities, deferred inflows of resources, and net position</b>	<u>\$ 299,315,302</u>	<u>\$ 304,978,154</u>

**OWENSBORO MUNICIPAL UTILITIES  
ELECTRIC LIGHT AND POWER SYSTEM**

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION

Years Ended May 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
<b>Operating revenues:</b>		
Charges for services:		
Residential	\$ 25,569,752	\$ 25,863,505
Commercial	5,730,964	5,795,780
Industrial	44,783,817	45,188,130
Water Works System	844,106	846,317
City of Owensboro	2,486,697	2,222,063
Supplemental power	1,709,220	1,904,016
Other wholesale	59,800,009	58,256,069
Build America Bond subsidy	557,863	577,875
Other	812,351	820,454
	<u>142,294,779</u>	<u>141,474,209</u>
<b>Operating expenses:</b>		
Production:		
Fuel for electric generation	66,708,167	59,599,856
Purchased power	6,535,616	8,087,283
Other	12,717,231	22,998,230
Transmission and distribution	7,980,313	7,278,676
Customer service and information	1,321,943	1,277,069
General and administrative	12,737,385	12,852,958
Telecommunications	370,743	337,713
Depreciation	14,684,966	13,602,364
	<u>123,056,364</u>	<u>126,034,149</u>
Total operating expenses		
	<u>19,238,415</u>	<u>15,440,060</u>
Operating income		
	<u>19,238,415</u>	<u>15,440,060</u>
<b>Nonoperating revenues (expenses):</b>		
Interest and debt expense	(10,472,877)	(11,228,701)
Interest income on investments	815,999	1,260,971
Other, net	45,402	42,663
Net decrease in fair value of investments	(260,523)	-
Deferred net change in fair value of investments	260,523	-
	<u>(9,611,476)</u>	<u>(9,925,067)</u>
Total nonoperating revenues (expenses)		
	<u>(9,611,476)</u>	<u>(9,925,067)</u>
Income before special item and transfers	9,626,939	5,514,993
Special item - gain on settlement	-	3,679,667
Transfers out - dividends to City of Owensboro	(8,631,197)	(8,365,863)
	<u>995,742</u>	<u>828,797</u>
Change in net position		
	<u>995,742</u>	<u>828,797</u>
Net position, beginning of year	112,938,576	112,109,779
	<u>112,938,576</u>	<u>112,109,779</u>
Net position, end of year	\$ 113,934,318	\$ 112,938,576
	<u>\$ 113,934,318</u>	<u>\$ 112,938,576</u>

See Notes to Financial Statements

**OWENSBORO MUNICIPAL UTILITIES  
ELECTRIC LIGHT AND POWER SYSTEM**

**STATEMENTS OF CASH FLOWS**

Years Ended May 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
<b>Cash flows from operating activities:</b>		
Receipts from customers, including collections as agent for third parties	\$ 154,966,755	\$ 149,587,789
Customer remittances to third parties	(17,623,769)	(17,137,333)
Proceeds from settlement	-	1,229,667
Payments to suppliers	(93,654,419)	(101,779,773)
Payments to employees	(12,981,008)	(12,034,294)
	<u>30,707,559</u>	<u>19,866,056</u>
<b>Cash flows from noncapital financing activities:</b>		
Transfers out - dividends to City of Owensboro	(6,149,600)	(6,149,600)
	<u>(6,149,600)</u>	<u>(6,149,600)</u>
<b>Cash flows from capital and related financing activities:</b>		
Capital expenditures	(9,374,030)	(8,525,908)
Payments on long-term debt	(18,035,000)	(17,900,000)
Interest paid on long-term debt	(4,066,826)	(4,515,239)
Debt issuance cost	(40,389)	-
	<u>(31,516,245)</u>	<u>(30,941,147)</u>
Net cash used in capital and related financing activities	<u>(31,516,245)</u>	<u>(30,941,147)</u>
<b>Cash flows from investing activities:</b>		
Purchase of investments	(20,725,000)	-
Proceeds from sale and maturities of investments	7,500,000	15,000,000
Interest on investments	749,295	1,392,205
	<u>(12,475,705)</u>	<u>16,392,205</u>
Net cash provided by (used in) investing activities	<u>(12,475,705)</u>	<u>16,392,205</u>
Net decrease in cash and cash equivalents	(19,433,991)	(832,486)
Cash and cash equivalents, beginning of year	84,398,185	85,230,671
Cash and cash equivalents, end of year	<u>\$ 64,964,194</u>	<u>\$ 84,398,185</u>
<b>Included in the following balance sheet captions:</b>		
Restricted assets	\$ 43,910,481	\$ 66,780,056
Cash and cash equivalents	21,053,713	17,618,129
	<u>\$ 64,964,194</u>	<u>\$ 84,398,185</u>

**OWENSBORO MUNICIPAL UTILITIES  
ELECTRIC LIGHT AND POWER SYSTEM**

STATEMENTS OF CASH FLOWS, Concluded

Years Ended May 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
<b>Reconciliation of operating income to net cash provided by operating activities:</b>		
Operating income	\$ 19,238,415	\$ 15,440,060
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	14,915,624	13,809,258
Other revenues	45,402	42,663
Proceeds from settlement	-	1,229,667
Noncash operating revenues from City of Owensboro	(2,481,597)	(2,216,263)
Change in assets and liabilities:		
Decrease (increase) in assets:		
Restricted assets:		
Fuel inventory	(980,238)	(1,612,120)
Other	42,565	(97,490)
Receivables	(599,714)	34,653
Materials and supplies	(37,902)	(246,248)
Prepayments	127,815	(28,587)
Other deferred charges	(2,190,680)	(6,579,842)
Increase (decrease) in liabilities:		
Accounts payable	2,721,386	280,324
Other current liabilities	321,559	670,446
Deferred revenue	(415,076)	(860,465)
Net cash provided by operating activities	<u>\$ 30,707,559</u>	<u>\$ 19,866,056</u>
<b>Noncash investing, capital and financing activities:</b>		
Accretion of interest expense on long-term debt	<u>\$ 6,357,592</u>	<u>\$ 6,971,962</u>
Amortization of debt premium (discount) and expense and deferred loss on debt defeasance	<u>\$ 109,482</u>	<u>\$ 109,481</u>
Noncash dividends to City of Owensboro	<u>\$ 2,481,597</u>	<u>\$ 2,216,263</u>
Deferred gain (loss) on hedging derivatives	<u>\$ (3,911,603)</u>	<u>\$ 990,533</u>

**OWENSBORO MUNICIPAL UTILITIES  
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2013 and 2012

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**1. Organization and Summary of Significant Accounting Policies**

General Information

In 1940, the City of Owensboro, Kentucky (City), established the City Utility Commission to manage, control and operate Owensboro Municipal Utilities (OMU). City officials appoint the five individuals who comprise the City Utility Commission. OMU consists of the Electric Light and Power System (Electric System) and the Water Works System (Water System), which are separate enterprise funds of the City. Accordingly, the Electric System and the Water System are part of the financial reporting entity of the City. The accompanying financial statements present only the Electric System and are not intended to present fairly the financial position of the City and the changes in its financial position or, where applicable, its cash flows, in conformity with accounting principles generally accepted in the United States of America. The Electric System is subject to regulation by the City, including approval of rates charged for utility services, as set forth in applicable City ordinances.

The Electric System provides electric power to approximately 26,000 residential, commercial and industrial customers in Owensboro, Kentucky. The Electric System also sells electric power into regional wholesale power markets and to other wholesale customers.

The Electric System consists of the original generating station, the transmission and distribution plant and the Elmer Smith Generating Station (ESGS). ESGS is operated, including subsequent additions, as a separate division.

System of Accounts and Basis of Accounting

The Electric System's accounts are maintained substantially in accordance with the Uniform System of Accounts of the Federal Energy Regulatory Commission and in conformity with accounting principles generally accepted in the United States of America using the economic resources measurement focus and the accrual basis of accounting, including the application of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 980, *Regulated Operations*, as the standard relates to the deferral of revenues and expenses to future periods in which the revenues are earned or the expenses are recovered through the rate-making process.

**OWENSBORO MUNICIPAL UTILITIES  
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2013 and 2012

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**1. Organization and Summary of Significant Accounting Policies, Continued**

System of Accounts and Basis of Accounting, Continued

The Electric System considers electric and telecommunications revenues and costs that are directly related to generation, purchase, transmission, and distribution of electricity and telecommunications services to be operating revenues and expenses. Revenues and expenses related to financing and other activities are reflected as nonoperating.

The Electric System accrues revenues as services are rendered to utility customers. In addition, the Electric System's present electric rate ordinance provides for an energy cost adjustment and environmental control cost adjustment to be made to customer bills, except bills rendered to the City, to reflect changes in the price of fuel and maintenance costs and environmental compliance costs to generate electricity. The Electric System estimates and records amounts to be billed or refunded under the energy cost adjustment on a monthly basis.

Utility Plant and Depreciation

Utility plant is stated at original cost, which includes the cost of contracted services, materials, labor, and labor-related expenditures, administrative and general costs, and an allowance for borrowed funds used during construction.

Replacements of depreciable property units, except minor replacements, are charged to utility plant. Property units replaced or retired, including cost of removal net of any salvage, are charged to accumulated depreciation. Routine maintenance, repairs and minor replacement costs are charged to expense as incurred.

Allowance for borrowed funds used during construction includes capitalized interest during the construction period less any interest income on construction fund investments from bond proceeds during such period. Capitalization of interest is discontinued when the project is completed and the related utility plant is placed in service.

Depreciation of utility plant and unclassified plant in service is provided using the straight-line composite rate method over the estimated service lives of the depreciable assets of the Electric System, excluding ESGS, and on the sinking fund method for ESGS depreciable assets. Estimated service lives of assets depreciated using the composite method range from 5 to 60 years. The sinking fund method was adopted for ESGS as a result of the terms of a power sale contract. Depreciation expense during 2013 and 2012 was approximately 3.5%, of the average original cost of depreciable utility plant in service.

**OWENSBORO MUNICIPAL UTILITIES  
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2013 and 2012

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**1. Organization and Summary of Significant Accounting Policies, Continued**

Restricted Assets

The City ordinances that authorized the Electric Light and Power Revenue Bonds require that certain amounts from bond proceeds and payments by customers for services provided be deposited into designated funds and be used only for the specified purposes of the funds. The Electric System's policy is to first apply restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

Cash and Investments

Cash deposits are reported at carrying amounts. Certificates of deposit and long-term repurchase agreements are reported at cost. U.S. government obligations and agency securities are stated at fair values based upon currently quoted market rates.

