# Heartland Consumers Power District

Independent Auditor's Reports and Financial Statements

December 31, 2018 and 2017

BKD LLP
CPAs & Advisors

# Heartland Consumers Power District
## December 31, 2018 and 2017

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# Independent Auditor's Report

Board of Directors
Heartland Consumers Power District
Madison, South Dakota

We have audited the accompanying financial statements of Heartland Consumers Power District (Heartland), as of and for the years ended December 31, 2018 and 2017, and the related notes to the financial statements, which collectively comprise Heartland's basic financial statements as listed in the table of contents.

### *Management's Responsibility for the Financial Statements*

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

### *Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

### *Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Heartland Consumers Power District as of December 31, 2018 and 2017, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

### *Other Matters*

#### *Required Supplementary Information*

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

#### *Other Information*

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Heartland’s basic financial statements. The schedules of transmission operation and maintenance expenses and of administrative and general expenses as listed in the table of contents, are presented for purposes of additional analysis and are not a required part of the basic financial statements.

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

BKD, LLP

Lincoln, Nebraska
April 3, 2019

## MANAGEMENT'S DISCUSSION AND ANALYSIS

This discussion and analysis of Heartland Consumers Power District's (Heartland or HCPD) financial statements provides the reader an overview of the financial activities for 2018, 2017 and 2016. Heartland's financial statements are comprised of three components: (1) Management's Discussion and Analysis, (2) financial statements, and (3) notes to the financial statements. Please read this in conjunction with the audited financial statements and footnotes contained herein.

### *Overview of Financial Statements*

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

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

| | Condensed Balance Sheets As of December 31, | | | Fiscal Year-to-Year Percentage Change | |
|---|---|---|---|---|---|
| | 2018 | 2017 | 2016 | From 2017 to 2018 | From 2016 to 2017 |
| Current assets | $ 25,332 | $ 27,285 | $ 28,769 | (7.2)% | (5.2)% |
| Capital assets, net | 2,509 | 22,155 | 20,402 | (88.7)% | 8.6% |
| Other noncurrent assets | 46,648 | 6,633 | 5,500 | 603.3% | 20.6% |
| Total assets | 74,489 | 56,073 | 54,671 | 32.8% | 2.6% |
| Deferred outflows of resources | 679 | 801 | 675 | (15.2)% | (5.9)% |
| Total assets and deferred outflows of resources | $ 75,168 | $ 56,874 | $ 55,346 | 32.2% | 2.8% |
| Current liabilities | $ 7,658 | $ 4,885 | $ 10,727 | 56.8% | (54.5)% |
| Noncurrent liabilities | 38,637 | 9,867 | 5,650 | 291.6% | 74.6% |
| Total liabilities | 46,295 | 14,752 | 16,377 | 213.8% | (9.9)% |
| Deferred inflows of resources | 1,909 | 1,914 | 1,776 | (0.3)% | 7.8% |
| Net investment in capital assets | 2,509 | 16,855 | 12,250 | (85.1)% | 37.6% |
| Restricted for debt service | 161 | - | 5,660 | 100.0% | (100.0)% |
| Unrestricted | 24,294 | 23,353 | 19,283 | 4.0% | 21.1% |
| Total net position | 26,964 | 40,208 | 37,193 | (32.9)% | 8.1% |
| Total liabilities, deferred inflows of resources and net position | $ 75,168 | $ 56,874 | $ 55,346 | 32.2% | 2.8% |

Heartland's overall net position decreased in 2018 by $13,243,937 and increased in 2017 and 2016 by $3,015,031 and $9,801,428, respectively.

Generation and transmission facilities have traditionally represented 95% of Heartland's total capital assets. The remaining 5% of capital assets includes Heartland's headquarters building, transportation equipment, and office equipment. During 2018, Heartland sold its ownership interest in Laramie River Station (LRS) to a third party, and also sold its ownership interests in TPI and TPIII to separate third parties. This disposition of ownership interests resulted in a decrease in capital assets, net of accumulated depreciation, of approximately $20.5 million. Heartland also received approximately $9.9 million from the third parties for the sale of its ownership interests in these generation and transmission facilities. Further information regarding capital assets can be found in Note 4.

Additionally, during 2018, Heartland issued Electric System Taxable Revenue Bonds, Series 2018, in the amount of $32,855,000. These bonds were issued at a premium of $2,485,000 resulting in total proceeds received by Heartland in the amount of $35,340,000. The proceeds were used by Heartland to make a $35 million prepayment during 2018 to terminate a transmission contract which is no longer necessary to Heartland's electric system. As Heartland qualifies as a rate-making entity under the provisions of Governmental Accounting Standards Board (GASB) Codification Section Re10, *Regulated Operations*, this prepayment was recorded as a regulatory asset (costs recoverable from future billings) and will be amortized in future rate periods when such costs are included in the revenue requirements to establish electric rates.

## *Results of Operations*

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

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

| | Condensed Statements of Revenues, Expenses and Changes in Net Position Years Ended December 31, | | | Fiscal Year-to-Year Percentage Change | |
|---|---|---|---|---|---|
| | 2018 | 2017 | 2016 | From 2017 to 2018 | From 2016 to 2017 |
| Power sales | | | | | |
| Customer energy (MWh) | 453,174 | 425,050 | 637,252 | 6.6% | (33.3)% |
| Customer cumulative demand (kW) | 807,498 | 762,089 | 1,085,799 | 6.0% | (29.8)% |
| Revenues | | | | | |
| Customer revenue | $ 38,484 | $ 36,217 | $ 50,071 | 6.3% | (27.7)% |
| Contracted requirements revenue | 12,025 | 15,455 | 17,893 | (22.2)% | (13.6)% |
| Surplus sales revenue | 1,085 | 4,098 | 2,557 | (73.5)% | 60.3% |
| Other operating revenue | 382 | 1,899 | 4,041 | (79.9)% | (53.0)% |
| Transfer for rate stabilization | - | - | (1,750) | —% | 100.0% |
| Total operating revenue | 51,976 | 57,669 | 72,812 | (9.9)% | (20.8)% |

