

HILLSDALE BOARD OF PUBLIC UTILITIES

**FINANCIAL STATEMENTS
AND INDEPENDENT AUDITOR'S REPORT**

YEAR ENDED JUNE 30, 2017

HILLSDALE BOARD OF PUBLIC UTILITIES

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INDEPENDENT AUDITOR'S REPORT

To the Board Members
Hillsdale Board of Public Utilities
Hillsdale, Michigan

We have audited the accompanying financial statements of the Electric Fund, Water Fund, and Sewer Fund of the City of Hillsdale, Michigan, as of and for the year ended June 30, 2017, 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 opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Electric Fund, the Water Fund and the Sewer Fund of the City of Hillsdale's Board of Public Utilities as of June 30, 2017, and the changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the financial statements present only the City of Hillsdale's Board of Public Utilities and do not purport to, and do not present fairly the financial position of the City of Hillsdale, Michigan, as of June 30, 2017, the changes in its financial position, or, where applicable, its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplemental Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis as listed in the table of contents be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 25, 2017 on our consideration of the City of Hillsdale's Board of Public Utilities' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City of Hillsdale's Board of Public Utilities' internal control over financial reporting and compliance.

CHBW & Co., P.C.

Certified Public Accountants

MANAGEMENT'S DISCUSSION AND ANALYSIS

HILLSDALE BOARD OF PUBLIC UTILITIES
Management's Discussion and Analysis
June 30, 2017

Within this section of the Hillsdale Board of Public Utilities' (HBPU) annual financial report, the HBPU's management provides narrative discussion and analysis of the financial activities of the HBPU for the year ending June 30, 2017.

The HBPU is comprised of three separate operating departments: Electric, Water and Wastewater (Sewer). Each department supports its operations through its own sales, revenues and fees.

Overview of the Financial Statements

The financial statements of HBPU are designed to provide readers with a broad overview of the HBPU's finances similar to a private-sector business. They are prepared using the accrual basis of accounting in accordance with generally accepted accounting principles. Under this basis of accounting, revenues are recognized in the period in which they are earned and expenses are recognized in the period in which they were incurred, regardless of the timing of related cash flows. These statements offer short and long-term financial information about HBPU activities.

The **Statement of Net Position** provides information about the nature and amount of investments in resources (assets) and the obligations to creditors (liabilities) and deferred inflows and outflows. Equity increases when revenues exceed expenses.

The **Statement of Revenues, Expenses and Changes in Net Position** reports the revenues and expenses during the periods indicated. The **Statement of Cash Flows** provides information about HBPU's cash receipts and payments for operations, as well as funds provided and used in investing and financing activities

The **Notes to the Financial Statements** provide additional information that is essential to gain a full understanding of the figures provided in the financial statements.

HILLSDALE BOARD OF PUBLIC UTILITIES
Management's Discussion and Analysis
June 30, 2017

Condensed Financial Information – Electric

Summary information regarding Hillsdale BPU's electric financial position is as follows:

Statement of Net Position

	6/30/2017	6/30/2016	Increase (Decrease)	%
Current & other assets	10,618,859	11,676,594	(1,057,735)	-9.06%
Capital assets	13,666,072	12,754,200	911,872	7.15%
Total assets	24,284,931	24,430,794	(145,863)	-0.60%
Deferred Outflows of Resources	343,031	496,993	(153,962)	-30.98%
Current & other liabilities	2,745,069	2,781,513	(36,444)	-1.31%
Long term liabilities	633,111	829,557	(196,446)	-23.68%
Total liabilities	3,378,180	3,611,070	(232,890)	-6.45%
Deferred Inflows of Resources	44,257	-	44,257	
Invested in capital assets	12,836,048	11,734,573	1,101,475	9.39%
Unrestricted	8,369,477	9,582,144	(1,212,667)	-12.66%
Total net position	21,205,525	21,316,717	(111,192)	-0.52%

Two extraordinary things occurred in this fiscal year: 1.) Hillsdale BPU's investment in MSCPA realized a loss of \$1,098,715; and 2.) The Power Plant obsolete inventory in the amount of \$340,322 was written off to bring asset book values more in line with actual costs. Net Position at fiscal year end June 30, 2017 decreased \$111,192 or (0.52%).

HILLSDALE BOARD OF PUBLIC UTILITIES
Management's Discussion and Analysis
June 30, 2017

Summary of information regarding Hillsdale BPU's electric operations is as follows:

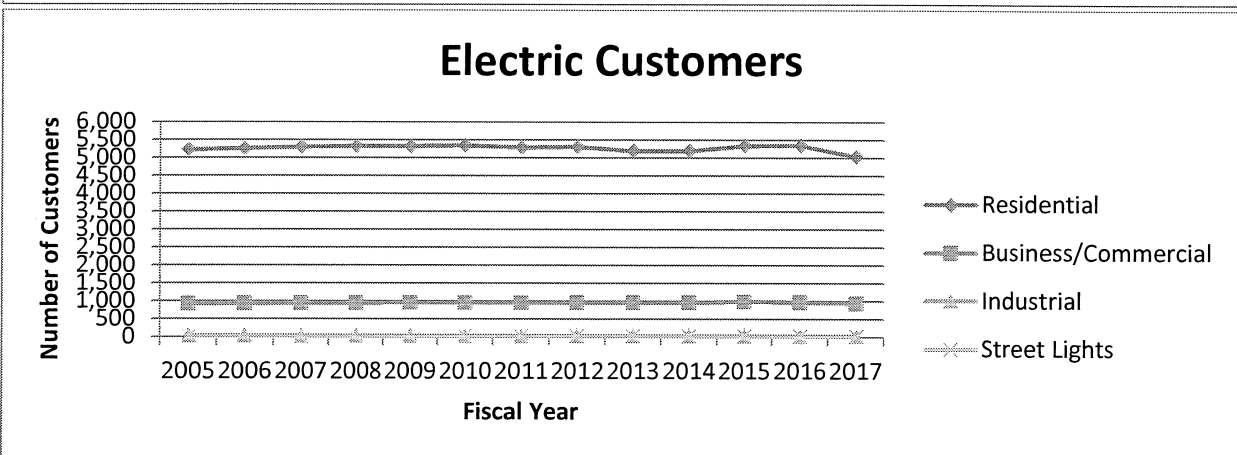
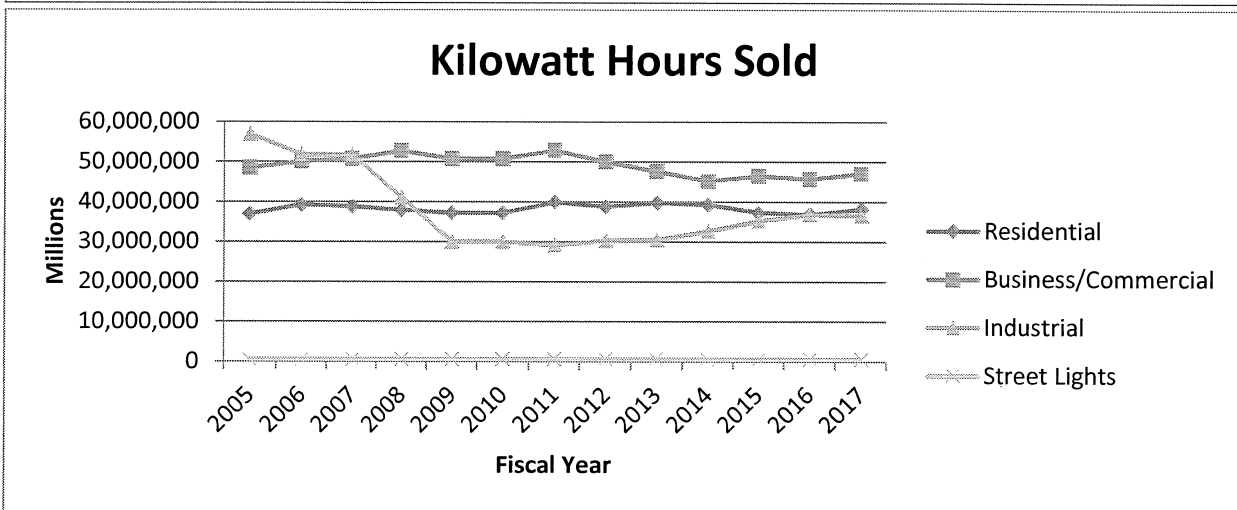
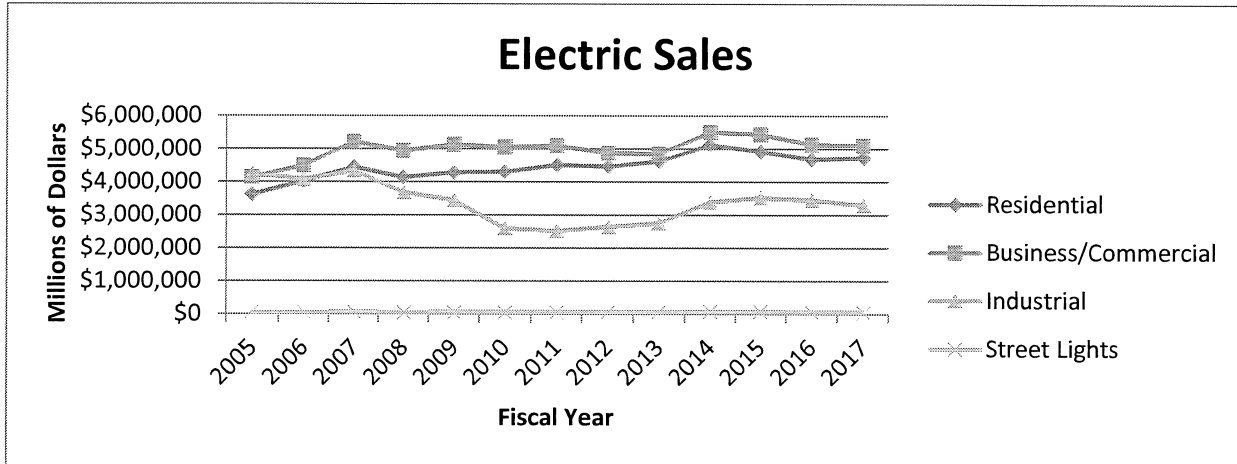
Statement of Revenues, Expenses and Changes in Net Position