The Electric System considers all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash equivalents. Unrestricted investments with initial maturities exceeding three months, consisting of certificates of deposit and U.S. agency securities, are classified as temporary investments.

Inventories

Inventories consisting of materials and supplies and fuel inventory (included in restricted assets) are valued at the lower of weighted average cost or market. Fuel for electric generation is charged to expense as used.

Bond Issuance Costs

Premiums, discounts and bond issue costs arising from various bond issues are deferred and amortized using the straight-line method over the lives of the issues.

The difference between the reacquisition price and the net carrying amount of defeased bond issues has been deferred and is being amortized using the straight line method over the lives of the refunding bond issues.

Income Taxes

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

**OWENSBORO MUNICIPAL UTILITIES  
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2013 and 2012

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**1. Organization and Summary of Significant Accounting Policies, Continued**

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 and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Hedging Derivative Instruments

The Electric System has adopted GASB Statement No. 53, "Accounting and Financial Reporting for Derivative Instruments" (GASB 53). GASB 53 requires that hedging derivative instruments (Hedging Transactions) be recorded at fair value and establishes certain requirements for revenue recognition, measurement and disclosure related to Hedging Transactions. The Electric System's Hedging Transactions have been tested for effectiveness under the guidelines prescribed by GASB 53. The Electric System utilized one of the three quantitative methods required by GASB 53, the synthetic instrument method. This method evaluates the effectiveness of a hedge transaction by comparing the relationship of the variable cash flows of the potential hedging item and the hedgeable item. The effectiveness testing of the Electric System's Hedging Transactions demonstrated that the hedges are effective as defined by GASB 53.

Change in Accounting Principle

In 2013, the Electric System adopted GASB Statement No. 63, "Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position." GASB 63 requires that deferred outflows and deferred inflows of resources be reported separately from assets and liabilities and also identifies net position, rather than net assets, as the residual of all other elements presented in a statement of financial position. The Electric System has restated its other noncurrent assets and deferred revenue to reflect that a component of those assets and liabilities, as of May 31, 2012, is now reported as a deferred inflow of resources in the Statement of Net Position. The effect of this change, as of May 31, 2012, is a decrease of \$371,378, in other noncurrent assets, a decrease of \$1,361,911, in deferred revenue, and a corresponding increase of \$990,533 in deferred inflows of resources.

**2. Utility Plant**

Electric utility plant activity for the year ended May 31, 2013, was as follows:

**OWENSBORO MUNICIPAL UTILITIES  
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2013 and 2012

**2. Utility Plant, Continued**

	<u>Balance at May 31, 2012</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance at May 31, 2013</u>
Utility plant:				
Production plant	\$ 284,805,946	\$ 1,091,100	\$ (65,358)	\$ 285,831,688
Transmission plant	26,624,686	3,603,307	(73,293)	30,154,700
Distribution plant	70,791,637	3,138,300	(1,555,416)	72,374,521
General plant	17,673,631	1,808,237	(209,548)	19,272,320
Unclassified plant in service	<u>2,209,312</u>	<u>2,197,696</u>	<u>-</u>	<u>4,407,008</u>
Total, at original cost	<u>402,105,212</u>	<u>11,838,640</u>	<u>(1,903,615)</u>	<u>412,040,237</u>
Accumulated depreciation:				
Production plant	(165,937,619)	(10,849,956)	65,358	(176,722,217)
Transmission plant	(14,605,006)	(902,795)	72,906	(15,434,895)
Distribution plant	(38,409,797)	(2,359,367)	501,835	(40,267,329)
General plant	<u>(11,108,082)</u>	<u>(803,506)</u>	<u>183,805</u>	<u>(11,727,783)</u>
Total accumulated depreciation	<u>(230,060,504)</u>	<u>(14,915,624)</u>	<u>823,904</u>	<u>(244,152,224)</u>
Construction in progress	<u>9,974,031</u>	<u>(3,223,004)</u>	<u>-</u>	<u>6,751,027</u>
Utility plant, net	<u>\$ 182,018,739</u>	<u>\$ (6,299,988)</u>	<u>\$ (1,079,711)</u>	<u>\$ 174,639,040</u>

Depreciation expense for the years ended May 31 was as follows:

	<u>2013</u>	<u>2012</u>
Electric utility plant	\$14,517,707	\$13,435,594
Telecommunications	<u>167,259</u>	<u>166,770</u>
	14,684,966	13,602,364
Transportation and stores depreciation charged to construction activities or other operating expenses	<u>230,658</u>	<u>206,894</u>
	<u>\$14,915,624</u>	<u>\$13,809,258</u>

**3. Restricted Assets**

Restricted assets at May 31 consist of the following:

	<u>2013</u>	<u>2012</u>
Cash and cash equivalents	\$43,910,481	\$66,780,056
Investments	21,864,477	8,900,000
Accrued interest receivable	351,876	279,297
Fuel and other inventories, at cost	6,453,061	5,472,823
Other	<u>739,448</u>	<u>782,013</u>
	<u>\$73,319,343</u>	<u>\$82,214,189</u>

**OWENSBORO MUNICIPAL UTILITIES  
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2013 and 2012

**3. Restricted Assets, Continued**

The above balances are contained in the following funds:

	<u>2013</u>	<u>2012</u>
Operation and Maintenance Fund	\$ 8,170,769	\$ 7,803,931
Construction Fund	16,134,201	22,179,291
Depreciation Fund	4,119,505	4,034,446
Sinking Funds	25,873,819	25,860,614
Facility Charge Fund	7,315,976	7,363,185
Reserve and Contingency Fund	<u>11,705,073</u>	<u>14,972,722</u>
	<u>\$73,319,343</u>	<u>\$82,214,189</u>

The terms of the City ordinances authorizing the Electric System's Electric Light and Power Revenue Bonds require all investment income to be credited to the various restricted asset funds.

OMU follows GASB No. 31, "Accounting and Financial Reporting for Certain Investments and for External Investments Pools," which requires certain investments to be carried at fair value in the balance sheets and changes in the fair value of investments to be reported in the statements of revenues, expenses and changes in fund net position. In accordance with GASB No. 31, OMU recorded unrealized losses of \$260,523 for the year ended May 31, 2013. OMU's rate making methodology does not consider unrealized gains or losses on marketable securities in its rate making process. Accordingly, under FASB ASC 980, *Regulated Operations*, the unrealized losses for the year ended May 31, 2013, have been deferred. Included in other assets at May 31, 2013, are cumulative net unrealized losses of \$260,523.

The net increase (decrease) in the fair value of investments consists of the following:

	<u>2013</u>
Net realized gains (losses) on sales of investments	\$ -
Net unrealized gains (losses) on investments	<u>(260,523)</u>
	<u>\$ (260,523)</u>

The calculation of realized gains or losses on sales of investments is independent of the calculation of the net change in the fair value of investments. Realized gains or losses on investments that were held in more than one fiscal year and sold in the current year were included as a net change in the fair value of investments reported in prior years and the current year.

**OWENSBORO MUNICIPAL UTILITIES  
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2013 and 2012

**4. Cash Deposits and Investments**

At May 31, the carrying amounts of the Electric System's deposits in financial institutions and investments other than deposits were:

	<u>2013</u>	<u>2012</u>
Deposits in financial institutions	\$64,964,194	\$84,398,185
Investments other than deposits	<u>21,864,477</u>	<u>8,900,000</u>
	<u>\$86,828,671</u>	<u>\$93,298,185</u>

These amounts are reflected in the statements of net position as:

	<u>2013</u>	<u>2012</u>
Cash and cash equivalents	\$21,053,713	\$17,618,129
Temporary investments	-	-
Restricted assets:		
Cash and cash equivalents	43,910,481	66,780,056
Investments	<u>21,864,477</u>	<u>8,900,000</u>
	<u>\$86,828,671</u>	<u>\$93,298,185</u>

*Deposit and Investment Policy.* The Electric System's deposit and investment policy prescribes to the prudent-person rule: Investments shall be made with applicable law and under prevailing circumstances which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital, as well as the probable income to be derived.

*Custodial Credit Risk.* Custodial credit risk is the risk that, in the event of a bank failure, the Electric System's deposits may not be returned to it. The Electric System's deposit and investment policy permits uncollateralized deposits only if issued by institutions ranked in one of the three highest categories by a nationally recognized rating agency. As of May 31, 2013, \$66,538,945 of the Electric System's bank balance of \$66,814,894 was exposed to custodial credit risk as follows:

Uninsured and uncollateralized	\$ -
Uninsured with collateral held by pledging bank's agent	<u>66,538,945</u>
Total	<u>\$66,538,945</u>

**OWENSBORO MUNICIPAL UTILITIES  
ELECTRIC LIGHT AND POWER SYSTEM**

**NOTES TO FINANCIAL STATEMENTS**

Years Ended May 31, 2013 and 2012

**4. Cash Deposits and Investments, Continued**

As of May 31, 2013, the Electric System had the following investments. Investments are reported at fair values with the exception of repurchase agreements, which are reported at cost.

<u>Investments</u>	<u>Maturities</u>	
Repurchase agreements	12/31/2019	\$ 8,900,000
Federal Home Loan Bank – Callable	11/01/2022	5,602,027
Federal Home Loan Bank – Callable	01/30/2022	<u>7,362,450</u>
		<u>\$21,864,477</u>

*Interest Rate Risk.* As a means of limiting its exposure to fair value losses arising from rising interest rates, the Electric System's deposit and investment policy limits investment maturities based upon provisions of bond ordinances. The bond ordinances limit investments contained in the Operation and Maintenance Fund to five years and limit investments in the Depreciation Fund, Sinking Funds, and Facility Charge Fund to ten years.

*Credit Risk.* The Electric System's deposit and investment policy authorizes the investment of funds in any manner permitted by bond ordinances and the Kentucky Revised Statutes and does not further limit its investment choices.

*Concentration of Credit Risk.* Other than the prudent-person rule, the Electric System's deposit and investment policy places no limit on the amount the Electric System may invest in any one issuer. The Electric System's investments are in U.S. agency securities and repurchase agreements at May 31, 2013.

**5. Hedging Transactions**

The Electric System is exposed to market price fluctuations on its sale of surplus electricity and to market price fluctuations on the price of diesel fuel, due to its long-term coal contracts, many of which contain diesel fuel adjustment clauses. To protect itself from wholesale electricity price fluctuations and diesel fuel price fluctuations, the Electric System periodically enters into electricity price and fuel oil swap contracts (Hedging Transactions).