| | Condensed Statements of Revenues, Expenses and Changes in Net Position Years Ended December 31, 2018 | 2017 | 2016 | Fiscal Year-to-Year Percentage Change From 2017 to 2018 | From 2016 to 2017 |
|---|---|---|---|---|---|
| Expenses | | | | | |
| LRS production & O&M | $ 3,108 | $ 7,020 | $ 7,732 | (55.7)% | (9.2)% |
| Cost of power | 33,776 | 34,229 | 41,368 | (1.3)% | (17.3)% |
| Transmission | 7,882 | 7,544 | 6,400 | 4.5% | 17.9% |
| Depreciation | 621 | 1,073 | 1,323 | (42.1)% | (18.9)% |
| Taxes | 473 | 628 | 447 | (24.7)% | 40.5% |
| Administration and general | 4,394 | 3,645 | 3,947 | 20.5% | (7.7)% |
| Amortization | 203 | 203 | 1,108 | —% | (81.7)% |
| Total operating expenses | 50,457 | 54,342 | 62,325 | (7.1)% | (12.8)% |
| Operating income | 1,519 | 3,327 | 10,487 | (54.3)% | (68.3)% |
| Total nonoperating revenues (expenses), net | 338 | (312) | (686) | (208.3)% | (54.5)% |
| Sale of interest in generating and transmission facilities | (15,101) | - | - | (100.0)% | —% |
| Change in net position | (13,244) | 3,015 | 9,801 | (362.7)% | (122.8)% |
| Net position, beginning of year | 40,208 | 37,193 | 27,392 | | |
| Net position, end of year | $ 26,964 | $ 40,208 | $ 37,193 | | |

Operating revenues include firm power sales to Heartland's wholesale rate customers, other contracted sales, short-term energy sales on the surplus market, and other revenues. Demand and energy sales for 2018 were 807 MW and 453,174 MWh, respectively. Heartland's customer peak was 78 MW in 2018. Demand and energy sales for 2017 were 762 MW and 425,050 MWh, respectively. The 2017 peak demand of Heartland's long-term wholesale customers was 73.5 MW. Heartland's wholesale customer demand and energy sales for 2016 were 1,086 MW and 637,252 MWh, respectively. Heartland's wholesale customer peak demand for 2016 was 126.7 MW. The increase in customer revenue in 2018 was a result of an increase in consumption from South Dakota customers, specifically Madison. The decrease in customer revenue in 2017 was a result of two of Heartland's long-term contracts ending June 30, 2016, with the most significant being Marshall, MN. Heartland received over 10 years advance notice of the contract termination.

Heartland has other energy sales contracts, in addition to its wholesale customers. The contracted requirements revenue mitigates exposure to the surplus market for excess power and the contracts typically contain fixed pricing and quantities. Many of these contracts are unit contingent and Heartland is not required to provide replacement power. These revenues were less in 2018 as a result of the termination of long-term power sales agreements with Basin Electric Power Cooperative. These agreements were terminated in conjunction with Heartland's sale of its ownership interest in LRS, as the energy provided under the agreements related to the output from LRS. Contracted requirements revenues were less in 2017 due to more scheduled and unscheduled outages compared to 2016.

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

The operating expenses fluctuated in some areas. Production expenses (the cost for coal, transportation, and operations and maintenance at Laramie River Station (LRS)) decreased by 55.7% and 9.2% in 2018 and 2017, respectively. The largest reason for the decrease was the disposition of Heartland's interest in LRS. LRS unit 1 had a long outage for environmental improvements in 2017.

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

Heartland is a member of Public Power Generation Agency (PPGA), an interlocal agency created under Nebraska statute to build WEC2, a 220 megawatt coal-fired project near Hastings, Nebraska. Heartland's participation in PPGA is for 80 megawatts. PPGA financed construction of WEC2 directly, rather than obtaining funding from its members. Heartland has a contract with Hastings Utilities for an additional share of WEC2. This contract decreases annually. Heartland also has a contract with North Iowa Municipal Electric Cooperative Association (NIMECA) in which NIMECA purchases output of WEC2 for the life of the unit. NIMECA's contract includes all owners' costs and increases annually until 2019. The combination of the Hastings Utilities contract reduction and the NIMECA contract increases resulted in reduced cost of power in 2018 and 2017. Also attributing to the reduction in the cost of power in 2017 was a short-term power supply contract that corresponded with the end date of Marshall's contract in 2016.

The nonoperating revenues/expenses include interest on bonds, investment income, and amortization of costs recoverable from future billings. Heartland recognized increased investment income in 2018 due to improved market conditions and higher interest rates on its cash and investments. Heartland also reported grant revenue of $300,000 in 2018 in relation to its involvement with the USDA's Rural Economic Development Loans and Grants (REDLG) program.

Heartland made principal payments of $5,300,000 on its Electric System Second Lien Revenue Bonds, Series 2011 paying off the entire balance in 2018.

Fitch assigned an underlying rating of A- to Heartland and Moody's assigned A2.

### *Contact Information*

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

# Heartland Consumers Power District

## Balance Sheets

## December 31, 2018 and 2017

### Assets and Deferred Outflows of Resources

| | 2018 | 2017 |
|---|---|---|
| **Current Assets** | | |
| Cash and cash equivalents | $ 3,744,582 | $ 10,052,900 |
| Restricted cash and cash equivalents | 302,760 | - |
| Short-term investments | 14,733,522 | 4,649,471 |
| Accounts receivable | 5,757,710 | 7,240,446 |
| Notes receivable, current portion | 701,840 | 581,330 |
| Plant operation assets | - | 4,715,107 |
| Prepaid expenses and other current assets | 91,173 | 45,428 |
| Total current assets | 25,331,587 | 27,284,682 |
| **Noncurrent Assets** | | |
| Notes receivable, net of allowance of $488,728 for 2018 and $539,907 for 2017 | 5,997,560 | 4,233,487 |
| Long-term investments | 2,192,954 | 215,662 |
| Capital assets, net | 2,509,353 | 22,154,984 |
| Costs recoverable from future billings | 37,360,250 | 1,080,970 |
| Net pension asset | 2,049 | 7,850 |
| Other noncurrent assets | 1,095,000 | 1,095,000 |
| Total noncurrent assets | 49,157,166 | 28,787,953 |
| **Deferred Outflows of Resources** | | |
| Deferred outflows for pensions | 678,817 | 801,578 |
| Total assets and deferred outflows of resources | $ 75,167,570 | $ 56,874,213 |

