

# STRATEGY FOR SUCCESS

2016 Annual Report



HEARTLAND



# blue•print

/ˈbl̩oo.prɪnt/

*noun*

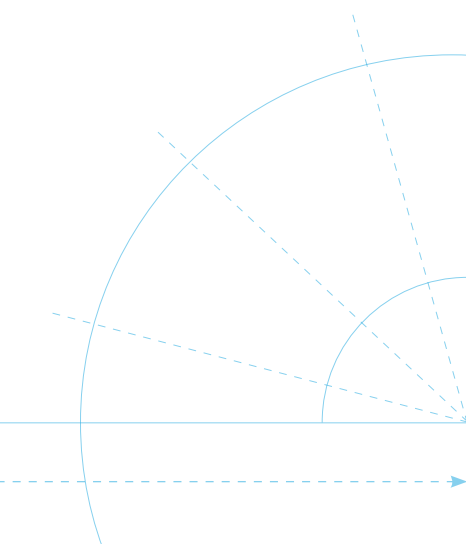
1. a design plan or other technical drawing

**something that acts as a plan, model, or template**

*synonyms: model, plan, template, framework, pattern, example, guide, prototype, pilot*

*Source: Google*

In 2016, Heartland adopted a strategic plan - a guiding document we will use to ensure a successful future for our company, and our customers.







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# 2016 ANNUAL REPORT

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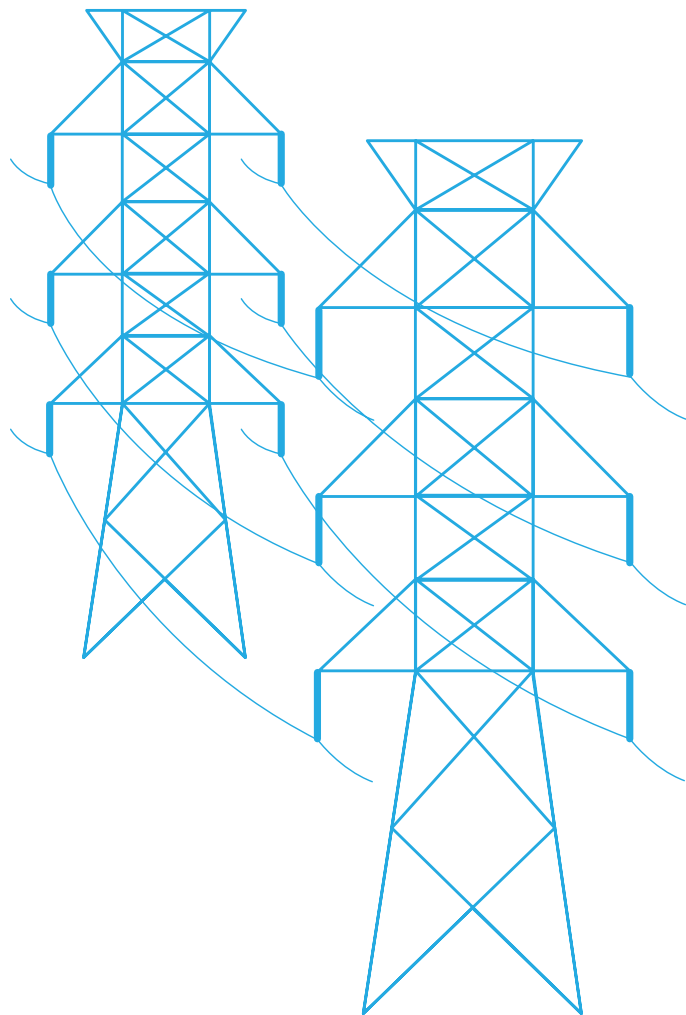
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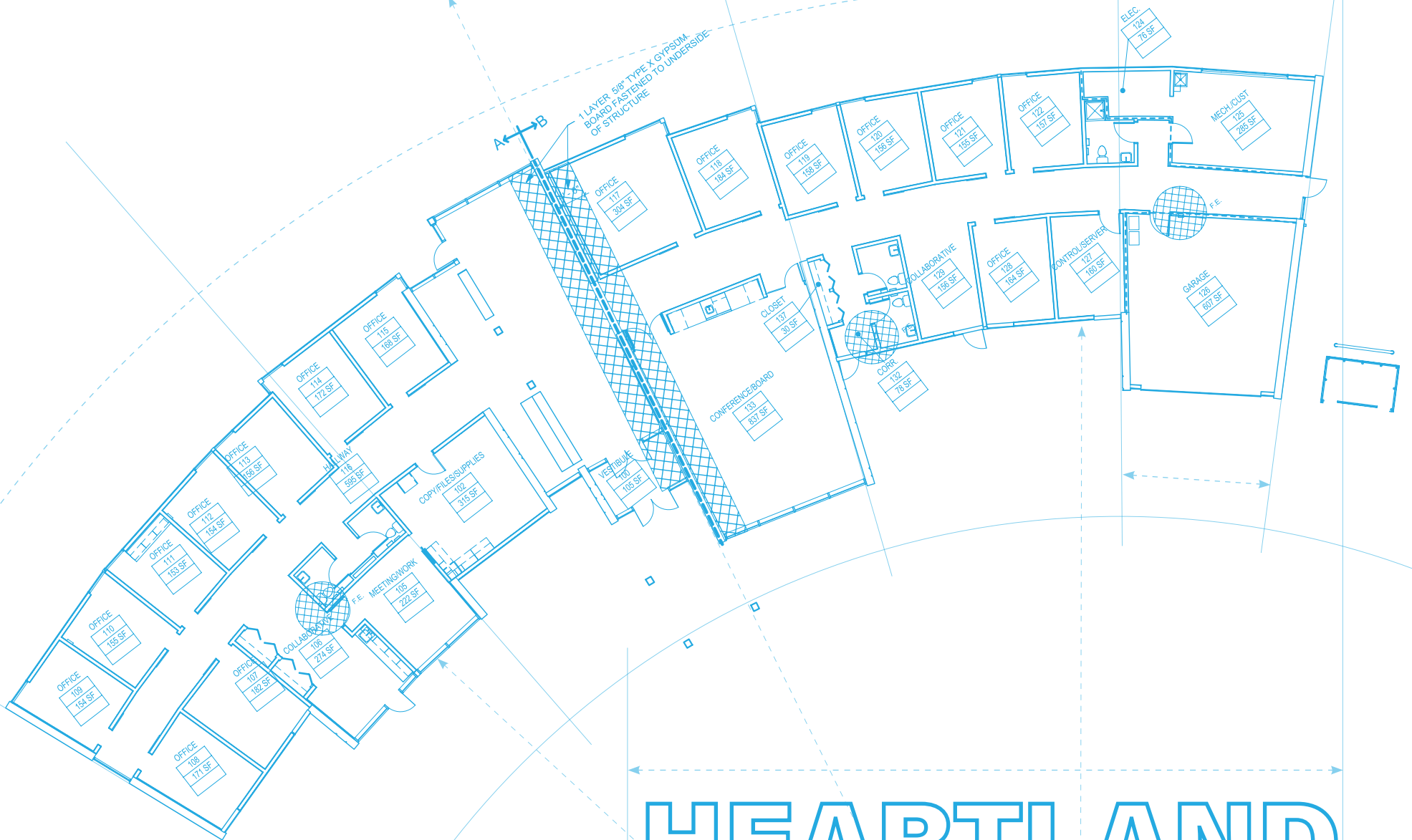
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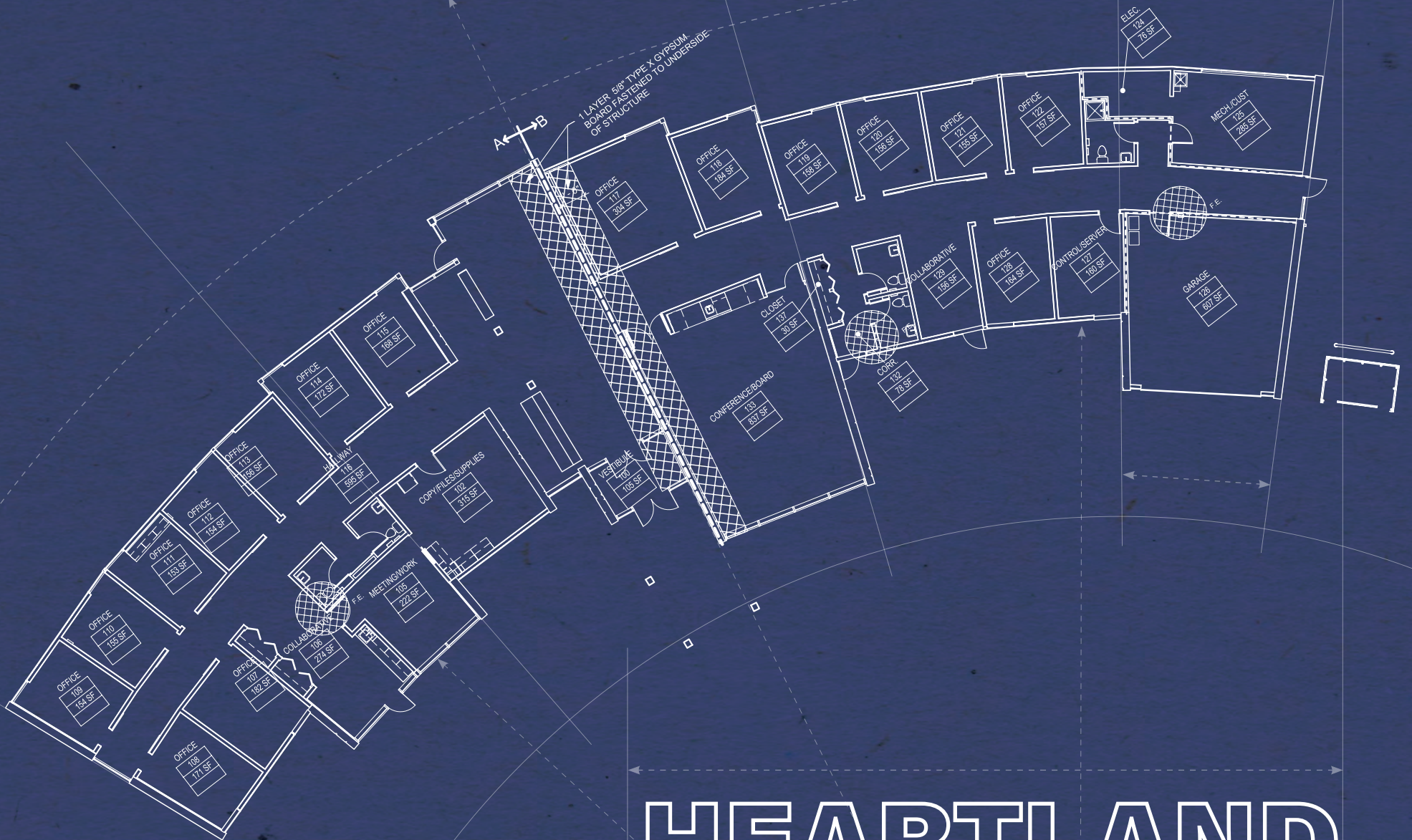
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# HEARTLAND SNAPSHOT





# HEARTLAND SNAPSHOT

## OVERVIEW

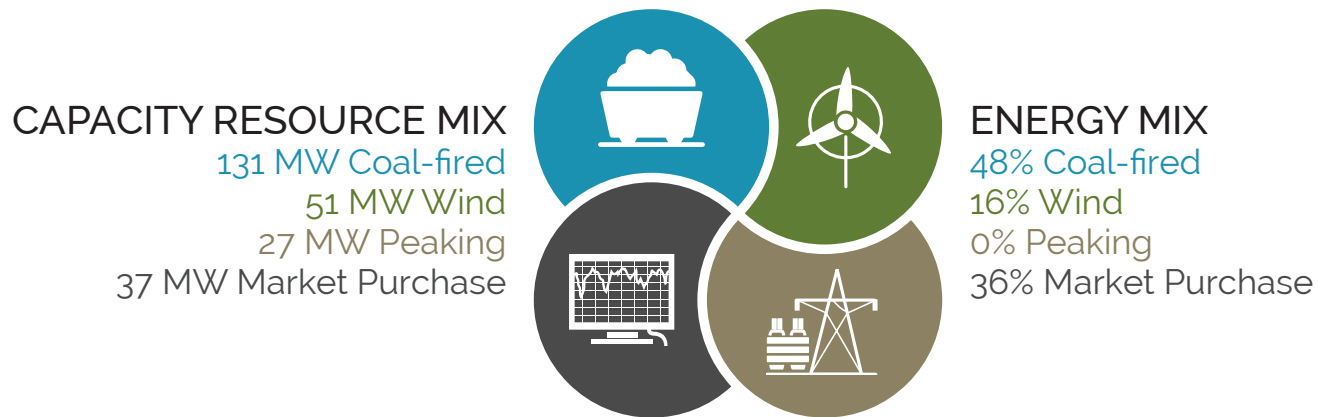
Heartland Consumers Power District has been powering the Midwest since 1969. Today, Heartland provides wholesale electric energy to 26 municipal electric systems in South Dakota, Minnesota and Iowa. We also provide energy solutions to six public institutions in South Dakota and have short-term block or unit-contingent contract requirements with other organizations.

Heartland provides supplemental, partial or full-requirements energy, depending on the needs of each of our customers. We serve primarily rural, agricultural communities with populations of less than 3,000.

Heartland is a non-profit, public power utility and political subdivision of the state of South Dakota.



Heartland's power supply portfolio includes baseload coal-fired resources, wind generation and peaking units. Heartland's generation resource and customer load assets are included within the Southwest Power Pool Integrated Marketplace.