The Electric System enters into electricity and fuel oil price swap contracts at various fixed prices and notional amounts. Each electricity swap contract provides for the Electric System to pay a floating price, and for the contract counterparty to pay a fixed price, and each fuel oil swap contract provides for the Electric System to pay a fixed price, and the contract counterparty to pay a floating price, for the notional amount of each type of contract. Furthermore, the Electric System from time to time will remove an electricity hedge position by entering into a swap contract to pay a fixed price, and for the contract counterparty to pay a floating price for a like notional amount as the original swap contract. The notional amount of

**OWENSBORO MUNICIPAL UTILITIES  
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2013 and 2012

**5. Hedging Transactions, Continued**

each electricity and fuel oil price swap contract is measured in megawatt hours (MWh) and gallons, respectively, with the floating price based on a specific published index (spot price) for the relevant contract month.

The Electric System entered into electricity swap contracts with notional amounts totaling 4,234,375 and 1,381,300 MWh in 2013 and 2012, respectively. Swap contracts with notional amounts totaling 3,104,775 and 299,950 MWh were settled in 2013 and 2012, respectively, with a resulting loss of \$1,877,122 in 2013 and gain of \$473,974 in 2012, which are reflected in other wholesale revenue. At May 31, 2013, the Electric System's outstanding electricity price swap contracts were as follows:

Executed	Maturity Date	Notional Quantity (MWh)	Fixed Price (\$/MWh)	Fair Value
<b>Hedge Positions:</b>				
12/21/11 – 5/15/13	June 30, 2013- August 31, 2013	373,600	27.65-51.00	\$ (1,878,714)
2/29/12 – 3/26/13	September 30, 2013- November 30, 2013	293,350	27.65-39.95	(676,859)
6/8/12 – 3/26/13	December 31, 2013- February 28, 2014	236,400	27.65-39.95	(580,037)
7/30/12 – 8/16/12	March 31, 2014- May 31, 2014	220,700	34.30-36.00	(4,806)
7/30/12 – 8/16/12	June 30, 2014- August 31, 2014	220,800	34.30-36.00	(923,384)
7/30/12 – 8/16/12	September 30, 2014- November 30, 2014	218,500	34.30-36.00	270,251
7/30/12 – 9/24/12	December 31, 2014- February 28, 2015	145,200	34.30-36.00	(231,449)
9/24/12	March 31, 2015- May 31, 2015	110,350	35.95	67,108
9/24/12	June 30, 2015- August 31, 2015	110,400	35.95	(380,256)
9/24/12	September 30, 2015- November 30, 2015	109,250	35.95	116,234
9/24/12	December 31, 2015- February 28, 2016	<u>37,200</u>	35.95	<u>11,998</u>
		<u>2,075,750</u>		<u>(4,209,914)</u>

**OWENSBORO MUNICIPAL UTILITIES  
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2013 and 2012

**5. Hedging Transactions, Continued**

Executed	Maturity Date	Notional Quantity (MWh)	Variable Price (\$/MWh)	Fair Value
Hedge Positions Removed:				
4/26/12 – 5/15/13	June 30, 2013- August 31, 2013	84,800	37.20-47.90	243,926
5/10/13	September 30, 2013	16,000	41.75	(24,800)
8/1/12	June 30, 2014- August 31, 2014	<u>34,400</u>	50.60	<u>92,797</u>
		<u>135,200</u>		<u>311,923</u>
		<u>2,210,950</u>		<u>\$ (3,897,991)</u>

During May 2013, the Electric System entered into fuel oil swap contracts in the amount of 42,000 gallons per month for each month from July 2013 through June 2014 at a fixed price of \$288.80 per hundred gallons per month, all of which were outstanding at May 31, 2013.

The electricity and fuel oil price swap contracts are settled by cash payments that are equal to the differential between the contract price and the settlement price (financially settled). These financially settled swap contracts are hedging derivative instruments as defined by GASB 53. Accordingly, the Electric System's unrealized gains and losses on its outstanding Hedging Transactions are reported at fair value in other current assets, other noncurrent assets and deferred revenues in its May 31, 2013 and 2012, balance sheets. The fair market value for each of the Electric System's Hedging Transactions have been determined by computing the difference between the contractual forward price and the published forward price at the respective market's settlement point at market closing as of May 31, 2013 and 2012. The Electric System's electricity Hedging Transactions settle and are valued at the AEP-Dayton Hub, which is a settlement hub in the PJM energy markets. The fuel oil Hedging Transactions settle and are valued at the fuel oil index of the New York Mercantile Exchange (NYMEX). The outstanding electricity price swap contracts had a fair value of (\$3,897,991) and \$990,533 at May 31, 2013 and 2012, respectively. The fuel oil price swap contracts had a fair value of (\$13,612) at May 31, 2013, and there were no outstanding fuel oil contracts at May 31, 2012.

**Credit Risk:** The Electric System is exposed to credit risk on Hedging Transactions that are in an asset position. To minimize the Electric System's exposure to loss related to credit risk, the Electric System requires certain counterparties to post collateral equal to all or a portion of the fair value of Hedging Transactions in asset positions (net of the effect of applicable netting arrangements) should the fair value of the netted contracts exceed contractually agreed upon parameters or if the credit rating of a certain counterparty or, an affiliated guarantor of the

**OWENSBORO MUNICIPAL UTILITIES  
ELECTRIC LIGHT AND POWER SYSTEM**

**NOTES TO FINANCIAL STATEMENTS**

Years Ended May 31, 2013 and 2012

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**5. Hedging Transactions, Continued**

counterparty, is at, or falls below, contractually agreed-upon levels. Collateral posted is in the form of a letter of credit or US dollars held by the Electric System. At May 31, 2013, the Electric System's rated counterparties, or affiliated guarantors, had credit ratings ranging from A to BBB+ as established by a nationally recognized rating organization. The Electric System also had two counterparties that were not rated but each had provided a letter of credit for the purpose of establishing credit for the counterparty.

It is the Electric System's practice to enter into netting arrangements whenever it has entered into more than one financially settled forward swap contract transaction with a counterparty. If one party becomes insolvent or defaults on its obligations, closeout netting provisions permit the non-defaulting party to accelerate and terminate all outstanding transactions and net the transactions' fair values so that a single sum will be owed to, or owed by, the non-defaulting party.

The Electric System had no outstanding Hedging Transactions with counterparties at May 31, 2013, in which the aggregate fair value was in a net asset position. The net asset position represents the maximum loss that would be incurred at the reporting date if all counterparties failed to perform as contracted. Outstanding Hedging Transactions in a liability positions totaled \$3,911,603 at May 31, 2013.

**Basis Risk:** The Electric System is exposed to basis risk on its Hedging Transactions because the price of the expected physical commodity sale being hedged will be priced at a pricing point (South Import Interface), which is different than the pricing point at which the Hedging Transactions will settle (AEP-Dayton Hub). Management believes this risk is not material based on quantitative analysis.

**Termination Risk:** The Electric System is exposed to termination risk on its Hedging Transactions because a counterparty may fail to perform under the terms of one or more contracts resulting in the termination of the aggregate contracts with that counterparty. To minimize the Electric System's exposure to loss related to termination risk, the Electric System requires counterparties to post collateral equal to the fair value of Hedging Transactions in asset positions (net of the effect of applicable netting arrangements) should the fair value of the netted contracts exceed contractually agreed upon parameters or if the credit rating of a certain counterparty, or an affiliated guarantor of the counterparty, is at, or falls below, contractually agreed-upon levels. If at the time of termination the net position of financially settled power contracts with a terminating party is in an aggregate liability position, the Electric System would be liable to the counterparty for a payment equal to the aggregate liability position, subject to netting arrangements.

**Commitments:** Hedging Transactions provide that the Electric System post collateral in the event that 1) OMU's credit profile falls below contractually agreed-upon parameters or 2) the fair value of the Electric System's Hedging Transactions are in a liability position (net of the effect of applicable netting arrangements) should the fair value of the netted contracts exceed

**OWENSBORO MUNICIPAL UTILITIES  
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2013 and 2012

**5. Hedging Transactions, Continued**

contractually agreed-upon parameters. When collateral is posted, it is in US dollars in the amount of the fair value of the hedging derivative instruments in liability positions (net of the effect of applicable netting arrangements). If the Electric System does not post collateral, the aggregate outstanding Hedging Transactions may be terminated by the counterparty. If the collateral posting requirements related to OMU's credit profile had been triggered at May 31, 2013, the Electric System would have been required to post collateral with its counterparties in the amount of \$3,897,991.

**6. Long-Term Debt**

Long-term debt activity for the year ended May 31, 2013, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Amounts Due Within One Year</u>
Bonds payable:					
Series of 1991-B	\$ 96,353,195	\$6,357,592	\$(15,725,000)	\$ 86,985,787	\$15,111,845
Series of 2002-A	23,140,000	-	(2,310,000)	20,830,000	2,455,000
Series of 2010-A	10,070,000	-	-	10,070,000	-
Series of 2010-B	31,425,000	-	-	31,425,000	-
Series of 2010-C	<u>8,935,000</u>	<u>-</u>	<u>-</u>	<u>8,935,000</u>	<u>-</u>
	169,923,195	6,357,592	(18,035,000)	158,245,787	17,566,845
Add unamortized debt premium (discount)	553,220	-	(50,885)	502,335	-
Less unamortized deferred loss on debt defeasance	<u>(145,604)</u>	<u>-</u>	<u>19,201</u>	<u>(126,403)</u>	<u>-</u>
Total long-term debt	<u>\$170,330,811</u>	<u>\$6,357,592</u>	<u>\$(18,066,684)</u>	<u>\$158,621,719</u>	<u>\$17,566,845</u>

**OWENSBORO MUNICIPAL UTILITIES  
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2013 and 2012

**6. Long-Term Debt, Continued**

Long-term debt at May 31 consists of the following Electric Light and Power Revenue Bonds:

	<u>2013</u>	<u>2012</u>
Series of 1991-B:		
Deferred interest bonds including interest compounded semi-annually at 6.70% to 6.95%, principal and interest due from 2013 to 2020 (original principal of outstanding bonds at May 31, 2013, was \$20,039,940)	\$ 86,985,787	\$ 96,353,195
Series of 2002-A:		
6.34% due 2020, subject to annual pro rata sinking fund redemption from 2013 to 2020	20,830,000	23,140,000
Series of 2010-A:		
Current interest bonds, 4.88% to 5.03%, due from 2021 to 2022	10,070,000	10,070,000
Series of 2010-B:		
Current interest bonds, 4.88% to 5.58%, due from 2021 to 2025	31,425,000	31,425,000
Series of 2010-C:		
Current interest bonds, 5.00%, due from 2021 to 2022	<u>8,935,000</u>	<u>8,935,000</u>
Total long-term debt	158,245,787	169,923,195
Less current maturities	(17,566,845)	(17,421,838)
Add unamortized debt premium (discount)	502,335	553,220
Less unamortized deferred net loss on debt defeasance	<u>(126,403)</u>	<u>(145,604)</u>
	<u>\$141,054,874</u>	<u>\$152,908,973</u>

**OWENSBORO MUNICIPAL UTILITIES  
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2013 and 2012

**6. Long-Term Debt, Continued**

Sinking fund requirements and scheduled aggregate maturities of long-term debt are as follows:

<u>Year Ending May 31:</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2014	\$ 18,180,000	\$ 3,920,366	\$ 22,100,366
2015	18,335,000	3,764,719	22,099,719
2016	18,505,000	3,599,245	22,104,245
2017	18,680,000	3,422,993	22,102,993
2018	18,865,000	3,235,646	22,100,646
2019 – 2023	73,520,000	11,600,052	85,120,052
2024 – 2028	<u>15,250,000</u>	<u>1,268,689</u>	<u>16,518,689</u>
	<u>\$181,335,000</u>	<u>\$30,811,710</u>	<u>\$212,146,710</u>

The scheduled principal maturities include \$23,089,213 of interest scheduled to be incurred in future years on deferred interest bonds, which will be compounded and added to the original principal amounts.