## Liabilities, Deferred Inflows of Resources and Net Position

| | 2018 | 2017 |
|---|---|---|
| **Current Liabilities** | | |
| Current maturities of long-term debt | $ 2,152,564 | $ 273,595 |
| Accounts payable | 4,926,564 | 4,275,336 |
| Accrued expenses | 429,805 | 331,732 |
| Accrued interest payable | 149,021 | 4,514 |
| Total current liabilities | 7,657,954 | 4,885,177 |
| **Noncurrent Liabilities** | | |
| Line of credit | - | 5,300,000 |
| Long-term debt, net | 38,342,257 | 4,310,842 |
| Other noncurrent liabilities | 294,598 | 256,443 |
| Total noncurrent liabilities | 38,636,855 | 9,867,285 |
| Total liabilities | 46,294,809 | 14,752,462 |
| **Deferred Inflows of Resources** | | |
| Deferred inflows for pensions | 158,789 | 163,842 |
| Reductions of future billings | 1,750,000 | 1,750,000 |
| Total deferred inflows of resources | 1,908,789 | 1,913,842 |
| **Net Position** | | |
| Net investment in capital assets | 2,509,353 | 16,855,030 |
| Restricted for debt service | 160,417 | - |
| Unrestricted | 24,294,202 | 23,352,879 |
| Total net position | 26,963,972 | 40,207,909 |
| Total liabilities, deferred inflows of resources and net position | $ 75,167,570 | $ 56,874,213 |

# Heartland Consumers Power District

## Statements of Revenues, Expenses and Changes in Net Position

## Years Ended December 31, 2018 and 2017

| | 2018 | 2017 |
|---|---|---|
| **Operating Revenues** | | |
| Customer requirements | $ 38,483,860 | $ 36,217,321 |
| Other contracted requirements | 12,024,567 | 15,455,330 |
| Surplus sales revenue | 1,084,711 | 4,098,323 |
| Other operating revenue | 382,664 | 1,898,491 |
| Total operating revenues | 51,975,802 | 57,669,465 |
| **Operating Expenses** | | |
| LRS production & O&M | 3,108,356 | 7,019,752 |
| Cost of power | 33,775,636 | 34,228,816 |
| Transmission | 7,882,354 | 7,544,266 |
| Depreciation | 620,853 | 1,073,257 |
| Taxes | 473,360 | 628,692 |
| Administration and general | 4,393,663 | 3,645,321 |
| Amortization | 202,641 | 202,641 |
| Total operating expenses | 50,456,863 | 54,342,745 |
| **Operating Income** | 1,518,939 | 3,326,720 |
| **Nonoperating Revenues (Expenses)** | | |
| Investment income | 430,716 | 197,498 |
| Interest expense | (224,510) | (74,081) |
| Amortization expense | (18,084) | (54,253) |
| Grant revenue | 300,000 | - |
| Other | (149,783) | (380,853) |
| Net nonoperating revenues (expenses) | 338,339 | (311,689) |
| **Sale of Interest in Generating and Transmission Facilities** | (15,101,215) | - |
| **Change in Net Position** | (13,243,937) | 3,015,031 |
| **Net Position, Beginning of Year** | 40,207,909 | 37,192,878 |
| **Net Position, End of Year** | $ 26,963,972 | $ 40,207,909 |

# Heartland Consumers Power District

## Statements of Cash Flows

## Years Ended December 31, 2018 and 2017

| | 2018 | 2017 |
|---|---|---|
| **Operating Activities** | | |
| Receipts from customers | $ 38,483,860 | $ 36,459,241 |
| Receipts from others | 14,974,678 | 21,747,194 |
| Payments to suppliers | (47,801,731) | (51,321,654) |
| Payment for transmission contract buyout | (35,000,000) | - |
| Payments to employees | (1,635,439) | (1,782,428) |
| Net cash provided by (used in) operating activities | (30,978,632) | 5,102,353 |
| **Noncapital Financing Activities** | | |
| Proceeds from issuance of promissory notes | 1,666,737 | 1,782,486 |
| Payments on promissory notes | (1,096,353) | (255,361) |
| Proceeds from issuance of revenue bonds | 35,340,000 | - |
| Debt issuance costs | (520,301) | - |
| Federal grants received | 300,000 | - |
| Other nonoperating payments | (181,875) | (184,727) |
| Net cash provided by noncapital financing activities | 35,508,208 | 1,342,398 |
| **Capital and Related Financing Activities** | | |
| Advances on revolving line of credit | - | 3,600,000 |
| Payments on revolving line of credit | - | (600,000) |
| Purchase of capital assets | (1,534,241) | (3,077,819) |
| Payments on revenue bonds and notes | (5,300,000) | (5,600,000) |
| Interest paid | (80,003) | (224,878) |
| Proceeds from sale of ownership interests | 9,899,887 | - |
| Net cash provided by (used in) capital and related financing activities | 2,985,643 | (5,902,697) |
| **Investing Activities** | | |
| Proceeds from sales and maturities of investment securities | 4,726,119 | 2,057,358 |
| Purchases of investment securities | (16,777,319) | (4,674,402) |
| Issuance of notes receivable | (3,645,747) | (2,745,000) |
| Repayments of notes receivable | 1,812,343 | 913,687 |
| Investment income received | 363,827 | 183,507 |
| Net cash used in investing activities | (13,520,777) | (4,264,850) |
| **Change in Cash and Cash Equivalents** | (6,005,558) | (3,722,796) |
| **Cash and Cash Equivalents, Beginning of Year** | 10,052,900 | 13,775,696 |
| **Cash and Cash Equivalents, End of Year** | $ 4,047,342 | $ 10,052,900 |
| **Composition of Cash and Cash Equivalents** | | |
| Cash and cash equivalents | $ 3,744,582 | $ 10,052,900 |
| Restricted cash and cash equivalents | 302,760 | - |
| Total | $ 4,047,342 | $ 10,052,900 |

# Heartland Consumers Power District

## Statements of Cash Flows - Continued

## Years Ended December 31, 2018 and 2017

| | 2018 | 2017 |
|---|---|---|
| **Reconciliation of Operating Income to Net Cash Provided by (Used in) Operating Activities** | | |
| Operating income | $ 1,518,939 | $ 3,326,720 |
| Adjustments to reconcile operating income to net cash provided by (used in) operating activities | | |
| Depreciation and amortization | 823,494 | 1,275,897 |
| Changes in balance sheet operating items | | |
| Accounts receivable | 1,482,736 | 536,970 |
| Plant operation assets | 253,942 | 54,147 |
| Prepaid expenses and other assets | (35,968,708) | 50,728 |
| Net pension asset | 5,801 | (304,557) |
| Deferred outflows for pensions | 122,761 | (126,705) |
| Accounts payable | 651,228 | 329,138 |
| Accrued liabilities | 136,228 | (181,936) |
| Deferred inflows for pensions | (5,053) | 141,951 |
| **Net Cash Provided by (Used in) Operating Activities** | $ (30,978,632) | $ 5,102,353 |
| **Supplemental Cash Flows Information** | | |
| Increase (decrease) in allowance for notes receivable | $ (51,179) | $ 196,126 |

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

### *Nature of Operations*

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

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

### *Reporting Entity*

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

### *Basis of Accounting*

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

Heartland's accounting policies also follow the provisions of GASB Codification Section Re10, *Regulated Operations*, which permits an entity with cost-based rates to defer certain costs or income that would otherwise be recognized when incurred to the extent that the rate-regulated entity is recovering or expects to recover such amounts in rates charged to its customers. This method includes the philosophy that debt service requirements, as opposed to depreciation or amortization, are a cost for rate making purposes.