	6/30/2017	6/30/2016	Increase (Decrease)	%
Operating Revenues	13,635,183	13,359,068	276,115	2.07%
Non-operating Revenue (Loss)	608,218	103,159	505,059	489.59%
Total Revenue	14,243,401	13,462,227	781,174	5.80%
Purchased Power	9,261,587	9,755,976	(494,389)	-5.07%
Production Expense	340,505	479,328	(138,823)	-28.96%
Transmission & Distribution	1,415,628	1,496,048	(80,420)	-5.38%
Administrative & General	1,897,836	1,426,911	470,925	33.00%
Total Operating Expenses	12,915,556	13,158,263	(242,707)	-1.84%
Extraordinary Item-Write off obsolete inventory	(340,322)	-	(340,322)	
Extraordinary Item-Loss on MSCPA	(1,098,715)	(5,115,604)	4,016,889	-93.35%
Changes in Net Position	(111,192)	(4,811,640)	4,700,448	-97.69%
Net Position Beginning of Year	21,316,717	26,128,357	(4,811,640)	-18.42%
Net Position End of Year	21,205,525	21,316,717	(111,192)	-0.52%

During fiscal year 2017, electric sales went up \$276,115, an increase of about 2%. Total operating expenses declined 1.84% resulting in the electric fund's net gain from operations of \$719,627. The \$1.1M loss on the MSCPA investment and the write-off of the obsolete inventory from the Power Plant were the major contributing factors in the \$111,194 decline in the electric fund's net position. The 500% increase in Non-operating Revenue is attributable to the purchase of an MSCPA substation for \$100 that had a book value of \$ 576,254 resulting in a net gain on the purchase of \$ 576,154.

HILLSDALE BOARD OF PUBLIC UTILITIES
 Management's Discussion and Analysis
 June 30, 2017

Historical trend information regarding sales, kilowatt hours sold and number of customers is as follows:



HILLSDALE BOARD OF PUBLIC UTILITIES
Management's Discussion and Analysis
June 30, 2017

Capital Improvements and Debt Administration

As part of the Hillsdale BPU's ongoing plan to improve services and the reliability of its electric distribution system, Hillsdale BPU made the following major additions for the year:

Replaced Poles
Overhead and Underground Construction
277 Upgrade Phase 1
Repairs to engines 5 & 6
Meter Replacements
MSCPA Substation
300 KVA Padmount Transformer
Electric meters for City Center apartment complex
Bucket Truck
Warehouse Generator
Computer Software Upgrades

HILLSDALE BOARD OF PUBLIC UTILITIES
Management's Discussion and Analysis
June 30, 2017

Condensed Financial Information – Water

Summary information regarding Hillsdale BPU's water financial position is as follows:

Statement of Net Position

	6/30/2017	6/30/2016	Increase (Decrease)	%
Current & other position	1,139,055	1,195,499	(56,444)	-4.72%
Capital assets	4,738,222	4,712,692	(25,530)	-0.54%
Restricted & Designated assets	-	185,379	(185,379)	-100.00%
Total assets	5,877,277	6,093,570	(216,293)	-3.55%
Deferred Outflows of Resources	171,516	248,496	(76,980)	-30.98%
Current & other liabilities	1,021,317	1,299,229	(277,912)	-21.39%
Long term liabilities	-	-	-	0.00%
Total liabilities	1,021,317	1,299,229	(277,912)	-21.39%
Deferred Inflows of Resources	22,129	-	22,129	
Invested in capital assets	4,587,008	4,529,692	57,316	1.27%
Restricted	-	185,379	(185,379)	-100.00%
Unrestricted	418,339	297,766	120,573	40.49%
Total net position	5,005,347	5,012,837	(7,490)	-0.15%

The final payment was made on the 2009 water bonds during this fiscal year. This resulted in the following changes in net position: Restricted and Designated assets were reclassified into Current and other assets and there was a 21.39% decrease in total liabilities. The water fund's Total Net Position decreased \$7,490 or 0.15% from the prior year.

HILLSDALE BOARD OF PUBLIC UTILITIES
Management's Discussion and Analysis
June 30, 2017

Summary information regarding Hillsdale BPU's water operating is as follows:

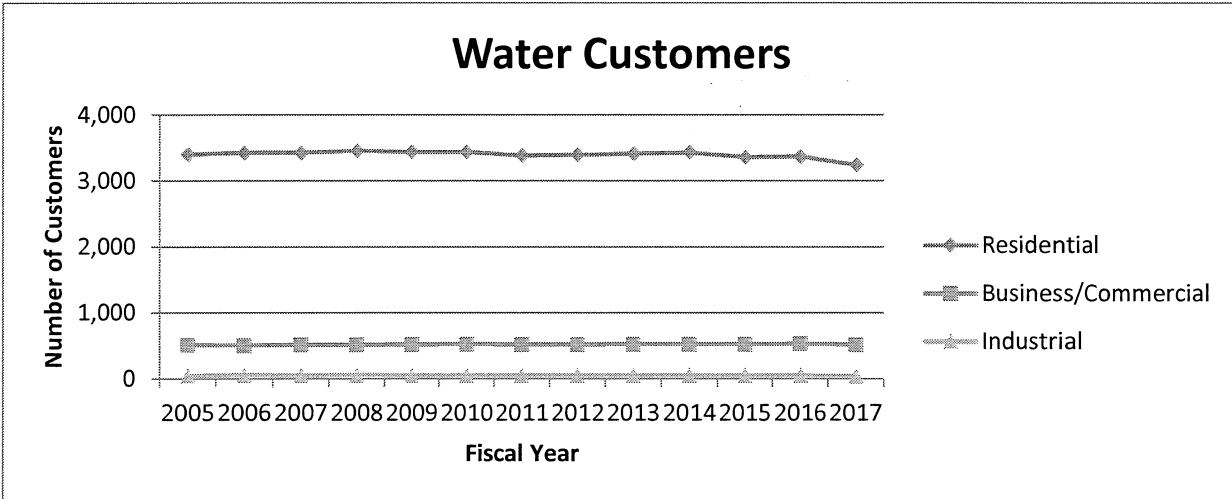
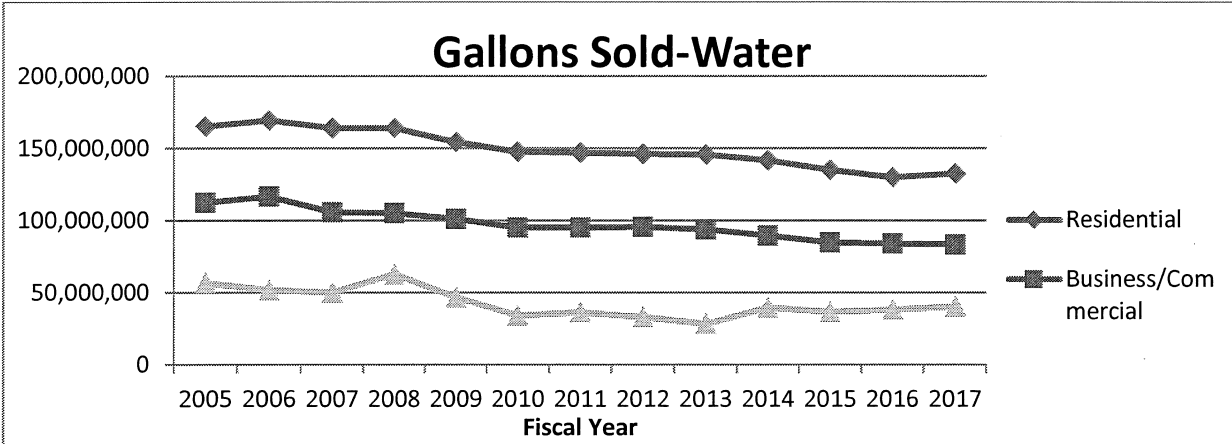
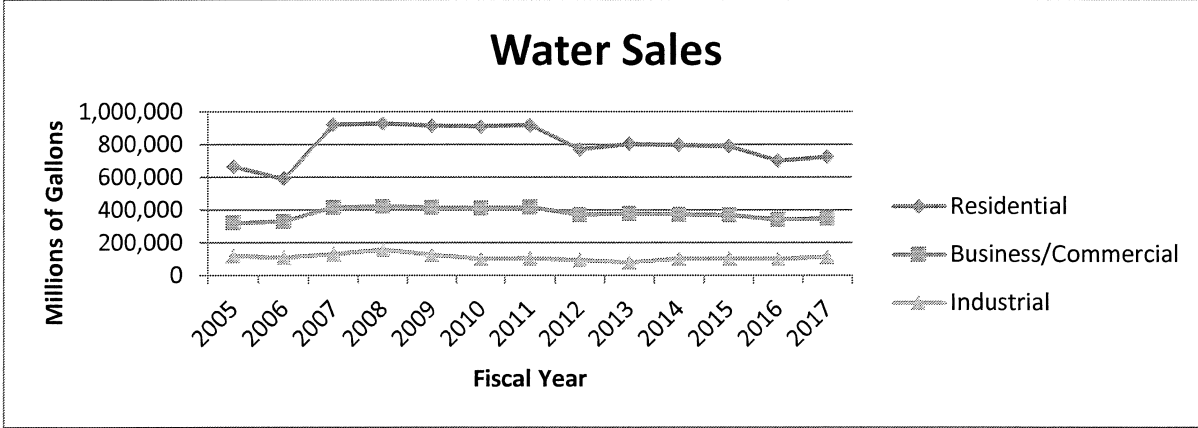
Statement of Revenues, Expenses and Changes in Net Position