The Electric System is subject to certain debt covenants, compliance with which is required by the ordinances authorizing its bond issues. Such ordinances require revenue to be first applied to the Sinking Funds, second to the Operations and Maintenance Fund, third to the Additions and Replacements Fund, fourth to the Depreciation Fund, fifth to the Reserve and Contingency Fund, and finally to the Facility Charge Fund.

On December 6, 1991, the City issued \$62,474,359 of Electric Light and Power System Revenue Bonds, 1991-B series, dated December 6, 1991. These deferred interest bonds bear interest at rates ranging from 6.70% to 6.95% which, when compounded semi-annually and added to the original principal amount, will result in compounded amounts at scheduled maturities in 2005 to 2020 of \$25,000 per bond.

The 1991-B Bonds were issued to provide construction funds for certain pollution control facilities and equipment, certain solid waste disposal facilities and equipment and related purposes.

The 1991-B series is not subject to redemption prior to maturity.

On February 27, 2002, the City issued \$34,905,000 of Electric Light and Power System Revenue Bonds, Taxable 2002-A Series and \$12,205,000 of Electric Light and Power System Revenue Bonds, Tax-Exempt 2002-B Series, each dated February 1, 2002.

**OWENSBORO MUNICIPAL UTILITIES  
ELECTRIC LIGHT AND POWER SYSTEM**

**NOTES TO FINANCIAL STATEMENTS**

Years Ended May 31, 2013 and 2012

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**6. Long-Term Debt, Continued**

The 2002-A and B Bonds were issued to provide construction funds for certain pollution control facilities and equipment.

The 2002-A series is subject to scheduled redemption prior to maturity based upon annual pro rata sinking fund redemptions. In addition, the 2002-A series is subject to early redemption, in whole or in part, at any time, at terms specified in the 2002 Official Statement. Certain 2002-B series bonds totaling \$3,230,000 due January 1, 2020, are subject to scheduled redemption beginning in 2018 based upon annual pro rata sinking fund redemptions. The 2002-B series is also subject to early redemption in whole or in part on any date on or after January 1, 2009, at redemption prices (expressed as a percentage of principal amount) of 101% for 2009, 100½% for 2010, and 100% thereafter, plus accrued interest to the redemption date.

On November 18, 2010, the City issued \$10,070,000 of Electric Light and Power System Revenue Bonds, Taxable 2010-A Series, \$31,425,000 of Electric Light and Power System Revenue Bonds, Taxable 2010-B Series (Build America Bonds) and \$8,935,000 of Electric Light and Power System Refunding Revenue Bonds, Tax-Exempt 2010-C Series, each dated November 4, 2010. The 2010 Bonds were issued to fund various capital improvement expenditures for the Electric System and to refund the 2002-B series bonds. The in-substance defeasance of the 2002-B Bonds was accomplished by placing approximately \$9,274,976 in proceeds from the 2010-C Bonds and \$170,826 in funds from the 2002-B Bond Sinking Fund in an irrevocable escrow fund to be used solely for satisfying scheduled debt service payments of the 2002-B Bonds. Accordingly, the 2002-B Bonds in the amount of \$9,230,000, net of unamortized discount and issuance costs of \$123,543 and accrued interest payable of \$164,248, were extinguished resulting in the accounting recognition of a loss from defeasance of \$175,097, reported in the accompanying financial statements as a reduction of long-term debt. The City advance refunded the 2002-B bonds to extend the repayment period of the bond, reduce its near term annual debt payments and reduce the effective rate on the debt. The advance refunding resulted in an economic gain (difference between the present value of the debt service payment on the old and new debt) of \$558,382.

The 2010-B Series bonds (Build America Bonds – Direct Payment) were issued in connection with the American Recovery and Reinvestment Act of 2009 (Act). Under the Act, state and local governments were authorized to issue taxable bonds to finance capital expenditures for which they could otherwise issue tax-exempt bonds, and receive from the IRS a direct interest subsidy totaling 35% of the total coupon interest paid to investors. Due to current federal budget sequestration, the direct interest subsidy is currently reduced to 32% of the total coupon interest. Interest subsidy received for fiscal years 2013 and 2012 was \$578,846 and \$647,986, respectively. Remaining interest subsidies scheduled through maturities of the bonds, before budget sequestration reductions, are as follows:

**OWENSBORO MUNICIPAL UTILITIES  
ELECTRIC LIGHT AND POWER SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2013 and 2012

**6. Long-Term Debt, Continued**

Year Ending May 31:

2014	\$ 578,846
2015	578,846
2016	578,846
2017	578,846
2018	578,846
2019 – 2023	2,664,345
2024 – 2028	<u>444,041</u>
	<u>\$6,002,616</u>

The 2010-A, B and C series are subject to redemption prior to maturity in whole or in part on any date on or after January 1, 2020, at the redemption price (expressed as a percentage of principal amount to be redeemed) of 100%, plus accrued interest to the redemption date. Furthermore, the 2010-B series (Build America Bonds) may be subject to redemption prior to maturity in whole or in part upon the occurrence of an Extraordinary Event, as defined in the Official Statement. As discussed above, Build America Bonds involve a payment to the issuer from the United States Treasury for a portion of the interest payable on such bonds. If the associated payment from the United States Treasury is reduced or eliminated through no fault of the issuer (Extraordinary Event), the bonds will become redeemable, at the option of the issuer, at a potentially reduced redemption price, as defined in the Official Statement.

All bonds are secured by a pledge of and are payable from the gross revenues derived from the operation of the Electric System and are secured by a statutory mortgage lien as provided and authorized by the Kentucky Revised Statutes.

**7. Dividends - City of Owensboro**

Under the terms of City ordinances authorizing the Electric System bonds, whenever all specified or required transfers and payments have been set aside and paid into the restricted asset funds and there is a balance in excess of the amount to be set aside and paid into the restricted asset funds during the next succeeding two months (approximately \$22,629,000 at May 31, 2013), the City Utility Commission may withdraw and transfer from such excess to the general fund of the City in any fiscal year an amount not to exceed 10% of the value of the City's ownership (net assets) exclusive of interest accumulated on deposits in the Reserve and Contingency Fund (\$10,445,438 at May 31, 2013) and amounts in the Facility Charge Fund (\$7,315,976 at May 31, 2013) as shown on the Electric System's books on the first day of the fiscal year. The Ordinance also allows for the transfer to the City of a sum equal to the dollar value of services purchased by the City from the Electric System in the fiscal year, not to exceed, however, \$700,000 for the fiscal year ended June 30, 1985, and thereafter increasing at a compound rate of 5% per annum. Transfers to the City under this ordinance and agreement were \$8,631,197 and \$8,365,863 for 2013 and 2012, respectively.

**OWENSBORO MUNICIPAL UTILITIES  
ELECTRIC LIGHT AND POWER SYSTEM**

**NOTES TO FINANCIAL STATEMENTS**

Years Ended May 31, 2013 and 2012

**8. Pension Plan**

OMU participates in the County Employees Retirement System (CERS) of the Commonwealth of Kentucky and the City of Owensboro City Employees Pension Fund (CEPF), which are both cost-sharing multiple-employer defined benefit pension plans. The plans provide retirement, disability and death benefits to plan members. The CERS provides for annual cost-of-living adjustments as enacted by the Kentucky legislature in 1996. Participation in the CEPF is limited to participants as of October 1, 1986, who elected to remain in the CEPF rather than enter the CERS.

The Kentucky Revised Statutes assign the administrative authority of the CERS to the Board of Trustees of the Kentucky Retirement Systems. The Kentucky Retirement Systems issues a publicly available financial report that includes financial statements and required supplementary information for the CERS. That report may be obtained by writing to Kentucky Retirement Systems, Perimeter Park West, 1260 Louisville Road, Frankfort, KY 40601 or by calling 502-564-4646.

The administrative authority of the CEPF is assigned to the Board of Trustees of the CEPF. The CEPF issues a publicly available financial report that includes financial statements and required supplementary information for the CEPF. That report may be obtained by writing to the Finance Director, City of Owensboro, P.O. Box 10003, Owensboro, KY 42302 or by calling 270-687-8534.

Plan members participating in CERS on or before August 31, 2008, are required to contribute 5% of their annual creditable compensation and plan members who began participating in CERS on or after September 1, 2008, are required to contribute 6%. OMU is required to contribute at an actuarially determined rate. The current rate is 19.55% of annual covered payroll. Such contributions are determined by the Board of Trustees of the Kentucky Retirement Systems each biennium. The Electric System's contributions to the CERS totaled approximately \$2,744,000, \$2,547,000 and \$2,278,000 for the years ended May 31, 2013, 2012, and 2011, respectively, equal to the required contributions for each year. At May 31, 2013 and 2012, the Electric System had no active employees participating in the CEPF and, accordingly, made no contributions to the plan.

**9. Commitments and Contingencies**

The Electric System has entered into contracts to purchase fuel and related products for electric generation. Although contracts have termination provisions, minimum future payments on these contracts for the years ending May 31 are estimated to be as follows:

2014	\$ 52,242,894
2015	50,646,873
2016	<u>30,938,853</u>
	<u>\$133,828,620</u>

**OWENSBORO MUNICIPAL UTILITIES  
ELECTRIC LIGHT AND POWER SYSTEM**

**NOTES TO FINANCIAL STATEMENTS**

Years Ended May 31, 2013 and 2012

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**9. Commitments and Contingencies, Continued**

OMU 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. OMU manages its risks through coverages provided by private insurance carriers for various risks of losses to which it is exposed, including directors and officers, employee dishonesty, boiler and machinery, workers' compensation and other property risks. The boiler and machinery policy contains a deductible of \$500,000 and excludes acts of terrorism from its coverage. OMU is self-insured for group health and limits its risks of loss by purchasing reinsurance coverage.