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

### *Use of Estimates*

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

### *Cash Equivalents*

Heartland considers all highly liquid investments with an original maturity of three months or less at the date of purchase to be cash equivalents. At December 31, 2018 and 2017, cash equivalents consisted of money market funds.

### *Investments and Investment Income*

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

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

### *Accounts and Notes Receivable*

Accounts receivable are stated at the amount billed to customers. Accounts receivable are ordinarily due 20 days after the issuance of the invoice. Delinquent receivables are charged off as they are deemed uncollectible. Management does not believe an allowance for doubtful accounts is necessary for accounts receivable at December 31, 2018 and 2017, as there were no delinquent accounts. Notes receivable relate to Heartland's economic development program (see Note 3), and amounts due generally follow amortization schedules contained within the related note agreements. Management has established an allowance for doubtful accounts for notes receivable of $488,728 and $539,907 at December 31, 2018 and 2017, respectively.

### *Plant Operation Assets*

The operation of the Laramie River Station (LRS) requires the establishment of certain operating assets, primarily fuel inventories, supplies, and operating cash. These assets are managed by the operating agent for LRS and are stated at cost. During 2018, the District sold its ownership interest in LRS (see Note 4).

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

### *Capital Assets*

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

### *Compensated Absences*

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

### *Regulated Operations*

Rates for Heartland's regulated operations are established and approved by the Board of Directors. Heartland applies the provisions of GASB Codification Section Re10, *Regulated Operations*, which provide for the deferral of expenses which are expected to be recovered through customer rates over some future period (costs recoverable from future billings) and reductions in earnings to cover future expenditures (reductions of future billings). Costs recoverable from future billings are primarily comprised of charges incurred in relation to Heartland's bond issuances, costs incurred by Heartland for initial payments made on long-term capacity contracts and a prepayment of $35 million made by the District during 2018 to terminate a transmission contract which is no longer necessary. These costs are being amortized in future rate periods when such costs are included in the revenue requirements to establish electric rates. Reductions of future billings are comprised of the unrealized net gains on investments and a Board approved transfer for rate stabilization.

### *Pensions*

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

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

### *Net Position Classification*

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

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

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

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

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

### *Classification of Revenues and Expenses*

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

### *Taxes*

Heartland is exempt from federal income taxes as it is a political subdivision of the state of South Dakota. Heartland may be subject to franchise taxes in states in which it operates. Franchise tax expense was $1,667 and $1,960 in 2018 and 2017, respectively.

## Note 2: Deposits, Investments and Investment Return

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

### *Deposits*

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

### *Investments*

At December 31, 2018 and 2017, Heartland had the following investments and maturities:

| | | Maturities in Years | | | |
|---|---|---|---|---|---|
| | Carrying Value | Less Than 1 | 1-5 | 6-10 | Credit Ratings (Moody's) |
| **December 31, 2018** | | | | | |
| Money market mutual funds | $ 3,266,347 | $ 3,266,347 | $ - | $ - | Aaa-mf |
| U.S. Treasury securities | 16,779,037 | 14,755,732 | 2,023,305 | - | N/A |
| U.S. agency obligations | 147,438 | - | - | 147,438 | Aaa |
| | $ 20,192,822 | $ 18,022,079 | $ 2,023,305 | $ 147,438 | |
| **December 31, 2017** | | | | | |
| Money market mutual funds | $ 8,660,744 | $ 8,660,744 | $ - | $ - | Aaa-mf |
| U.S. Treasury securities | 4,675,044 | 4,675,044 | - | - | N/A |
| U.S. agency obligations | 190,089 | - | - | 190,089 | Aaa |
| | $ 13,525,877 | $ 13,335,788 | $ - | $ 190,089 | |

### *Disclosures About Fair Value of Assets and Liabilities*

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

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

## Note 2: Deposits, Investments and Investment Return - Continued

### *Disclosures About Fair Value of Assets and Liabilities - Continued*

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

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

Heartland's investments in money market mutual funds are carried at cost and thus are not included within the fair value hierarchy. Heartland's investments in U.S. Treasury securities and U.S. agency obligations are measured at fair value on a recurring basis, and are classified within Level 2 of the fair value hierarchy at December 31, 2018 and 2017.

### *Interest Rate Risk*

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

### *Credit Risk*

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

### *Custodial Credit Risk*

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

## Note 2: Deposits, Investments and Investment Return - Continued

### *Concentration of Credit Risk*

Concentration of credit risk is the risk associated with the amount of investments Heartland has with any one issuer that exceeds 5% or more of its total investments. Investments issued or explicitly guaranteed by the U.S. Government are excluded from this requirement. Heartland's investment policy limits the amount of its investment portfolio that may be invested in any one issuer, other than U.S. government securities, to 10%. No investments at December 31, 2018 or 2017 exceeded 5%.

### *Summary of Carrying Values*

The carrying values of deposits and investments shown above are included in the balance sheets at December 31, 2018 and 2017 as follows:

| | 2018 | 2017 |
|---|---|---|
| Carrying value | | |
| Deposits | $ 780,996 | $ 1,392,156 |
| Investments | 20,192,822 | 13,525,877 |
| | $ 20,973,818 | $ 14,918,033 |

Included in the following balance sheet captions:

| | 2018 | 2017 |
|---|---|---|
| Current Assets | | |
| Cash and cash equivalents | | |
| Operating funds | $ 391,122 | $ 352,987 |
| General reserve funds | 2,791,134 | 8,510,584 |
| Revolving loan fund program accounts | 539,872 | 1,189,216 |
| Rate stabilization fund | 22,454 | 113 |
| Total | 3,744,582 | 10,052,900 |
| Restricted cash and cash equivalents | | |
| Debt service funds | 302,760 | - |
| Short-term investments | | |
| General reserve funds | 12,004,367 | - |
| Rate stablilization fund | 2,729,155 | 4,649,471 |
| | 14,733,522 | 4,649,471 |
| Noncurrent Assets | | |
| Long-term investments - rate stabilization fund | 2,192,954 | 215,662 |
| | $ 20,973,818 | $ 14,918,033 |

## Note 2: Deposits, Investments and Investment Return - Continued

### *Investment Return*

Investment return for the years ended December 31, 2018 and 2017 consisted of interest income and realized gains of $333,893 and $120,380, respectively. Unrealized gains and losses on restricted investments are deferred and reported as reductions of future billings shown as a deferred inflow of resources in accordance with the provisions of GASB Codification Section Re10 *Regulated Operations*.

