

COVINGTON ELECTRIC SYSTEM
FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION
JUNE 30, 2015

COVINGTON ELECTRIC SYSTEM TABLE OF CONTENTS

Introductory Section

Directory	1
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Financial Section

Independent Auditor's Report	2
Management's Discussion and Analysis.....	5

Financial Statements:

Statement of Net Position	10
Statement of Revenues, Expenses, and Changes in Net Position	12
Statement of Cash Flows	13
Notes to Financial Statements	15

Required Supplementary Information:

Schedule of Changes in Net Position Liability (Asset) and Related Ratios Based on Participation in the Public Employee Pension Plan	26
Schedule of Contributions Based on Participation in the Public Employee Pension Plan	27
Notes to Required Supplementary Information	28

Supplementary and Other Information Section

Schedule of Operating Revenues and Expenses - Electric System	29
Schedule of Long-Term Debt.....	31
Electric Rates in Force	32
Supplemental Information - Electric System - Unaudited	33
Schedule of Expenditures of Federal Awards.....	34

Internal Control and Compliance Section

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 <i>Government Auditing Standards</i>	35
Schedule of Findings	37
Schedule of Prior Year Findings	38

**INTRODUCTORY SECTION
COVINGTON ELECTRIC SYSTEM
DIRECTORY**
June 30, 2015

GOVERNING BOARD

Keith McCalla
Quincy Barlow
James Baddour
Christy Hayden
William E. Timberlake

MANAGEMENT TEAM

Tim Sallee, General Manager
Kathy McClinton, Comptroller

COUNSEL

David E. Owen
Covington, Tennessee

INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Alexander Thompson Arnold, PLLC
Jackson, Tennessee

FINANCIAL SECTION

Members of:

American Institute of Certified Public Accountants
AICPA Center for Public Company Audit Firms
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Tennessee Society of Certified Public Accountants
Kentucky Society of Certified Public Accountants



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Independent Auditor's Report

Board of Directors
Covington Electric System
Covington, Tennessee

Report on the Financial Statements

We have audited the accompanying financial statements of the Covington Electric System (the System), an enterprise fund of the City of Covington, Tennessee, as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the System's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the System as of June 30, 2015, and the respective changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in Note 1, the financial statements present only the Covington Electric System enterprise fund and do not purport to, and do not, present fairly the financial position of Covington, Tennessee, as of June 30, 2015, 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.

Change in Accounting Principle

As discussed in note 1 to the financial statements, in 2015 the System adopted new accounting guidance, GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27* and GASB Statement No. 71, *Pension Transition for Contributions made subsequent to the Measurement Date – an amendment of GASB Statement No. 68*. 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, Schedule of Changes in Net Position Liability (Asset) and Related Ratios Based on Participation in the Public Employee Pension Plan, Schedule of Contributions Based on Participation in the Public Employee Pension Plan, and the Notes to the Required Supplementary Information on pages 5 through 9, and 26 through 28 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the System's basic financial statements. The introductory section and supplementary and other information section as listed in the Table of Contents are presented for purposes of additional analysis and are not a required part of the financial statements.

The supplementary and other information section as listed in the Table of Contents, except that which has been marked unaudited, is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements.

Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary and other information section as listed in the Table of Contents except that which is marked unaudited is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

The introductory section and the supplementary and other information marked unaudited have not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 11, 2015 on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control over financial reporting and compliance.

Alexander Thompson Arnold PLLC

Jackson, Tennessee
December 11, 2015

MANAGEMENT DISCUSSION AND ANALYSIS

As management of the Covington Electric System, we offer readers of the System's financial statements this narrative overview and analysis of the financial activities of the System for the fiscal years ended June 30, 2015. All amounts, unless otherwise indicated, are expressed in actual dollars. The implementation of Governmental Accounting Standards Board (GASB) Statements No. 68 and 71, *Accounting and Financial reporting for pensions – an amendment of GASB Statement No. 27* and *Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment to GASB Statement No. 68*, during 2015 causes some financial information reported in the MD&A for 2015 and 2014 not to be comparable.

FINANCIAL HIGHLIGHTS

Management believes the System's financial condition is strong. The System is well within the stringent financial policies and guidelines set by the Board and management. The following are combined key financial highlights for the Electric System.

- Total assets and deferred outflows of resources at year-end were \$23.40 million and exceeded liabilities and deferred inflows in the amount of \$17.39 million (i.e. net position).
- Net position decreased \$257 thousand during the current year. Unrestricted net position decreased by \$105 thousand, net investment in capital assets decreased by \$154 thousand, and restricted for debt service increased by \$1 thousand.
- During fiscal year 2015, the System delivered 234.68 million kWh compared to 216.40 million kWh during the fiscal year 2014.
- Operating revenues were \$20.79 million, an increase over fiscal year 2014 in the amount of \$1.11 million.
- Operating expenses were \$20.36 million, an increase over fiscal year 2014 in the amount of \$1.59 million.
- The operating income for the year was \$428 thousand as compared to \$903 thousand during the 2014 fiscal year.

OVERVIEW OF THE FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION

Management's Discussion and Analysis (MD&A) serves as an introduction to, and should be read in conjunction with, the financial statements and supplementary information. The MD&A represents management's examination and analysis of the System's financial condition and performance. Summary financial statement data, key financial and operational indicators used in the System's strategic plan, budget, bond resolutions and other management tools were used for this analysis. The Financial Statements and Supplementary Information is made up of four sections: 1) the introductory section, 2) the financial section, 3) the supplementary and other information section, and 4) the internal control and compliance section. The introductory section includes the System's directory. The financial section includes the required MD&A, the independent auditor's report, the financial statements with accompanying notes, and the required supplementary information. The supplementary and other information section includes selected financial and operational information. The internal control and compliance section includes the report on internal control and compliance. These sections make up the financial report presented here.

REQUIRED FINANCIAL STATEMENTS

An Enterprise Fund is used to account for the operations of the System, which is financed and operated in a manner similar to private business enterprises where the intent is that the costs of providing services to the general public on a continuing basis be financed or recovered primarily through user charges. The financial statements report information about the System, using accounting methods similar to those used by private sector companies. These statements offer short-term and long-term financial information about its activities.

MANAGEMENT DISCUSSION AND ANALYSIS

The *Statement of Net Position* presents the financial position of the System on a full accrual historical cost basis. The statement includes all of the System's assets, liabilities, and deferred inflows/outflows of resources with the differences reported as net position. Over time, increases and decreases in net position may serve as a useful indicator of whether the financial position of the System is improving or deteriorating.

The *Statement of Revenues, Expenses, and Changes in 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 assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. This statement measures the success of the System's operations and can be used to determine whether the System has successfully recovered all of its costs. This statement also measures the System's profitability and credit worthiness.

The *Statement of Cash Flows* presents changes in cash and cash equivalents, resulting from operational, financing, and investing activities. This statement presents cash receipt and cash disbursement information, without consideration of the earnings event, 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 System's accounting policies, significant account balances and activities, material risks, obligations, commitments, contingencies and subsequent events, if any.