	6/30/2017	6/30/2016	Increase (Decrease)	%
Operating Revenues	1,213,809	1,149,464	64,345	5.60%
Non-operating Revenue (Loss)	29,974	33,288	(3,314)	-9.96%
Total Revenue	1,243,783	1,182,752	61,031	5.16%
Production Expense	143,530	128,823	14,707	11.42%
Purification Expense	247,482	270,014	(22,532)	-8.34%
Distribution Expense	391,135	495,529	(104,394)	-21.07%
Administrative & General	469,126	310,775	158,351	50.95%
Total Operating Expenses	1,251,273	1,205,141	46,132	3.83%
Changes in Net Assets	(7,490)	(22,389)	14,899	-66.55%
Net Position Beginning of Year	5,012,837	5,035,226	(22,389)	-0.44%
Net Position End of Year	5,005,347	5,012,837	(7,490)	-0.15%

The Statement of Revenues, Expenses and Changes in Net Position indicated that operating revenue increased 5.6% or \$64,345 during the fiscal year due to planned rate increases. Operating expenses increased 3.8% or \$46,132. Net Position at fiscal year-end 2017 was down slightly (0.15%).

HILLSDALE BOARD OF PUBLIC UTILITIES
 Management's Discussion and Analysis
 June 30, 2017

Historical trend information regarding sales, water gallons sold and number of customers is as follows:



HILLSDALE BOARD OF PUBLIC UTILITIES
Management's Discussion and Analysis
June 30, 2017

Capital Improvements and Debt Administration

As part of Hillsdale BPU's ongoing plan to improve services and the reliability of its water production, purification and distribution system, Hillsdale BPU made the following major additions for the year:

- Computer Software Upgrades
- Repair water mains
- AMI Meter Project
- Vactor Truck
- Replacement Meters

On August 27, 2009, the Hillsdale BPU Refunded \$1,156,000 of the Callable 1999 Water Revenue bonds. They became the Water Supply and Sewage Disposal System Revenue Refunding Bonds Series 2009. The final payment on these bonds was made October 1, 2016.

HILLSDALE BOARD OF PUBLIC UTILITIES
Management's Discussion and Analysis
June 30, 2017

Condensed Financial Information – Sewer

Summary information regarding Hillsdale BPU's sewer financial position is as follows:

Statement of Net Position

	6/30/2017	6/30/2016	Increase (Decrease)	%
Current & other assets	1,459,976	1,859,574	(399,598)	-21.49%
Capital assets	7,947,889	5,453,175	2,494,714	45.75%
Total assets	9,407,865	7,312,749	2,095,116	28.65%
Deferred Outflows of Resources	171,516	248,496	(76,980)	-30.98%
Current & other liabilities	1,382,719	2,255,385	(872,666)	-38.69%
Long term liabilities	2,798,138	556,471	2,241,667	100.00%
Total liabilities	4,180,857	2,811,856	1,369,001	48.69%
Deferred Inflows of Resources	22,129	-	22,129	
Invested in capital assets	4,788,465	4,896,704	(108,239)	-2.21%
Unrestricted	587,929	(147,315)	735,244	0.00%
Total net position	5,376,394	4,749,389	627,005	13.20%

The Statement of Net Position shows a 13% increase in Net Position for the year. That's an increase of \$627,005. Construction continued on the wastewater treatment system improvements begun in the prior fiscal year. The funding for these improvements is coming from revenue bond proceeds and federal and state grants.

HILLSDALE BOARD OF PUBLIC UTILITIES
Management's Discussion and Analysis
June 30, 2017

Summary information regarding Hillsdale BPU's sewer operations is as follows:

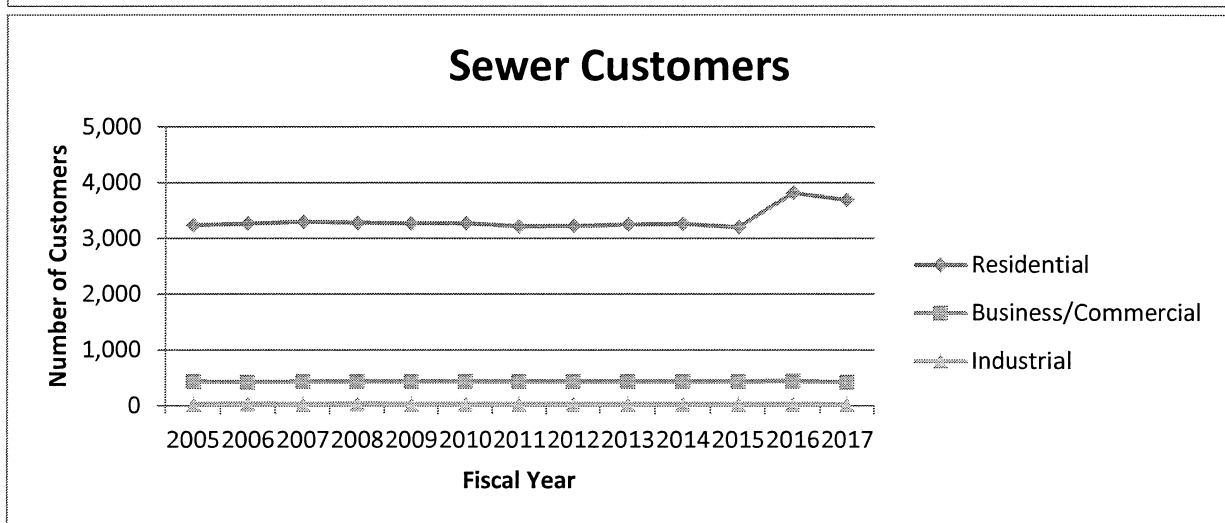
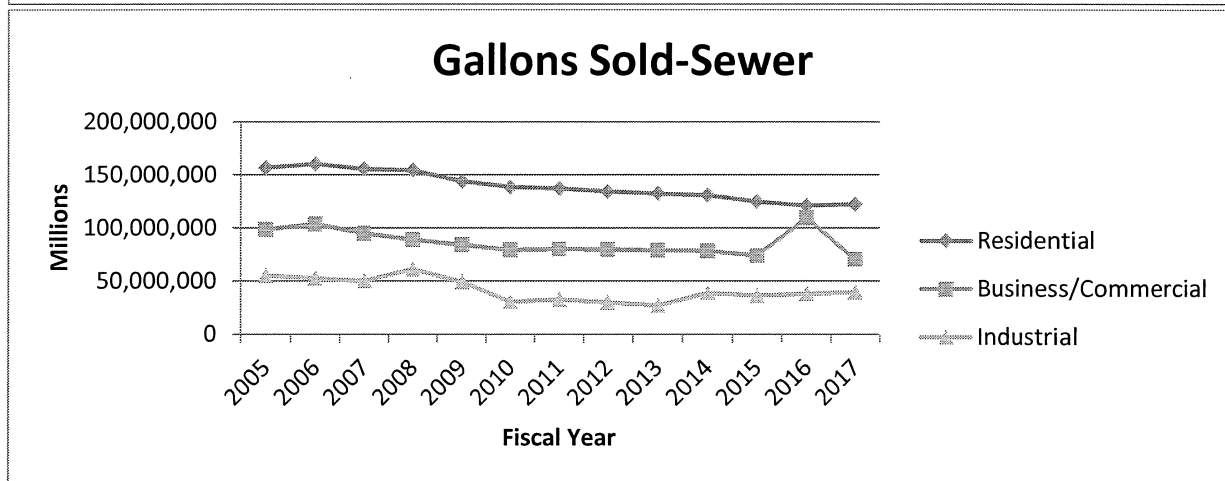
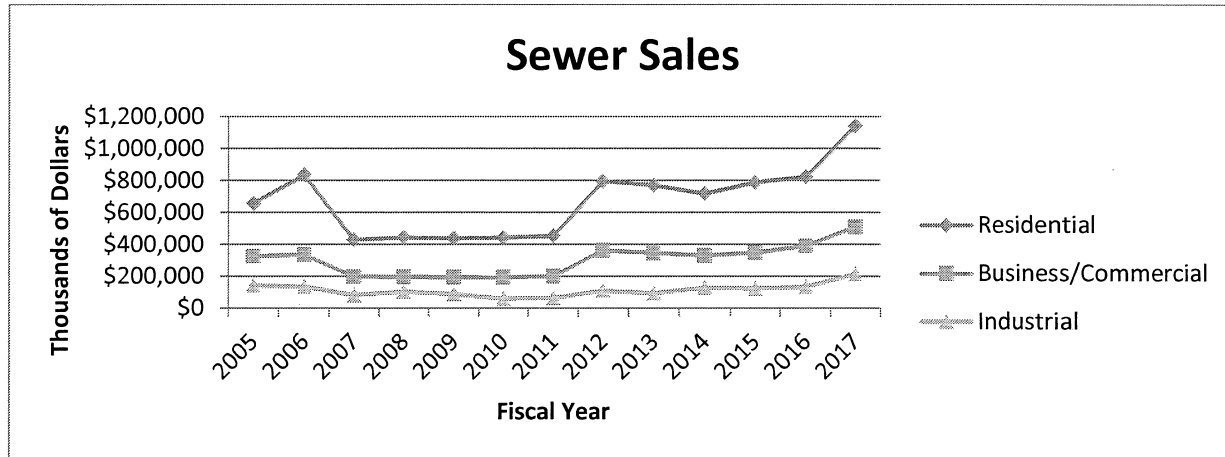
Statement of Revenues, Expenses and Changes in Net Position