## Note 3: Notes Receivable

| | 2018 | | | | |
|---|---|---|---|---|---|
| Type of Notes | January 1, | Additions | Reductions | December 31, | Due Within One Year |
| 4.0% note in connection with Heartland's economic development program, payable in monthly installments through December 2019 | $ 132,872 | $ - | $ 11,764 | $ 121,108 | $ 121,108 |
| 2.0% to 5.0% notes in connection with the Intermediary Relending Program Promissory Note (see Note 13), due in monthly installments through December 2028 | 2,180,372 | 1,786,867 | 425,407 | 3,541,832 | 379,466 |
| 0.0% to 3.0% notes in connection with the Rural Economic Development Loan Agreement and Rural Economic Development Grant Agreement (see Note 13), due in monthly installments through November 2028 | 3,041,480 | 1,858,880 | 1,375,172 | 3,525,188 | 201,266 |
| Allowance for notes receivable | (539,907) | 81,688 | 132,867 | (488,728) | - |
| Total notes receivable, net | $ 4,814,817 | $ 3,727,435 | $ 1,945,210 | $ 6,699,400 | $ 701,840 |

## Note 3: Notes Receivable - Continued

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

Interest income on these notes totaled $96,823 and $77,118 for 2018 and 2017, respectively, and is included within investment income on the statements of revenues, expenses and changes in net position.

## Note 4: Capital Assets

Capital assets at December 31, 2018 and 2017 consisted of the following:

| | 2018 | 2017 |
|---|---|---|
| Depreciable assets | | |
| Missouri Basin Power Project | $ - | $ 56,663,387 |
| Transmission Project I (TP I) | - | 1,085,293 |
| Groton substation (TP III) | - | 415,292 |
| Heartland headquarters building | 2,837,333 | 2,837,333 |
| General plant | 883,290 | 821,526 |
| Total depreciable assets | 3,720,623 | 61,822,831 |
| Nondepreciable assets | | |
| Land | 80,402 | 80,402 |
| Construction in progress | - | 3,035,525 |
| Total nondepreciable assets | 80,402 | 3,115,927 |
| | $ 3,801,025 | $ 64,938,758 |

## Note 4: Capital Assets - Continued

Capital assets activity for 2018 and 2017 was:

| | 2018 | | | | |
|---|---|---|---|---|---|
| | Beginning Balance | Additions | Retirements | Transfers | Ending Balance |
| Missouri Basin Power Project | $ 56,663,387 | $ 174,100 | $ (56,837,487) | $ - | $ - |
| Transmission Project I (TP I) | 1,085,293 | - | (1,085,293) | - | - |
| Groton substation (TP III) | 415,292 | - | (415,292) | - | - |
| Heartland headquarters building | 2,837,333 | - | - | - | 2,837,333 |
| General plant | 821,526 | 91,090 | (29,326) | - | 883,290 |
| Land | 80,402 | - | - | - | 80,402 |
| Construction in progress | 3,035,525 | 1,269,051 | (4,304,576) | - | - |
| Total capital assets | 64,938,758 | 1,534,241 | (62,671,974) | - | 3,801,025 |
| Less accumulated depreciation | (42,783,774) | (620,853) | 42,112,955 | - | (1,291,672) |
| Capital assets, net | $ 22,154,984 | $ 913,388 | $ (20,559,019) | $ - | $ 2,509,353 |

| | 2017 | | | | |
|---|---|---|---|---|---|
| | Beginning Balance | Additions | Retirements | Transfers | Ending Balance |
| Missouri Basin Power Project | $ 56,029,934 | $ - | $ (135,755) | $ 769,208 | $ 56,663,387 |
| Transmission Project I (TP I) | 1,085,293 | - | - | - | 1,085,293 |
| Groton substation (TP III) | 408,641 | 6,651 | - | - | 415,292 |
| Heartland headquarters building | 2,837,333 | - | - | - | 2,837,333 |
| General plant | 811,285 | 45,543 | (35,302) | - | 821,526 |
| Land | 80,402 | - | - | - | 80,402 |
| Construction in progress | 1,030,796 | 2,773,937 | - | (769,208) | 3,035,525 |
| Total capital assets | 62,283,684 | 2,826,131 | (171,057) | - | 64,938,758 |
| Less accumulated depreciation | (41,881,574) | (1,073,257) | 171,057 | - | (42,783,774) |
| Capital assets, net | $ 20,402,110 | $ 1,752,874 | $ - | $ - | $ 22,154,984 |

Heartland was a 3% co-owner of the Missouri Basin Power Project, which includes Laramie River Station (LRS), a three-unit, 1,650 MW, coal-fired power supply station in eastern Wyoming, and a related transmission system. Effective June 30, 2018, Heartland sold its ownership interest in Laramie River Station to a third-party, which included its capacity and energy entitlement and related transmission and substation facilities. The net proceeds from the sale, in the amount of \$7,400,000, were received by Heartland in September 2018. Heartland also received payment of \$2,000,000 from Basin Electric Power Cooperative to buy out the power sales agreements described in Note 7, which related to output from Laramie River Station.

## Note 4: Capital Assets - Continued

Heartland was also a 24% of 75% (total of 18%) owner of TP I, which consists of approximately eight miles of 115 kv transmission line and associated switching equipment. TP III consists of a 345/115 kv substation located near Groton, South Dakota; a 115 kv tie line between the Groton substation and the substation owned by Western Area Power Administration (WAPA); and a 115 kv circuit breaker in addition to the WAPA Groton substation for the termination of the tie line. Heartland owned a 3.9% share in TP III. Effective June 30, 2018, Heartland sold its ownership interest in TPI and TPIII to separate third parties, which resulted in net proceeds of approximately $500,000.

## Note 5: Credit Facilities

### *Line of Credit*

In March 2015, Heartland entered into a revolving credit agreement with a financial institution that provides for borrowings up to $25,000,000. The maximum amount available under this agreement was decreased to $10,000,000 during 2018. The agreement expires on March 22, 2019, and can be extended at the option of Heartland. Borrowings under the credit agreement bear interest at varying rates, and cannot exceed a maximum rate, as defined in the agreement (2.76% and 1.92% at December 31, 2018 and 2017, respectively). The agreement also provides for standby letters of credit, not to exceed $5,000,000 in the aggregate. The amount available under Heartland's revolving credit agreement is reduced by the amount of any issued standby letters of credit. Heartland had outstanding borrowings of $0 and $5,300,000 on this line at December 31, 2018 and 2017, respectively. This revolving credit agreement is secured as described in Note 6.