FINANCIAL ANALYSIS

One of the most important questions asked about the System's finances is "Is the System, as a whole, better off or worse off as a result of the year's activities?" The Statement of Net Position and the Statement of Revenues, Expenses, and Changes in Net Position report information about the System's activities in a way that will help answer this question. These two statements report the net position of the System, and the changes in the net assets. Net position is one way to measure the financial health or financial position of the System. Over time, increases or decreases in the System's net position is an indicator of whether its financial health is improving or deteriorating. However, you will need to also consider other non-financial factors such as changes in economic conditions, customer growth, and legislative mandates.

The System's total net position decreased by \$257 thousand for the fiscal year ended June 30, 2015. The analysis below focuses on the System's net position (Tables 1A) and changes in net position during the year (Tables 2A).

MANAGEMENT DISCUSSION AND ANALYSIS

Table 1A
CONDENSED STATEMENT OF NET POSITION

	<u>June 30, 2015</u>	<u>June 30, 2014</u>	Increase (Decrease)	
			<u>\$</u>	<u>%</u>
Assets				
Current and other assets	\$ 10,668,044	\$ 10,381,624	\$ 286,420	2.76%
Capital assets	<u>12,593,063</u>	<u>12,850,391</u>	<u>(257,328)</u>	-2.00%
Total assets	<u>23,261,107</u>	<u>23,232,015</u>	<u>29,092</u>	0.13%
Deferred outflows of resources	<u>135,533</u>	<u>-</u>	<u>135,533</u>	100.00%
Liabilities				
Long-term liabilities	1,284,090	1,175,803	108,287	9.21%
Other liabilities	<u>4,624,125</u>	<u>4,406,374</u>	<u>217,751</u>	4.94%
Total liabilities	<u>5,908,215</u>	<u>5,582,177</u>	<u>326,038</u>	5.84%
Deferred inflows of resources	<u>96,054</u>	<u>-</u>	<u>96,054</u>	100.00%
Net Position				
Net investment in capital assets	11,429,226	11,582,979	(153,753)	-1.33%
Restricted for debt service	298,406	297,082	1,324	0.45%
Unrestricted	<u>5,664,739</u>	<u>5,769,777</u>	<u>(105,038)</u>	-1.82%
Total net position	<u>\$ 17,392,371</u>	<u>\$ 17,649,838</u>	<u>\$ (257,467)</u>	-1.46%

In 2015 the decrease in capital assets was primarily due to the depreciation of assets. In 2015, the increase in current and other assets was due to an increase in cash and cash equivalents on deposit. Liabilities increased in 2015 primarily due to implementation of GASB Statement No. 68.

MANAGEMENT DISCUSSION AND ANALYSIS

Changes in the System's net position can be determined by reviewing the following condensed Statement of Revenues, Expenses, and Changes in Net Position for the years.

Table 2A

	<u>June 30, 2015</u>	<u>June 30, 2014</u>	Increase (Decrease)	
			<u>\$</u>	<u>%</u>
Revenues				
Operating revenues	\$ 20,790,543	\$ 19,679,801	\$ 1,110,742	5.64%
Non-operating revenues	<u>25,388</u>	<u>26,064</u>	<u>(676)</u>	-2.59%
Total revenues	<u>20,815,931</u>	<u>19,705,865</u>	<u>1,110,066</u>	5.63%
Expenses				
Cost of sales and services	17,141,050	15,935,924	1,205,126	7.56%
Operations expense	1,723,811	1,635,671	88,140	5.39%
Maintenance expense	701,849	414,592	287,257	69.29%
Depreciation and amortization	703,259	704,869	(1,610)	-0.23%
Taxes	92,312	85,573	6,739	7.88%
Interest and other expenses	<u>68,278</u>	<u>66,970</u>	<u>1,308</u>	1.95%
Total expenses	<u>20,430,559</u>	<u>18,843,599</u>	<u>1,586,960</u>	8.42%
Extraordinary item	<u>-</u>	<u>(152,622)</u>	<u>152,622</u>	-100.00%
Transfers in (out)	<u>(382,786)</u>	<u>(385,106)</u>	<u>2,320</u>	-0.60%
Change in net position	<u>2,586</u>	<u>324,538</u>	<u>(321,952)</u>	-99.20%
Beginning net position	17,649,838	17,325,300	324,538	1.87%
Restatement of net position - beginning	<u>(260,053)</u>	<u>-</u>	<u>(260,053)</u>	100.00%
Total net position - beginning restated	<u>17,389,785</u>	<u>17,325,300</u>	<u>64,485</u>	0.37%
Ending net position	<u>\$ 17,392,371</u>	<u>\$ 17,649,838</u>	<u>\$ (257,467)</u>	-1.46%

Operating revenues showed a 5.64% increase in 2015. This increase is due to increases in rates and usages. In 2015, non-operating revenues decreased 2.59% as the result of fluctuations in interest rates on certificates of deposits and savings accounts. The extraordinary item in 2014 was due to a transfer of assets loss of \$152,622. The System transferred \$313,267 of plant assets 161 kV transmission line to the TVA which was not fully depreciated. The difference resulted in a loss of \$152,622. Total expenses increased 8.42% in 2015 due to an increase in operating expenses in relation to the increase in sales. Although the System increased its rates, it did so in response to TVA's rate increase. TVA's rate increase caused operating expenses, specifically cost of sales and service to increase. Ending net position showed a decrease of 1.46% in 2015, due to the above mentioned facts and the implementation of GASB Statement No. 69 and 71.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At the end of fiscal years 2015, the system had \$12,593,063 (net of accumulated depreciation) invested in a broad range of System capital assets. This investment includes land, land rights, distribution and transmission systems and their related equipment, and various types of equipment. Based on the uses of the aforementioned assets, they are classified for financial purposes as general plant, transmission plant, distribution plant, and construction in progress. This investment represents an overall decrease of 2.00% from fiscal year 2014 to 2015, due to depreciation.

MANAGEMENT DISCUSSION AND ANALYSIS

The following table summarizes the System's capital assets, net of accumulated depreciation, and changes therein, for the years ended June 30, 2015. These changes are presented in detail in Note 3D to the financial statements.

Table 3A

CAPITAL ASSETS, NET OF ACCUMULATED DEPRECIATION

	<u>June 30, 2015</u>	<u>June 30, 2014</u>	Increase (Decrease)	
			<u>\$</u>	<u>%</u>
General plant	\$ 4,536,965	\$ 4,713,320	\$ (176,355)	-3.74%
Transmission plant	1,134,860	1,219,400	(84,540)	-6.93%
Distribution plant	6,642,838	6,584,361	58,477	0.89%
Unamortized acquisition adjustment	173,177	197,341	(24,164)	100.00%
Construction in progress	<u>105,223</u>	<u>135,969</u>	<u>(30,746)</u>	-22.61%
Total capital assets	\$ 12,593,063	\$ 12,850,391	\$ (257,328)	-2.00%

Debt Administration

The System has outstanding Revenue Bonds of \$1,175,000 as of June 30, 2015. Principal payments are due in the upcoming fiscal year in the amount of \$110,000 with interest payments totaling \$46,376 also due. Details relating to the outstanding debt can be found in Note 3G. The System also has no current plans to issue new debt or refund outstanding debt.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

The System's electric supplier is also expected to increase rates in the next fiscal year, and this will cause the System to have to pass on the additional costs to customers. The City is actively recruiting new industries to the area to make up for past plant closures. Any new industry that comes to the area will increase the System's power sales and should help the overall financial condition of the System.