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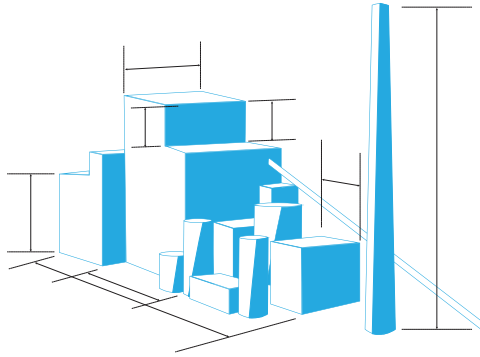
PROJECT:  
HEARTLAND  
CONSUMERS  
POWER DISTRICT

SECTION:  
HEARTLAND  
SNAPSHOT

SHEET TITLE:  
OVERVIEW

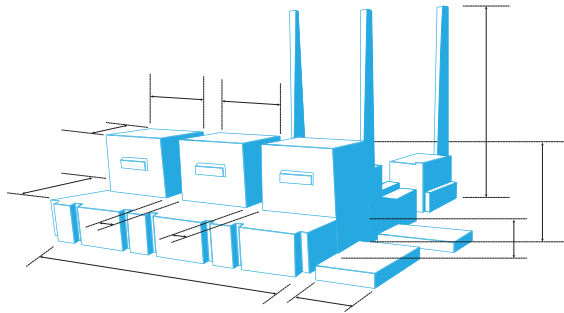
H.1

## RESOURCES



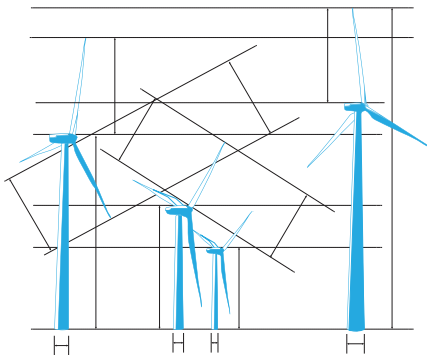
### WHELAN ENERGY CENTER UNIT 2 / 80 MW

- Location: Hastings, Nebraska
- 220 MW coal-fired generating plant
- Heartland ownership: 36%
- Meets or exceeds all current pollution control standards and well-positioned to provide Heartland with low-cost, reliable energy well into the future



### LARAMIE RIVER STATION / 51 MW

- Location: Wheatland, Wyoming
- 3-unit, 1,710 MW coal-fired generating station
- Heartland ownership: 3% undivided, all energy taken from Unit 1
- Constructed as part of the Missouri Basin Power Project, which also includes Grayrocks Dam and Reservoir and nearly 650 miles of high voltage transmission line



### WESSINGTON SPRINGS WIND ENERGY CENTER / 51 MW

- Location: Wessington Springs, SD
- 34 turbines, 1.5 MW each
- Heartland purchases the full output through a long-term purchased power agreement with NextEra Energy
- Situated on approximately 3,500 acres



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SECTION:  
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SHEET TITLE:  
RESOURCES

# H.2





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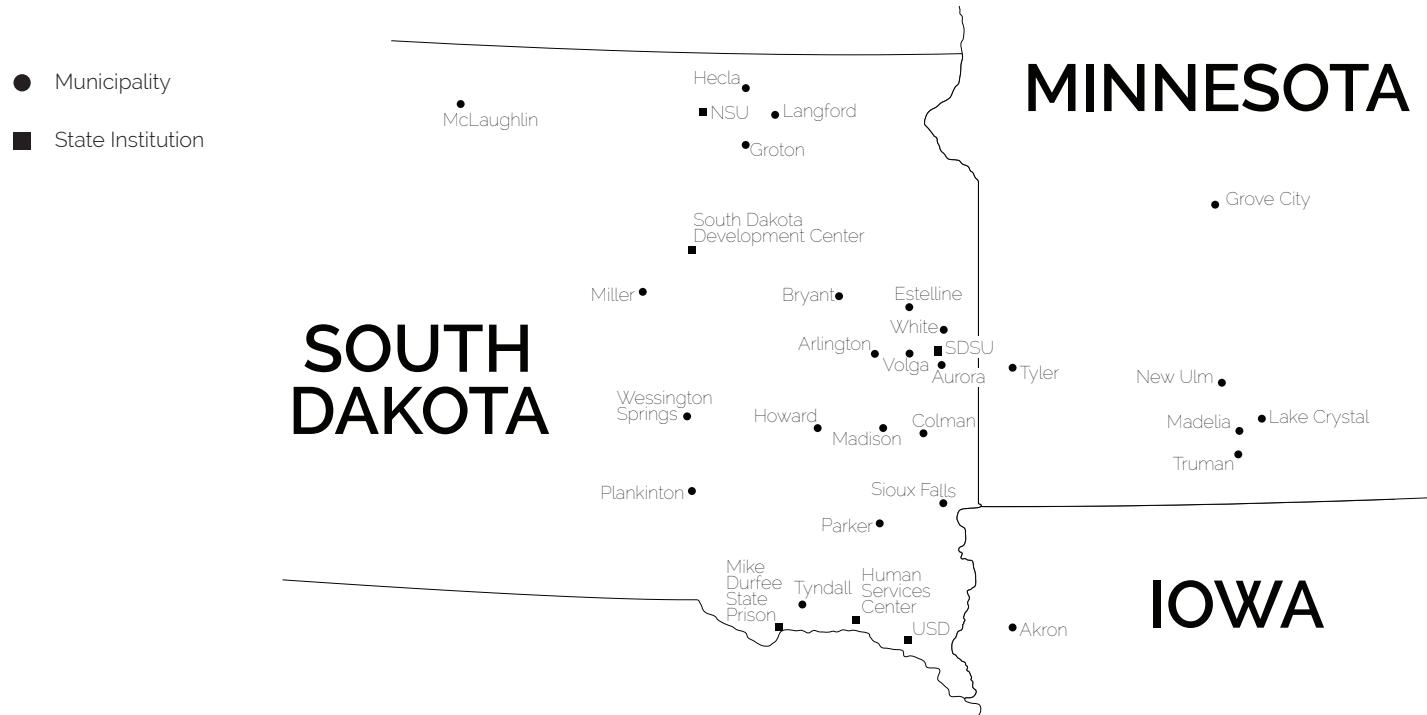
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HEARTLAND  
SNAPSHOT

SHEET TITLE:  
CUSTOMERS

H.3  
9

## CUSTOMERS

Heartland has 26 long-term municipal customers in South Dakota, Minnesota and Iowa. We also supply energy to six state institutions in South Dakota and have short-term block or unit contingent contracted requirements with Basin Electric Power Cooperative and North Iowa Municipal Electric Cooperative Association, as well as the cities of Stanhope and Auburn, Iowa, and Garden City, Kansas. These contracts vary between three years in length and life of the unit.



## CUSTOMER CONNECTIONS COMMITTEE



- Formed in 2011 to provide a formal channel for interaction between Heartland and our customers
- Offers customer perspective and feedback to Heartland's staff and board of directors
- Consists of up to 9 members, each representing a different customer
- Members serve three-year, staggered terms, elected by all customers at Heartland's Annual Meeting
- Meets quarterly or more frequently if needed

## GOVERNING BOARD



**Merlin Van Walleghen**  
*President*  
Subdivision 7  
Board member since 1993



**Mark Joffer**  
*Vice President*  
Subdivision 1  
Board member since 2009



**Jeff Heinemeyer**  
*Secretary*  
Subdivision 6  
Board member since 2013



**Dave Westbrook**  
*Treasurer*  
Subdivision 10  
Board member since 2009



**Roger Fritz**  
*Asst. Secretary/Treasurer*  
Subdivision 9  
Board member since 2005



**Pat Anderson**  
Subdivision 2  
Board member since 2016



**Larry Nielson**  
Subdivision 3  
Board member since 2011



**Lee Ann Wheeler**  
Subdivision 4  
Board member since 2015



**Dave Hahler**  
Subdivision 5  
Board member since 2015



**Lisa Rave**  
Subdivision 8  
Board member since 2009



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SECTION:  
HEARTLAND  
SNAPSHOT

SHEET TITLE:  
GOVERNING  
BOARD

H.4

## STAFF

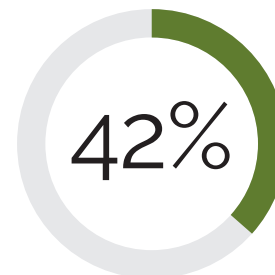


Back row, left to right: Director of Power Supply Adam Graff; Energy Scheduler McCord Stowater; Chief Financial Officer Mike Malone; Chief Executive Officer Russell Olson; Director of Economic Development Casey Crabtree; and Chief Operations Officer Nate Jones.

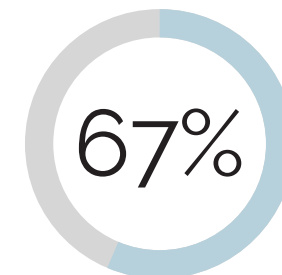
Front row, left to right: Projects & Marketing Coordinator Danielle Rosheim; Communications Manager Ann Hyland; Accountant Sharla Fedeler; Benefits Administrator Theresa Schaefer; Customer Relations Manager Steve Moses; and Administrative Assistant Katie Hahn.

## GENERAL NOTES

- Casey Crabtree joined Heartland as Director of Economic Development in February of 2016
- Katie Hahn joined Heartland as Administrative Assistant in May of 2016
- Long-time Executive Assistant and Heartland's third full-time hiree Kathie Lewis, pictured at right, retired June 6 after 39 years of service



Staff with 10 or more years employment with Heartland



Staff with 5 or more years employment with Heartland

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PROJECT:  
HEARTLAND  
CONSUMERS  
POWER DISTRICT

SECTION:  
HEARTLAND  
SNAPSHOT

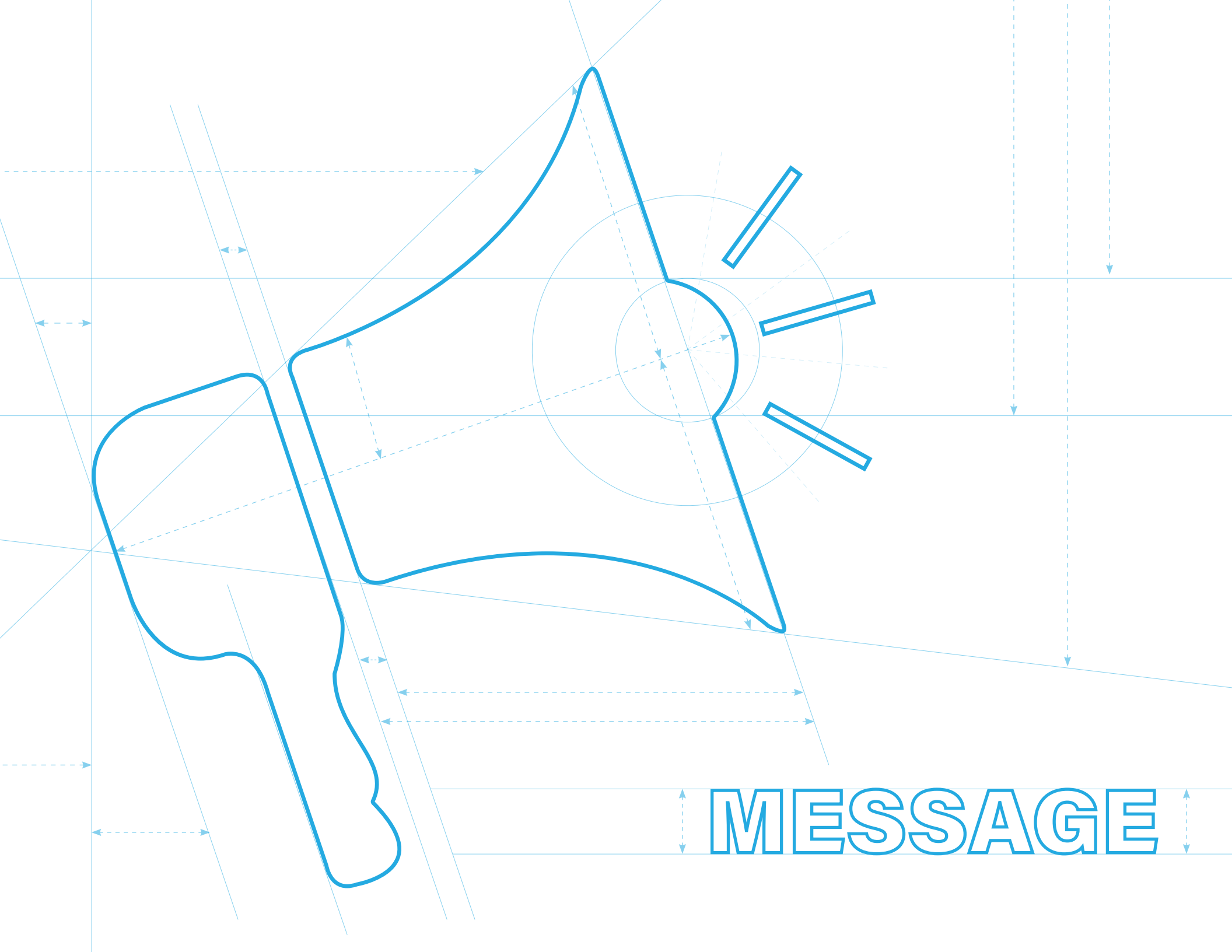
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STAFF