### *Letter of Credit*

As financial security for Heartland's performance under certain financial transmission rights and transmission congestion rights in regional transmission organizations in which Heartland participates, Heartland has obtained a standby letter of credit for $1.5 million at December 31, 2018 and 2017. The letter of credit expires September 30, 2019, and can be renewed for an additional one-year term.

## Note 6: Long-term Liabilities

Long-term liabilities at December 31, 2018 consisted of the following:

| | 2018 | | | | |
|---|---|---|---|---|---|
| Type of Debt | January 1, | Additions | Reductions | December 31, | Due Within One Year |
| 3.1-6.137% Revenue Bonds, Series 2018, with interest and principal payments due annually beginning December 1, 2019 through December 2031 | $ - | $ 32,855,000 | $ - | $ 32,855,000 | $ 1,925,000 |
| 1.0% Intermediary Relending Program Promissory Note, due annually on October 16 with a final payment due October 16, 2036 | 547,178 | - | 26,366 | 520,812 | 26,630 |
| 1.0% Intermediary Relending Program Promissory Note, due annually on June 25 with a final payment due June 25, 2040 | 642,125 | - | 25,417 | 616,708 | 25,671 |
| 1.0% Intermediary Relending Program Promissory Note, due annually on November 10, beginning in 2020, with a final payment due November 10, 2046 | 918,750 | 81,250 | - | 1,000,000 | - |
| 1.0% Intermediary Relending Program Promissory Note, due annually on October 11 with a final payment due October 11, 2047 | - | 541,250 | - | 541,250 | - |
| 0% Rural Economic Development Promissory Note, with principal payments due in monthly installments of $6,852 through July 31, 2019; paid in full in 2018 | 137,024 | - | 137,024 | - | - |
| 0% Rural Economic Development Promissory Note, with principal payments due in monthly installments of $3,299 through April 30, 2031 | 531,018 | - | 42,886 | 488,132 | 39,588 |
| 0% Rural Economic Development Promissory Note, with principal payments due in monthly installments of $8,333 through December 31, 2025, paid in full in 2018 | 808,342 | - | 808,342 | - | - |
| 0% Rural Economic Development Promissory Note, with principal payments due in monthly installments of $10,417, beginning in October 2019, through September 21, 2027 | 1,000,000 | - | - | 1,000,000 | 31,251 |
| 0% Rural Economic Development Promissory Note, with principal payments due in monthly installments of $3,202, beginning in April 2018, through March 23, 2028 | - | 384,237 | 28,818 | 355,419 | 38,424 |
| 0% Rural Economic Development Promissory Note, with principal payments due in monthly installments of $5,500, beginning in August 2018, through July 24, 2028 | - | 660,000 | 27,500 | 632,500 | 66,000 |
| | 4,584,437 | 34,521,737 | 1,096,353 | 38,009,821 | 2,152,564 |
| Revenue bonds issuance premium | - | 2,485,000 | - | 2,485,000 | - |
| Total bonds and notes payable | 4,584,437 | 37,006,737 | 1,096,353 | 40,494,821 | 2,152,564 |
| Compensated absences | 347,950 | 155,056 | 113,138 | 389,868 | 95,270 |
| Total long-term liabilities | $ 4,932,387 | $ 37,161,793 | $ 1,209,491 | $ 40,884,689 | $ 2,247,834 |

## Note 6: Long-term Liabilities - Continued

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

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

## Note 6: Long-term Liabilities - Continued

Debt service requirements at December 31, 2018 are as follows:

| | Principal | Interest | Total |
|---|---|---|---|
| 2019 | $ 2,152,564 | $ 1,759,103 | $ 3,911,667 |
| 2020 | 2,314,258 | 1,723,555 | 4,037,813 |
| 2021 | 2,417,175 | 1,657,001 | 4,074,176 |
| 2022 | 2,488,408 | 1,583,881 | 4,072,289 |
| 2023 | 2,564,651 | 1,506,171 | 4,070,822 |
| 2024-2028 | 14,709,721 | 5,439,614 | 20,149,335 |
| 2029-2033 | 10,522,542 | 1,279,320 | 11,801,862 |
| 2034-2038 | 464,243 | 31,294 | 495,537 |
| 2039-2043 | 251,423 | 13,004 | 264,427 |
| 2044-2048 | 124,836 | 2,554 | 127,390 |
| | $ 38,009,821 | $ 14,995,497 | $ 53,005,318 |

During 2018, Heartland issued Electric System Taxable Revenue Bonds, Series 2018, in the amount of $32,855,000 to provide funds to terminate a transmission contract which is no longer necessary in connection with the operation of the District's electric system. The Series 2018 bonds and the revolving credit agreement described in Note 5 are secured equally and ratably by a pledge of (a) the proceeds of the sale of the Series 2018 bonds, pending application thereof, (b) the revenues of Heartland's electric system, after application to operating expenses in accordance with the bond resolution, and (c) all funds and accounts established under the bond resolution, including income, if any, from investments thereof.

Heartland has executed two credit agreements with two financial institutions, one for $740,000 and one for $1,000,000, which are renewed annually. The credit agreements allow Heartland to retain drawing capacity at least equal to the issued and outstanding amount of the Rural Economic Development Promissory Notes. There were no amounts outstanding under these credit agreements at December 31, 2018 and 2017.

## Note 7: Power Sales Agreements

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

## Note 7: Power Sales Agreements - Continued

Heartland entered into power sales agreements with Basin Electric Power Cooperative (Basin) whereby Heartland was contracted to sell and deliver approximately 50 MW of power to Basin through May 31, 2021. The agreements provided for a fixed energy rate throughout the term of the contracts. In relation to Heartland selling its ownership interest in LRS (see Note 4), Basin made a payment of $2,000,000 to terminate the power sales agreements.

## Note 8: Commitments

### *Public Power Generation Agency (PPGA)*

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

## Note 9: Retirement Plans

### *Defined Benefit Plan*

*Plan Description*

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

## Note 9: Retirement Plans - Continued

### *Defined Benefit Plan - Continued*

*Contributions*

Covered employees are required by state statute to contribute a percentage of their salary (6%) to the Plan, and Heartland is required to match the employee contribution. The contribution requirements of plan members and Heartland are established and may be amended by the Plan's board of trustees. Contributions made to the Plan by Heartland were $124,500 and $107,920 during 2018 and 2017, respectively, and were in accordance with statutory rates. The employees' contributions during 2018 and 2017 were $99,778 and $88,534, respectively, and were in accordance with statutory rates.