CONTACTING THE AUTHORITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide a general overview of the System's finances for all those with an interest in the System's finances and to demonstrate the System's accountability for the money it receives. Questions concerning any information provided in this report or requests for any additional information should be directed to the General Manager of the Covington Electric System, P.O. Box 488, Covington, TN, 38019.

**COVINGTON ELECTRIC SYSTEM
STATEMENT OF NET POSITION**

June 30, 2015

	2015
Assets	
Current assets:	
Cash on hand	\$ 2,650
Cash and cash equivalents on deposit	7,522,312
Accounts receivable (net of allowance for uncollectibles \$0)	2,382,126
Due from other funds - municipality	340
Inventories	221,685
Prepayments and other current assets	165,999
Total current assets	10,295,112
Noncurrent assets:	
Restricted cash, cash equivalents, and investments:	
Cash and cash equivalents on deposit	310,522
Customer's CD's held for deposit	30,721
Total restricted assets	341,243
Other assets:	
Investments in associated companies	2,110
Unamortized debt expense	18,953
Advances to customers - Home insulation	10,626
Total other assets	31,689
Capital assets:	
Not being depreciated	
General plant	195,885
Transmission plant	8,267
Distribution plant	16,560
Construction in progress	105,223
Being depreciated	
General plant	6,422,475
Transmission plant	2,161,810
Distribution plant	12,396,818
Less: Accumulated depreciation	(8,887,152)
Unamortized acquisition adjustment	173,177
Total capital assets (net of accumulated depreciation)	12,593,063
Total noncurrent assets	12,965,995
Total assets	23,261,107
Deferred outflows of resources:	
Pension contributions subsequent to the measurement date	120,292
Net difference between projected and actual earnings in pension investments	15,241
Unamortized debt discount	-
Total deferred outflows of resources	\$ 135,533

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

**COVINGTON ELECTRIC SYSTEM
STATEMENT OF NET POSITION**

June 30, 2015

	2015
Liabilities	
Current liabilities:	
Accounts payable	\$ 3,245,194
Customer deposits	1,025,954
Accrued expenses and other liabilities	200,140
Total current liabilities	4,471,288
Current liabilities payable from restricted assets:	
Accrued interest payable	12,116
Consumer's deposits	30,721
Current maturities of long-term debt	110,000
Total current liabilities payable from restricted assets:	152,837
Noncurrent liabilities:	
Advances - Home insulation program	10,894
Net pension liability	219,359
Bonds payable (less current maturities)	1,053,837
Total noncurrent liabilities	1,284,090
Total liabilities	5,908,215
Deferred inflows of resources	
Net difference between expected and actual experience	96,054
Net Position	
Net investment in capital assets	11,429,226
Restricted for debt service	298,406
Unrestricted	5,664,739
Total net position	\$ 17,392,371

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

COVINGTON ELECTRIC SYSTEM
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
For the Year Ended June 30, 2015

	2015
Operating revenues:	
Charges for sales and services	\$ 20,497,322
Other revenue	<u>293,221</u>
Total operating revenues	<u>20,790,543</u>
Operating expenses:	
Cost of sales and services	17,141,050
Operations expense	1,723,811
Maintenance expense	701,849
Depreciation and amortization	703,259
Taxes	<u>92,312</u>
Total operating expenses	<u>20,362,281</u>
 Operating income (loss)	 <u>428,262</u>
Nonoperating revenues (expenses):	
Interest and other revenue	25,388
Other expenses	(18,842)
Interest	<u>(49,436)</u>
Total nonoperating revenues (expenses)	<u>(42,890)</u>
 Change in net position before extraordinary item and transfers	 385,372
 Transfers in (out) - City - in lieu of taxes	 <u>(382,786)</u>
 Change in net position after extraordinary item and transfers	 2,586
 Total net position - beginning	 <u>17,649,838</u>
Restatement of net position - beginning due to GASB Statement No. 68 and 71	<u>(260,053)</u>
Total net position - beginning restated	<u>17,389,785</u>
 Total net position - ending	 <u>\$ 17,392,371</u>

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

COVINGTON ELECTRIC SYSTEM
STATEMENTS OF CASH FLOWS
For the Years Ended June 30, 2015

	2015
Cash flows from operating activities:	
Cash received from consumers	\$ 20,542,427
Cash paid to suppliers and employees	(19,417,769)
Taxes paid including payments in lieu of taxes	(92,312)
Transfers to the City - payment in lieu of taxes	(382,786)
Customer deposits received	280,950
Customer deposits refunded	(213,369)
Net cash provided (used) by operating activities	717,141
Cash flows from non-capital and related financing activities:	
Increase (decrease) in advances from TVA	(2,497)
Net cash provided (used) by non-capital and related financing activities	(2,497)
Cash flows from capital and related financing activities:	
Principal paid on debt	(105,000)
Interest paid on bonds, notes and leases	(50,408)
Construction and acquisition of plant	(431,834)
Disposal of plant	56,378
Plant removal cost	(59,045)
Materials salvaged from retirements	20,421
Net cash provided (used) by capital and related financing activities	(569,488)
Cash flows from investing activities:	
Interest earned	25,388
Expenses from other nonoperating expenses	(18,842)
(Increase) decrease in unamortized debt expense	-
(Increase) decrease in conservation loans	2,497
Net cash provided (used) by investing activities	9,043
Net increase (decrease) in cash and cash equivalents	154,199
Cash and cash equivalents - beginning of year	7,681,285
Cash and cash equivalents - end of year	\$ 7,835,484
Cash and cash equivalents	
Unrestricted cash on hand	\$ 2,650
Unrestricted cash and cash equivalents on deposit	7,522,312
Restricted cash and cash equivalents on deposit	310,522
Total cash and cash equivalents	\$ 7,835,484

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

COVINGTON ELECTRIC SYSTEM
STATEMENTS OF CASH FLOWS
For the Years Ended June 30, 2015

	2015
Reconciliation of operating income (loss) to net cash provided (used) by operating activities:	
Operating income (loss)	\$ 428,262
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:	
Depreciation and amortization	675,250
Amortization on debt expense and bond premium	
Pension contributions in excess of actuarially determined pension expense	15,307
Operating transfer in (out)	(382,783)
Changes in assets and liabilities:	
Accounts and other receivable	(248,116)
Materials and supplies	13,823
Prepayments and other current assets	1,749
Net pension liability	-
Due from other funds	(60)
Accounts payable and accrued expenses	146,128
Customer deposits	67,581
Net cash provided (used) by operating activities	\$ 717,141

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

**COVINGTON ELECTRIC SYSTEM
NOTES TO FINANCIAL STATEMENTS**

June 30, 2015

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

These are enterprise fund financial statements and include only the financial activities of the Covington Electric System, Covington, Tennessee (the System). The oversight unit consists of the funds maintained by the Office of the City Recorder of the City of Covington, Tennessee (the City). The System is under the regulatory authority of the Tennessee Valley Authority.

B. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The accounting and financial reporting treatment is determined by the applicable measurement focus and basis of accounting. Measurement focus indicates the type of resources being measured such as current financial resources or economic resources. The basis of accounting indicates the timing of transactions or events for recognition in the financial statements.

The System's financial statements are reported using the economic resources measurement focus and the full accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. The accounting policies of the System conform to applicable accounting principles generally accepted in the United States of America as defined in by the *Governmental Accounting Standards Board (GASB)*.

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

C. Assets, Liabilities, and Net Position

Deposits and Investments

The System's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

State statutes authorize the System to invest in certificates of deposit, obligations of the U. S. Treasury, agencies, instrumentalities, and obligations guaranteed as to principal and interest by the United States or any of its agencies, repurchase agreements, and the Tennessee local government investment pool.

Receivables and 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 balance sheet.

COVINGTON ELECTRIC SYSTEM
NOTES TO FINANCIAL STATEMENTS
June 30, 2015

Trade receivables result from unpaid billings for service to customers and from unpaid billings related to work performed for or materials sold to certain entities. All trade receivables are shown at their estimated realizable amount, which does not include an allowance for uncollectible accounts. The System did not record an allowance for uncollectible customer accounts based on the past history of uncollectible accounts and management's analysis of the current accounts.

Inventories and Prepaid Items

All inventories are valued at the lower of average cost or market, using the first-in/first-out (FIFO) method. Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in the financial statements.

Restricted Assets

Certain proceeds of the bond issues, as well as certain resources set aside for their repayment, are classified as restricted assets on the statement of net position because they are maintained in separate bank accounts and their use is limited by applicable bond covenants. The System elects to use restricted assets before unrestricted assets when the situation arises where either can be used.

Capital Assets

Capital assets, which include property, plant, equipment, and construction in progress, are recorded at historical cost or estimated historical cost if purchased or constructed. Capital assets are defined by the system as assets with an initial undivided cost of more than \$500 and an estimated useful life of at least 5 years. Assets acquired through contributions from developers or other customers are capitalized at their 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 assets' lives are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed.

Property, plant, and equipment of the System are depreciated using the straight line method over the following useful lives:

General plant	5 - 50 years
Transmission plant	25 - 33.33 years
Distribution plant	16.66 - 36.36 years

Compensated Absences

It is the System's policy to permit employees to accumulate earned but unused vacation benefits. All vacation pay has been accrued and is reflected as a current liability on the financial statements.

Long-term Obligations

Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. The Utility will continue to report bond cost as an asset and amortize those over the life of the bonds instead of expensing those costs in the current year in accordance with certain provisions included in GASB Statement No. 62 – Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements. This regulatory option as part of GASB Statement No. 65 is available due to the above mentioned cost being used for rate setting by the utility.

COVINGTON ELECTRIC SYSTEM
NOTES TO FINANCIAL STATEMENTS
June 30, 2015

Impact of Recently Issued Accounting Pronouncements

In March of 2012, the GASB issued Statement No. 68, *Accounting and financial reporting for pensions – an amendment to GASB Statement No. 27* and in November 2013 issued statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date - an amendment of GASB Statement No. 68*. Statement No. 68 improves accounting and financial reporting by state and local governments for pensions and is effective for fiscal years beginning after June 15, 2014. These statements establish a definition of a pension plan that reflects the primary activities associated with the pension arrangement - determining pensions, accumulating and managing assets dedicated for pensions, and paying benefits to plan members as they come due. Statement No.68 details the recognition and disclosure requirements for employers with liabilities (payables) to a defined benefit pension plan and for employers whose employees are provided with defined contribution pensions. These pension standards include significant changes to how governmental employers will report liabilities related to pension obligation. The Utility has implemented GASB Statement No. 68 and 71 for the year ended June 30, 2015. This implementation resulted the reporting of deferred outflows and inflows and pension liability on the statement of net position.

Deferred Outflows/Inflows of Resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (expense/expenditure) until then. The System currently has two items that qualify for reporting in this category: Pension contributions subsequent to the measurement date and pension net difference between projected and actual earnings in pension investments.

In addition to liabilities, the statement of financial position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (revenue) until that time. The System has one item that qualifies for reporting in this category as of June 30, 2015, the pension difference between expected and actual experience.

Net Position Flow Assumption

Sometimes the System will fund outlays for a particular purpose from both restricted (e.g., restricted bond or grant proceeds) and unrestricted resources. In order to calculate the amounts to report as restricted – net position and unrestricted – net position in the financial statements, a flow assumption must be made about the order in which the resources are considered to be applied. It is the System policy to consider restricted – net position to have been depleted before unrestricted – net position is applied.

Net Position

Equity is classified as net position and displayed in the following three components:

- Net Investment in Capital Assets - Consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds that are attributable to the acquisition, construction, or improvement of those assets; debt related to unspent proceeds or other restricted cash and investments is excluded from the determination.

COVINGTON ELECTRIC SYSTEM
NOTES TO FINANCIAL STATEMENTS
June 30, 2015

- Restricted for Debt Service – Consists of net position for which constraints are placed thereon by external parties, such as lenders, grantors, contributors, laws, regulations, and enabling legislation, including self-imposed legal mandates, less any related liabilities.
- Unrestricted – All other net assets that do not meet the description of the above categories.

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 Covington Electric System's participation in Covington Electric System's Employees' Retirement Plan, and additions to/deductions from Covington Electric System's fiduciary net position have been determined on the same basis as they are reported by Covington Electric System's Employees' Retirement Plan. For this purpose, benefits (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms of Covington Electric System's Employees' Retirement Plan. Investments are reported at fair value.

NOTE 2 - STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

A. Budgetary Information

The System adopts flexible annual operating and capital budgets. Budgets are adopted on a basis consistent with generally accepted accounting principles. The current operating budget details the System's plans to earn and expend funds for charges incurred for operation, maintenance, certain interest, and general functions and other charges for the fiscal year. The capital budget details the plan to receive and expend cash basis capital contribution fees, special assessments, grants, borrowings, and certain revenues for capital projects.

All unexpended appropriations in the operating budget remaining at the end of the fiscal year lapse.

Management submits a proposed budget to the System's Board. A budget is then adopted for the next fiscal year. During the year, management is authorized to transfer budgeted amounts between line items.

NOTE 3 - DETAILED NOTES ON ALL FUNDS

A. Deposits and Investments

At June 30, 2015, the System had cash on hand of \$2,650 and deposits with a carrying amount of \$7,832,834 and a bank balance of \$7,851,504. Of the bank balances, \$250,000 was covered by federal depository insurance, with the remaining covered by the State Collateral Pool. In both years, investments were made up entirely of consumer's certificates of deposits held for customer deposits.