	6/30/2017	6/30/2016	Increase (Decrease)	%
Operating Revenues	1,929,864	1,351,477	578,387	42.80%
Non-operating Revenue (Loss)	53,405	1,032,536	(979,131)	-94.83%
Total Revenue	1,983,269	2,384,013	(400,744)	-16.81%
Collection System	158,179	304,634	(146,455)	-48.08%
Treatment	651,676	707,256	(55,580)	-7.86%
Administrative & General	546,409	514,463	31,946	6.21%
Total Operating Expenses	1,356,264	1,526,353	(170,089)	-11.14%
Changes in Net Assets	627,005	857,660	(230,655)	-26.89%
Net Assets, Beginning of Year	4,749,389	3,891,729	857,660	22.04%
Net Assets, End of Year	5,376,394	4,749,389	627,005	13.20%

The Statement of Revenues, Expenses, and Changes in Net Position indicate that operating revenue increased by \$578,387 or 43%. That increase is due to a rate increase instituted July 1, 2016. The federal and state grant funding for the wastewater treatment plant improvements received in the prior fiscal year created the 95% decrease in the Non-operating Revenues and resulted in the 17% decrease in Total Revenues. Collection System Expenses were reduced by almost 50% and Treatment costs declined 8%. These reductions offset the increase in Administrative and General Expenses resulting in an overall reduction in operating expenses of \$170,089. Wastewater Treatment Plant improvements were the major contributor to the \$627,005 increase in Net Assets at fiscal yearend.

HILLSDALE BOARD OF PUBLIC UTILITIES
 Management's Discussion and Analysis
 June 30, 2017

Historical trend information regarding sales, water gallons sold and number of customers is as follows



HILLSDALE BOARD OF PUBLIC UTILITIES

Management's Discussion and Analysis

June 30, 2017

Capital Improvements and Debt Administration

As part of Hillsdale BPU's ongoing plan to improve services and the reliability of its sewer collection and treatment system, the Hillsdale BPU made the following major additions for the year:

Wastewater Treatment Plant improvements

Computer Software Upgrades

In October 2016, the Hillsdale Board of Public Utilities issued \$1.9 M revenue bonds in addition to the \$7.5M issued in October 2015. These bonds were issued through the State Revolving Fund Loan Program and the proceeds will be used to fund additional wastewater treatment plant system improvements not included in the first issue. The series 2016 20-year bonds have the same interest rate as the 2015 issue, 2.5%. The annual interest payments will be approximately \$47,500. Principal payments are not expected to begin until completion of the project which is anticipated to be sometime in the spring of 2018. A principle loan forgiveness grant of \$100,000 was awarded and is reflected in the federal and state grant revenues in 2017 financial statements.

Economic Conditions and Next Year Rates

Management expects the customer count to remain the same in the next year in all three departments. Sales revenue will increase in all three funds as new rates take effect July 1, 2017. The 5-year rate model for all utility operations (electric, water and sewer) was updated in the spring of 2017. Based on the updated model, the Board approved a 2% rate increase in electric rates, a 17% increase in the water rates and a 2.5% increase in the wastewater (sewer) rates. The new strategy of updating these models annually helps to insure that the rates are adequately covering operational costs, providing for future capital to maintain infrastructure and provide sufficient funding to pay all debt obligations.

Request for Information

This financial report is designed to provide a general overview of the Hillsdale Board of Public Utilities, finances for those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Finance Department, 45 Monroe Street, Hillsdale, MI 49242.

BASIC FINANCIAL STATEMENTS

HILLSDALE BOARD OF PUBLIC UTILITIES
STATEMENT OF NET POSITION
JUNE 30, 2017

	<u>ELECTRIC FUND</u>	<u>WATER FUND</u>	<u>SEWER FUND</u>	<u>TOTAL ENTERPRISE FUNDS</u>
ASSETS				
Current Assets				
Cash and investments	\$ 3,539,484	\$ 945,014	\$ 711,801	\$ 5,196,299
Receivables (net allowance of \$13,533)	1,140,828	73,151	115,797	1,329,776
Other receivables	51,602	156	33,941	85,699
Interest receivable	6,761	1,450	-	8,211
Due from state	-	-	558,153	558,153
Due from other funds of HBPU	228,823	-	-	228,823
Due from other funds of City	46,476	-	-	46,476
Inventories	343,342	74,278	3,823	421,443
Prepaid expenses	93,769	45,006	36,461	175,236
Total current assets	<u>5,451,085</u>	<u>1,139,055</u>	<u>1,459,976</u>	<u>8,050,116</u>
Capital assets				
Land	181,108	49,613	122,902	353,623
Plant, systems and equipment	36,978,822	11,241,940	14,227,561	62,448,323
Construction in progress	54,802	44,413	3,980,414	4,079,629
Less: accumulated depreciation	<u>(23,548,660)</u>	<u>(6,597,744)</u>	<u>(10,382,988)</u>	<u>(40,529,392)</u>
Total capital assets (net)	<u>13,666,072</u>	<u>4,738,222</u>	<u>7,947,889</u>	<u>26,352,183</u>
Other assets				
Prepaid operating lease (net of \$23,095 amortization)	217,208	-	-	217,208
Other investment	32,141	-	-	32,141
Investment in M.S.C.P.A.	4,918,425	-	-	4,918,425
Total other assets	<u>5,167,774</u>	<u>-</u>	<u>-</u>	<u>5,167,774</u>
TOTAL ASSETS	<u>\$ 24,284,931</u>	<u>\$ 5,877,277</u>	<u>\$ 9,407,865</u>	<u>\$ 39,570,073</u>
DEFERRED OUTFLOWS OF RESOURCES				
Pension	<u>\$ 343,031</u>	<u>\$ 171,516</u>	<u>\$ 171,515</u>	<u>\$ 686,062</u>

See accompanying notes to the basic financial statements.

HILLSDALE BOARD OF PUBLIC UTILITIES
STATEMENT OF NET POSITION
JUNE 30, 2017

	ELECTRIC FUND	WATER FUND	SEWER FUND	TOTAL ENTERPRISE FUNDS
LIABILITIES				
Current liabilities payable from current assets				
Accounts payable	\$ 189,128	\$ 30,255	\$ 374,388	\$ 593,771
Accrued purchased power	847,665	-	-	847,665
Due to other funds of HBPU	-	228,823	-	228,823
Due to other funds of City	136,477	15,736	22,130	174,343
Accrued interest	23,611	2,583	20,355	46,549
Accrued liabilities	12,130	5,210	8,078	25,418
Customer deposits	108,811	7,899	7,777	124,487
Current portion of long-term debt	196,913	36,285	361,285	594,483
Total current liabilities payable from current assets	<u>1,514,735</u>	<u>326,791</u>	<u>794,013</u>	<u>2,635,539</u>
Other noncurrent liabilities:				
Compensated absences payable	105,403	17,142	26,251	148,796
Net pension liability	1,124,931	562,455	562,455	2,249,841
Total other noncurrent liabilities	<u>1,230,334</u>	<u>579,597</u>	<u>588,706</u>	<u>2,398,637</u>
Long-term debt, net of current maturities				
Municipal finance	633,111	114,929	114,929	862,969
Bonds payable	-	-	2,683,209	2,683,209
Total long-term debt	<u>633,111</u>	<u>114,929</u>	<u>2,798,138</u>	<u>3,546,178</u>
TOTAL LIABILITIES	<u>\$ 3,378,180</u>	<u>\$ 1,021,317</u>	<u>\$ 4,180,857</u>	<u>\$ 8,580,354</u>
DEFERRED INFLOWS OF RESOURCES				
Pension	\$ 44,257	\$ 22,129	\$ 22,129	\$ 88,515
NET POSITION				
Net investment in capital assets	12,836,048	4,587,008	4,788,465	22,211,521
Unrestricted	8,369,477	418,339	587,929	9,375,745
TOTAL NET POSITION	<u>\$ 21,205,525</u>	<u>\$ 5,005,347</u>	<u>\$ 5,376,394</u>	<u>\$ 31,587,266</u>

See accompanying notes to the basic financial statements.