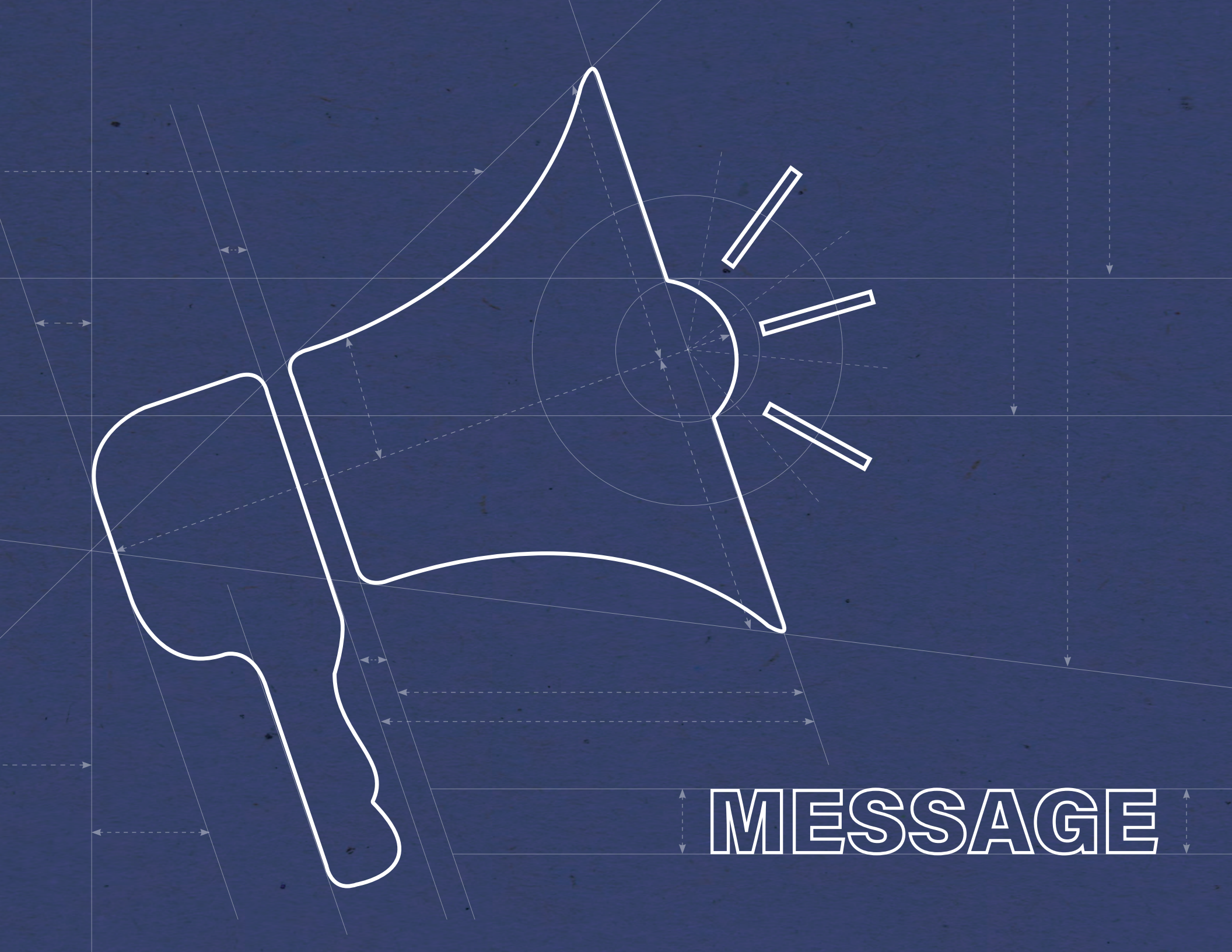
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MESSAGE



MESSAGE

## KEYNOTES FROM THE PRESIDENT & CEO

### PLANNING IS AN ESSENTIAL AND IMPORTANT RESPONSIBILITY OF ANY ORGANIZATION.

While Heartland has always been planning for the future, we formalized the process in 2016 with the adoption of our strategic plan. It will serve as our blueprint moving forward.

In order to develop a plan representative of everyone affected by it, we gathered input from board members, staff and most importantly, customers. That feedback helped us develop a vision of where we want to be in the long run, as well as short-term goals to help us get there.

In our industry, there are a lot of unknowns that can make it more difficult to effectively chart out a perfect course. But having a strategic plan will guide our path forward, giving us a clear destination, no matter what bumps may appear in the road along the way.

Our plan consists of three goals we plan to achieve in the next three to five years as well as strategies and objectives to make that possible.

Our motto has always been 'the power of forward thinking' and our strategic plan reinforces that idea. It is a constant reminder that our customers come first and will help us continue to make informed decisions today for a sound and stable future, all the while serving as a reliable partner.

As our industry is ever evolving, we will continue to monitor our progress and update our plan as needed. This will be a living document we will re-visit often to make sure we remain on the right track. For more on our strategic plan, see section M2.

### SAVINGS REALIZED

While the strategic plan formalized our overall strategy for the future, a significant amount of planning and sometimes tough decision-making led to some good news early in 2016.



Heartland CEO Russell Olson, left, and Board President Merlin Van Walleghen

Moody's Investors Service upgraded Heartland's credit rating from Baa1 to A3 with a stable outlook. This came after receiving a rating of A- with a stable outlook in 2015 from Fitch.

Moody's rating reflects Heartland's responsiveness to contracting load to new customers through short-term power purchase agreements and timely and adequate rate increases in the last few years.

The stable outlook is based on Moody's expectation that going forward Heartland will maintain sufficient credit metrics.

Heartland's credit rating is important for many reasons and positive change doesn't happen overnight. It has taken a lot of work and we look forward to continuing to strengthen our company.

The higher rating helped lead to another piece of good news in 2016 – approximately \$26.6 million in net present value savings for Public Power Generation Agency from the advanced refunding of \$150 million in outstanding bonds. Heartland's portion of that savings is \$9.6 million.



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MESSAGE

SHEET TITLE:  
KEYNOTES  
FROM THE  
PRESIDENT & CEO

# M.1



## KEYNOTES FROM THE PRESIDENT & CEO, continued

PPGA, the collective group formed to build Whelan Energy Center Unit 2, issued bonds to finance the construction of WEC 2 and will now realize lower interest costs.

PPGA's credit rating mirrors Heartland's rating due to Heartland's 36% ownership interest in the plant. The interest rate obtained in the refunding process is a direct reflection of that rating.

### A VALUED PARTNER

Customer service continued to play a key role in our operations throughout 2016. We looked for new opportunities to bring value to the communities we serve and were able to accomplish the following:

- Issued over \$50,000 in Power Forward rebates, the most since the program started in 2012, as well as energy efficiency grants to 13 customers
- Hosted events to educate customers on industry topics including social media, key accounts, rural development and entrepreneurship
- Received \$1 million from the Intermediary Relending Program from USDA Rural Development to assist with community development projects via our HELP Fund
- Advocated on behalf of our customers on legislative issues, promoting policies that put consumers first while ensuring a stable supply of electricity and protecting the environment
- Partnered with SBS CyberSecurity to complete Phase 1 of their cybersecurity program in two customer communities
- Recognized Mathias Phelps of Lake Crystal Municipal Utilities as our Distinguished Service Award winner in conjunction with Public Power Week
- Employed two interns throughout the summer months to assist with customer programs

### ANTICIPATING AND ADAPTING

Heartland saw many positive outcomes in 2016. We saw decreased customer revenue, largely a result of our long-term contract with Marshall, MN ending on June 30, but because we had planned for the departure, we were still able to see improved financial metrics and a positive change in net position.

Both Laramie River Station and Whelan Energy Center Unit 2 saw decreased production expenses in 2016 over 2015 and performed well throughout the year. LRS underwent a fall outage for environmental improvements.

We were also pleased with the announcement of the Clean Power Plan being halted for judicial review. With a new administration taking the helm in 2017, we are cautiously optimistic the plan will be withdrawn or re-worked to provide more sensible directives.

There are a lot of unknowns in our industry. However, no matter what changes may occur, our number one priority will remain providing reliable, affordable electricity while serving as a valued partner to our customers.

Our strategic plan will help ensure we never lose focus of that objective.

**WE ARE OPTIMISTIC ABOUT OUR FUTURE  
AND WILL CONTINUE TO WORK TIRELESSLY  
FOR OUR CUSTOMERS.**

  
Merlin Van Walleghe, Board President

  
Russell Olson, CEO



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MESSAGE

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KEYNOTES  
FROM THE  
PRESIDENT & CEO

M.1

## STRATEGIC PLAN

Heartland formalized our planning process in 2016 with the adoption of our strategic plan. It will serve as our blueprint moving forward and outlines our strategy for the next three to five years to ensure customers' expectations of stable rates and quality service are met. It redefines our long-term vision and operating mission, putting customers at the focus of our operations.

We gathered input from all of our key stakeholders to develop a vision of where we want to be in the future.

Our plan consists of three goals we plan to achieve in the next three to five years as well as strategies and objectives to make that possible. It outlines our aspiration to work in the short term to become stable in the long term.

### MISSION

#### *Who We Are and What We Do*

Heartland is dedicated to providing reliable, affordable power to our customers while ensuring open communication, excellent customer service and sound decision making for a brighter tomorrow.

### VISION

#### *Optimal Desired Future State*

To be a trusted leader and partner of choice in the delivery of competitively priced electricity while adding value to the communities we serve.

### GOALS

1. STABILIZE RATES
2. ENHANCE CUSTOMER RELATIONS
3. MAINTAIN SOUND FINANCIAL HEALTH

Plan Implementation: Each goal has been assigned to a team to execute strategies and report on progress.

### CORE VALUES

HONESTY  
RELIABILITY  
LEADERSHIP

Heartland believes in the power of forward thinking--strategically planning and making decisions today for a sound and stable future while serving as a reliable partner to customers.



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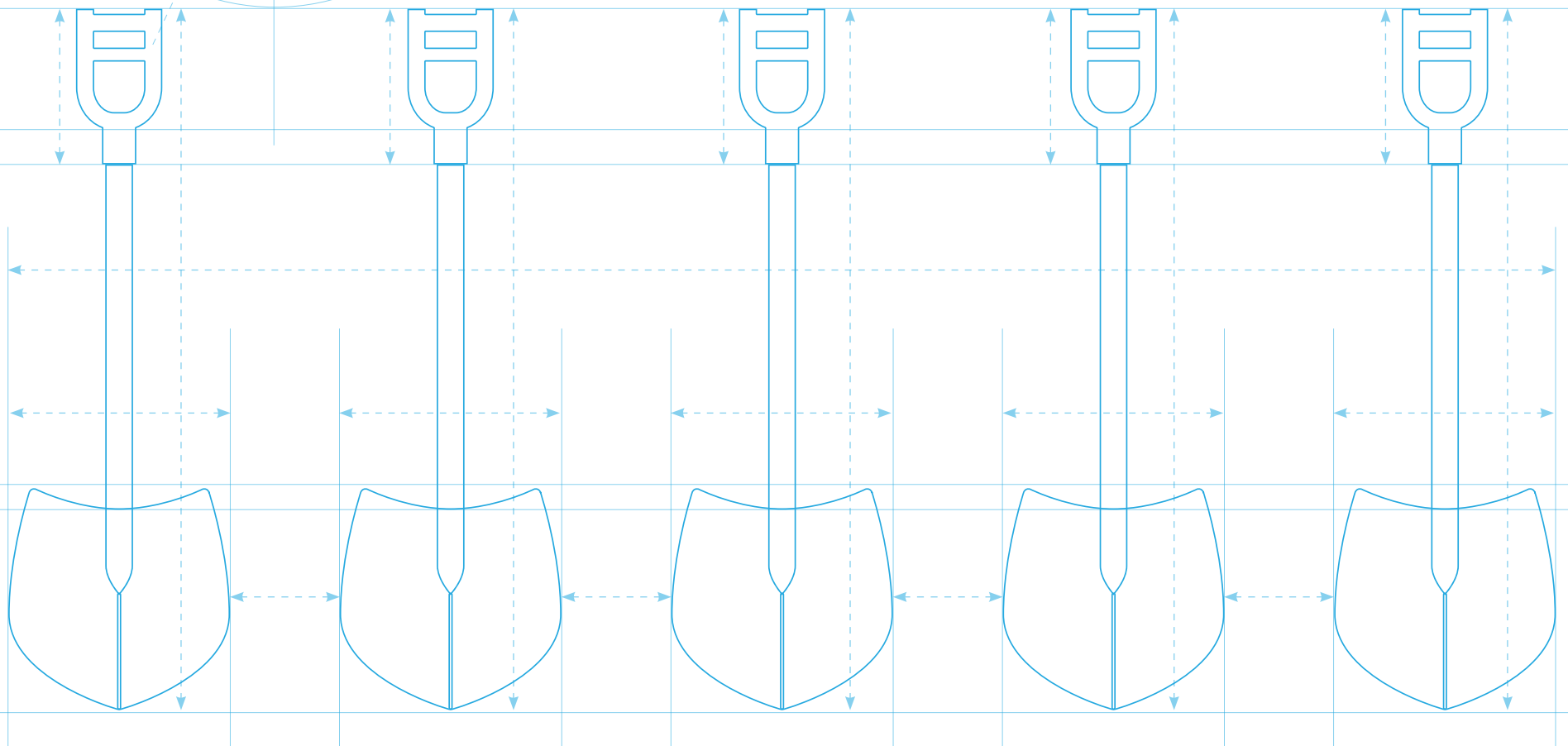
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MESSAGE