Custodial Credit Risk

The System's policies limit deposits and investments to those instruments allowed by applicable state laws and described in Note 1. State statute requires that all deposits with financial institutions must be collateralized by securities whose market value is equal to 105% of the value of uninsured deposits. The deposits must be collateralized by federal depository insurance or the Tennessee Bank Collateral Pool, by collateral held by the System's agent in the System's name, or by the Federal Reserve Banks acting as third party agents. State statutes also authorize the System to

COVINGTON ELECTRIC SYSTEM
NOTES TO FINANCIAL STATEMENTS
June 30, 2015

invest in bonds, notes, or treasury bills of the United States or any of its agencies, certificates of deposit at Tennessee state chartered banks and savings and loan associations, and federally chartered banks and savings and loan associations, or repurchase agreements utilizing obligations of the United States or its agencies, as the underlying repurchase agreements must have a market value of at least equal to the amount of funds invested in the repurchase transaction. As of June 30, 2015, all bank deposits were fully collateralized or insured.

B. Receivables

Receivables as of the fiscal year ends were made up of the following:

	<u>June 30, 2015</u>
Billed services for utility customers	\$ 2,382,126
Less: Allowance for uncollectibles	-
Total	<u>\$ 2,382,126</u>

C. Restricted Assets

The following amounts represent only the accounts with restrictions associated with use of the funds. The funding applicable to the bonds issued is in compliance with the funding requirements.

	<u>June 30, 2015</u>
Sinking funds	\$ 97,430
Reserve funds	213,092
Construction	-
Certificates of deposit	30,721
Total	<u>\$ 341,243</u>

D. Capital Assets

Capital asset activity during the year was as follows:

Depreciation and amortization expense amounted to \$675,250 (additional \$28,052 charged to transportation clearing) for the fiscal year ended June 30, 2015.

COVINGTON ELECTRIC SYSTEM
NOTES TO FINANCIAL STATEMENTS
June 30, 2015

Description	Balance at June 30, 2014	Additions	Disposals	Reclassifications	Balance at June 30, 2015
Capital assets, not being depreciated					
General plant	\$ 195,885	\$ -	\$ -	\$ -	\$ 195,885
Transmission plant	8,267	-	-	-	8,267
Distribution plant	16,560	-	-	-	16,560
Construction in progress	<u>135,969</u>	-	<u>30,746</u>	-	<u>105,223</u>
Total capital assets not being depreciated	<u>356,681</u>	-	<u>30,746</u>	-	<u>325,935</u>
Capital assets, being depreciated					
General plant	6,391,989	30,486	-	-	6,422,475
Transmission plant	2,161,810	-	-	-	2,161,810
Distribution plant	<u>12,063,330</u>	<u>431,777</u>	<u>98,289</u>	-	<u>12,396,818</u>
Total capital assets being depreciated	<u>20,617,129</u>	<u>462,263</u>	<u>98,289</u>	-	<u>20,981,103</u>
Less accumulated depreciation for:					
General plant	1,874,554	206,841	-	-	2,081,395
Transmission plant	950,677	84,540	-	-	1,035,217
Distribution plant	<u>5,495,529</u>	<u>411,921</u>	<u>136,910</u>	-	<u>5,770,540</u>
Total accumulated depreciation	<u>8,320,760</u>	<u>703,302</u>	<u>136,910</u>	-	<u>8,887,152</u>
Total capital assets, being depreciated, net	<u>12,296,369</u>	<u>(241,039)</u>	<u>(38,621)</u>	-	<u>12,093,951</u>
Unamortized acquisition adjustment	<u>197,341</u>	-	<u>24,164</u>	-	<u>173,177</u>
Total capital assets, net	<u>\$ 12,850,391</u>	<u>\$ (241,039)</u>	<u>\$ 16,289</u>	<u>\$ -</u>	<u>\$ 12,593,063</u>

E. Interfund Receivables, Payables, and Transfers

The composition of interfund balances as of June 30, 2015 is as follows:

	Due from		City -
	<u>City</u>		<u>Transfer In</u>
Due to Electric	<u>\$ 340</u>	Transfer out	<u>\$ 382,786</u>

For the fiscal year ended, the interfund receivables to Electric from the City are for unpaid invoices.

The transfer from the Electric System to the City is for property taxes for fiscal year 2015.

F. Leases

Operating Leases

The System leases its copy machine usage. This lease has been classified as an operating lease for reporting purposes. The system makes a monthly payment that is dependent upon the number of copies used.

COVINGTON ELECTRIC SYSTEM
NOTES TO FINANCIAL STATEMENTS
June 30, 2015

Lease expense for the years ended June 30, 2015 was \$342.

G. Long-term Debt

Revenue and Tax Bonds

On April 1, 2003, the System issued \$2,280,000 in Electric System Revenue Bonds, Series 2003 with interest of 2.50% to 4.375% to provide funds to finance the construction of improvements and expansion of the City's electrical power distribution system. The bonds are to be repaid solely from and be secured by a pledge of the net revenues to be derived from the operation of the system.

	<u>June 30, 2015</u>
Bonds payable are as follows:	
Electric System Revenue Bonds, Series 2003, 2.50% to 4.375%, due serially through 2024	\$ 1,163,837
Less current portion bonds payable	110,000
Total long-term portion bonds payable	<u>\$ 1,053,837</u>

The annual requirements to amortize all debt outstanding at June 30, 2015, including interest of \$237,619 are as follows:

Year ending June 30	Revenue and Tax Bonds	
	Principal	Interest
2016	110,000	46,376
2017	115,000	42,057
2018	120,000	37,488
2019	125,000	32,648
2020	130,000	27,483
2021-2024	575,000	51,567
	1,175,000	237,619

The following is a summary of long-term debt transactions for the years ended June 30, 2015 and 2013.

	Balance at June 30, 2014	Additions	Retirements	Balance at June 30, 2015	Due within one year
Electric System					
Revenue and tax bonds payable	\$ 1,280,000	\$ -	\$ 105,000	\$ 1,175,000	\$ (110,000)
Compensated absences	90,186	-	8,021	82,165	-
Bond discounts	12,588	-	1,425	11,163	(1,425)
Total debt outstanding	\$ 1,382,774	\$ -	\$ 114,446	\$ 1,268,328	\$ (111,425)

H. Net Position

Net position represents the difference between assets and liabilities and deferred outflows/inflows of resources. The restricted net position amounts were as follows:

COVINGTON ELECTRIC SYSTEM
NOTES TO FINANCIAL STATEMENTS
June 30, 2015

	<u>June 30, 2015</u>
Net investment in capital assets	
Net property, plant, and equipment in services	\$ 12,593,063
Unamortized debt discount	11,163.00
Less: Debt as disclosed in Note 3G	<u>(1,175,000)</u>
Total invested in capital assets	<u>11,429,226</u>
Restricted for debt service:	
Restricted cash and cash equivalents	310,522
Restricted investments	30,721
Less: Current liabilities payable from restricted assets	<u>(42,837)</u>
Total restricted for debt service	<u>298,406</u>
Unrestricted	<u>5,664,739</u>
Total net position	<u>\$ 17,392,371</u>

NOTE 4 - OTHER INFORMATION

A. Pension Plan

Plan Description: The Retirement Plan Committee accounts for the activity of the Retirement Plan for employees of Covington Electric System. The Plan is a single employer public employee retirement System (PERS) administered by Ellis & Ward Consulting Group Inc.. All employees of the Covington Electric System participate as of April 1st following one year of service.