HILLSDALE BOARD OF PUBLIC UTILITIES
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
YEAR ENDED JUNE 30, 2017

	<u>ELECTRIC FUND</u>	<u>WATER FUND</u>	<u>SEWER FUND</u>	<u>TOTAL ENTERPRISE FUNDS</u>
OPERATING REVENUES				
Sales to customers				
Residential	\$ 4,980,375	\$ 507,532	\$ 795,129	\$ 6,283,036
Business	1,521,273	133,089	181,914	1,836,276
Commercial	3,663,908	223,320	336,634	4,223,862
Industrial	3,297,263	119,358	217,542	3,634,163
Apartments	-	226,489	365,019	591,508
Street light sales	58,114	-	-	58,114
Other operating income	114,250	4,021	33,626	151,897
TOTAL OPERATING REVENUE	<u>13,635,183</u>	<u>1,213,809</u>	<u>1,929,864</u>	<u>16,778,856</u>
OPERATING EXPENSES				
Production	9,602,092	143,530	-	9,745,622
Distribution	1,415,628	391,135	-	1,806,763
Collection system	-	-	158,179	158,179
Treatment	-	-	651,676	651,676
Purification	-	247,482	-	247,482
Administrative and general	1,897,836	469,126	546,409	2,913,371
TOTAL OPERATING EXPENSES	<u>12,915,556</u>	<u>1,251,273</u>	<u>1,356,264</u>	<u>15,523,093</u>
OPERATING INCOME (LOSS)	<u>719,627</u>	<u>(37,464)</u>	<u>573,600</u>	<u>1,255,763</u>
NON-OPERATING REVENUE (EXPENSE)				
Federal grants	-	-	100,000	100,000
Donated capital	576,154	-	-	576,154
Investment income	10,417	4,506	-	14,923
Interest and other	(48,254)	(6,152)	(38,770)	(93,176)
Other non-operating income (expense)	69,901	31,620	(7,825)	93,696
TOTAL NON-OPERATING REVENUE (EXPENSE)	<u>608,218</u>	<u>29,974</u>	<u>53,405</u>	<u>691,597</u>
EXTRAORDINARY ITEMS:				
Loss on investment	(1,098,715)	-	-	(1,098,715)
Write off obsolete inventory	(340,322)	-	-	(340,322)
Total Extraordinary Items	<u>(1,439,037)</u>	<u>-</u>	<u>-</u>	<u>(1,439,037)</u>
CHANGES IN NET POSITION	<u>(111,192)</u>	<u>(7,490)</u>	<u>627,005</u>	<u>508,323</u>
NET POSITION - BEGINNING OF YEAR	<u>21,316,717</u>	<u>5,012,837</u>	<u>4,749,389</u>	<u>31,078,943</u>
NET POSITION - END OF YEAR	<u>\$ 21,205,525</u>	<u>\$ 5,005,347</u>	<u>\$ 5,376,394</u>	<u>\$ 31,587,266</u>

See accompanying notes to the basic financial statements.

HILLSDALE BOARD OF PUBLIC UTILITIES
STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2017

	ELECTRIC FUND	WATER FUND	SEWER FUND	TOTAL ENTERPRISE FUNDS
CASH FLOWS FROM OPERATING ACTIVITIES				
Cash received from customers, residents and users	\$ 13,229,720	\$ 1,192,428	\$ 1,908,427	\$ 16,330,575
Other operating receipts	114,250	4,021	33,626	151,897
Operating cash to/from other funds	1,278,341	(206,099)	(1,072,242)	-
Payments to suppliers of goods and services	(11,170,665)	(520,109)	(729,815)	(12,420,589)
Payments to employees for services and benefits	(1,005,076)	(392,871)	(524,251)	(1,922,198)
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	<u>2,446,570</u>	<u>77,370</u>	<u>(384,255)</u>	<u>2,139,685</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES				
Other nonoperating income	<u>10,060</u>	<u>17,365</u>		<u>27,425</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES				
Purchase of capital assets, net	(925,161)	(63,752)	(128,257)	(1,117,170)
Capital grants	-	-	100,000	100,000
Payments on capital debt	(189,603)	(223,428)	(40,428)	(453,459)
Interest payments on capital debt	(37,134)	(3,568)	(18,415)	(59,117)
NET CASH PROVIDED (USED) BY CAPITAL AND RELATED FINANCING ACTIVITIES	<u>(1,151,898)</u>	<u>(290,748)</u>	<u>(87,100)</u>	<u>(1,529,746)</u>
CASH FLOWS FROM INVESTING ACTIVITIES				
Purchase of investments	-	(203,467)	-	(203,467)
Proceeds from the sales of investments	-	-	-	-
Interest income received	<u>10,417</u>	<u>4,506</u>	<u>-</u>	<u>14,923</u>
NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES	<u>10,417</u>	<u>(198,961)</u>	<u>-</u>	<u>(188,544)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,315,149	(394,974)	(471,355)	448,820
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	<u>366,900</u>	<u>393,005</u>	<u>1,183,156</u>	<u>1,943,061</u>
CASH AND CASH EQUIVALENTS - END OF YEAR	<u>\$ 1,682,049</u>	<u>\$ (1,969)</u>	<u>\$ 711,801</u>	<u>\$ 2,391,881</u>

Continued...

See accompanying notes to the basic financial statements.

HILLSDALE BOARD OF PUBLIC UTILITIES
STATEMENT OF CASH FLOWS (CONCLUDED)
YEAR ENDED JUNE 30, 2017

	ELECTRIC FUND	WATER FUND	SEWER FUND	TOTAL ENTERPRISE FUNDS
BALANCE SHEET CLASSIFICATION OF CASH AND CASH EQUIVALENTS				
Cash and investments	3,539,484	945,014	711,801	5,196,299
Less amounts classified as investments	(1,857,435)	(946,983)	-	(2,804,418)
	1,682,049	(1,969)	711,801	2,391,881
Reconciliation of Operating Income (Loss) to Net Cash Provided by Operating Activities				
Operating income (loss)	\$ 719,627	\$ (37,464)	\$ 573,600	\$ 1,255,763
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:				
Depreciation and amortization	637,647	268,299	196,406	1,102,352
(Increase)/decrease in:				
Receivables	(296,560)	(18,966)	(12,189)	(327,715)
Due from other funds	1,234,180	1,177	1,177	1,236,534
Inventories	98,946	5,523	1,885	106,354
Prepays and other assets	(107,619)	6,000	7,322	(94,297)
Deferred outflows	153,962	76,980	76,981	307,923
Increase/(decrease) in:				
Accounts payable	120,866	20,804	(121,142)	20,528
Due to other funds	(69,266)	(207,860)	(1,072,443)	(1,349,569)
Accrued expenses	34,635	2,801	4,071	41,507
Deferred inflows	44,257	22,139	22,139	88,535
Net pension liability	(124,105)	(62,063)	(62,062)	(248,230)
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	\$ 2,446,570	\$ 77,370	\$ (384,255)	\$ 2,139,685

See accompanying notes to the basic financial statements.

NOTES TO FINANCIAL STATEMENTS

HILLSDALE BOARD OF PUBLIC UTILITIES

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2017

Note 1: Summary of Significant Accounting Policies

The financial statements of the Hillsdale Board of Public Utilities (HBPU) have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP), as applicable to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. The more significant of the government's accounting policies are described below.

Reporting Entity

The HBPU provides electric, water and sewage disposal services to residents of the City of Hillsdale (the City) and nearby townships, as recorded in three separate enterprise funds. Policy is set and operations are directed by a five-member Board.

Measurement Focus and Basis of Accounting

The HBPU uses funds to report on its financial position and the results of its operations. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. A fund is a separate accounting entity with a self-balancing set of accounts.

The operations of the HBPU are accounted for as Enterprise Funds of the City of Hillsdale, Michigan, which are designed to be self-supporting. Enterprise Funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprises, where the intent of the governing body is that the cost of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges, or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and the resulting net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The HBPU reports the following major proprietary funds:

Electric – This fund accounts for the activities of the HBPU's electric generation and distribution systems.

Water – This fund accounts for the activities of the HBPU's water production, purification and distribution systems.

Sewer – This fund accounts for the activities of the HBPU's sewer collection and treatment systems.

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All enterprise funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of these funds are included on the statement of net position. Proprietary fund-type operating statements present increases (i.e. revenues) and decreases (i.e. expenses) in total net position.

The accrual basis of accounting is utilized by enterprise funds. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Proprietary funds (enterprise funds) distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the HBPU's enterprise funds are charges to customers for sales and services. The HBPU also recognizes as operating revenue the portion of fees intended to record the cost of connecting new customers to the system.

HILLSDALE BOARD OF PUBLIC UTILITIES

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2017

Note 1: Summary of Significant Accounting Policies (Continued)

Measurement Focus and Basis of Accounting (Concluded)

Operating expenses for enterprise funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Cash, Cash Equivalents and Investments

Cash and cash equivalents include cash on hand, demand deposits and certificates of deposits with original maturities of three months or less from the date of acquisition.

State statutes authorize the HBPU to invest surplus funds in bonds, securities, other obligations of the United States or an agency or instrumentality of the United States; repurchase agreements; certificates of deposit, savings accounts, deposit accounts or depository receipts of a qualified financial institution; commercial paper rated at the time of purchase within the two highest classifications established by not less than two standard rating services and that matures not more than 270 days after the date of purchase; bankers; acceptances of United States banks; obligations of the State of Michigan or any of its political subdivisions that, at the time of purchase, are rated as investment grade by at least one standard rating service; mutual funds registered under the Investment Company Act of 1940 with the authority to purchase only investment vehicles that are legal for direct investment by a public corporation; and external investment pools as authorized by Public Act 20 as amended through December 31, 1997.

Investments are stated at fair value.

Short-term Interfund Receivables/Payables

During the course of operations, numerous transactions occur between individual funds for goods provided or services rendered. These receivables and payables are classified as "due from other funds" or "due to other funds" on the statement of net position.

Receivables

All receivables are reported at their net value. They are reduced, where appropriate, by the estimated portion that is expected to be uncollectible.

Inventories and Prepaid Items

Inventories are valued at cost, which approximates market, using the average cost method. Certain payments to vendors reflect costs applicable to future fiscal years and are recorded as prepaid items.