OMU has been identified by the United States Environmental Protection Agency as one of numerous parties that may be liable for damages under federal law with respect to a superfund hazardous waste site. Through May 31, 2013, OMU has paid \$57,500, plus legal costs, related to this matter. Based upon the opinion of its outside legal counsel, management does not anticipate additional costs to be material, however, the ultimate resolution of this matter and the related financial impact on OMU, if any, cannot be determined at this time.

There are a number of other pending legal actions involving OMU. Management believes that the outcome of such legal actions and claims will not have a material effect on OMU's financial position or results of operations.

**10. Gain on Settlement**

As part of a settlement, the Electric System received cash and real property and equipment totaling \$3,679,667 in 2012. In accordance with nonmonetary transaction provisions of Governmental Accounting Standards Board (GASB) Statement No. 62, the Electric System valued the property and equipment at estimated fair value at the acquisition date.

**11. Rate Matters**

Effective June 1, 2011 and 2013, the Electric System discontinued billing credits for retail customers associated with environmental costs at ESGS which was anticipated to increase retail revenues by approximately 7% and 6%, respectively.

**12. Subsequent Events**

On June 25, 2013, OMU issued \$86 million in revenue bonds to provide funding for various Electric System improvements and to refinance \$42.6 million in existing debt.

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**OWENSBORO MUNICIPAL UTILITIES  
ELECTRIC LIGHT AND POWER SYSTEM**

**SCHEDULE OF REVENUES AND EXPENSES**

Year Ended May 31, 2013 (with comparative totals for 2012)

	<u>Retail Electric System</u>	<u>Wholesale Power Marketing</u>
<b>Operating revenues:</b>		
Charges for services:		
Residential	\$ 25,569,752	\$ -
Commercial	4,795,850	-
Industrial	44,783,817	-
Water Works System	808,512	-
City of Owensboro	2,481,597	-
Supplemental power	-	1,709,220
Other wholesale	-	59,842,593
Electric Light and Power System	-	-
Build America Bond subsidy	397,406	-
Other	913,161	-
	<hr/>	<hr/>
Total operating revenues	79,750,095	61,551,813
<b>Operating expenses:</b>		
Production:		
Fuel for electric generation	-	-
Purchased power	47,424,375	66,316,455
Other	-	-
Transmission and distribution	4,416,056	3,331,517
Customer service and information	1,291,402	-
General and administrative	4,267,472	1,509,473
Telecommunications	-	-
Depreciation	3,147,238	-
	<hr/>	<hr/>
Total operating expenses	60,546,543	71,157,445
Operating income (loss)	<hr/>	<hr/>
	19,203,552	(9,605,632)
<b>Nonoperating revenues (expenses):</b>		
Interest and debt expense	(1,214,174)	-
Interest income on investments	70,018	-
Interest income on Elmer Smith Generating Station investments allocated to:		
Electric System	745,981	-
Other, net	-	-
Net decrease in fair value of investments	-	-
Deferred net change in fair value of investments	-	-
	<hr/>	<hr/>
Total nonoperating revenues (expenses)	(398,175)	-
Income before special item and transfers	18,805,377	(9,605,632)
Special item - gain on settlement	-	-
Transfers out - dividends to City of Owensboro	(8,631,197)	-
	<hr/>	<hr/>
<b>Change in net position</b>	\$ <u>10,174,180</u>	\$ <u>(9,605,632)</u>

Elmer Smith Generating Station	Telecommunications	Eliminations	Total	2012 Total
\$ -	\$ -	\$ -	\$ 25,569,752	\$ 25,863,505
-	935,114	-	5,730,964	5,795,780
-	-	-	44,783,817	45,188,130
-	35,594	-	844,106	846,317
-	5,100	-	2,486,697	2,222,063
-	-	-	1,709,220	1,904,016
-	-	(42,584)	59,800,009	58,256,069
107,162,630	148,139	(107,310,769)	-	-
160,457	-	-	557,863	577,875
-	-	(100,810)	812,351	820,454
<u>107,323,087</u>	<u>1,123,947</u>	<u>(107,454,163)</u>	<u>142,294,779</u>	<u>141,474,209</u>
66,708,167	-	-	66,708,167	59,599,856
-	-	(107,205,214)	6,535,616	8,087,283
12,742,041	-	(24,810)	12,717,231	22,998,230
336,990	-	(104,250)	7,980,313	7,278,676
-	30,541	-	1,321,943	1,277,069
6,952,119	128,210	(119,889)	12,737,385	12,852,958
-	370,743	-	370,743	337,713
11,370,469	167,259	-	14,684,966	13,602,364
<u>98,109,786</u>	<u>696,753</u>	<u>(107,454,163)</u>	<u>123,056,364</u>	<u>126,034,149</u>
9,213,301	427,194	-	19,238,415	15,440,060
(9,258,703)	-	-	(10,472,877)	(11,228,701)
745,981	-	-	815,999	1,260,971
(745,981)	-	-	-	-
45,402	-	-	45,402	42,663
(260,523)	-	-	(260,523)	-
260,523	-	-	260,523	-
<u>(9,213,301)</u>	<u>-</u>	<u>-</u>	<u>(9,611,476)</u>	<u>(9,925,067)</u>
-	427,194	-	9,626,939	5,514,993
-	-	-	-	3,679,667
-	-	-	(8,631,197)	(8,365,863)
<u>\$ -</u>	<u>\$ 427,194</u>	<u>\$ -</u>	<u>\$ 995,742</u>	<u>\$ 828,797</u>



## INDEPENDENT AUDITOR'S REPORT

City Utility Commission  
City of Owensboro, Kentucky

We have audited the accompanying financial statements of the Owensboro Municipal Utilities Water Works System (Water System) of the City of Owensboro, Kentucky, as of and for the years ended May 31, 2013 and 2012, and the related notes to the 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 audit. We conducted our audit 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 the Owensboro Municipal Utilities Water Works System of the City of Owensboro, Kentucky, as of May 31, 2013 and 2012, and the changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

**Emphasis of Matter**

As discussed in Note 1 to the financial statements, the financial statements present only the Water System, an enterprise fund of the City of Owensboro, Kentucky, and do not purport to, and do not, present fairly the financial position of the City of Owensboro, Kentucky, as of May 31, 2013 and 2012, and the changes in its financial position or, where applicable, its cash flows, for the years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

**Other Matters**

**Required Supplementary Information**

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 34 through 37 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.

*Riney Hancock CPAs PSC*

Owensboro, Kentucky  
September 13, 2013

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of the Owensboro Municipal Utilities Water Works System (Water System) financial performance provides an overview of the Water System's financial activities for the fiscal year ended May 31, 2013. Please read it in conjunction with the Water System's financial statements, which begin on page 38.

### Overview of the Financial Statements

This annual report consists of two parts: Management's Discussion and Analysis and the Financial Statements.

Management's Discussion and Analysis (MD&A) serves as an introduction to the basic financial statements. The MD&A represents management's examination and analysis of the Water System's financial condition and performance.

The financial statements report information using accounting methods similar to those used by private sector companies. The financial statements include a Statement of Net Position; a Statement of Revenues, Expenses, and Changes in Fund Net Position; a Statement of Cash Flows; and Notes to the Financial Statements.

The Statement of Net Position presents the financial position of the Water System and thus provides information about the nature and amount of resources and obligations at year-end.

The Statement of Revenues, Expenses, and Changes in Fund Net Position presents the results of the business activities over the course of the fiscal year and information as to how the net position changed during the year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flow.

The Statement of Cash Flows presents changes in cash and cash equivalents resulting from operational, financing and investing activities. This statement presents cash receipts and cash disbursements information, without consideration of the earnings event or when an obligation arises.

The Notes to the Financial Statements provide required disclosures and other information that are essential to a full understanding of material data provided in the statements. The notes present information about the Water System's accounting policies, significant account balances and activities, material risks, obligations, commitments, contingencies and subsequent events, if any.

## MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED

### Financial Summary

The following table summarizes the financial condition and operations of the Water System for 2013 and 2012.

<b>Assets</b>	<b><u>2013</u></b>	<b><u>2012</u></b>
Utility plant, net	\$ 44,721,538	\$ 44,677,358
Restricted assets	4,412,855	5,790,543
Current assets	4,542,057	4,313,911
Other noncurrent assets	<u>914,502</u>	<u>915,478</u>
	<b><u>\$ 54,590,952</u></b>	<b><u>\$ 55,697,290</u></b>
 <b>Liabilities and Net Position</b>		
Net position		
Invested in capital assets, net	\$ 24,798,195	\$ 25,579,005
Restricted	663,773	583,205
Unrestricted	<u>3,496,065</u>	<u>3,001,677</u>
Total net position	28,958,033	29,163,887
Long-term debt	23,405,896	23,898,762
Current liabilities	1,616,383	1,764,477
Other noncurrent liabilities	276,895	407,447
Deferred revenue	<u>333,745</u>	<u>462,717</u>
	<b><u>\$ 54,590,952</u></b>	<b><u>\$ 55,697,290</u></b>
 <b>Revenues, Expenses and Changes in Fund</b>		
<b>Net Position</b>		
Operating revenues	\$ 9,948,355	\$ 9,491,705
Operating expenses	<u>8,809,175</u>	<u>8,340,459</u>
Operating income	<u>1,139,180</u>	<u>1,151,246</u>
Interest expense	(1,345,753)	(1,368,139)
Interest income	<u>27,223</u>	<u>8,818</u>
Net nonoperating expenses	<u>(1,318,530)</u>	<u>(1,359,321)</u>
Income (loss) before contributions and transfers	(179,350)	(208,075)
Capital contributions	141,409	447,895
Transfers out - dividends to City of Owensboro	<u>(167,913)</u>	<u>(147,013)</u>
Change in net position	<b><u>\$ (205,854)</u></b>	<b><u>\$ 92,807</u></b>

## MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED

### FINANCIAL HIGHLIGHTS

- Net position decreased by \$205,854 in 2013, and the loss before contributions and transfers was \$179,350 in 2013 versus \$208,075 in 2012, as a result of changes in operating revenues, operating expenses and interest, as discussed below.
- Operating revenues increased by \$456,650 in 2013 when compared to 2012, or 4.8%. The increase in revenues in 2013 is partially attributable to a slight increase in retail sales volumes, including an increase in water usage by the Electric System, at Elmer Smith Generating Station. Also contributing to the increased revenues was an increase in revenue from the three rural water districts for whom the Water System supplies wholesale water. The cost-based revenues provided in the water district contracts increased as a result of increased operating costs, as discussed below.
- Operating expenses increased \$468,716 in 2013 when compared to 2012, or 5.6%, largely due to general increases in all expense categories. Production and purification increased \$184,774 or 7.5%, partially due to increased power cost; transmission and distribution increased \$41,558 or 4.6%, primarily due to increased maintenance of water mains; general and administrative expenses increased \$176,185, or 8.1%, primarily due to increases in employee payroll tax and retirement costs; and depreciation increased by \$43,734, or 1.9%, primarily from routine additions to capital assets, as discussed below.
- Interest expense decreased by \$22,386, or 1.6%, due to a reduction in debt as a result of scheduled maturities and interest income increased \$18,405 due primarily to higher rates received from investment in U.S. agency securities in 2013.