The Retirement Plan for employees of Covington Electric System issues a publically available report that can be obtained by contacting Ellis & Ward Consulting Group Inc. P.O. Box 2470, Cordova, TN 38088-2470.

Benefits Provided: The Plan provides retirement benefits as well as death and disability benefits. Retirement benefits vest at a rate of 20% per year beginning with three years of service. Employees may retire after age 60 and the completion of 10 years of service with a reduction for early commencement.

At June 30, 2015, the Retirement Plan membership consisted of:

Inactive plan members or beneficiaries currently receiving benefits	17
Inactive plan members entitled to but not yet receiving benefits	-
Active plan members	<u>19</u>
	<u>36</u>

Contributions: Required contributions are determined by The Retirement Plan for employees of Covington Electric System based on calculations performed by an independent actuary. The actuarially determined rate is the estimated amount necessary to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability.

Employee contributions are based on the employee's annual covered salary. For the year ended June 30, 2015, the employee contribution rate was 10.50%. The Retirement Plan for employees of Covington Electric System is required to contribute the difference between the actuarially determined rate and the contribution rate of employees. The Utility's contribution rate and required

COVINGTON ELECTRIC SYSTEM
NOTES TO FINANCIAL STATEMENTS
June 30, 2015

contribution for the year ended June 30, 2015 were 10.62% and \$127,307, respectively. Actual contributions for the year equaled \$127,307, or 10.62% of required contributions.

Net Pension Liability (Asset): Covington Electric System's net pension liability (asset) was measured as of March 31, 2015, and the total pension liability used to calculate net pension liability (asset) was determined by an actuarial valuation as of that date.

Actuarial assumptions: The total pension liability as of March 31, 2015 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Actuarial cost method	Aggregate
Asset valuation method	Market value
Inflation	2.5%
Salary increases	3.0%
Investment rate of return	6.5%, net of plan investment expense, including inflation
Retirement age	65
Mortality	RP-2000
Withdrawal rates	None

The actuarial assumptions used in the April 1, 2015 actuarial valuation were based on the results of an actuarial experience study performed for the period April 1, 2014 through March 31, 2015. The demographic assumptions were adjusted to more closely reflect actual and expected future experience.

Discount Rate: The discount rate used to measure the total pension liability was 6.5%. The projection of cash flows used to determine the discount rate assumes that employee contributions will be made at the current contribution rate and the employer will continue to contribute the actuarially determined contribution in accordance with the plan's current funding policy on an annual basis. Based on that assumption, the pension plan's fiduciary net position is projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Changes in the Net Pension Liability (Asset):

COVINGTON ELECTRIC SYSTEM
NOTES TO FINANCIAL STATEMENTS
June 30, 2015

	Increases/Decrease		
	Total Pension	Plan Fiduciary	Net Pension
	<u>Liability</u>	<u>Net Position</u>	<u>Liability</u>
Balance at March 31, 2014	\$ 3,106,888	\$ 2,815,008	\$ 291,880
Changes for the year:			
Service cost	92,286	-	92,286
Interest cost	201,831	-	201,831
Difference between expected and actual experience	(102,458)	-	(102,458)
Employer contributions	-	127,307	(127,307)
Employee contributions	-	-	-
Net investment income	-	164,946	(164,946)
Benefit payments	(95,873)	(95,873)	-
Administrative expense	-	(28,073)	28,073
Other charges	-	-	-
Net changes:	<u>95,786</u>	<u>168,307</u>	<u>(72,521)</u>
Balance at March 31, 2015	<u>\$ 3,202,674</u>	<u>\$ 2,983,315</u>	<u>\$ 219,359</u>

Sensitivity of the net pension liability (asset) to changes in the discount rate: The following presents the net pension liability (asset) of Covington Electric System calculated using the discount rate of 6.5 percent, as well as what the net pension liability (asset) would be if it were calculated using a discount rate that is 1-percentage-point lower (5.5 percent) or 1-percentage-point higher (7.5 percent) than the current rate:

Net Pension Liability with a 1% Decrease in Discount Rate: 5.5%	\$ 665,784
Net Pension Liability at Current Discount Rate: 6.5%	219,359
Net Pension Liability with a 1% Increase in Discount Rate: 7.5%	\$ (157,724)

Plan Fiduciary Net Position: Detailed information about the Plan's fiduciary net position is available in the separately issued Retirement Plan for Employees of Covington Electric System financial report.

Pension Expense (Income) and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions: For the year ended June 30, 2015, the Utility recognized pension expense of \$135,599. At June 30, 2015, deferred outflows of resources and inflows of resources in relation to pensions were as follows:

	<u>Deferred</u>	<u>Deferred</u>
	<u>Outflows</u>	<u>Inflows</u>
Difference between expected and actual experience	\$ -	\$ 96,054
Change of assumptions	-	-
Net difference between projected and actual earnings in pension investments	15,241	-
Pension contributions subsequent to measurement date	120,292	-
	<u>\$ 135,533</u>	<u>\$ 96,054</u>

COVINGTON ELECTRIC SYSTEM
NOTES TO FINANCIAL STATEMENTS
June 30, 2015

Amounts reported as deferred outflows of resources and deferred inflows of resources will be recognized in pension expense as follows:

Year ending September 30,		
2016	\$	10,214
2017		10,214
2018		10,214
2019		10,214
2020		6,404
Thereafter	\$	64,034

Payable to The Retirement Plan for employees of Covington Electric System: At June 30, 2015, the utility showed no amounts outstanding for contributions due to The Retirement Plan for Employees of Covington Electric System.

B. Power Contract

The System has a power contract with the Tennessee Valley Authority (TVA) whereby the System purchases all its electric power from TVA and is subject to certain restrictions and conditions as provided for in the power contract. Such restrictions include, but are not limited to, prohibitions against furnishing, advancing, lending, pledging, or otherwise diverting System funds, revenues, or property to other operations of the municipality and the purchase or payment of or providing security for indebtedness on other obligations applicable to such other operations.

C. Risk Management

The System 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. During the year ended June 30, 2015, the System purchased commercial insurance for all of the above risks. Settled claims have not exceeded this commercial coverage in any of the past three years and there has been no significant reduction in the amount of coverage.

D. Unamortized Acquisition Adjustment - Vandergrift Annexation

As of May 2012, the System has made an agreement to pay Southwest Tennessee Electric Membership Corporation a one time payment in the amount of \$241,642 for lost revenue in a recent Vandergrift annexation. This payment took place in the fiscal year 2013 when the project was closed. The annexation cost is reflected as an unamortized acquisition adjustment on the Statement of Net Positions and is amortized monthly over 10 years. The amortization expense related to this annexation as of June 30, 2015 was \$24,164. The balance as of June 30, 2015 is \$173,177.