Capital Assets

Capital assets include land and buildings, plant, vehicles and equipment, and infrastructure assets (e.g., pipes, poles, wire, transformers, and similar items). Capital assets are defined by the government as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

HILLSDALE BOARD OF PUBLIC UTILITIES

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2017

Note 1: Summary of Significant Accounting Policies (Concluded)

Capital Assets (Concluded)

Major outlays for capital assets and improvements are capitalized when projects are completed.

Property, plant, and equipment of the HBPU is depreciated using the straight-line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Plant and systems	10 - 65

Net Position

Certain proceeds of enterprise fund revenue bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the statement of net position because their use is limited by applicable bond covenants. Restricted resources are applied first when an expense is incurred for which both restricted and unrestricted net position is available. Restricted net position segregates resources accumulated for debt service payments.

Interfund Transactions

Quasi-external transactions are accounted for as revenues or expenses. Transactions that constitute reimbursements to a fund for expenses initially made from it that are properly applicable to another fund, are recorded as expenses in the reimbursing fund and as reductions of expenses in the fund that is reimbursed.

Use of Estimates

The process of preparing financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues, and expenditures. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

Pensions

For purposes of measuring the Net Pension Liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Municipal Employees Retirement System (MERS) of Michigan and additions to/deductions from MERS' fiduciary net position have been determined on the same basis as they are reported by MERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value. *See Note No. 8 for information on the defined benefit pension plan.*

Compensated Absences

Accumulated unpaid vacation, sick, and personal days are accrued when earned.

HILLSDALE BOARD OF PUBLIC UTILITIES

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2017

Note 2: **Cash and Investments**

The following is a reconciliation of deposit and investment balances as of June 30, 2017:

Cash and cash equivalents	\$	2,391,881
Investments		<u>2,804,418</u>
	\$	<u>5,196,299</u>

Deposits and Investments

Bank deposits (checking, savings, certificate of deposit, money market)	\$	4,490,065
Investments		705,334
Cash on hand		<u>900</u>
	\$	<u>5,196,299</u>

The HBPU has the following recurring fair value measurements as of June 30, 2017:

- U.S. Treasury securities of \$249,308 are valued using quoted market prices (Level 1)
- Municipal bonds of \$456,026 are valued using quoted prices in active markets (Level 2)

Custodial Credit Risk - Deposits

Custodial credit risk is the risk that in the event of a bank failure, the HBPU's deposits may not be returned. The HBPU has not adopted and State law does not require a policy for deposit custodial credit risk. As of year-end, \$597,637 of the HBPU's bank balance of \$4,188,605 was exposed to custodial credit risk because it was uninsured and uncollateralized.

Custodial Credit Risk - Investments

For an investment, custodial credit risk is the risk that in the event of the failure of the counterparty, the HBPU will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The HBPU has not adopted and State law does not require a policy for investment custodial risk. All investments are insured under SPIC.

Interest Rate Risk

State law limits the allowable investments and the maturities of some of the allowable investments as identified in the list of authorized investments above (see Note 1). The HBPU's investment policy does not have specific limits in excess of State law on investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. The maturity dates for each investment type are identified above for investments held at year-end.

Credit Risk

State law limits investments to specific government securities, certificates of deposits and bank accounts with qualified financial institutions, commercial paper with specific maximum maturities and ratings when purchased, bankers acceptances of specific financial institutions, qualified mutual funds and qualified external investment pools as identified in the list of authorized investments above (see Note 1). The HBPU's investment policy does not have specific limits in excess of State law on investment credit risk.

HILLSDALE BOARD OF PUBLIC UTILITIES

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2017

Note 2: Cash and Investments (Concluded)

Fair Value Measurement

The HBPU is required to disclose amounts within a framework established for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described as follows:

Level 1: Quoted prices in active markets for identical securities.

Level 2: Prices determined using other significant observable inputs. Observable inputs are inputs that other market participants may use in pricing a security. These may include prices for similar securities, interest rates, prepayment speeds, credit risk and others.

Level 3: Prices determined using significant unobservable inputs. In situations where quoted prices or observable inputs are unavailable or deemed less relevant, unobservable inputs may be used. Unobservable inputs reflect the HBPU's own assumptions about the factors market participants would use in pricing an investment and would be based on the best information available.

Note 3: Supplemental Disclosure of Cash Flow Information

For the year ended June 30, 2017, the HBPU purchased \$959,436 of equipment with debt financing arrangements.

Note 4: Capital Assets

Capital assets activity for the year ended June 30, 2016 was as follows:

Primary Government	Beginning Balance	Additions	Disposals and Adjustments	Ending Balance
Capital assets not being depreciated:				
Land	\$ 353,623	\$	\$	\$ 353,623
Construction in progress	2,273,530	2,585,986	(779,887)	4,079,629
Total capital assets not being depreciated	2,627,153	2,585,986	(779,887)	4,433,252
Capital assets being depreciated:				
Plant, systems and equipment	60,007,383	2,637,572	(196,632)	62,448,323
Accumulated depreciation:				
Plant, systems and equipment	39,714,469	1,011,556	(196,632)	40,529,393
Total capital assets being depreciated - net	20,292,914	1,626,016		21,918,930
Capital assets - net	\$ 22,920,067	\$ 4,212,002	\$ (779,887)	\$ 26,352,182

HILLSDALE BOARD OF PUBLIC UTILITIES

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2017

Note 4: Capital Assets

Depreciation expense was charged to operating expenses as follows:

Electric Fund	\$	637,647
Water Fund		268,299
Sewer Fund		196,406
		1,102,352
	\$	1,102,352

Note 5: Investment in Michigan South Central Power Agency

The Michigan South Central Power Agency (MSCPA) was organized in 1978 under the authority of Michigan Public Act 448 of 1976, to supply electricity to member municipalities in South Central Michigan. The Act provides that the agency will establish rates and charges to produce revenues sufficient to cover its costs, but may not operate for profit, except for the benefit of the public. The agency is governed by a Board of Commissioners which is comprised of one representative from each participating municipality and the general manager of the agency.

Participating municipalities and their respective shares of ownership are as follows:

	Percent of Ownership
City of Coldwater	45.98%
City of Hillsdale	22.96
City of Marshall	21.61
Village of Clinton	5.85
Village of Union City	3.60
	100.0%

Currently, the MSCPA has decommissioned its power generating operation, resulting in a significant decrease in net position. The HBPU's share of changes in net position \$(1,098,715) is reported as an extraordinary item in the Statement of Revenues, Expenses and Changes in Net Position.

The Hillsdale Board of Public Utilities is accounting for its investment in MSCPA as a joint venture in association with Governmental Accounting Standard Board Statement No. 14. Information presented below is taken from financial statements of the MSCPA for the year ended June 30, 2017, audited by other auditors, who expressed an unqualified opinion on those statements in their report dated August 21, 2017.

The HBPU has entered into a Power Sales Contract with MSCPA which requires the HBPU to purchase all of its bulk power supply from MSCPA and to pay its share of MSCPA's operating and debt service costs. The HBPU was also entered into an agreement for services to be provided by the MSCPA in respect to substation facilities and an agreement which requires the HBPU to sell to MSCPA power generated by its facilities.

Summary information of the HBPU investment in the MSCPA for the year ended June 30, 2017 is as follows:

	Total MSCPA	Hillsdale Board of Public Utilities' Portion
Total assets and deferred outflows of resources	\$ 58,304,621	\$ 10,530,499
Total liabilities and deferred inflows of resources	36,881,009	5,612,074
Net Position	\$ 21,423,612	\$ 4,918,425

HILLSDALE BOARD OF PUBLIC UTILITIES

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2017

Note 6: Major Customers

The HBPU had three customers that comprised 10%, 5% and 4% of the June 30, 2017 revenue.

Note 7: Long-Term Debt

Long-term debt at June 30, 2017 is comprised of the following:

Capital Lease Agreement – Government Capital Corporation, annual lease payments of \$226,737 including interest at 3.6% through September 16, 2020.	\$	830,024
Capital Lease Agreement – Key Government Finance, Inc., annual lease payments of \$80,855 including interest at 2.74% through September 30, 2020.		302,427
2015 Sewage Disposal System Revenue Bonds – maturing \$250,000 to \$405,000 annually plus interest at 2.50% through 2037. Payments are estimated to begin in April 2018 after completion of sewer project.		2,889,747
2016 Sewage Disposal System Revenue Bonds – maturing \$75,000 to \$120,000 annually plus interest at 2.50% through 2040. Payments are estimated to begin in April 2018 after completion of sewer project.		118,463
Accrued compensated absences		148,796
	\$	<u>4,289,457</u>

Changes in long-term debts:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
2009 Water Refunding Bonds	\$ 183,000	\$	\$ 183,000	\$	\$
2015 Sewage Disposal System Revenue Bonds	556,471	2,333,276		2,889,747	250,000
Government Capital Corporation 2016 Sewage Disposal System Revenue Bonds	1,019,627		189,603	830,024	196,913
Key Government Financing, Inc.		118,463		118,463	75,000
Compensated absences		383,283	80,856	302,427	72,570
Total	<u>138,129</u>	<u>10,667</u>	<u>148,796</u>	<u>4,289,457</u>	<u>594,483</u>
	\$ <u>1,897,227</u>	\$ <u>2,845,689</u>	\$ <u>453,459</u>	\$ <u>4,289,457</u>	\$ <u>594,483</u>

Annual debt service requirements to maturity on the above governmental bond and lease obligations are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2018	\$ 594,483	\$ 104,190	\$ 698,673
2019	581,280	91,296	672,576
2020	552,682	74,536	627,218
2021	567,469	58,124	625,593
2022	280,000	41,250	321,250
Thereafter	1,564,747	98,381	1,663,128
Total	<u>\$ 4,140,661</u>	<u>\$ 467,777</u>	<u>\$ 4,608,438</u>

HILLSDALE BOARD OF PUBLIC UTILITIES

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2017

Note 8: Employee Retirement System

Plan Description

The HBPU in conjunction with the City of Hillsdale participates in an agent multiple-employer defined benefit, public employee retirement system governed by the State of Michigan, titled Municipal Employees' Retirement System (MERS). Information regarding this plan can be found in the City of Hillsdale's annual financial statements.