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STRATEGIC PLAN

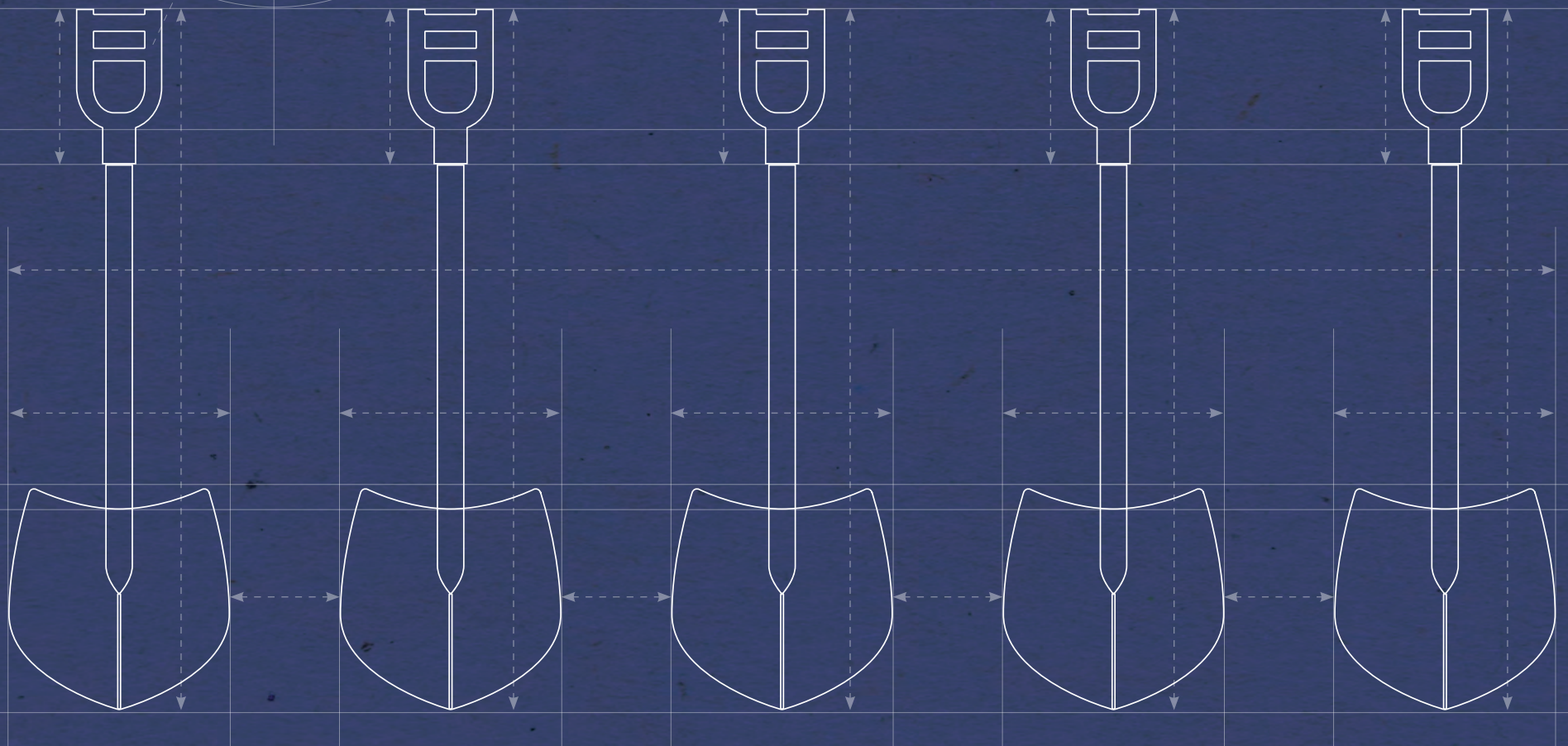
# M.2

# ECONOMIC DEVELOPMENT





# ECONOMIC DEVELOPMENT



## GRANTS

Heartland seeks to add value to the communities we serve by awarding grants for projects that spark growth and development. Heartland customers and their local economic development corporations are eligible to apply for funding to promote economic prosperity and support new business opportunities.

IN 2016



MORE THAN  
**\$80K**  
AWARDED



**14**  
RECIPIENTS



**MOST \$**  
**AWARDED**  
SINCE PROGRAM START  
IN 2002

## PROJECT FUNDING

- Marketing
- New business transition
- Infrastructure
- Green space
- Community foundation
- Trade memberships
- Certified Ready sites

## GENERAL NOTES

"Heartland's grants have allowed us to expand our marketing efforts as a way to put New Ulm in front of site selectors and real estate people. Without their help, we would not have been able to do this."

- Brian Tohal, Executive Director  
*New Ulm, MN Economic Development Corporation*



"With Heartland's help, we're completing long-term projects critical to improving our community's quality of life."

- Jason Uphoff, Executive Director  
*Arlington, SD Community Development Corporation*



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DEVELOPMENT

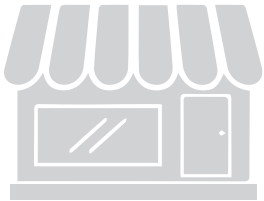
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GRANTS

**ED.1**

## INCENTIVES

Starting or expanding a business can be challenging and Heartland's rebate program hopes to provide support. Qualifying businesses are eligible for cash incentives for new jobs created as well as rebates on their retail electric bills.

SINCE 2004



**120**  
PARTICIPATING  
BUSINESSES



MORE THAN  
**350**  
JOBS CREATED  
OR SAVED



MORE THAN  
**\$1M**  
AWARDED

IN 2016



**1.26**  
MWH NEW  
ENERGY



MORE THAN  
**46K**  
kWH EXPANDING  
ENERGY



MORE THAN  
**\$47K**  
AWARDED



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ECONOMIC  
DEVELOPMENT

SHEET TITLE:  
INCENTIVES

ED.2



## FINANCING

Access to affordable financing is key to growth in any community. The Heartland Economic development Loan Program (HELP) Fund provides funds for business ownership and expansion, job creation and retention, and entrepreneurial endeavors through a revolving loan fund.

### HELP FUND IN 2016



MORE THAN  
**\$1.8M**  
AWARDED



LED TO MORE THAN  
**\$4.6M**  
IN CAPITAL  
INVESTMENT



EXPANDED PROGRAM TO  
**MINNESOTA  
& IOWA**

### PROJECT FINANCING

- Manufacturing
- Housing development
- Restaurant
- Main Street rebuild
- Infrastructure
- Warehousing and distribution
- Convenience store

### GENERAL NOTES

- Secured \$1 million in funding from USDA Rural Development Intermediary Relending Program
- Applied for \$1.9 million in USDA's Rural Economic Development Loan & Grant Program funds on behalf of our customers
- Helped create 25 jobs at four businesses throughout our customer communities



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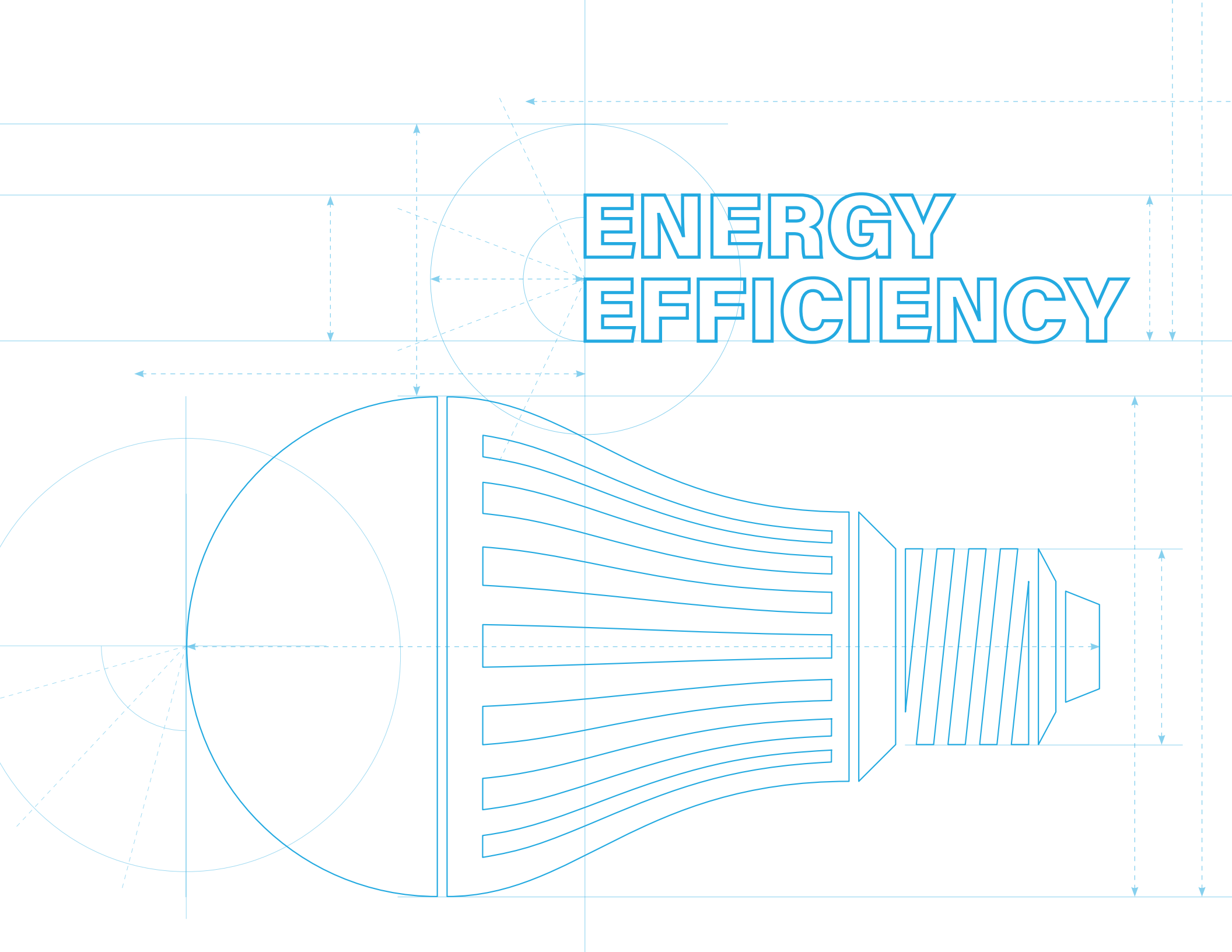
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ECONOMIC  
DEVELOPMENT

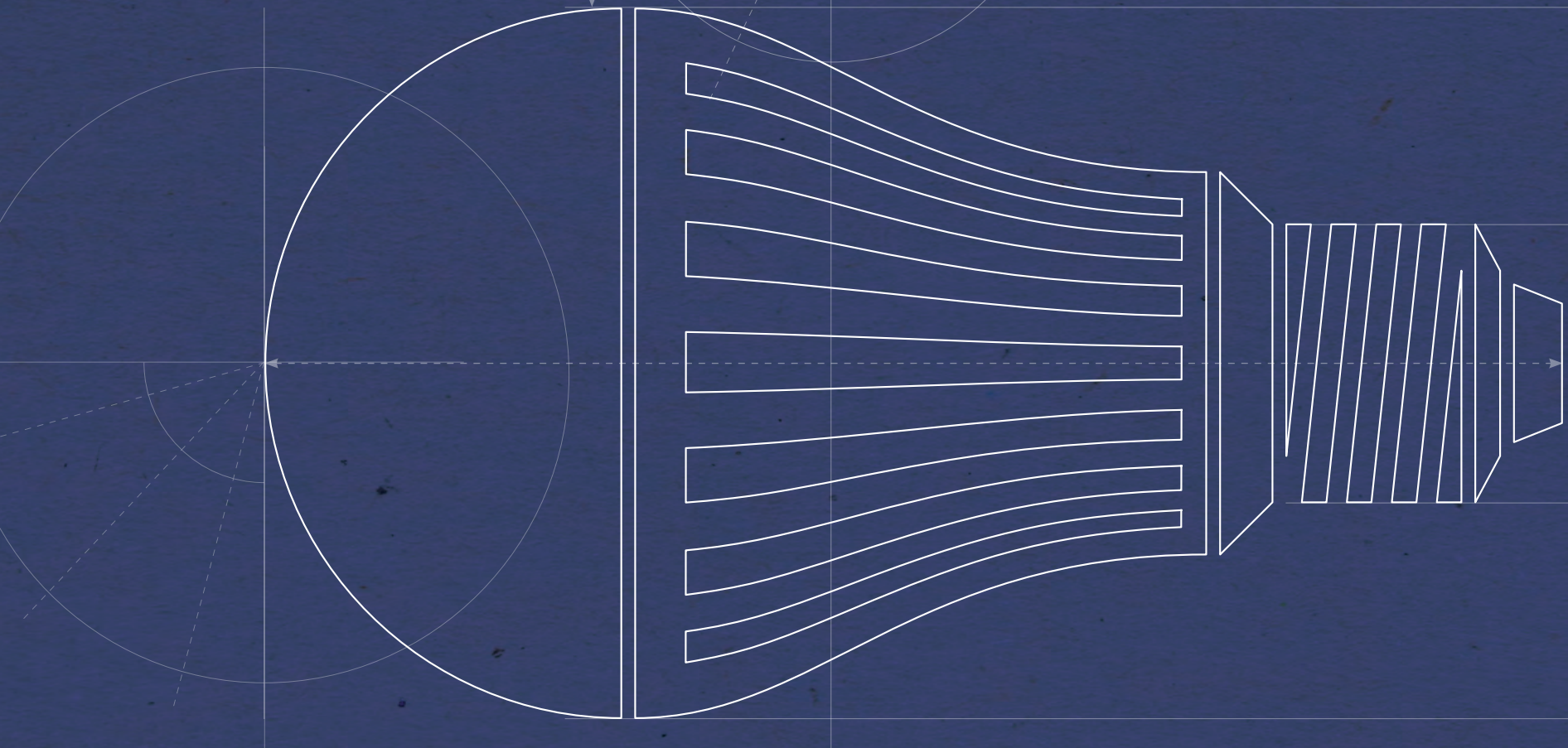
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FINANCING

ED.3

# ENERGY EFFICIENCY



# ENERGY EFFICIENCY





## GRANTS

As cities attempt to reduce their energy costs by optimizing electric energy use at their facilities, Heartland is happy to offer grants to help fund those improvements. Funding is available on a first-come, first-served basis, with a cost-share requirement. Heartland customers have invested in more efficient lighting, HVAC systems and street lighting with the help of Heartland's grant program.

IN 2016



MORE THAN  
**\$60K**  
AWARDED

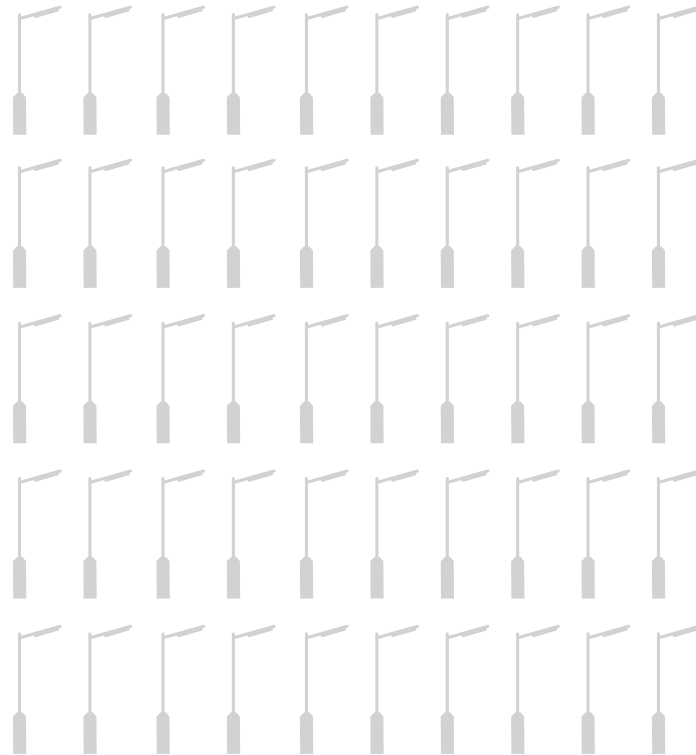


**13**  
RECIPIENTS



MORE THAN  
**\$40K**  
IN PROJECTED  
ANNUAL SAVINGS

 = 10 STREET LIGHTS



 **506**  
STREET LIGHTS  
UPGRADED TO LED



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SHEET TITLE:  
GRANTS

**EE.1**

## REBATES

While making energy efficient purchases may cost a bit more upfront, savings are realized in the long-run. In order to mitigate the up-front cost of making the more efficient choice, Heartland offers a comprehensive rebate program for residents and businesses in our customer communities.