E. Restatement of Beginning Net Position – GASB 68 Implementation

As of July 1, 2014 a restatement of beginning net position was made for net pension liability and the net difference between projected and actual earnings on pension plan investments due to the System implementing GASB Statement No. 68, *Accounting and Financial Reporting for Pensions— an amendment of GASB Statement No. 27*. The implementation of GASB Statement No. 68 resulted in the System restating net position by (\$260,053). The net effect of this restatement of beginning net position resulted in a decrease in the July 1, 2014 net position in the amount of (\$260,053).

REQUIRED SUPPLEMENTARY INFORMATION

COVINGTON ELECTRIC SYSTEM
SCHEDULE OF CHANGES IN NET POSITION LIABILITY (ASSET) AND RELATED
RATIOS BASED ON PARTICIPATION IN THE PUBLIC EMPLOYEE PENSION PLAN
June 30, 2015

	2015
Total pension liability	
Service cost	\$ 92,286
Interest	201,831
Changes in benefit terms	-
Differences between actual & expected experience	(102,458)
Change of assumptions	-
Benefit payments, including refunds of employee contributions	(95,873)
Net change in total pension liability	95,786
Total pension liability - beginning	3,106,888
Total pension liability - ending (a)	3,202,674
 Plan fiduciary net position	
Contributions - employer	127,307
Contributions - employee	-
Net investment income	164,946
Benefit payments, including refunds of employee contributions	(95,873)
Administrative expense	(28,073)
Net change in plan fiduciary net position - beginning	168,307
Plan fiduciary net position - beginning	2,815,008
Plan fiduciary net position - ending (b)	2,983,315
 Net pension liability (asset) - ending (a) - (b)	219,359
 Plan fiduciary net position as a percentage of total pension liability	93.15%
 Covered - employee payroll	1,198,494
 Net pension liability (asset) as a percentage of covered - employee payroll	18.30%

This is a 10-year schedule; however, the information in this schedule is not required to be presented retroactively. Years will be added to this schedule in future fiscal years until 10 years of information is available

See independent auditor's report.

COVINGTON ELECTRIC SYSTEM
SCHEDULE OF CONTRIBUTIONS BASED ON PARTICIPATION IN THE PUBLIC
EMPLOYEE PENSION PLAN
For the Year Ended June 30, 2015

	2014
Actuarially determined contribution	\$ 127,307
Contributions in relation to the actuarially determined contribution	127,307
Contribution deficiency (excess)	\$ -
Covered-employee payroll	\$ 1,198,494
Contributions as a percentage of covered - employee payroll	10.62%

This is a 10-year schedule; however, the information in this schedule is not required to be presented retroactively. Years will be added to this schedule in the future fiscal years until 10 years of information is available.

See independent auditor's report.

COVINGTON ELECTRIC SYSTEM
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION
For the Year Ended June 30, 2015

Valuation Date	Actuarially determined contributions are calculated as of July 1st, twelve months prior to the fiscal year in which contributions are reported
Actuarial cost method	Aggregate Cost Method
Amortization Method	NA
Remaining Amortization	NA
Asset valuation	Market Value
Inflation	2.5%
Withdrawal Rates	None
Salary Increases	3% , including inflation
Investment Rate of Return	6.5 percent, net of plan investment expense, including inflation
Retirement age	Age 65
Mortality	RP-2000 Mortality Table

See independent auditor's report.

SUPPLEMENTARY AND OTHER INFORMATION SECTION

COVINGTON ELECTRIC SYSTEM
SCHEDULE OF OPERATING REVENUES AND EXPENSES - ELECTRIC SYSTEM
For the Years Ended June 30, 2015

	2015	
	Amount	Percent
Operating revenues:		
Charges for sales and services:		
Residential sales	\$ 4,871,108	23.43
Small lighting and power sales	1,726,998	8.31
Large lighting and power sales	13,986,334	67.27
Power credit	(472,306)	(2.27)
Street and athletic lighting sales	164,034	0.79
Outdoor lighting	225,989	1.09
Uncollectible accounts	(4,835)	(0.02)
Total charges for sales and services	20,497,322	98.59
Other revenues		
Forfeited discounts	106,916	0.51
Miscellaneous service revenue	53,117	0.26
Rent from electric property	120,112	0.58
Other electric revenue	13,076	0.06
Total other revenues	293,221	1.41
Total operating revenues	20,790,543	100.00
Operating expenses:		
Cost of sales and services:		
Purchased power	17,141,050	82.45
Distribution expenses:		
Supervision and engineering	110,531	0.53
Station expense	22,830	0.11
Overhead line expense	195,591	0.94
Underground line expense	15,694	0.08
Street lighting and signal system	5,209	0.03
Meter expense	121,068	0.58
Customer installation expense	15,812	0.08
Miscellaneous	25,588	0.12
Rents	13,456	0.06
Total distribution expenses	\$ 525,779	2.53

See independent auditor's report.

COVINGTON ELECTRIC SYSTEM
SCHEDULE OF OPERATING REVENUES AND EXPENSES - ELECTRIC SYSTEM
For the Years Ended June 30, 2015

	2015	
	<u>Amount</u>	<u>Percent</u>
Customer accounts expenses:		
Supervision Customer Accounts	\$ 47,266	0.23
Meter reading expense	56,235	0.27
Customer records and collection	<u>234,171</u>	<u>1.13</u>
Total customer accounts expenses	<u>337,672</u>	<u>1.62</u>
Customer service and information expenses:		
Customer assistance expense	4,637	0.02
Miscellaneous customer service	<u>7,500</u>	<u>0.04</u>
Total customer service and information expenses	<u>12,137</u>	<u>0.06</u>
Administrative expenses		
Salaries	258,360	1.24
Office supplies and expense	87,056	0.42
Administrative expenses transferred	(56,305)	(0.27)
Outside services employed	20,392	0.10
Insurance	736	0.00
Injuries and damages	95,691	0.46
Employee pension and benefits	362,175	1.74
Advertising	1,935	0.01
Miscellaneous	<u>78,183</u>	<u>0.38</u>
Total administrative expenses	<u>848,223</u>	<u>4.08</u>
Total operations expenses	<u>1,723,811</u>	<u>8.29</u>
Maintenance expenses		
Distribution expenses:		
Supervision and engineering	110,520	0.53
Station equipment	25,562	0.12
Overhead lines	434,911	2.09
Underground lines	1,263	0.01
Line transformers	4,633	0.02
Fiber Cable	1,970	0.01
Street lights and signal system	9,771	0.05
Outdoor lighting	<u>27,989</u>	<u>0.13</u>
Total distribution expenses	<u>616,619</u>	<u>2.97</u>
Administrative expenses:		
General plant and equipment	<u>85,230</u>	<u>0.41</u>
Total maintenance expenses	<u>701,849</u>	<u>3.38</u>
Depreciation and amortization	<u>703,259</u>	<u>3.38</u>
Taxes	<u>92,312</u>	<u>0.44</u>
Total operating expenses	<u>\$ 20,362,281</u>	<u>97.94</u>

See independent auditor's report.