Note 9: Risk Management

The HBPU is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The HBPU carries commercial insurance to cover risks or losses. The HBPU settled claims resulting from these risks did not exceed the amount of insurance coverage in any of the past three fiscal years.

Note 10: Interfund Receivables and Payables

The composition of interfund balances at year-end is as follows:

	Receivable	Payable
Due to/from other funds of HBPU:		
Electric	\$ 228,823	\$
Water		228,823
	\$ 228,823	\$ 228,823
	Receivable	Payable
Due to/from other funds of City:		
Electric	\$ 46,476	\$ 136,477
Water		15,736
Sewer		22,130
	\$ 46,476	\$ 174,343

The HBPU reports interfund balances between many of its funds. The sum of all balances presented in the tables above agree with the sum of interfund balances presented in the statement of net position. Those interfund balances resulted primarily from the time lag between the dates that (1) interfund goods and services are provided or reimbursable expenditures occur, (2) transactions are recorded in the accounting system, and (3) payments between funds are made.

Note 11: Prepaid Operating Lease

In 2014, the HBPU (City) entered into a 20-year operating lease with KEPS Technologies, Inc. d/b/a ACD.net, for 48 strands of dark fiber to support its business operations. The agreement was for total upfront costs of \$166,208, and will be amortized over the 20-year life of the lease. An additional \$74,096 was prepaid on this project during the year.

HILLSDALE BOARD OF PUBLIC UTILITIES

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2017

Note 12: Purchased Power Contracts

American Municipal Power (AMP)

The City is a member of American Municipal Power (AMP) and has participated in the AMP Generating Station (AMPGS) Project. This project intended to develop a pulverized coal power plant in Meigs County, Ohio. The City's share was 12,000 kilowatts of a total 771,281 kilowatts, giving the City a 1.55 percent share. The AMPGS Project required participants to sign "take or pay" contracts with AMP. As such, the participants are obligated to pay any costs incurred for the project. In November 2009, the participants voted to terminate the AMPGS Project due to projected escalating costs. These costs were therefore deemed impaired and participants were obligated to pay costs already incurred. In prior years, the payment of these costs was not considered probable due to AMP's pursuit of legal action to void them. As a result of a March 31, 2014 legal ruling, the AMP Board of Trustees on April 15, 2014 and the AMPGS participants on April 16, 2014 approved the collection of the impaired costs and provided the participants with an estimate of their liability. The City's estimated share at March 31, 2014 of the impaired costs is \$2,076,796. The City received a credit of \$775,876 related to their participation in the AMP Fremont Energy Center (AFEC) Project, and another credit of \$542,698 related to the AMPGS costs deemed to have future benefit for the project participants, leaving a net impaired cost estimate of \$758,222. Because payment is now probable and reasonably estimable, the City is reporting a payable to AMP in its business-type activities and in its electric enterprise fund for these impaired costs. AMP financed these costs on its revolving line of credit. Any additional costs (including line-of-credit interest and legal fees) or amounts received related to the project will impact the City's liability. These amounts will be recorded as they become estimable.

In late 2016, AMP reached a settlement in the Bechtel Corporation litigation. On December 8, 2016, at the AMPGS Participants meeting, options for the allocation of the settlement funds were approved. The AMPGS Participants and the AMP Board of Trustees voted to allocate the settlement among the participants and the AMP General Fund based on each participant's original project share in kW including the AMP General Fund's project share.

Since March 31, 2014 the City has made payments of \$817,344 to AMP toward its net impaired cost estimate. Also since March 31, 2014, the City's allocation of additional costs incurred by the project is \$22,879 and interest expense incurred on AMP's line-of-credit of \$4,102, resulting in a net credit balance for impaired cost estimate at June 30, 2017 of \$32,141. The City does have a potential PHFU Liability of \$563,173 resulting in a net total potential liability of \$531,032, assuming the credit balance earns zero interest and the assets making up the PHFU (principally the land comprising the Meigs County site) have no value. Stranded costs as well as PHRU costs are subject to change, including future borrowing costs on the AMP line of credit. Activities include items such as negative items as property taxes as well as positive items revenue from leases or sale of all or a portion of the Meigs County site property.

The net credit balance for the impaired cost estimate has been included in the business-type activities and the electric fund as a contra purchased power expense.

AMP Fremont Energy Center (AFEC) (87 Members)

In February 3, 2011 American Municipal Power, Inc. (AMP) entered into a non-binding memorandum of understanding (MOU) with FirstEnergy Corp. regarding the Fremont Energy Center ("AFEC"). AFEC is a 707 MW natural gas fired combined cycle generation plant with a Base Capacity of 512 MW, located near the city of Fremont, Ohio. The closing date to purchase was July 28, 2011. AMP's acquisition of the plant was financed with draws on an additional line of credit for \$600,000,000 secured solely for the purpose of purchasing the plant.

HILLSDALE BOARD OF PUBLIC UTILITIES

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2017

Note 12: Purchased Power Contracts (Continued)

AMP Fremont Energy Center (AFEC) (87 Members) (Concluded)

To provide permanent financing for the AFEC Project on June 29, 2012 AMP issued in two series \$546,085,000 of its AMP Fremont Center Project Revenue Bonds consisting of taxable and tax-exempt obligations to (i) with other available funds, to repay the \$600,000,000 principal amount of an interim loan that financed the acquisition of the AMP Fremont Energy Center ("AFEC") and development costs and completion of construction and commissioning of AFEC; (ii) to make deposits to the Construction Accounts under the Indenture to finance additional capital expenditures allocable to AMP's 90.69% undivided ownership interest in AFEC; (iii) to fund deposits to certain reserve accounts; and (iv) to pay the costs of issuance of the Series 2012 Bonds.

On January 21, 2012 the AMP Fremont Energy Center ("AFEC") began commercial operation. The total cost of construction of the AFEC at the date it was placed in service was \$582,200,642. This amount included a development fee of \$35,535,448 paid by AFEC participants for the account of AMP Generating Station participants who are also AFEC participants. The amount was previously recorded as a noncurrent regulatory asset at December 31, 2011. In June 2012, AMP sold 26.419 MW or 5.16% undivided ownership interest in AFEC to Michigan Public Power Agency ("MPPA") and entered into a power sales contract with Central Virginia Electric Cooperative ("CVEC") for the output of a 21.248 MW or 4.15% interest in AFEC. AMP has sold the output of the remaining 464.355 MW or 90.69% interest to the AFEC participants, which consist of the 87 members, pursuant to a take-or-pay power sales contract. As of June 30, 2017 the outstanding obligation on the Fremont Energy Center ("AFEC") on AMP's books is \$511,710,000. The City of Hillsdale has executed a take-or-pay power sales contract with AMP for a Project Share of 7,220 kW or 1.55% of capacity and associated energy from the AFEC facility. The City's share of debt as of June 30, 2017 is approximately \$7,931,505.

Combined Hydroelectric Projects (79 Members)

AMP is currently developing three hydroelectric projects, the Cannelton, the Smithland and the Willow Island hydroelectric generating facilities (the "Combined Hydroelectric Projects"), all on the Ohio River, with an aggregate generating capacity of approximately 208 MW. Each of the Combined Hydroelectric Projects entails the installation of run-of-the-river hydroelectric generating facilities on existing United States Army Corps of Engineers' dams and includes associated transmission facilities. The Combined Hydroelectric Projects, including associated transmission facilities, will be constructed and operated by AMP. AMP holds the licenses from FERC for the Combined Hydroelectric Projects.

The Cannelton Hydro Project (88MW), now in operation as of June 7, 2016, is located on the Kentucky shore of the Cannelton Locks and Dam on federal land. AMP has a FERC license for the project that expires May 31, 2041. The hydro project diverts water from the locks and dam through bulb turbines, which have a horizontal shaft and Kaplan-type turbines. The site includes an intake channel, a reinforced concrete powerhouse (to house turbine and 3 generator units), and a tailrace or downstream channel.

The Willow Island Hydro Project, 44MW, in operation as of February 4, 2016 diverts water from the existing Willow Island Locks and Dam through bulb turbines. The FERC license for the Willow Project expires August 31, 2030. Average gross annual output is 279 million kWh. The powerhouse houses two horizontal 29.3 MW bulb type turbines and generating units.

The Smithland Hydro Project (76MW), in operation as of September 1, 2017 is located 62.5 miles upstream of the confluence of the Ohio and Mississippi Rivers. The Smithland project has a FERC license that expires May 31, 2038. The powerhouse houses three horizontal 29.3 MW bulb type turbines and generating units. Average gross annual output is 379 million kWh.

HILLSDALE BOARD OF PUBLIC UTILITIES

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2017

Note 12: Purchased Power Contracts (Continued)

Combined Hydroelectric Projects (79 Members) (Concluded)

To provide financing for the Combined Hydroelectric Projects, in 2009 and 2010 AMP has issued in seven series \$2,045,425,000 of its Combined Hydroelectric Projects Revenue Bonds (the "Combined Hydroelectric Bonds"), consisting of taxable, tax-exempt and tax advantaged obligations (Build America Bonds, Clean Renewable Energy Bonds and New Clean Renewable Energy Bonds). As of June 30, 2017 the total outstanding Hydro Project debt on AMP's books is approximately \$2,151,954,706. The Combined Hydroelectric Bonds are net revenue obligations of AMP, secured by a master trust indenture and payable from amounts received by AMP under a take-or-pay power sales contract with 79 of its Members.