*Benefits*

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

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

At December 31, 2018 and 2017, Heartland reported an asset of $2,049 and $7,850, respectively, for its proportionate share of the collective net pension asset for the Plan. The net pension asset was measured as of June 30, 2018 and 2017, and the total pension liability used to calculate these amounts was determined by an actuarial valuation as of those dates. Heartland's proportionate share of the net pension asset was based on Heartland's share of contributions to the Plan relative to all employer contributions to the Plan for the measurement period. At December 31, 2018 and 2017, Heartland's proportion was 0.088% and 0.086%, respectively.

## Note 9: Retirement Plans - Continued

### *Defined Benefit Plan - Continued*

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

For the years ended December 31, 2018 and 2017, Heartland recognized pension expense of $123,509 and pension revenue of $289,311, respectively. At December 31, 2018 and 2017, Heartland reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

| | December 31, 2018 | | December 31, 2017 | |
|---|---|---|---|---|
| | Deferred Outflows of Resources | Deferred Inflows of Resources | Deferred Outflows of Resources | Deferred Inflows of Resources |
| Differences between expected and actual experience | $ 77,437 | $ - | $ 125,778 | $ - |
| Net difference between projected and actual earnings on pension plan investments | - | 154,842 | - | 150,923 |
| Changes of assumptions | 520,157 | - | 609,500 | - |
| Change in Heartland's proportionate share | - | 3,947 | - | 12,919 |
| Heartland contributions subsequent to the measurement date | 81,223 | - | 66,300 | - |
| Total | $ 678,817 | $ 158,789 | $ 801,578 | $ 163,842 |

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

| Year Ending December 31, | |
|---|---|
| 2019 | $ 275,417 |
| 2020 | 207,823 |
| 2021 | (27,258) |
| 2022 | (17,177) |
| | $ 438,805 |

## Note 9: Retirement Plans - Continued

### *Defined Benefit Plan - Continued*

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

**Actuarial assumptions** – The total pension liability in the June 30, 2018 and 2017 actuarial valuations was determined using the following actuarial assumptions, applied to all periods included in the measurement:

| | |
|---|---|
| Inflation | 2.25% |
| Salary increases | 6.50% at entry to 3.0% after 25 years of service |
| Discount rate | 6.50%, net of pension plan investment expense |

Mortality rates for the June 30, 2018 and June 30, 2017 actuarial valuation were both based on the RP-2014 Mortality Table, projected generationally with Scale MP-2016.

The actuarial assumptions used in the June 30, 2018 and 2017 valuations were based on the results of an actuarial experience study, which covered the five-year period ending June 30, 2011.

The long-term expected rate of return on pension plan investments was determined using a method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class as of December 31, 2018 and 2017, are summarized in the following table:

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

## Note 9: Retirement Plans - Continued

### *Defined Benefit Plan - Continued*

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

**Discount rate** – The discount rate used to measure the total pension liability in 2018 and 2017 was 6.50%, for both years. The projection of cash flows used to determine the discount rate assumed that contributions from plan members will be made at the current contribution rate, and that contributions from employers will be made at contractually required rates. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

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

| | 1% Decrease (5.50%) | Current Discount Rate (6.50%) | 1% Increase (7.50%) |
|---|---|---|---|
| Heartland's proportionate share of the net pension (asset) liability December 31, 2018 | $ 1,547,426 | $ (2,049) | $ (1,262,462) |

*Pension Plan Fiduciary Net Position*

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

### *Defined Contribution Plan*

In addition to the above retirement plan, Heartland has a savings plan with the National Rural Electric Cooperative Association, which is a defined contribution plan. Employees are eligible to participate in this plan after one month of service. The National Rural Electric Cooperative Association board of directors has the authority to establish and amend provisions to the plan. Heartland matches up to 4% of participating employees' salaries; employees must contribute a minimum of 1% of their salaries. The contributions made by, and related expense of, Heartland for the years ended December 31, 2018 and 2017 were $69,605 and $60,611, respectively. No forfeitures were used to reduce Heartland's contributions during 2018 and 2017. The contributions made by Heartland employees for the years ended December 31, 2018 and 2017 were $101,930 and $92,281, respectively.

## Note 10: Significant Estimates and Concentrations

### *Major Customers*

Sales to one and two customers were approximately 22% and 20%, respectively, of total operating revenues for the years ended December 31, 2018 and 2017, respectively. Approximately 47% and 34% of total accounts receivable were owed from three customers at December 31, 2018 and 2017, respectively.

## Note 11: Risk Management

Heartland is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions, injuries to employees and others; and natural disasters. Heartland carries commercially available insurance, subject to certain limits and deductibles, to reduce the financial impact for claims arising from such matters. Claims have not exceeded this commercial coverage in any of the three preceding years.

## Note 12: Statutory Reporting Requirement

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

| | 2018 | 2017 |
|---|---|---|
| Employees (unaudited) | 12 | 12 |
| Total salaries | $ 1,729,063 | $ 1,506,831 |
| Maintenance expense | $ 252,711 | $ 326,624 |
| Total kilowatt hours sold (unaudited) | 931,747,228 | 956,328,108 |

## Note 13: Segment Information

In accordance with the provisions of the Intermediary Relending Program Loan Agreements, Rural Economic Development Loan Agreement and Rural Economic Development Grant Agreement, Heartland is required to create and maintain a revolving loan fund. Heartland administers this revolving loan fund as a division within its Heartland operations. Condensed 2018 and 2017 financial information for the revolving loan fund is presented below:

### Condensed Balance Sheet

| | 2018 | 2017 |
|---|---|---|
| Current assets | $ 1,126,523 | $ 1,775,976 |
| Other assets | 5,997,560 | 4,233,487 |
| Total assets | $ 7,124,083 | $ 6,009,463 |
| Liabilities | | |
| Current liabilities | $ 234,242 | $ 283,110 |
| Noncurrent liabilities | 4,927,257 | 4,310,842 |
| Total liabilities | 5,161,499 | 4,593,952 |
| Net Position | 1,962,584 | 1,415,511 |
| Total liabilities and net position | $ 7,124,083 | $ 6,009,463 |

## Note 13: Segment Information - Continued

### Condensed Statement of Revenues, Expenses and Changes in Net Position

| | 2018 | 2017 |
|---|---|---|
| Nonoperating revenues (expenses) | | |
| Investment income | $ 93,307 | $ 75,288 |
| Interest expense | (24,502) | (19,746) |
| Bad debt expense | (81,688) | (63,260) |
| Other | 289,456 | (17,645) |
| Capital contributions | 270,500 | 337,513 |
| Increase in Net Position | 547,073 | 312,150 |
| Net Position, Beginning of Year | 1,415,511 | 1,103,361 |
| Net Position, End of Year | $ 1,962,584 | $ 1,415,511 |