COVINGTON ELECTRIC SYSTEM
SCHEDULE OF LONG-TERM DEBT
June 30, 2015

Year Ended June 30,	Series 2003	
	Electric Revenue and Tax	
	Bonds	
	Principal	Interest
2016	110,000	46,376
2017	115,000	42,057
2018	120,000	37,488
2019	125,000	32,648
2020	130,000	27,483
2021	135,000	22,034
2022	140,000	16,188
2023	145,000	9,954
2024	155,000	3,391
	\$ 1,175,000	\$ 237,619

See independent auditor's report.

COVINGTON ELECTRIC SYSTEM
ELECTRIC RATES IN FORCE
June 30, 2015

Residential rate schedule

Customer charge - per delivery point per month	\$ 10.11
Energy charge - cents per kWh	0.09022

General power schedule

GSA1 (Under 50 kW demand & less than 15,000 kWh)	
Customer charge - per delivery point per month	30.00
Energy charge - cents per kWh	0.10165
GSA2 (51-1000 kW demand or more than 15,000 kWh)	
Customer charge - per delivery point per month	100.00
Demand charges - per kW per month	
First 50 Kw	No Charge
Excess over 50 kW	12.96
Energy charge - cents per kWh	
First 15,000 kWh per month	0.10165
Additional kWh per month	0.06116
GSA3 (1000 - 5000 kW demand)	
Customer charge - per delivery point per month	225.00
Demand charges - per kW per month	
First 1,000 kW	11.94
Excess over 1,000 kW	11.91
Excess over 2,500 kW	12.21
Energy charge - cents per kWh	0.06573
SMSB (Seasonal Demand and Energy - Manufacturing Service)	
Customer charge - per delivery point per month	1,500.00
Administrative charge	350.00
Summer kW (all)	19.54
Energy charge - cents per kWh	0.04047

Outdoor Lighting LS	\$ 0.06520
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See independent auditor's report.

COVINGTON ELECTRIC SYSTEM
SUPPLEMENTAL INFORMATION - ELECTRIC SYSTEM - UNAUDITED
For the Years Ended June 30,

	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>
Revenue					
Residential	\$ 4,871,108	\$ 4,987,937	\$ 4,869,572	\$ 4,835,570	\$ 5,018,475
Small lighting	1,726,998	1,729,783	1,704,784	1,768,007	1,791,691
Large lighting	13,514,028	12,278,732	12,085,778	11,305,806	10,857,546
Street and athletic lighting	164,034	171,194	164,898	163,154	162,475
Outdoor lighting	225,989	223,851	217,026	217,108	222,478
Uncollectible accounts	(4,835)	(11,955)	(5,524)	(9,379)	(10,073)
Other operating	293,221	300,259	261,731	266,949	292,667
Interest and other revenue	25,388	26,064	27,856	34,806	47,484
	<u>20,815,931</u>	<u>19,705,865</u>	<u>19,326,121</u>	<u>18,582,021</u>	<u>18,382,743</u>
Expense					
Electric power costs	17,141,050	15,935,924	15,717,411	14,871,426	15,645,031
Other operating expenses	2,425,660	2,050,261	2,086,057	2,103,900	2,207,100
Provision for depreciation	703,259	704,869	698,990	652,221	633,755
Taxes	92,312	85,573	86,471	85,739	83,209
Extraordinary item	-	152,622	-	-	-
Transfer - tax equivalent	382,786	385,106	370,348	366,594	373,272
Interest and other expense	68,278	66,972	68,784	75,245	78,995
	<u>20,813,345</u>	<u>19,381,327</u>	<u>19,028,061</u>	<u>18,155,125</u>	<u>19,021,362</u>
Net income (loss)	<u>\$ 2,586</u>	<u>\$ 324,538</u>	<u>\$ 298,060</u>	<u>\$ 426,896</u>	<u>\$ (638,619)</u>
Financial					
Plant in service (at original cost)	<u>\$ 21,480,215</u>	<u>\$ 21,171,149</u>	<u>\$ 20,988,625</u>	<u>\$ 20,451,264</u>	<u>\$ 20,358,090</u>
Bonds and notes outstanding	<u>\$ 1,175,000</u>	<u>\$ 1,280,000</u>	<u>\$ 1,380,000</u>	<u>\$ 1,480,000</u>	<u>\$ 1,580,000</u>
Power in use - kWh					
Residential	50,126,898	51,793,728	50,574,591	50,242,372	54,333,339
Small commercial	14,419,190	14,646,330	14,424,491	15,098,034	15,776,386
Large commercial	166,848,132	146,593,119	141,887,306	129,754,172	124,277,665
Street and athletic lighting	1,510,016	1,613,465	1,534,728	1,519,201	1,529,708
Outdoor lighting	1,777,038	1,753,610	1,697,839	1,706,472	1,771,732
Total	<u>234,681,274</u>	<u>216,400,252</u>	<u>210,118,955</u>	<u>198,320,251</u>	<u>197,688,830</u>
Peak kW demand	<u>46,959</u>	<u>46,959</u>	<u>46,916</u>	<u>44,941</u>	<u>45,920</u>
Number of customers					
Residential	3,795	3,761	3,777	3,735	3,748
Small lighting	811	796	783	798	809
Large lighting	138	132	134	131	141
Street and athletic lighting	30	30	29	28	41
Outdoor lighting	31	28	28	25	25
	<u>4,805</u>	<u>4,747</u>	<u>4,751</u>	<u>4,717</u>	<u>4,764</u>
Line loss	<u>3.06%</u>	<u>2.37%</u>	<u>2.78%</u>	<u>2.87%</u>	<u>5.16%</u>

See independent auditor's report.

COVINGTON ELECTRIC SYSTEM
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended June 30, 2015

	<u>CFDA Number</u>	<u>Contract Number</u>	<u>Expenses</u>
Federal Grantor/PassThrough Grantor			
U.S. Department of Homeland Security/ Federal Emergency Management Agency			
Passed through Tennessee Department of Military, Tennessee Emergency Management Agency			
Public Assistance - 2015			
	97.036	FEMA-4189-DR-TN	\$ <u>60,262</u>

All revenues and expenses reported are under the modified accrual basis of accounting.

Due to the regulatory basis of accounting of Tennessee Valley Authority, the above grant is not recorded as revenues and expenses. It is recorded through plant.

See independent auditor's report.

INTERNAL CONTROL AND COMPLIANCE SECTION

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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 of Directors
Covington Electric System
Covington, Tennessee

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 Covington Electric System (the System), an enterprise fund of the City of Covington, Tennessee, as of and for the year ended June 30, 2015 and the related notes to the financial statements, which collectively comprise the System's basic financial statements, and have issued our report thereon dated December 11, 2015.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the System's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System'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. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on

the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

In addition, we noted certain other matters involving the internal control and its operation that we reported to management of the System in a separate letter dated December 11, 2015.

Purpose of this Report

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

Alexander Thompson Arnold PLLC

Jackson, Tennessee
December 11, 2015

COVINGTON ELECTRIC SYSTEM
SCHEDULE OF FINDINGS
June 30, 2015

Current Year Findings:

No current year findings reported.

**COVINGTON ELECTRIC SYSTEM
SCHEDULE OF PRIOR YEAR FINDINGS**
June 30, 2015

Prior Year Findings:

No prior year findings reported.