### CAPITAL ASSET AND DEBT ADMINISTRATION

#### Capital Assets

At the end of 2013, the Water System had \$44.7 million invested in a broad range of assets, including wells, treatment facilities and equipment, storage tanks, buildings and water mains. This amount represents a slight increase from 2012 due to capital asset additions. The following table summarizes capital assets, net of accumulated depreciation, at the end of 2013 and 2012.

	<u>2013</u>	<u>2012</u>
Source of supply plant	\$ 1,964,142	\$ 1,612,578
Pumping plant	403,692	431,687
Water treatment plant	15,362,777	15,460,817
Transmission and distribution plant	22,786,078	22,931,084
General plant	1,419,367	1,200,447
Unclassified plant and construction in progress	<u>2,785,482</u>	<u>3,040,745</u>
	<u>\$ 44,721,538</u>	<u>\$ 44,677,358</u>

## MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED

### CAPITAL ASSET AND DEBT ADMINISTRATION, CONTINUED

#### Capital Assets, Continued

In addition to the Water System's routine additions and replacement of distribution plant, the Water System incurred \$256,000 as its share of the OMU Enterprise system implementation, \$231,000 toward a water facilities master plan, \$370,000 toward treatment plant roof and structural improvements and \$154,000 toward treatment plant clarifier improvements.

#### Debt

At the end of 2013, the Water System had \$24.0 million in bonds outstanding versus \$24.5 million in 2012, for a decrease of 1.9%. As there was no new debt issued during 2013, this decrease is due to scheduled bond payments.

#### Outlook

We expect the 2014 results to decline as comparable with 2013, with anticipated reductions in revenues and slight cost increases. For the first two months of fiscal 2014, the Water system has experienced lower sales volumes than 2013 as a result of higher rainfall totals in the area. As a result, overall revenues are expected to decrease from 2013. On the cost side, production and purification costs are anticipated to increase, largely due to the increased well and treatment plant maintenance requirements, as well as increased power cost. These additional costs, as well as other general cost increases, are expected to be partially offset by a slight reduction in general and administrative costs due to anticipated reductions in employee benefit costs.

The Water System is currently analyzing rates in anticipation of a potential future rate adjustment and is expecting to issue additional debt near the end of fiscal 2014 for capital funding.

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**OWENSBORO MUNICIPAL UTILITIES  
WATER WORKS SYSTEM**

**STATEMENTS OF NET POSITION**

May 31, 2013 and 2012

<b>ASSETS</b>	<u>2013</u>	<u>2012</u>
Utility plant, net	\$ <u>44,721,538</u>	\$ <u>44,677,358</u>
Restricted assets	<u>4,412,855</u>	<u>5,790,543</u>
Current assets:		
Cash and cash equivalents	2,230,088	2,059,509
Accounts receivable, less allowance for doubtful accounts of \$8,684 for 2013 and \$11,787 for 2012	1,607,977	1,576,767
Materials and supplies	585,839	563,204
Prepayments	<u>118,153</u>	<u>114,431</u>
Total current assets	<u>4,542,057</u>	<u>4,313,911</u>
Other noncurrent assets:		
Unamortized debt expense	868,055	914,527
Other	<u>46,447</u>	<u>951</u>
	<u>914,502</u>	<u>915,478</u>
 <b>Total assets</b>	 <b>\$ <u>54,590,952</u></b>	 <b>\$ <u>55,697,290</u></b>

**LIABILITIES AND NET POSITION**

	<u>2013</u>	<u>2012</u>
Net position:		
Net investment in capital assets	\$ 24,798,195	\$ 25,579,005
Restricted for capital projects, net of related debt	92,063	90,579
Restricted for debt service	571,710	492,626
Unrestricted	<u>3,496,065</u>	<u>3,001,677</u>
 Total net position	 <u>28,958,033</u>	 <u>29,163,887</u>
 Long-term debt	 <u>23,405,896</u>	 <u>23,898,762</u>
 Current liabilities (payable from restricted assets):		
Current maturities of long-term debt	595,000	570,000
Accrued interest payable	248,015	252,783
Accounts payable	<u>52,801</u>	<u>91,226</u>
	 <u>895,816</u>	 <u>914,009</u>
 Current liabilities (payable from current assets):		
Accounts payable	720,567	792,606
Other	<u>-</u>	<u>57,862</u>
	 <u>720,567</u>	 <u>850,468</u>
 Total current liabilities	 <u>1,616,383</u>	 <u>1,764,477</u>
 Other noncurrent liabilities:		
Customers' advances for construction	276,895	407,447
Other	<u>-</u>	<u>-</u>
	 <u>276,895</u>	 <u>407,447</u>
 Deferred revenue	 <u>333,745</u>	 <u>462,717</u>
 Total liabilities and net position	 <u>\$ 54,590,952</u>	 <u>\$ 55,697,290</u>

See Notes to Financial Statements

**OWENSBORO MUNICIPAL UTILITIES  
WATER WORKS SYSTEM**

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION

Years Ended May 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
<b>Operating revenues:</b>		
Charges for services:		
Residential	\$ 3,596,626	\$ 3,542,072
Commercial	3,392,550	3,374,545
Water districts	2,102,849	1,933,526
Fire protection	192,830	192,343
City of Owensboro	167,913	147,013
Electric Light and Power System	269,679	110,093
Service revenues	<u>225,908</u>	<u>192,113</u>
Total operating revenues	<u>9,948,355</u>	<u>9,491,705</u>
<b>Operating expenses:</b>		
Production and purification	2,664,555	2,479,781
Transmission and distribution	951,011	909,453
Customer service and information	549,087	526,622
General and administrative	2,356,066	2,179,881
Depreciation	<u>2,288,456</u>	<u>2,244,722</u>
Total operating expenses	<u>8,809,175</u>	<u>8,340,459</u>
Operating income	<u>1,139,180</u>	<u>1,151,246</u>
<b>Nonoperating revenues (expenses):</b>		
Interest and debt expense	(1,345,753)	(1,368,139)
Interest income on investments	27,223	8,818
Net decrease in fair value of investments	(38,127)	-
Deferred net change in fair value of investments	<u>38,127</u>	<u>-</u>
Total nonoperating revenues (expenses)	<u>(1,318,530)</u>	<u>(1,359,321)</u>
Loss before contributions and transfers	(179,350)	(208,075)
Capital contributions	141,409	447,895
Transfers out - dividends to City of Owensboro	<u>(167,913)</u>	<u>(147,013)</u>
Change in net position	(205,854)	92,807
Net position, beginning of year	<u>29,163,887</u>	<u>29,071,080</u>
Net position, end of year	<u>\$ 28,958,033</u>	<u>\$ 29,163,887</u>

See Notes to Financial Statements

**OWENSBORO MUNICIPAL UTILITIES  
WATER WORKS SYSTEM**

STATEMENTS OF CASH FLOWS

Years Ended May 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
<b>Cash flows from operating activities:</b>		
Receipts from customers	\$ 9,554,196	\$ 9,361,137
Payments to suppliers	(4,111,906)	(3,752,871)
Payments to employees	(2,454,594)	(2,084,228)
	<u>2,987,696</u>	<u>3,524,038</u>
<b>Cash flows from capital and related financing activities:</b>		
Capital expenditures	(2,397,884)	(1,767,596)
Payments on long-term debt	(570,000)	(545,000)
Interest paid on long-term debt	(1,201,915)	(1,223,946)
Contributions in aid of construction	-	980
Customers' advances	1,500	2,198
Reimbursements of customers' advances	(15,587)	(17,339)
	<u>(4,183,886)</u>	<u>(3,550,703)</u>
Net cash used in capital and related financing activities		
	<u>(4,183,886)</u>	<u>(3,550,703)</u>
<b>Cash flows from investing activities:</b>		
Purchase of investments	(2,370,373)	-
Interest on investments	24,190	8,520
	<u>(2,346,183)</u>	<u>8,520</u>
Net cash provided by (used in) investing activities		
	<u>(2,346,183)</u>	<u>8,520</u>
Net decrease in cash and cash equivalents	(3,542,373)	(18,145)
Cash and cash equivalents, beginning of year	<u>7,849,868</u>	<u>7,868,013</u>
Cash and cash equivalents, end of year	<u>\$ 4,307,495</u>	<u>\$ 7,849,868</u>
<b>Included in the following balance sheet captions:</b>		
Cash and cash equivalents, unrestricted	\$ 2,230,088	\$ 2,059,509
Cash and cash equivalents, restricted	<u>2,077,407</u>	<u>5,790,359</u>
	<u>\$ 4,307,495</u>	<u>\$ 7,849,868</u>

**OWENSBORO MUNICIPAL UTILITIES  
WATER WORKS SYSTEM**

STATEMENTS OF CASH FLOWS, Concluded

Years Ended May 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
<b>Reconciliation of operating income to net cash provided by operating activities:</b>		
Operating income	\$ 1,139,180	\$ 1,151,246
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	2,377,841	2,329,487
Noncash operating revenues from City of Owensboro	(167,913)	(147,013)
Change in assets and liabilities:		
Decrease (increase) in assets:		
Accounts receivable	(68,813)	(107,725)
Materials and supplies	(22,635)	(39,718)
Prepayments	(3,722)	(20,250)
Other deferred charges	(7,369)	9,491
Increase (decrease) in liabilities:		
Accounts payable	(72,039)	199,933
Other current liabilities	(57,862)	8,640
Deferred revenue	(128,972)	139,947
Net cash provided by operating activities	<u>\$ 2,987,696</u>	<u>\$ 3,524,038</u>
<b>Noncash investing, capital and financing activities:</b>		
Noncash contributions in aid of construction	<u>\$ 24,944</u>	<u>\$ 485,906</u>
Unrefunded customers' advances credited to contributions in aid of construction	<u>\$ 116,465</u>	<u>\$ 7,569</u>
Amortization of debt discount and expense and deferred loss on debt defeasance	<u>\$ 148,606</u>	<u>\$ 148,605</u>
Noncash dividends to City of Owensboro	<u>\$ 167,913</u>	<u>\$ 147,013</u>

**OWENSBORO MUNICIPAL UTILITIES  
WATER WORKS SYSTEM**

**NOTES TO FINANCIAL STATEMENTS**

Years Ended May 31, 2013 and 2012

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**1. Organization and Summary of Significant Accounting Policies**

**General Information**

In 1940, the City of Owensboro, Kentucky (the City) established the City Utility Commission to manage, control and operate Owensboro Municipal Utilities (OMU). City officials appoint the five individuals who comprise the City Utility Commission. OMU consists of the Electric Light and Power System (Electric System) and the Water Works System (Water System), which are separate enterprise funds of the City. Accordingly, the Electric System and the Water System are part of the financial reporting entity of the City. The accompanying financial statements present only the Water System and are not intended to present fairly the financial position of the City and changes in its financial position or, where applicable, its cash flows, in conformity with accounting principles generally accepted in the United States of America. The Water System is subject to regulation, including approval of rates charged for utility services, by the City, as set forth in the applicable city ordinances.