### Condensed Statement of Cash Flows

| | 2018 | 2017 |
|---|---|---|
| Net cash provided by (used in) | | |
| Noncapital financing activities | $ 837,502 | $ 1,489,895 |
| Investing activities | (1,486,846) | (1,423,477) |
| Increase (Decrease) in Cash | (649,344) | 66,418 |
| Cash, Beginning of Year | 1,189,216 | 1,122,798 |
| Cash, End of Year | $ 539,872 | $ 1,189,216 |

# Required Supplementary Information

# Heartland Consumers Power District

## Schedule of Heartland's Proportionate Share of the Net Pension Asset (Liability)

## South Dakota Retirement System

## December 31, 2018

| | 2018 | 2017 | 2016 | 2015 | 2014 |
|---|---|---|---|---|---|
| Heartland's proportion of the net pension asset (liability) | 0.088% | 0.086% | 0.088% | 0.087% | 0.097% |
| Heartland's proportionate share of the net pension assets (liability) | $ 2,049 | $ 7,850 | $ (296,707) | $ 370,005 | $ 697,294 |
| Heartland's covered payroll | $ 1,552,936 | $ 1,458,085 | $ 1,394,520 | $ 1,390,734 | $ 1,404,232 |
| Heartland's proportionate share of the net pension asset (liability) as a percentage of its covered payroll | 0.13% | 0.54% | -21.28% | 26.61% | 49.66% |
| Plan fiduciary net position as a percentage of the total pension liability | 100.02% | 100.08% | 96.89% | 104.10% | 107.29% |

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

# Heartland Consumers Power District
## Schedule of Heartland's Contributions
## South Dakota Retirement System
## December 31, 2018

| | 2018 | 2017 | 2016 | 2015 | 2014 |
|---|---|---|---|---|---|
| Statutorily required contribution | $ 124,500 | $ 107,920 | $ 103,771 | $ 99,453 | $ 97,153 |
| Contributions in relation to the statutorily required contribution | (124,500) | (107,920) | (103,771) | (99,453) | (97,153) |
| Contribution deficiency (excess) | $ - | $ - | $ - | $ - | $ - |
| Heartland's covered payroll | $ 1,729,063 | $ 1,506,831 | $ 1,422,500 | $ 1,377,344 | $ 1,414,132 |
| Contributions as a percentage of covered payroll | 7.20% | 7.16% | 7.29% | 7.22% | 6.87% |

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

# Other Information

# Heartland Consumers Power District

## Schedule of Transmission Operation and Maintenance Expenses

## FERC Uniform System of Accounts Classification

## Year Ended December 31, 2018

| | Amount |
|---|---|
| **Operation** | |
| 560 – Operation Supervision and Engineering | $ 35,004 |
| 561 – Load Dispatching | - |
| 561.1 – Load Dispatch – Reliability | - |
| 561.2 – Load Dispatch – Monitor and Operate Transmission System | - |
| 561.3 – Load Dispatch – Transmission Service and Scheduling | - |
| 561.4 – Scheduling, System Control and Dispatch Services | - |
| 561.5 – Reliability, Planning and Standards Development | - |
| 561.6 – Transmission Service Studies | - |
| 561.7 – Generation Interconnection Studies | - |
| 561.8 – Reliability, Planning and Standards Development Service | - |
| 562 – Station Expenses | 24,028 |
| 563 – Overhead Lines Expenses | 10,561 |
| 564 – Underground Lines Expenses | - |
| 565 – Transmission of Electricity by Others | 7,763,661 |
| 566 – Miscellaneous Transmission Expenses | 14,394 |
| 567 – Rents | - |
| **Total Operation Expense** | 7,847,648 |
| **Maintenance** | |
| 568 – Maintenance Supervision and Engineering | - |
| 569 – Maintenance of Structures | - |
| 569.1 – Maintenance of Computer Hardware | - |
| 569.2 – Maintenance of Computer Software | - |
| 569.3 – Maintenance of Communication Equipment | - |
| 569.4 – Maintenance of Miscellaneous Regional Transmission Plant | - |
| 570 – Maintenance of Station Equipment | 12,205 |
| 571 – Maintenance of Overhead Lines | 18,422 |
| 572 – Maintenance of Underground Lines | - |
| 573 – Maintenance of Miscellaneous Transmission Plant | 4,079 |
| **Total Maintenance Expense** | 34,706 |
| **Total Transmission O&M Expense** | $ 7,882,354 |

# Heartland Consumers Power District

## Schedule of Administrative and General Expenses
## FERC Uniform System of Accounts Classification
## Year Ended December 31, 2018

| | Amount |
|---|---|
| **Customer Accounts Expenses** | |
| 901 – Supervision | $ - |
| 902 – Meter Reading Expenses | - |
| 903 – Customer Records and Collection Expenses | - |
| 904 – Uncollectible Accounts | - |
| 905 – Miscellaneous Customer Accounts Expenses | - |
| **Total Customer Accounts Expense** | $ - |
| **Customer Service and Informational Expenses** | |
| 907 – Supervision | $ 261,075 |
| 908 – Customer Assistance Expenses | 363,162 |
| 909 – Informational and Instructional Expenses | - |
| 910 – Miscellaneous Customer Service and Informational Expenses | - |
| **Total Customer Service and Informational Expenses** | $ 624,237 |
| **Sales Expenses** | |
| 911 – Supervision | $ - |
| 912 – Demonstrating and Selling Expenses | - |
| 913 – Advertising Expenses | - |
| 916 – Miscellaneous Sales Expenses | - |
| **Sales Expenses** | $ - |
| **Administrative and General Expenses** | |
| 920 – Administrative and General Salaries | $ 1,480,682 |
| 921 – Office Supplies and Expenses | 206,778 |
| 922 – Administrative Expenses Transferred Credit | - |
| 923 – Outside Services Employed | 429,444 |
| 924 – Property Insurance | 6,833 |
| 925 – Injuries and Damages | 14,570 |
| 926 – Employee Pension and Benefits | 640,590 |
| 927 – Franchise Requirements | - |
| 928 – Regulatory Commission Expenses | 1,343 |
| 929 – Duplicate Charges Credit | - |
| 930.1 – General Advertising Expenses | 48,563 |
| 930.2 – Miscellaneous General Expenses | 616,924 |
| 931 – Rents | - |
| 935 – Maintenance of General Plant | 207,435 |
| **Administrative and General Expenses** | $ 3,653,162 |