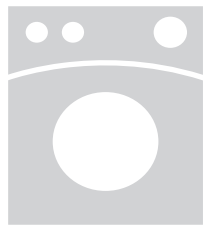


Throughout 2016, Heartland provided rebates through our Power Forward program for the purchase of lifetime warranty electric water heaters, LED lights, ENERGY STAR rated appliances and heating and cooling equipment, as well as efficient refrigeration equipment.

IN 2016



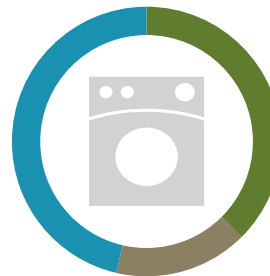
MORE THAN  
**\$53K**  
AWARDED



**110**  
EQUIPMENT  
UPGRADES

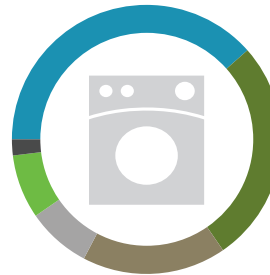


**2,304**  
LIGHTS  
UPGRADED



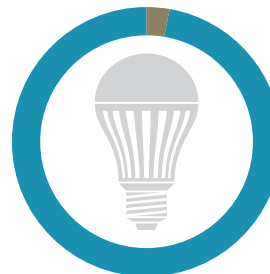
### EQUIPMENT UPGRADES

52 Appliances  
49 Water Heaters  
9 Heating & Cooling Systems



### APPLIANCE REBATES

20 Dishwashers  
14 Refrigerators  
9 Clothes Washers  
4 Clothes Dryers  
4 Freezers  
1 Dehumidifier



### LIGHTING UPGRADES

2,053 Commercial Fixtures  
251 Residential Bulbs



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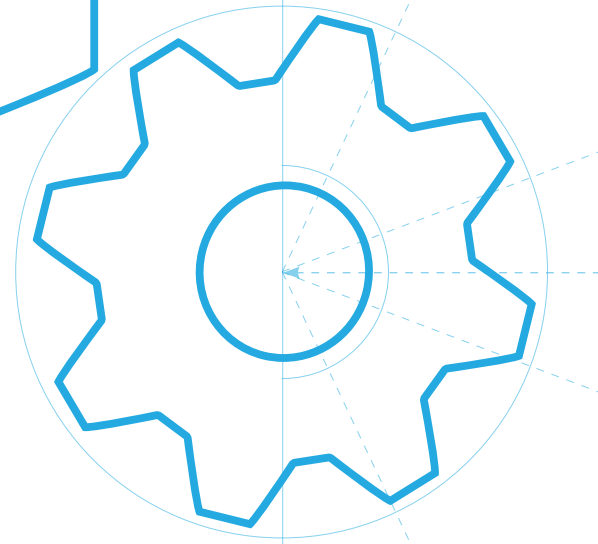
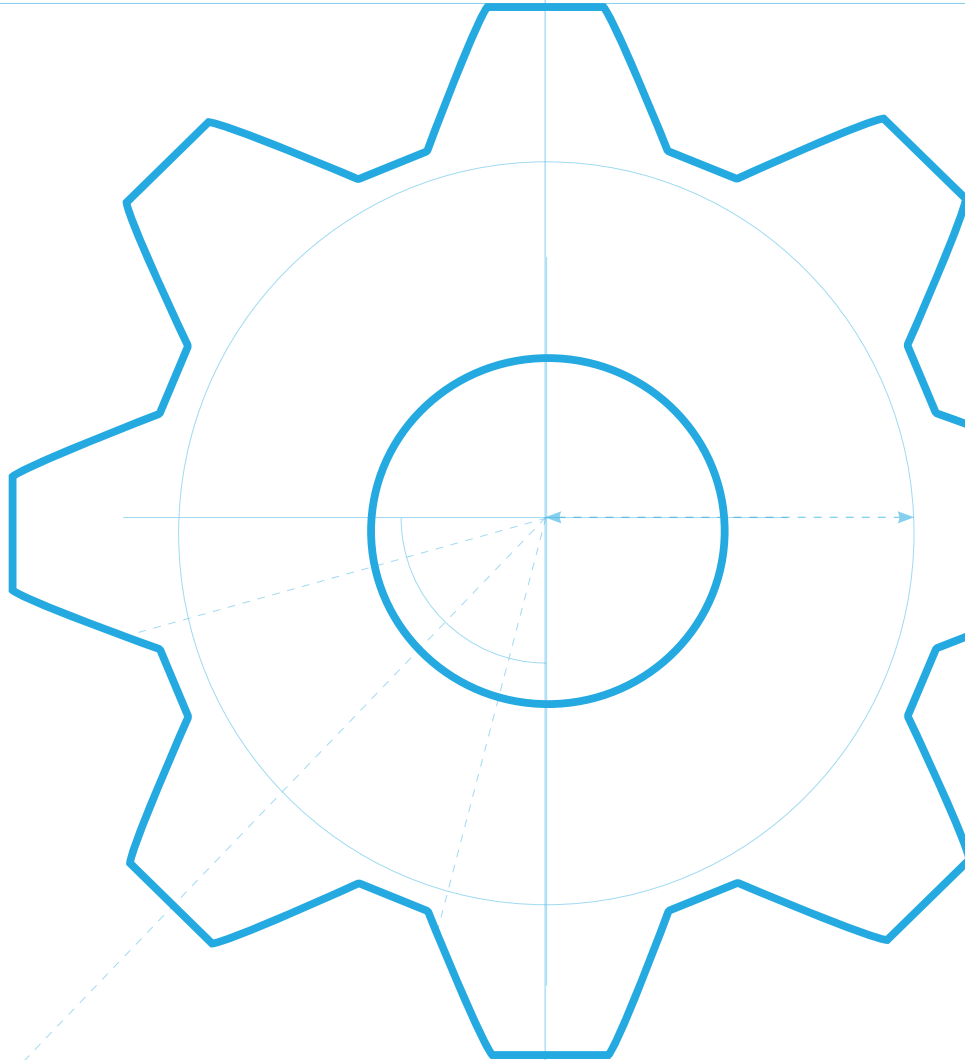
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ENERGY  
EFFICIENCY

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REBATES

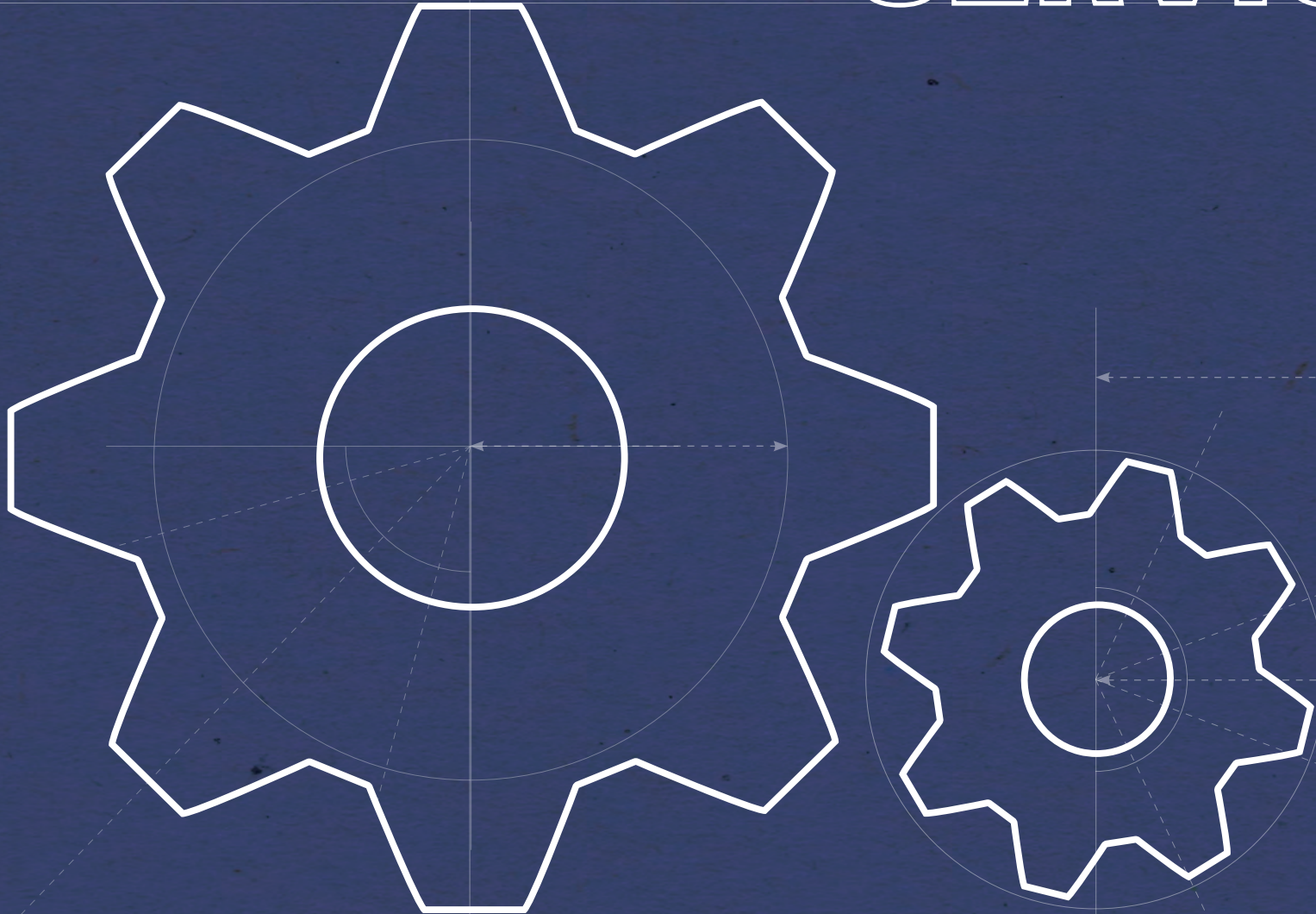
**EE.2**

SERVICES





SERVICES



## CYBERSECURITY

Cybersecurity is the duty and obligation of any organization handling confidential information from its customer base. Heartland has partnered with SBS CyberSecurity to help our customers develop a solid framework to protect private data.



SBS CyberSecurity offers a five phase program to help customers establish and maintain a cybersecurity program. Customers who sign up do not need to commit to more than Phase 1, and Heartland pays half the cost of implementing each phase, up to \$5,000 per phase, per Heartland customer.



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### PHASE 1

#### STEP 01

##### IT ASSET DISCOVERY

SBS will identify the technology, hardware and software used by the organization.

##### INTERNAL SECURITY SCAN

SBS will scan the internal network of your organization to identify spots that cyber criminals would most likely exploit.

#### STEP 02

#### STEP 03

##### INFORMATION SECURITY RISK ASSESSMENT

SBS will put together a document identifying the most and least risky use of technology in the organization.

##### CYBER RISK MANAGEMENT PRIORITIZATION

Based on the services above, SBS will put together a plan for the organization to immediately improve their cybersecurity posture.

#### STEP 04

### GENERAL NOTES

"We were surprised how quickly they were able to complete the onsite portion of the Phase 1 assessment. They provided us with valuable feedback right away, and we look forward to seeing the full report to determine where we can improve our security controls."

- Ashley Rentsch, Finance Officer  
Volga, SD



"Having our cybersecurity evaluated was very worthwhile and informative. We found several things that needed to be changed in our procedures. Now we have the peace of mind that we are doing things right."

- Jim Maras, General Manager  
Madelia, MN Municipal Light & Power



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## CUSTOMER SERVICE

Heartland offers a number of services to assist customers as well as programs and events to educate them on the latest industry topics. Customers are at the core of our operations and we are always seeking to enhance relationships with open communication and idea sharing. It is Heartland's goal to continually exceed our customers' expectations of us and provide value to each community we serve.

## EVENTS



### 1. ANNUAL MEETING

Updates customers on current activities at Heartland as well as the latest news, events and information relevant to the electric industry.

### 2. SUMMER CONFERENCE

Connects customers with legislators and economic development officials while discussing tools and programs designed to help communities grow and thrive.

### 3. BUDGET MEETINGS

Consists of a series of meetings in various customer communities in which the budget for the upcoming fiscal year is discussed in detail.

### 4. WINTER CONFERENCE

Offers insight on topics related to utility operations, such as safety, key accounts or load management.

## ADVOCATING/INDUSTRY REPRESENTATION

Heartland provides membership in industry organizations for our customers as well as works with leading trade groups to advocate on issues important to our customers' continued successful operation.

- Midwest Electric Consumers Association
- Southwest Power Pool
- American Public Power Association membership
- Demonstration of Energy & Efficiency Developments (DEED) membership
- State and Federal lobbyists
- State electric associations

## OTHER SERVICES

- On-site assistance
- Reporting requirements



# FINANCIALS



# FINANCIALS



# INDEPENDENT AUDITOR'S REPORT

Board of Directors  
Heartland Consumers Power District  
Madison, South Dakota

We have audited the accompanying financial statements of Heartland Consumers Power District (the District), as of and for the years ended December 31, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the District's basic financials 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, 2016 and 2015, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

## OTHER MATTERS

### Required Supplementary Information

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

### Other Information

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

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

*BKD, LLP*

Lincoln, Nebraska  
March 29, 2017



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## 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 2016, 2015 and 2014. Heartland's financial statements are comprised of three components: (1) Management's Discussion and Analysis, (2) financial statements, and (3) notes to the financial statements. Please read this in conjunction with the audited financial statements and footnotes contained herein.