The Water System provides water to approximately 24,000 residential, commercial and industrial customers in Owensboro, Kentucky. The Water System also furnishes water to three rural water districts in Daviess County, Kentucky, under wholesale supply agreements.

**System of Accounts and Basis of Accounting**

The Water System's accounts are maintained substantially in accordance with the Uniform System of Accounts for water companies developed by the National Association of Regulatory Utility Commissioners and in conformity with accounting principles generally accepted in the United States of America using the economic resources measurement focus and the accrual basis of accounting.

The Water System considers water revenues and costs that are directly related to production, purification, transmission, and distribution of water to be operating revenues and expenses. Revenues and expenses related to financing and other activities are reflected as nonoperating. The Water System accrues revenues as services are rendered to utility customers.

**Utility Plant and Depreciation**

Utility plant is stated at original cost, which includes the cost of contracted services, materials, labor, labor-related expenditures, general and administrative costs and an allowance for borrowed funds used during construction.

**OWENSBORO MUNICIPAL UTILITIES  
WATER WORKS SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2013 and 2012

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**1. Organization and Summary of Significant Accounting Policies, Continued**

Utility Plant and Depreciation, Continued

Replacements of depreciable property units, except minor replacements, are charged to utility plant. In addition, the costs of refurbishments of water tanks are charged to utility plant. Property units replaced or retired, including cost of removal net of any salvage, are charged to accumulated depreciation. Routine maintenance, repairs and minor replacement costs are charged to expense as incurred.

Allowance for borrowed funds used during construction includes capitalized interest during the construction period less any interest income on construction fund investments from bond proceeds during such period. Capitalization of interest is discontinued when the project is completed and the related utility plant is placed in service.

Depreciation of utility plant and unclassified plant in service is provided using the straight-line composite rate method over the estimated service lives of the depreciable assets. Estimated service lives of assets range from 5 to 80 years. Depreciation expense during 2013 and 2012 was approximately 3.2% of the average original cost of depreciable utility plant in service.

Restricted Assets

The City ordinances that authorized the Water Revenue Bonds require that certain amounts from bond proceeds and payments by customers for services provided be deposited into designated funds and be used only for the specified purposes of the funds. The Water System's policy is to first apply restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

Cash and Investments

Cash deposits are reported at carrying amounts. Certificates of deposit and long-term repurchase agreements are reported at cost. U.S. government obligations and agency securities, are stated at fair values based upon currently quoted market rates.

The Water System considers all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash equivalents. Unrestricted investments with initial maturities exceeding three months, consisting of certificates of deposit and U.S. agency securities, are classified as temporary investments.

**OWENSBORO MUNICIPAL UTILITIES  
WATER WORKS SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2013 and 2012

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**1. Organization and Summary of Significant Accounting Policies, Continued**

Inventories

Inventories consisting of materials and supplies are valued at the lower of weighted average cost or market.

Bond Issuance Costs

Premiums, discounts and bond issue costs arising from various bond issues are deferred and amortized using the straight-line method over the lives of the issues.

The difference between the reacquisition price and the net carrying amount of defeased bond issues has been deferred and is being amortized using the straight-line method over the lives of the refunding bond issues.

Customers' Advances for Construction

Customers' advances for construction are refundable to depositors over a 10-year period. Refund amounts under the contracts are based on annual revenues from the extensions. Unrefunded balances at the end of the contract period are credited to contributions in aid of construction and are no longer refundable.

Contributions of Contributed Property and Equipment

The donor cost or appraised value of contributed property and equipment is included in contributions.

Income Taxes

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

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 and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**OWENSBORO MUNICIPAL UTILITIES  
WATER WORKS SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2013 and 2012

**2. Utility Plant**

Water utility plant activity for the year ended May 31, 2013, was as follows:

	Balance at May 31, <u>2012</u>	<u>Additions</u>	<u>Retirements</u>	Balance at May 31, <u>2013</u>
Utility plant:				
Source of supply plant	\$ 3,462,589	\$ 473,119	\$ (15,302)	\$ 3,920,406
Pumping plant	1,136,737	-	(40,974)	1,095,763
Water treatment plant	28,235,580	537,363	(88,588)	28,684,355
Transmission and distribution plant	35,085,711	984,307	(68,915)	36,001,103
General plant	3,631,786	479,794	(175,955)	3,935,625
Unclassified plant in service	<u>1,574,630</u>	<u>(967,921)</u>	<u>-</u>	<u>606,709</u>
Total, at original cost	<u>73,127,033</u>	<u>1,506,662</u>	<u>(389,734)</u>	<u>74,243,961</u>
Accumulated depreciation:				
Source of supply plant	(1,850,011)	(121,555)	15,302	(1,956,264)
Pumping plant	(705,050)	(28,229)	41,208	(692,071)
Water treatment plant	(12,774,763)	(635,168)	88,353	(13,321,578)
Transmission and distribution plant	(12,154,627)	(1,332,619)	272,221	(13,215,025)
General plant	<u>(2,431,339)</u>	<u>(260,270)</u>	<u>175,351</u>	<u>(2,516,258)</u>
Total accumulated depreciation	<u>(29,915,790)</u>	<u>(2,377,841)</u>	<u>592,435</u>	<u>(31,701,196)</u>
Construction in progress	<u>1,466,115</u>	<u>712,658</u>	<u>-</u>	<u>2,178,773</u>
Utility plant, net	<u>\$ 44,677,358</u>	<u>\$ (158,521)</u>	<u>\$ 202,701</u>	<u>\$ 44,721,538</u>

Depreciation expense for the years ended May 31 was as follows:

	<u>2013</u>	<u>2012</u>
Water utility plant	\$ 2,288,456	\$ 2,244,722
Transportation depreciation charged to construction activities or other operating expenses	<u>89,385</u>	<u>84,765</u>
	<u>\$ 2,377,841</u>	<u>\$ 2,329,487</u>

**OWENSBORO MUNICIPAL UTILITIES  
WATER WORKS SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2013 and 2012

**3. Restricted Assets**

Restricted assets at May 31 consist of the following:

	<u>2013</u>	<u>2012</u>
Cash and cash equivalents	\$ 2,077,407	\$ 5,790,359
Investments	2,332,246	-
Accrued interest receivable	<u>3,202</u>	<u>184</u>
	<u>\$ 4,412,855</u>	<u>\$ 5,790,543</u>

The above balances are contained in the following funds:

Sinking Fund	\$ 2,484,232	\$ 2,519,434
Renewal and Replacement Fund	280	218
Construction Fund	<u>1,928,343</u>	<u>3,270,891</u>
	<u>\$ 4,412,855</u>	<u>\$ 5,790,543</u>

Under the terms of the Water Revenue Bond ordinances, interest income from the temporary investment of the Water System's restricted assets must be credited to the various restricted asset funds. In addition, whenever all specified and required payments and transfers into the restricted asset funds have been made as provided in the Water Revenue Bond ordinances and there is a balance in excess of the estimated amounts required to pay current month operation and maintenance costs (approximately \$525,000 at May 31, 2013), all or any part of such excess may be used for any lawful purpose related to the Water System.

The Water System follows GASB No. 31, "Accounting and Financial Reporting for Certain Investments and for External Investments Pools," which requires certain investments to be carried at fair value in the balance sheets and changes in the fair value of investments to be reported in the statements of revenues, expenses and changes in fund net assets. In accordance with GASB No. 31, the Water System recorded unrealized losses of \$38,127 for the year ended May 31, 2013. The Water System's rate making methodology does not consider unrealized gains or losses on marketable securities in its rate making process. Accordingly, under FASB ASC 980, *Regulated Operations*, the unrealized losses for the year ended May 31, 2013, have been deferred. Included in other assets at May 31, 2013, are cumulative net unrealized losses of \$38,127.

The net increase (decrease) in the fair value of investments consists of the following:

**OWENSBORO MUNICIPAL UTILITIES  
WATER WORKS SYSTEM**

**NOTES TO FINANCIAL STATEMENTS**

Years Ended May 31, 2013 and 2012

**3. Restricted Assets, Continued**

	<u>2013</u>
Net realized gains (losses) on sales of investments	\$ -
Net unrealized gains (losses) on investments	<u>(38,127)</u>
	\$ <u>(38,127)</u>

The calculation of realized gains or losses on sales of investments is independent of the calculation of the net change in the fair value of investments. Realized gains or losses on investments that were held in more than one fiscal year and sold in the current year were included as a net change in the fair value of investments reported in prior years and the current year.

**4. Cash Deposits and Investments**

At May 31, the carrying amounts of the Water System's deposits in financial institutions and investments other than deposits were:

	<u>2013</u>	<u>2012</u>
Deposits in financial institutions	\$ 4,902,868	\$ 7,849,868
Investments other than deposits	<u>1,736,873</u>	<u>-</u>
	\$ <u>6,639,741</u>	\$ <u>7,849,868</u>

These amounts are reflected in the statements of net position as:

	<u>2013</u>	<u>2012</u>
Cash and cash equivalents	\$ 2,230,088	\$ 2,059,509
Restricted assets:		
Cash and cash equivalents	2,077,407	5,790,359
Investments	<u>2,332,246</u>	<u>-</u>
	\$ <u>6,639,741</u>	\$ <u>7,849,868</u>

**OWENSBORO MUNICIPAL UTILITIES  
WATER WORKS SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2013 and 2012

**4. Cash Deposits and Investments, Continued**

*Deposit and Investment Policy.* The Water System's deposit and investment policy prescribes to the prudent-person rule: Investments shall be made with applicable law and under prevailing circumstances which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital, as well as the probable income to be derived.