In addition, AMP issued the Combined Hydro Project Revenue Bonds, Series 2016A (Green Bonds) (the "Series 2016A Bonds") for \$194,500,000 on October 6, 2016. The bonds will finance final completion costs and also reimbursement to the AMP credit line, which provided interim financing for costs related to the construction of the three run-of-the-river hydroelectric facilities (8 units) along the Ohio River, fund a deposit to the Parity Common Reserve Account, deposit to Escrow Account and pay the cost of issuance of the Series 2016A. The purpose of the "Green bonds" label is to allow investors to invest in an environmentally beneficial project.

The City of Hillsdale has executed a take-or-pay power sales contract with AMP for a Project Share of 3,398 kW or 1.63% of capacity and associated energy from the Combined Hydro Project facility. The City's share of debt as of June 30, 2017 is approximately \$35,076,862.

Meldahl Hydroelectric Project (48 Members)

AMP constructed a three unit hydroelectric generation facility on the Captain Anthony Meldahl Locks and Dam, an existing dam, on the Ohio River, constructed by the United States Army Corps of Engineers and of related equipment and associated transmission facilities (the "Meldahl Project"). Now that the Meldahl Project has entered commercial operation, it has a generating capacity of approximately 105 MW. The City of Hamilton, Ohio, a Member of AMP and a participant in the Meldahl Project, and AMP hold, as co-licensees, the Federal Energy Regulatory Commission license to operate the Meldahl Project.

In June 2008, Hamilton received a FERC license to operate a hydroelectric generation facility to be constructed on the Captain Anthony Meldahl Locks Dam, an existing dam on the Ohio River ("Meldahl Project"). In March 2009, AMP and Hamilton executed a series of agreements (the "AMP-Hamilton Agreements") pursuant to which AMP committed to finance the development and the construction of Meldahl Project and to acquire within 60 days of the date on which Meldahl Project entered commercial operation, a 48.6% undivided ownership interest in the City of Hamilton's Greenup Hydroelectric Facility.

Pursuant to the various agreements between Hamilton and AMP, the Meldahl Project is owned by Meldahl, LLC, a single member, Delaware not-for-profit limited liability company ("Meldahl, LLC"). AMP is the sole member of Meldahl, LLC and appoints three members of its Board of Directors (the Meldahl Board). AMP, acting as agent of Meldahl LLC, has financed the development, acquisition, construction and equipping of the Meldahl Project. In order to finance the construction of the Meldahl Project and related costs, in 2010 and 2011 AMP issued six series of its Meldahl Hydroelectric Project Revenue Bonds (the "Meldahl Bonds") in the amount of \$685,100,000 consisting of taxable, tax-exempt and tax advantaged obligations (Build America Bonds, Clean Renewable Energy Bonds and New Clean Renewable Energy Bonds). The Meldahl Bonds are secured by a master trust indenture and payable from amounts received by AMP under a take-or-pay power sales contract with 48 of its Members. The Meldahl Project entered commercial operation on April 12, 2016.

HILLSDALE BOARD OF PUBLIC UTILITIES

NOTES TO FINANCIAL STATEMENTS (CONCLUDED)

JUNE 30, 2017

Note 12: Purchased Power Contracts (Concluded)

Meldahl Hydroelectric Project (48 Members) (Concluded)

Additionally, AMP issued Meldahl Hydro Project Revenue Bonds, Series 2016A (Green Bonds) (the "Series 2016A Bonds") in the amount of \$80,050,000 on July 27, 2016. The proceeds were utilized to make a deposit to the Construction Account to retire balances held for the costs and expenses associated with the Project on AMP's line of credit, fund a deposit to the Parity Common Reserve Account and pay the cost of issuance of the Series 2016A. As of June 30, 2017, the outstanding debt for the Meldahl Hydroelectric Projects facility on AMP's books was approximately \$694,280,000. The City of Hillsdale has executed a take-or-pay power sales contract with AMP for a Project Share of 731 kW or 0.70% of capacity and associated energy from the Meldahl Hydroelectric Projects facility. The City's share of debt as of June 30, 2017 is approximately \$4,859,960.

Greenup Hydroelectric Project (47 Members)

The Greenup Hydroelectric Facility (the "Greenup Facility") is a 70.2 MW run-of-the river hydroelectric generating facility located on the Greenup Locks and Dam on the Ohio River. The Greenup Facility entered commercial operation in 1982 and has been owned and operated by the City of Hamilton, Ohio ("Hamilton") since 1988. AMP and Hamilton executed a series of agreements (the "AMP-Hamilton Agreements") pursuant to which AMP acquired a 48.6% undivided ownership interest in the Greenup Facility (the "AMP Interest") on May 11, 2016.

On May 11, 2016, in order to finance the acquisition of AMP's Interest as well as AMP's share of certain capital expenditures at the Greenup Facility and related costs, AMP issued its Greenup Hydroelectric Project Revenue Bonds, Series 2016A (the "Greenup Bonds") in the principal amount of \$125,630,000. The Greenup Bonds are secured by a master trust indenture and payable from amounts received by AMP under a take-or-pay power sales contract with 47 of its Members.

AMP and Hamilton are responsible for an aliquot share, equal to their respective undivided ownership interest in the Greenup Facility (51.4% for Hamilton and 48.6% for AMP), of the operating and maintenance expenses of the Greenup Facility. In accordance with, and subject to the provisions of, the AMP-Hamilton Agreements, Hamilton continues to operate the Greenup Facility.

As of June 30, 2017, the total outstanding Greenup Facility debt on AMP's books is approximately \$125,630,000.

The City of Hillsdale has executed a take-or-pay power sales contract with AMP for a Project Share of 479 kW or 1.40% of capacity and associated energy from the Greenup Hydroelectric Facility. The City's share of debt as of June 30, 2017 is approximately \$1,758,820.

Note 13: Subsequent Events

In preparing these financial statements, we have evaluated, for potential recognition or disclosure, significant events or transactions that occurred during the period subsequent to June 30, 2017, the most recent statement of net position presented herein, through the auditor's report date, the date these financial statements were available to be issued.

OTHER REPORTS



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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Board Members
Hillsdale Board of Public Utilities
Hillsdale, Michigan

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Electric Fund, Water Fund, and Sewer Fund of the City of Hillsdale, Michigan as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Hillsdale Board of Public Utilities' (HBPU) basic financial statements and have issued our report thereon dated October 25, 2017.

Internal Control Over Financial Reporting

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and responses that we consider to be material weaknesses - Findings 2017-1 and 2017-2.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the HBPU's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

HILLSDALE BOARD OF PUBLIC UTILITIES

SCHEDULE OF FINDINGS AND RESPONSES

YEAR ENDED JUNE 30, 2017

Finding 2017-1 Financial Statement Preparation (Repeat finding)

Internal Control Finding considered a material weakness

Requirement: The preparation of GAAP financial statements requires internal controls over (1) recording, processing, and summarizing accounting data, and (2) reporting the fund financial statements, including the related footnotes.

Condition: The HBPU has historically relied on its independent external auditors to assist in the preparation of the financial statements and footnotes as part of its external financial reporting process. Accordingly, the HBPU's ability to prepare financial statements is based, in part, on its reliance on its external auditors, who cannot by definition be considered part of the HBPU's internal controls.

Cause: This condition is caused by the HBPU's decision that it is more cost effective to outsource the preparation of its annual financial statements to the auditors than to incur the added time and expense of outsourcing to another accounting firm, or obtaining the necessary training for its Treasurer to perform this task.

Effect: The result of this condition is that the HBPU lacks internal controls over the preparation of financial statements and notes, and instead relies, in part, on its external auditors for assistance with this task.

View of responsible officials: The HBPU will continue to evaluate the cost vs. benefit of establishing internal controls over the preparation of financial statements in accordance with GAAP. In addition, the HBPU will carefully review the draft financial statements and notes prior to approving them and accept responsibility for their content and presentation.

Finding 2017-2 Material Audit Adjustments

Internal Control Finding considered a material weakness

Requirement: The business office is responsible for the reconciliation of all general ledger accounts to their proper underlying balances for the purpose of creating a reasonably adjusted trial balance, from which the basic financial statements are derived.

Condition: During the course of the audit, there were many audit findings that resulted in material adjustments to the financial statements. Specific and material items that required correction included capital assets, customer deposits, accounts payable, bonds payable, deferred inflows, deferred outflows and pension expense.

Cause: Lack of adequate financial analysis to timely detect material misstatements in the financial statements, and lack of proper review and oversight of third party consultants engaged to assist in the year-end close procedures.

Effect: At the time of audit, the financial statements were materially misstated.

View of responsible officials: The HBPU's business office has undergone a variety of changes in staffing, as well as a complete conversion of all their accounting systems. The last of these conversions took place just a month prior to the audit field work being done. In the confusion of all the changes these details were overlooked. There was not adequate time, with the current level of staffing to prepare for the audit given the amount of research needed dealing with two accounting systems. Staffing levels and workloads are being evaluated and new internal controls and procedures are being implemented to correct these issues moving forward.

Hillsdale Board of Public Utilities' Response to Findings

The HBPU's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. HBPU's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

CHBW & Co., P.C.

Certified Public Accountants