### OVERVIEW OF FINANCIAL STATEMENTS

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

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

	Net Position as of December 31,			Fiscal Year-to-Year Percentage Change	
	2016	2015	2014	From 2015 to 2016	From 2014 to 2015
Current assets	\$ 28,769	\$ 25,552	\$ 19,254	12.6%	32.7%
Capital assets, net	20,402	20,260	19,862	0.7%	2.0%
Other noncurrent assets	5,500	8,601	22,833	(36.1)%	(62.3)%
Total assets	54,671	54,413	61,949	0.5%	(12.2)%
Deferred outflows of resources	675	536	570	25.9%	(5.9)%
Total assets and deferred outflows of resources	\$ 55,346	\$ 54,949	\$ 62,519	0.7%	(12.1)%
Current liabilities	\$ 10,727	\$ 14,464	\$ 16,344	(25.8)%	(11.5)%
Noncurrent liabilities	5,650	12,667	28,980	(55.4)%	(56.3)%
Total liabilities	16,377	27,131	45,324	(39.6)%	(40.1)%
Deferred inflows of resources	1,776	426	1,546	316.9%	(72.4)%
Net investment in capital assets	12,250	4,789	(969)	155.8%	(594.2)%
Restricted for debt service	5,660	6,668	10,660	(15.1)%	(37.4)%
Restricted for pensions	-	370	697	(100.0)%	100.0%
Unrestricted	19,283	15,565	5,261	23.9%	195.9%
Total net position	37,193	27,392	15,649	35.8%	75.0%
Total liabilities, deferred inflows of resources and net position	\$ 55,346	\$ 54,949	\$ 62,519	0.7%	(12.1)%

Heartland's overall net position increased in 2016, 2015 and 2014 by \$9,801,428, \$11,742,652 and \$6,997,741, respectively. In 2016, a decrease in customer contracts and a transfer for rate stabilization lead to a lower increase in net position compared to 2015. Heartland had reductions in power supply contracts in 2015 that resulted in less cost of power and an increase in net position in 2015 compared to 2014.

The decrease in customer revenue in 2016 was a result of two of Heartland's long-term contracts ending June 30, 2016, with the most significant being Marshall, MN. Heartland received over 10 years advance notice of the contract termination. The increased customer revenue in 2015 was attributed to an



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## MANAGEMENT'S DISCUSSION AND ANALYSIS

increase in wholesale electric demand and energy rates. The demand and energy rates were increased to meet the costs of power supply generation and maintenance, other operating expenses, debt service, and other financial metrics. Generation and transmission facilities represent 95% of Heartland's total capital assets. The remaining 5% of capital assets includes Heartland's headquarters building, transportation equipment, and office equipment. The level of assets should remain reasonably stable until such time as Laramie River Station (LRS) requires substantial capital improvements.

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

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

### RESULTS OF OPERATIONS

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

	2016 Actual	2015 Actual	2014 Actual	Fiscal Year-to-Year Percentage Change	
				From 2015 to 2016	From 2014 to 2015
Power sales					
Customer energy (MWh)	637,252	855,651	862,805	(25.5)%	(0.8)%
Customer cumulative demand (kW)	1,085,799	1,433,896	1,452,937	(24.3)%	(1.3)%
Revenues					
Customer revenue	\$ 50,071	\$ 62,717	\$ 60,953	(20.2)%	2.9%
Contracted requirements revenue	17,893	12,609	16,462	41.9%	(23.4)%
Surplus sales revenue	2,557	2,976	3,588	(14.1)%	(17.1)%
Other operating revenue	4,041	969	1,079	317.0%	(10.2)%
Transfer for rate stabilization	(1,750)	-	-	100.0%	-%
Total operating revenue	72,812	79,271	82,082	(8.1)%	(3.4)%
Expenses					
LRS production and O&M	7,732	8,470	9,230	(8.7)%	(8.2)%
Cost of power	41,368	46,543	53,153	(11.1)%	(12.4)%
Transmission	6,400	5,439	5,254	17.7%	3.5%
Depreciation	1,323	1,242	1,188	6.5%	4.5%
Taxes	447	199	185	124.6%	7.6%
Administration and general	3,947	4,264	4,021	(7.4)%	6.0%
Amortization	1,108	203	195	445.8%	4.1%
Total operating expenses	62,325	66,360	73,226	(6.1)%	(9.4)%
Operating income	10,487	12,911	8,856	(18.8)%	45.8%
Total nonoperating expenses, net	(686)	(1,168)	(1,858)	(41.3)%	(37.1)%
Change in net position	9,801	11,743	6,998	(16.5)%	67.8%
Net position, beginning of year	27,392	15,649	8,651		
Net position, end of year	\$ 37,193	\$ 27,392	\$ 15,649		



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## MANAGEMENT'S DISCUSSION AND ANALYSIS

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 2016 were 1,086 MW and 637,252 MWh, respectively. The 2016 peak demand of Heartland's long-term wholesale customers was 126.7 MW. Heartland's wholesale customer demand and energy sales for 2015 were 1,443 MW and 855,651 MWh, respectively. Heartland's wholesale customer demand and energy sales for 2014 were 1,453 MW and 862,805 MWh. Heartland's wholesale customer peak demand for 2015 and 2014 were 135.7 MW and 138.3 MW, respectively.

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 increased in 2016 due to less scheduled and unscheduled unit outages compared to 2015.

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 nonfirm. 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. Heartland has contracted with other parties for most of its excess energy and the market prices have declined resulting in declining surplus sales revenue.

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 8.7% and 8.2% in 2016 and 2015, respectively. The largest reason for the decrease was a reduction in generation. LRS unit 1 had a long Fall outage for environmental improvements in 2016. LRS unit 1 did not generate as many MWh in 2015 due to maintenance outages and decreased market dispatch compared to 2014.

Heartland purchases power, in addition to its ownership share in LRS, to meet the total contract resource obligations to its customers. The purchased power contracts include base-load resources, renewable generation facilities, short-term purchases during peak conditions or during an outage, 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 2016 and 2015. Also attributing to the reduction in the cost of power was a short-term power supply contract that corresponded with the end date of Marshall's contract.

The nonoperating revenues/expenses include interest on bonds, investment income, and amortization of costs recoverable from future billings. Heartland's debt service coverage (as defined in the senior bond resolution which includes other available sources) for 2016 and 2015 was 2.72 and 3.21, respectively. The debt service coverage was 5.22 in 2014.

Heartland made principal payments of \$5,750,000 on its Electric System Second Lien Revenue Bonds, Series 2011 in 2016, and also paid down \$1,700,000 on its operating line related to the previously outstanding Electric System Second Lien Revenue Note, Series 2010. Heartland called the Electric System Second Lien Revenue Note, Series 2010, in 2015 and the remaining balance was moved to Heartland's line of credit. This allowed Heartland to take advantage of the lower short-term interest rates on the line of credit compared to the 4.29% of the Series 2010 Note.

In March 2015, Heartland completed a transaction to defease the remainder of its Electric System Revenue Bonds, Series 1992. Heartland used fully funded reserve accounts, previously established, to pay the final two years of debt service of the Series 1992 bonds, to defease the remaining \$9,760,000. In addition to the defeasance, Heartland made payments of \$4,645,590 on revenue bonds and notes. Principal payments in 2014 were \$703,401. Additions to plant in service were primarily the result of improvements to the Missouri Basin Power Project, which includes LRS and various associated transmission facilities. There were no significant additions in 2016, 2015, or 2014.

Fitch assigned an underlying rating of A- to Heartland, Moody's assigned A3, and Standard & Poor's has assigned an issuer credit rating of BBB+ to Heartland.

### 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.



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# BALANCE SHEETS

YEARS ENDED DECEMBER 31, 2016 AND 2015

## Assets and Deferred Outflows of Resources

	2016	2015
<b>Current Assets</b>		
Cash and cash equivalents	\$ 7,965,003	\$ 4,030,999
Restricted cash and cash equivalents	5,810,693	6,951,367
Short-term investments	1,977,173	2,387,702
Accounts receivable	7,777,416	8,082,970
Notes receivable, current portion	435,732	427,767
Plant operation assets	4,769,254	3,560,089
Prepaid expenses and other current assets	33,279	111,072
Total current assets	28,768,550	25,551,966
<b>Noncurrent Assets</b>		
Notes receivable, net of allowance of \$343,781 for 2016 and \$326,774 for 2015	2,743,898	2,816,366
Long-term investments	273,044	2,327,533
Capital assets, net	20,402,110	20,260,272
Costs recoverable from future billings	1,388,285	2,792,435
Net pension asset	-	370,005
Other noncurrent assets	1,095,000	295,000
Total noncurrent assets	25,902,337	28,861,611
<b>Deferred Outflows of Resources</b>		
Deferred outflows for pensions	674,873	429,423
Deferred loss on debt defeasance	-	106,244
Total deferred outflows of resources	674,873	535,667
Total assets and deferred outflows of resources	\$ 55,345,760	\$ 54,949,244



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SEE NOTES TO FINANCIAL STATEMENTS

# BALANCE SHEETS: DECEMBER 31, 2016 AND 2015

YEARS ENDED DECEMBER 31, 2016 AND 2015

*Liabilities, Deferred Inflows of Resources and Net Position*

	2016	2015
<b>Current Liabilities</b>		
Current maturities of long-term debt	\$ 5,873,946	\$ 6,023,832
Accounts payable	4,197,886	6,548,434
Accrued expenses	500,361	412,409
Accrued interest payable	155,312	287,531
Unearned revenue	-	1,191,877
Total current liabilities	10,727,505	14,464,083
<b>Noncurrent Liabilities</b>		
Line of credit	2,300,000	4,000,000
Long-term debt, net	2,783,366	8,432,331
Net pension liability	296,707	-
Other noncurrent liabilities	269,750	235,065
Total noncurrent liabilities	5,649,823	12,667,396
Total liabilities	16,377,328	27,131,479
<b>Deferred Inflows of Resources</b>		
Deferred inflows for pensions	21,891	350,782
Deferred gain on refunding	-	75,533
Reductions of future billings	1,753,663	-
Total deferred inflows of resources	1,775,554	426,315
<b>Net Position</b>		
Net investment in capital assets	12,250,422	4,789,036
Restricted for debt service	5,659,735	6,667,805
Restricted for pensions	-	370,005
Unrestricted	19,282,721	15,564,604
Total net position	37,192,878	27,391,450
Total liabilities, deferred inflows of resources and net position	\$ 55,345,760	\$ 54,949,244



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# STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
<b>Operating Revenues</b>		
Customer requirements	\$ 50,070,249	\$ 62,716,984
Other contracted requirements	17,893,259	12,609,096
Surplus sales revenue	2,557,198	2,976,217
Other operating revenue	4,041,568	968,729
Transfer for rate stabilization	(1,750,000)	-
Total operating revenues	72,812,274	79,271,026
<b>Operating Expenses</b>		
Cost of power	49,099,837	55,013,347
Depreciation and amortization	2,430,760	1,445,041
Transmission	6,400,660	5,439,290
Other	4,394,270	4,462,499
Total operating expenses	62,325,527	66,360,177
<b>Operating Income</b>	10,486,747	12,910,849
<b>Nonoperating Revenues (Expenses)</b>		
Investment income	133,171	149,080
Interest expense	(386,639)	(802,421)
Amortization expense	(238,825)	(205,969)
Grant revenue	-	300,000
Other	(193,026)	(608,887)
Net nonoperating expenses	(685,319)	(1,168,197)
<b>Change in Net Position</b>	9,801,428	11,742,652
<b>Net Position, Beginning of Year</b>	27,391,450	15,648,798
<b>Net Position, End of Year</b>	\$ 37,192,878	\$ 27,391,450



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# STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2016 AND 2015

## Operating Activities

Receipts from customers  
Receipts from others  
Payments to suppliers  
Payments to employees  
Net cash provided by operating activities

## Noncapital Financing Activities

Advances on revolving line of credit  
Payments on revolving line of credit  
Federal grants received  
Proceeds from issuance of promissory notes  
Payments on promissory notes  
Remittance of BNSF settlement funds  
Other non operating payments  
Net cash provided by (used in) noncapital financing activities

## Capital and Related Financing Activities

Purchase of capital assets  
Payments on revenue bonds and notes  
Net payments for debt defeasance and refunding  
Interest paid  
Net cash used in capital and related financing activities

## Investing Activities

Proceeds from sales and maturities of investment securities  
Purchases of investment securities  
Issuance of notes receivable  
Repayments of notes receivable  
Investment income received  
Net cash provided by investing activities

## Change in Cash and Cash Equivalents

## Cash and Cash Equivalents

## Cash and Cash Equivalents, End of Year

## Composition of Cash and Cash Equivalents

Cash and cash equivalents  
Restricted cash and cash equivalents  
Total

	2016	2015
	\$	\$
	51,349,152	63,084,525
	23,518,676	15,766,286
	(63,773,731)	(66,958,232)
	(1,422,534)	(1,345,693)
	9,671,563	10,546,886
	-	1,615,718
	(1,700,000)	(2,064,544)
	-	300,000
	225,000	1,225,000
	(273,851)	(175,158)
	-	(628,380)
	(176,020)	-
	(1,924,871)	272,636
	(1,365,219)	(1,606,250)
	(5,750,000)	(4,645,590)
	-	(10,050,000)
	(488,147)	(1,280,182)
	(7,603,366)	(17,582,022)
	7,183,717	13,830,000
	(4,756,393)	(5,324,586)
	(436,407)	(1,600,000)
	483,903	546,847
	175,184	188,975
	2,650,004	7,641,236
	2,793,330	878,736
	10,982,366	10,103,630
	\$ 13,775,696	\$ 10,982,366
	7,965,003	4,030,999
	\$ 5,810,693	\$ 6,951,367
	\$ 13,775,696	\$ 10,982,366



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# STATEMENTS OF CASH FLOWS, continued

YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
<b>Reconciliation of operating income to Net Cash Provided by Operating Activities</b>		
Operating income	\$ 10,486,747	\$ 12,910,849
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation and amortization	2,430,760	1,445,041
Amortization of advance payment received under energy purchase contract	(1,191,877)	(2,404,062)
Changes in balance sheet operating items		
Accounts receivable	305,554	(418,990)
Plant operation assets	(1,209,165)	35,440
Prepaid expenses and other assets	(665,175)	(18,775)
Net pension asset (liability)	666,712	327,289
Deferred outflows for pensions	(245,450)	141,133
Accounts payable	(2,450,289)	(1,052,200)
Accrued liabilities	122,637	37,963
Deferred inflows for pensions	(328,891)	(456,802)
Deferred inflows for rate stabilization	1,750,000	-
<b>Net Cash Provided by Operating Activities</b>	<b>\$ 9,671,563</b>	<b>\$ 10,546,886</b>
<b>Supplemental Cash Flows Information</b>		
Capital asset acquisitions included in accounts payable	\$ 251,688	\$ 151,947
Increase in allowance for notes receivable	\$ 17,007	\$ 10,358



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SEE NOTES TO FINANCIAL STATEMENTS

# NOTES TO FINANCIAL STATEMENTS: DECEMBER 31, 2016 AND 2015

## 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 District 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) the District'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 the District and (3) the entity's fiscal dependency on the District. Based upon the above criteria, Heartland has determined that it has no reportable component units.