*Custodial Credit Risk.* Custodial credit risk is the risk that, in the event of a bank failure, the Water System's deposits may not be returned to it. The Water System's deposit and investment policy permits uncollateralized deposits only if issued by institutions ranked in one of the three highest categories by a nationally recognized rating agency. As of May 31, 2013, \$4,885,387 of the Water System's bank balance of \$4,902,518 was exposed to custodial credit risk as follows:

Uninsured and uncollateralized	\$ -
Uninsured with collateral held by pledging bank's agent	<u>4,885,387</u>
<b>Total</b>	<b><u>\$ 4,885,387</u></b>

As of May 31, 2013, the Water System had the following investments. Investments are reported at fair values.

<u>Investments</u>	<u>Maturities</u>	
Federal Home Loan Bank – Callable	11/01/2022	\$ 1,736,873

*Interest Rate Risk.* As a means of limiting its exposure to fair value losses arising from rising interest rates, the Water Works System's deposit and investment policy limits investment maturities based upon provisions of bond ordinances.

*Credit Risk.* The Water System's deposit and investment policy authorizes the investment of funds in any manner permitted by bond ordinances and the Kentucky Revised Statutes and does not further limit its investment choices.

*Concentration of Credit Risk.* Other than the prudent-person rule, the Water System's deposit and investment policy places no limit on the amount the Water System may invest in any one issuer. All of the Water System's investments are in U.S. agency securities at May 31, 2013.

**OWENSBORO MUNICIPAL UTILITIES  
WATER WORKS SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2013 and 2012

**5. Long-Term Debt**

Long-term debt activity for the year ended May 31, 2013, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Amounts Due Within One Year</u>
Bonds payable:					
Series of 1999	\$ 2,445,000	\$ -	\$ (365,000)	\$ 2,080,000	\$ 380,000
Series of 2003	3,155,000	-	(205,000)	2,950,000	215,000
Series of 2009	<u>19,160,000</u>	<u>-</u>	<u>-</u>	<u>19,160,000</u>	<u>-</u>
	24,760,000	-	(570,000)	24,190,000	595,000
Add unamortized debt premium	326,655	-	(14,633)	312,022	-
Less unamortized deferred loss on debt defeasance	<u>(617,893)</u>	<u>-</u>	<u>116,767</u>	<u>(501,126)</u>	<u>-</u>
Total bonds payable	\$ <u>24,468,762</u>	\$ <u>-</u>	\$ <u>(467,866)</u>	\$ <u>24,000,896</u>	\$ <u>595,000</u>

Long-term debt at May 31 consists of the following Water Revenue Bonds:

	<u>2013</u>	<u>2012</u>
Series of 1999: 4.0% to 4.75%, due serially September 15, 1999 to 2017	\$ 2,080,000	\$ 2,445,000
Series of 2003: 2.0% to 4.25%, due serially September 15, 2004 to 2023	2,950,000	3,155,000
Series of 2009: 5.0% to 5.25%, due serially September 15, 2018 to 2035	<u>19,160,000</u>	<u>19,160,000</u>
Total long-term debt	24,190,000	24,760,000
Less current maturities	(595,000)	(570,000)
Add unamortized debt premium	312,022	326,655
Less unamortized deferred loss on debt defeasance	<u>(501,126)</u>	<u>(617,893)</u>
	\$ <u>23,405,896</u>	\$ <u>23,898,762</u>

**OWENSBORO MUNICIPAL UTILITIES  
WATER WORKS SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2013 and 2012

**5. Long-Term Debt, Continued**

Sinking fund requirements and scheduled aggregate maturities of long-term debt are as follows:

<u>Year Ending May 31:</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2014	\$ 595,000	\$ 1,178,240	\$ 1,773,240
2015	620,000	1,152,091	1,772,091
2016	650,000	1,123,619	1,773,619
2017	680,000	1,093,831	1,773,831
2018	710,000	1,062,694	1,772,694
2019 – 2023	4,100,000	4,761,138	8,861,138
2024 – 2028	5,220,000	3,641,556	8,861,556
2029 - 2033	6,695,000	2,160,203	8,855,203
2034 - 2038	4,920,000	395,403	5,315,403
	<u>\$ 24,190,000</u>	<u>\$ 16,568,775</u>	<u>\$ 40,758,775</u>

The Water System is subject to certain debt covenants, compliance with which is required by the ordinances authorizing its bond issues. Such ordinances require revenue to be first applied to the Sinking Fund, next to the Operations and Maintenance Fund and finally to the Renewal and Replacement Fund.

On January 12, 1999, the City issued \$26,410,000 of Water Revenue Refunding and Improvement Bonds, Series 1999, dated January 1, 1999. The 1999 Bonds were issued to refund, at a lower cost, all outstanding 1991 and 1992 series bonds and to provide funds for the cost of extensions and improvements to the Water System. The in-substance defeasance of the 1991 and 1992 Bonds was accomplished by placing approximately \$23,271,892 in proceeds from the 1999 Bonds and \$3,117,030 in funds from the 1991 and 1992 Bonds Sinking Funds in an irrevocable escrow fund to be used solely for satisfying scheduled debt service payments of the 1991 and 1992 Bonds.

The Series 1999 Bonds maturing on and after September 15, 2009, are subject to redemption prior to maturity in whole or in part on March 15, 2009, and on any date thereafter, at the redemption price of 100% of the principal amount redeemed, plus accrued interest to the redemption date.

On May 29, 2003, the City issued \$4,500,000 of Water Revenue Improvement Bonds, Series 2003, dated May 15, 2003. The 2003 Bonds were issued to provide funds for the cost of extensions and improvements to the Water System. The Series 2003 Bonds maturing on and after September 15, 2013, are subject to redemption in whole or in part on September 15, 2012, and on any date thereafter, at the redemption price of 100% of the principal amount redeemed, plus accrued interest to the redemption date.

**OWENSBORO MUNICIPAL UTILITIES  
WATER WORKS SYSTEM**

NOTES TO FINANCIAL STATEMENTS

Years Ended May 31, 2013 and 2012

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**5. Long-Term Debt, Continued**

On February 5, 2009, the City issued \$19,160,000 of Water Revenue Refunding and Improvement Bonds, Series 2009, dated February 5, 2009. The 2009 Bonds were issued to refund a portion of the 1999 series bonds, to fund various capital improvement expenditures for the Water System and to fully fund the Bond Reserve Account. The in-substance defeasance of the 1999 Bonds was accomplished by placing approximately \$11,803,854 in proceeds from the 2009 Bonds and \$591,666 in funds from the 1999 Bond Sinking Fund in an irrevocable escrow fund to be used solely for satisfying scheduled debt service payments of the 1999 Bonds. Accordingly, 1999 Bonds in the amount of \$12,120,000, net of unamortized discount and issuance costs of \$181,145 and accrued interest payable of \$214,591, were extinguished resulting in the accounting recognition of a loss from defeasance of \$242,074, reported in the accompanying financial statements as a reduction of long-term debt. The City advance refunded the 1999 bonds to extend the repayment period of the bonds and reduce its near term annual debt payments. The advance refunding resulted in an economic loss (difference between the present value of the debt service payment on the old and new debt) of \$476,174.

The Series 2009 Bonds maturing on and after September 15, 2019, are subject to redemption prior to maturity in whole or in part on September 15, 2018, and on any date thereafter, at the redemption price of 100% of the principal amount redeemed, plus accrued interest to the redemption date.

All bonds are secured by a pledge of and are payable from the gross revenues derived from the operation of the Water System and are secured by the statutory mortgage lien as provided and authorized by the Kentucky Revised Statutes.

**6. Pension Plan**

OMU participates in the County Employees Retirement System (CERS) of the Commonwealth of Kentucky and the City of Owensboro City Employees Pension Fund (CEPF), which are both cost-sharing multiple-employer defined benefit pension plans. The plans provide retirement, disability and death benefits to plan members. The CERS provides for annual cost-of-living adjustments as enacted by the Kentucky legislature in 1996. Participation in the CEPF is limited to participants as of October 1, 1986, who elected to remain in the CEPF rather than enter the CERS.

The Kentucky Revised Statutes assign the administrative authority of the CERS to the Board of Trustees of the Kentucky Retirement Systems. The Kentucky Retirement Systems issues a publicly available financial report that includes financial statements and required supplementary information for the CERS. That report may be obtained by writing to Kentucky Retirement Systems, Perimeter Park West, 1260 Louisville Road, Frankfort, KY 40601 or by calling 502-564-4646.

**OWENSBORO MUNICIPAL UTILITIES  
WATER WORKS SYSTEM**

**NOTES TO FINANCIAL STATEMENTS**

Years Ended May 31, 2013 and 2012

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**6. Pension Plan, Continued**

The administrative authority of the CEPF is assigned to the Board of Trustees of the CEPF. The CEPF issues a publicly available financial report that includes financial statements and required supplementary information for the CEPF. That report may be obtained by writing to the Finance Director, City of Owensboro, P.O. Box 10003, Owensboro, KY 42302 or by calling 270-687-8534.

Plan members participating in CERS on or before August 31, 2008, are required to contribute 5% of their annual creditable compensation and plan members who began participating in CERS on or after September 1, 2008, are required to contribute 6%. OMU is required to contribute at an actuarially determined rate. The current rate is 19.55% of annual covered payroll. Such contributions are determined by the Board of Trustees of the Kentucky Retirement Systems each biennium. The Water System's contributions to the CERS totaled approximately \$552,000, \$498,000, and \$446,000 for the years ended May 31, 2013, 2012, and 2011, respectively, equal to the required contributions for each year. At May 31, 2013 and 2012, the Water System had no active employees participating in the CEPF and, accordingly, made no contributions to the plan.

**7. Dividends - City of Owensboro**

The Water System transfers to the City each year a sum equal to the dollar value of services purchased by the City from the Water System.

**8. Major Customers**

Water revenues from three rural water district customers in Daviess County, Kentucky, under wholesale supply agreements totaled approximately \$2,103,000 and \$1,934,000 for 2013 and 2012, respectively.

**9. Risk Management**

OMU 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. OMU manages its risks through coverages provided by private insurance carriers for various risks of losses to which it is exposed, including directors and officers, employee dishonesty, workers' compensation and other property risks. OMU is self-insured for group health and limits its risks of loss by purchasing reinsurance coverage.