### *Basis of Accounting*

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

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

### *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, 2016 and 2015, cash equivalents consisted of money market funds.

### *Investments and Investment Income*

Heartland maintains various debt service reserve accounts that are available for debt service obligations. The reserve accounts consist of bank deposits and investments. 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.



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## NOTES TO FINANCIAL STATEMENTS: DECEMBER 31, 2016 AND 2015, continued

### NOTE 1: NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

#### *Investments and Investment Income, continued*

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

#### *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, 2016 and 2015, 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 \$343,781 and \$326,774 at December 31, 2016 and 2015, respectively.

#### *Plant Operation Assets*

The operation of the Missouri Basin Power Project (MBPP) requires the establishment of certain operating assets, primarily fuel inventories, supplies, and operating cash. These assets are managed by the operating agent for MBPP and are stated at cost.

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

#### *Pensions*

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



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## NOTES TO FINANCIAL STATEMENTS: DECEMBER 31, 2016 AND 2015, continued

### NOTE 1: NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

#### *Net Position Classification*

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

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

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

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

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

#### *Classification of revenues*

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

#### *Income Taxes*

Heartland is exempt from federal income taxes as it is a political subdivision of the state of South Dakota. Heartland may be subject to franchise taxes in states in which it operates. Tax expense was \$9,840 and \$9,660 in 2016 and 2015, respectively.

#### *Reclassifications*

Certain reclassifications were made to the 2015 financial statements to conform to the 2016 financial statement presentation. These reclassifications had no effect on the change in net position.

#### *Implementation of New Accounting Principles*

In 2016, the District implemented the provisions of the following accounting principles:

GASB Statement No. 72, Fair Value Measurement and Application. This Statement provides guidance for determining a fair value measurement for financial reporting purposes as well as applying fair value to certain investments and the disclosure related to all fair value measurements.

GASB Statement No. 76, The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments. The objective of this Statement is to identify – in the context of the current governmental financial reporting environment – the hierarchy of generally accepted accounting principles (GAAP). This statement reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and nonauthoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP.

The implementation of GASB Statements No. 72 and 76 did not have a significant impact on the financial statements of the District.



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# NOTES TO FINANCIAL STATEMENTS: DECEMBER 31, 2016 AND 2015, continued

## 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. The District'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 the District and thus, no custodial risk exists. No legal opinion has been obtained regarding the enforceability of any collateral arrangements.

### Investments

At December 31, 2016 and 2015, Heartland had the following investments and maturities:

	Maturities in Years					Credit Ratings (Moody's)
	Carrying value	Less than 1	1-5	6-10	More than 10	
December 31, 2016						
Money market mutual funds	\$ 12,257,085	\$ 12,257,085	\$ -	\$ -	\$ -	Aaa-mf
U.S. Treasury securities	2,002,110	-	2,002,110	-	-	N/A
U.S. agency obligations	248,107	-	-	248,107	-	Aaa
	<u>\$ 14,507,302</u>	<u>\$ 12,257,085</u>	<u>\$ 2,002,110</u>	<u>\$ 248,107</u>	<u>\$ -</u>	
December 31, 2015						
Money market mutual funds	\$ 9,694,910	\$ 9,694,910	\$ -	\$ -	\$ -	Aaa-mf
U.S. Treasury securities	4,382,433	2,385,013	1,997,420	-	-	N/A
U.S. agency obligations	332,800	-	-	-	332,800	Aaa
	<u>\$ 14,410,143</u>	<u>\$ 12,079,923</u>	<u>\$ 1,997,420</u>	<u>\$ -</u>	<u>\$ 332,800</u>	

### Disclosures About Fair Value of Assets and Liabilities

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

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

The District's investments in money market mutual funds are carried at cost and thus are not included within the fair value hierarchy. The District'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, 2016 and 2015.



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## NOTES TO FINANCIAL STATEMENTS: DECEMBER 31, 2016 AND 2015, continued

### NOTE 2: DEPOSITS, INVESTMENTS AND INVESTMENT RETURN, continued

#### *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. The District'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 the District as owner.

#### *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, 2016 or 2015 exceeded 5%.

#### *Summary of Carrying Values*

The carrying values of deposits and investments shown above are included in the balance sheets at December 31, 2016 and 2015 as follows:

	2016	2015
Carrying value		
Deposits	\$ 1,518,611	\$ 1,287,458
Investments	14,507,302	14,410,143
	<u>\$ 16,025,913</u>	<u>\$ 15,697,601</u>

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# NOTES TO FINANCIAL STATEMENTS: DECEMBER 31, 2016 AND 2015, continued

## NOTE 2: DEPOSITS, INVESTMENTS AND INVESTMENT RETURN, continued

### Summary of Carrying Values, continued

Included in the following balance sheet captions:

	2016	2015
Current Assets		
Cash and cash equivalents		
Operating funds	\$ 545,812	\$ 297,163
General reserve funds	3,715,507	2,531,755
Revolving loan fund program accounts	1,122,798	1,140,292
Rate stabilization fund	2,580,886	61,789
Total	7,965,003	4,030,999
Restricted cash and cash equivalents		
Energy efficiency and incentive grant fund	59,730	59,577
Wessington PPA collateral account	-	850,000
Debt service funds	5,750,963	6,041,790
Total	5,810,693	6,951,367
Short-term investments - rate stabilization fund	1,977,173	2,387,702
Noncurrent Assets		
Long-term investments - rate stabilization fund	273,044	2,327,533
	\$ 16,025,913	\$ 15,697,601

### Investment Return

Investment return for the years ended December 31, 2016 and 2015 consisted of interest income and realized gains of \$92,257 and \$115,807, respectively. Unrealized gains and losses on restricted investments are deferred and reported as reductions of future billings shown as a deferred inflow of resources in accordance with the regulated operations provisions of GASB Statement No. 62.



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# NOTES TO FINANCIAL STATEMENTS: DECEMBER 31, 2016 AND 2015, continued

## NOTE 3: NOTES RECEIVABLE

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

Type of Notes	2015					Due Within One Year
	January 1,	Additions	Reductions	December 31,		
4.0% to 4.5% notes in connection with Heartland's economic development program, payable in annual installments through December 2018	\$ 224,078	\$ —	\$ 62,860	\$ 161,218	\$	24,044
3.0% to 6.25% notes in connection with the Intermediary Relending Program Promissory Note (see Note 13), due in monthly installments through January 2024	847,024	300,000	304,431	842,593		94,169
Interest-free notes in connection with the Rural Economic Development Loan Agreement and Rural Economic Development Grant Agreement (see Note 13), due in monthly installments through November 2028	1,446,652	1,300,000	179,556	2,567,096		309,554
Allowance for notes receivable	(316,416)	(10,358)	—	(326,774)		—
Total notes receivable, net	\$ 2,201,338	\$ 1,589,642	\$ 546,847	\$ 3,244,133	\$	427,767

Interest income on these notes totaled \$40,914 and \$33,273 for 2016 and 2015, respectively, and is included within investment income on the statements of revenues, expenses and changes in net position.



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# NOTES TO FINANCIAL STATEMENTS: DECEMBER 31, 2016 AND 2015, continued

## NOTE 4: CAPITAL ASSETS

Capital assets at December 31, 2016 and 2015 consisted of the following:

	2016	2015
Depreciable assets		
Missouri Basin Power Project	\$ 56,029,934	\$ 54,555,764
Transmission Project I (TP I)	1,085,293	1,085,293
Transmission Project II (TP II)	-	6,752,305
Groton substation (TP III)	408,641	408,641
Heartland headquarters building	2,837,333	2,837,333
General plant	811,285	759,685
Total depreciable assets	61,172,486	66,399,021
Nondepreciable assets		
Land	80,402	80,402
Construction in progress	1,030,796	1,280,756
Total nondepreciable assets	1,111,198	1,361,158
	<u>\$ 62,283,684</u>	<u>\$ 67,760,179</u>

Capital assets activity for 2016 and 2015 was:

	2016				
	Beginning Balance	Additions	Retirements	Transfers	Ending Balance
Missouri Basin Power Project	\$ 54,555,764	\$ 66,704	\$ (189,150)	\$ 1,596,616	\$ 56,029,934
Transmission Project I (TP I)	1,085,293	-	-	-	1,085,293
Transmission Project II (TP II)	6,752,305	-	(6,752,305)	-	-
Groton substation (TP III)	408,641	-	-	-	408,641
Heartland headquarters building	2,837,333	-	-	-	2,837,333
General plant	759,685	51,600	-	-	811,285
Land	80,402	-	-	-	80,402
Construction in progress	1,280,756	1,346,656	-	(1,596,616)	1,030,796
Total capital assets	67,760,179	1,464,960	(6,941,455)	-	62,283,684
Less accumulated depreciation	(47,499,907)	(1,323,122)	6,941,455	-	(41,881,574)
Capital assets, net	<u>\$ 20,260,272</u>	<u>\$ 141,838</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 20,402,110</u>



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# NOTES TO FINANCIAL STATEMENTS: DECEMBER 31, 2016 AND 2015, continued

## NOTE 4: CAPITAL ASSETS, continued

	2015				
	Beginning Balance	Additions	Retirements	Transfers	Ending Balance
Missouri Basin Power Project	\$ 54,566,157	\$ 1,742	\$ (712,368)	\$ 700,233	\$ 54,555,764
Transmission Project I (TP I)	1,085,293	-	-	-	1,085,293
Transmission Project II (TP II)	6,752,305	-	-	-	6,752,305
Groton substation (TP III)	408,641	-	-	-	408,641
Heartland headquarters building	2,837,333	-	-	-	2,837,333
General plant	752,277	70,925	(63,517)	-	759,685
Land	80,402	-	-	-	80,402
Construction in progress	412,892	1,568,097	-	(700,233)	1,280,756
Total capital assets	66,895,300	1,640,764	(775,885)	-	67,760,179
Less accumulated depreciation	(47,033,390)	(1,242,402)	775,885	-	(47,499,907)
Capital assets, net	\$ 19,861,910	\$ 398,362	\$ -	\$ -	\$ 20,260,272

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

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

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

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

LRS project participants, including Heartland, filed a rate case in 2004 with the federal Surface Transportation Board (STB) challenging the reasonableness of the freight rates charged by the Burlington Northern Santa Fe (BNSF) railroad for coal deliveries to LRS.

In early 2009, the STB issued its decision and awarded the LRS project participants a favorable decision estimated by the STB at approximately \$345 million in rate relief. The STB awarded \$119 million to the LRS participants for past freight overcharges plus an expectation of present value rate benefits of approximately \$245 million due to a new tariff the STB ordered to be charged through 2024. Of this total award, BNSF remitted approximately \$3.6 million to Heartland.

On January 28, 2015, Western Fuels and Burlington Northern Santa Fe (BNSF) filed a joint petition with the Surface Transportation Board (STB) asking the STB to hold the rate proceeding in abeyance due to the fact that the parties had reached a settlement that called for dismissal of the case and vacation of the rate prescription ordered by STB. In accordance with the settlement terms, Heartland remitted approximately \$600,000 back to BNSF during 2015.



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# NOTES TO FINANCIAL STATEMENTS: DECEMBER 31, 2016 AND 2015, continued

## NOTE 5: CREDIT FACILITIES

### Line of Credit

In March 2015, Heartland entered into a revolving credit agreement with a financial institution that provides for borrowings up to \$25,000,000; secured by a subordinate lien on the revenues of Heartland's electric system. The agreement expires on March 23, 2018, and can be extended at the option of Heartland. Borrowings under the credit agreement bear interest at varying rates, and cannot exceed a maximum rate, as defined in the agreement (1.41% and 1.17% at December 31, 2016 and 2015, 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 \$2,300,000 and \$4,000,000 on this line at December 31, 2016 and 2015, respectively. District management has created an internal loan amortization schedule to document their intent of repayment of the outstanding balance on the line of credit by February 2019. This internal amortization schedule shows principal repayments of \$600,000, \$1,200,000 and \$500,000 in 2017, 2018 and 2019, respectively.

### Letter of Credit

As financial security for Heartland's performance under certain financial transmission rights and transmission congestion rights in regional transmission organizations in which Heartland participates, Heartland has obtained a standby letter of credit for \$1.5 million at December 31, 2016 and 2015. The letter of credit expires September 30, 2017, and can be renewed for an additional one-year term.

## NOTE 6: LONG-TERM LIABILITIES

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

Type of Debt	2015				
	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	\$ 11,350,000	\$ -	\$ 5,750,000	\$ 5,600,000	\$ 5,600,000
1.0% Intermediary Relending Program Promissory Note, due annually on October 16 with a final payment due October 16, 2036	599,130	-	25,847	573,283	26,105
1.0% Intermediary Relending Program Promissory Note, due annually on June 25 beginning in 2014 with a final payment due June 25, 2040	605,518	-	26,196	579,322	26,029
1.0% Intermediary Relending Program Promissory Note, due annually on November 10, beginning in 2020, with a final payment due November 10, 2046; this Note is authorized, and expected, to be drawn to a maximum of \$1,000,000 in 2017	-	225,000	-	225,000	-
0% Rural Economic Development Promissory Note, with principal payments due in monthly installments of \$6,852 through July 31, 2019	294,620	-	82,224	212,396	82,224
0% Rural Economic Development Promissory Note, with principal payments due in monthly installments of \$3,299 through April 30, 2031	606,895	-	39,588	567,307	39,588
0% Rural Economic Development Promissory Note, with principal payments due in monthly installments of \$8,333 through December 31, 2025	1,000,000	-	99,996	900,004	100,000
Total bonds and notes payable	14,456,163	225,000	6,023,851	8,657,312	5,873,946
Compensated absences	327,804	99,682	99,716	327,770	82,572
Total long-term liabilities	\$ 14,783,967	\$ 324,682	\$ 6,123,567	\$ 8,985,082	\$ 5,956,518



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# NOTES TO FINANCIAL STATEMENTS: DECEMBER 31, 2016 AND 2015, continued

## NOTE 6: LONG-TERM LIABILITIES, continued

Long-term liabilities at December 31, 2015 consisted of the following:

Type of Debt	2015				
	January 1,	Additions	Reductions	December 31,	Due Within One Year
6.0% Electric System Revenue Bonds, Series 1992, due annually on January 1, 2015 with a final payment due January 1, 2017. Outstanding principal of \$9,760,000 was defeased in 2015	\$ 14,225,000	\$ -	\$ 14,225,000	\$ -	\$ -
4.29% Electric System Second Lien Revenue Note, Series 2010, due quarterly on January 1, April 1, July 1 and October 1 with final payment due on July 1, 2020. Callable at Heartland's option on June 1, 2013. Redeemed in full in 2015	4,682,443	-	4,682,443	-	-
4.75-5.25% Electric System Second Lien Revenue Bonds, Series 2011, with interest payments due semi-annually and principal payments due on January 1, 2016 and 2017	11,350,000	-	-	11,350,000	5,750,000
1.0% Intermediary Relending Program Promissory Note, due annually on October 16 with a final payment due October 16, 2036	624,721	-	25,591	599,130	25,847
1.0% Intermediary Relending Program Promissory Note, due annually on June 25 beginning in 2014 with a final payment due June 25, 2040	408,273	225,000	27,755	605,518	26,173
0% Rural Economic Development Promissory Note, with principal payments due in monthly installments of \$6,852 through July 31, 2019	376,844	-	82,224	294,620	82,224
0% Rural Economic Development Promissory Note, with principal payments due in monthly installments of \$3,299 through April 30, 2031	646,483	-	39,588	606,895	39,588
0% Rural Economic Development Promissory Note, with principal payments due in monthly installments of \$8,333 through December 31, 2025	-	1,000,000	-	1,000,000	100,000
Total bonds and notes payable	32,313,764	1,225,000	19,082,601	14,456,163	6,023,832
Compensated absences	307,773	154,697	134,666	327,804	92,739
Total long-term liabilities	\$ 32,621,537	\$ 1,379,697	\$ 19,217,267	\$ 14,783,967	\$ 6,116,571

Debt service requirements at December 31, 2016 are as follows:

	Principal	Interest	Total
2017	\$ 5,873,946	\$ 189,499	\$ 6,063,445
2018	274,483	30,772	305,255
2019	240,734	13,591	254,325
2020	233,512	12,202	245,714
2021	234,457	11,257	245,714
2022-2026	1,021,734	42,084	1,063,818
2027-2031	465,275	24,532	489,807
2032-2036	313,171	9,601	322,772
	\$ 8,657,312	\$ 333,538	\$ 8,990,850



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## NOTES TO FINANCIAL STATEMENTS: DECEMBER 31, 2016 AND 2015, continued

### NOTE 6: LONG-TERM LIABILITIES, continued

The District has executed three credit agreements with two financial institutions, two for \$740,000 and the other for \$1,000,000, which is 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, 2016 and 2015.

The principal and interest on the revenue notes and bonds are payable solely from, and secured solely by, a pledge of and lien on: (1) the revenues of Heartland's electric system, subject to prior payments there from of operation and maintenance expense; (2) the proceeds of the sale of the notes or bonds; and (3) all accounts established under the Bond Resolution, including income, if any, from investments thereof. The total principal and interest remaining to be paid on the secured bond is \$5,747,000, with the final payment on January 1, 2017 expecting to require approximately 10% of net revenues in 2017. Principal and interest for the current year and total operating revenues were \$6,180,563 and \$72,812,274, respectively.

#### *Debt Defeasance*

In March 2015, Heartland completed a transaction to defease the remaining outstanding balance of the Electric System Revenue Bonds, Series 1992 ("defeased bonds"). Under this transaction, Heartland used a total of \$10,638,621 to purchase U.S. government securities, which were then deposited with an escrow agent to provide for the future principal and interest payments on the defeased bonds. The outstanding balance of the defeased bonds was \$5,030,000 and \$9,760,000 at December 31, 2016 and 2015, respectively.

### NOTE 7: POWER SALES AGREEMENTS

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

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

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

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

### NOTE 8: COMMITMENTS

#### *Western Area Power Administration (WAPA)*

Heartland has a long-term agreement with WAPA whereby WAPA is making available to Heartland the use of a shared transmission system. Effective September 1998, Heartland, WAPA, and Basin Electric Power Cooperative transmission facilities created the Integrated System (IS), which is a combined transmission system operated as a single integrated system by WAPA. The IS has been developed to allow for third-party transmission use consistent with the Federal Energy Regulatory Commission final orders and policies governing open access transmission service.

#### *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 the District 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.



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## NOTES TO FINANCIAL STATEMENTS: DECEMBER 31, 2016 AND 2015, continued

### NOTE 8: COMMITMENTS, continued

#### *Energy Purchase Contracts*

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

### 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 the District. 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, the District accounts for and reports its participation in the Plan, based on its calculated proportionate share of contributions to the Plan. The Plan issues a publicly available financial report that includes financial statements and required supplementary information for the Plan. That report may be obtained at <http://www.sdrs.sd.gov/publications/> or by writing the South Dakota Retirement System, P.O. Box 1098, Pierre, SD 57501-1098.

##### *Contributions*

Covered employees are required by state statute to contribute a percentage of their salary (6%) to the Plan, and Heartland is required to match the employee contribution. Participating employers may also make an additional contribution of 1.50% of compensation for optional spouse coverage. 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 \$103,771 and \$99,453 during 2016 and 2015, respectively, and were in accordance with statutory rates. The employees' contributions during 2016 and 2015 were \$84,452 and \$82,227, 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, 2016, the District reported a liability of \$296,707 for its proportionate share of the collective net pension liability for the Plan. At December 31, 2015, the District reported an asset of \$370,005 for its proportionate share of the collective net pension asset for the Plan. The net pension liability and net pension asset were measured as of June 30, 2016 and 2015, respectively, and the total pension liability used to calculate these amounts was determined by an actuarial valuation as of those dates. The District's proportionate share of the net pension liability and net pension asset was based on the District's share of contributions to the Plan relative to all employer contributions to the Plan for the measurement period. At December 31, 2016 and 2015, the District's proportion was 0.088% and 0.087%, respectively.



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# NOTES TO FINANCIAL STATEMENTS: DECEMBER 31, 2016 AND 2015, continued

## 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, 2016 and 2015, the District recognized pension expense of \$92,371 and \$11,620, respectively. At December 31, 2016 and 2015, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	December 31, 2015		December 31, 2015	
	Deferred Outflows of Resources	Deferred Inflows of Resources	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	\$ 103,290	\$ -	\$ 75,760	\$ -
Net difference between projected and actual earnings on pension plan investments	330,039	-	-	319,919
Changes of assumptions	177,714	-	293,390	-
Change in Heartland's proportionate share	-	21,891	-	30,863
Heartland contributions subsequent to the measurement date	63,830	-	60,273	-
Total	<u>\$ 674,873</u>	<u>\$ 21,891</u>	<u>\$ 429,423</u>	<u>\$ 350,782</u>

The deferred outflows of resources related to pensions resulting from District contributions subsequent to the measurement date will be recognized as a reduction of pension expense in the fiscal year ending December 31, 2017. 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,	
2017	\$ 155,907
2018	90,763
2019	205,034
2020	<u>137,448</u>
	<u>\$ 589,152</u>

**Actuarial assumptions** – The total pension liability in the June 30, 2016 and 2015 actuarial valuations was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.25%
Salary increases	2016 - 5.83% at entry to 3.87% after 30 years of service
	2015 - 5.83% at entry to 3.75% after 30 years of service
Discount rate	7.50%, net of pension plan investment expense

Mortality rates were based on the RP-2000 Mortality Table, projected generally with Scale BB and with rates reduced to fit recent experience.

The actuarial assumptions used in the June 30, 2016 and 2015 valuations were based on the results of an actuarial experience study, which covered the five-year period ending June 30, 2011.



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## NOTES TO FINANCIAL STATEMENTS: DECEMBER 31, 2016 AND 2015, continued

### 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*

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 are summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
<b>December 31, 2016</b>		
Global Equity	58.0%	4.8%
Fixed Income	30.0%	1.8%
Real Estate	10.0%	5.2%
Cash	2.0%	0.7%
Total	100.0%	
<b>December 31, 2015</b>		
Global Equity	61.0%	4.5%
Fixed Income	27%	1.8%
Real Estate	10%	5.2%
Cash	2%	0.0%
Total	100%	

**Discount rate** – The discount rate used to measure the total pension liability was 7.50% for 2016 and 2015. 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 the District's proportionate share of the net pension asset (liability) to changes in the discount rate** – The following presents the District's proportionate share of the net pension asset (liability) calculated using the discount rate of 7.50%, as well as what the District'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 (6.50%) or one percentage point higher (8.50%) than the current rate.

	1% Decrease (6.50%)	Current Discount Rate (7.50%)	1% Increase (8.50%)
District's proportionate share of the net pension asset (liability)			
December 31, 2015	\$ (1,660,371)	\$ (296,707)	\$ 815,507

#### 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.



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## NOTES TO FINANCIAL STATEMENTS: DECEMBER 31, 2016 AND 2015, continued

### NOTE 9: RETIREMENT PLANS, continued

#### *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, 2016 and 2015 were \$57,691 and \$56,878, respectively. No forfeitures were used to reduce Heartland's contributions during 2016 and 2015. The contributions made by Heartland employees for the years ended December 31, 2016 and 2015 were \$85,966 and \$82,020, respectively.

### NOTE 10: SIGNIFICANT ESTIMATES AND CONCENTRATIONS

#### *Major Customers*

Sales to two customers were approximately 37% and 51% of total operating revenues for the years ended December 31, 2016 and 2015, respectively. Approximately 24% and 57% of total accounts receivable were owed from three customers at December 31, 2016 and 2015, respectively.

#### *Proposed Environmental Standards*

In June 1999, the Environmental Protection Agency (EPA) issued final regulations for a Regional Haze Program. The purpose of the regulations is to improve visibility in the form of reduced regional haze in 156 national parks and wilderness areas across the country. The EPA's claim is that haze is formed, in part, from emissions of SO<sub>2</sub> (sulfur dioxide) and NO<sub>2</sub> (nitrogen dioxide). Heartland is impacted by these regulations through its co-ownership of Laramie River Station (LRS) in Wyoming.

As part of the EPA's Clean Air Act regulations, each state is required to submit a state implementation plan (SIP) identifying the emission control technology proposed to comply with the Regional Haze Program. The State of Wyoming submitted its SIP to the EPA in 2011, which included plans for LRS. In January 2014, the EPA issued their final ruling on this SIP, requiring installation of selective catalytic reduction (SCR) NO<sub>2</sub> removal technology for five coal plants in Wyoming, including the three units at LRS. MBPP is currently evaluating the impact of this decision and its options in responding to the decision.

The EPA's final rule is expected to impose significant future costs at LRS, as a result of the extensive renovations at these facilities, the high capital cost of the SCR equipment and dramatically increased operating costs associated with SCRs. Although initial estimates of these costs have been calculated, the level of regulatory and legal uncertainty related to these facilities makes it impractical to quantify the specific potential financial impacts at this time.

### NOTE 11: RISK MANAGEMENT

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

### 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:

	2016	2015
Employees (unaudited)	12	12
Total salaries	\$ 1,422,500	\$ 1,377,344
Maintenance expense	\$ 220,820	\$ 301,994
Total kilowatt hours sold (unaudited)	1,282,757.118	1,497,663.374

# NOTES TO FINANCIAL STATEMENTS: DECEMBER 31, 2016 AND 2015, continued

## 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 District operations. Condensed 2016 and 2015 financial information for the revolving loan fund is presented below:

### Condensed Balance Sheet

	2016	2015
Current assets	\$ 1,551,824	\$ 1,545,902
Other assets	2,613,527	2,679,193
Total assets	<u>\$ 4,165,351</u>	<u>\$ 4,225,095</u>
Liabilities		
Current liabilities	\$ 278,623	\$ 277,802
Noncurrent liabilities	2,783,367	2,832,331
Total liabilities	3,061,990	3,110,133
Net Position	1,103,361	1,114,962
Total liabilities and net position	<u>\$ 4,165,351</u>	<u>\$ 4,225,095</u>

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

	2016	2015
Nonoperating revenues (expenses)		
Investment income	\$ 37,871	\$ 28,668
Interest expense	(12,017)	(10,885)
Bad debt recoveries (expense)	(17,007)	(10,358)
Other	(20,448)	292,120
Capital contributions	-	75,000
Increase (Decrease) in Net Position	(11,601)	374,545
Net Position, Beginning of Year	1,114,962	740,417
Net Position, End of Year	<u>\$ 1,103,361</u>	<u>\$ 1,114,962</u>

### Condensed Statement of Cash Flows

	2016	2015
Net cash provided by (used in)		
Noncapital financing activities	\$ (80,608)	\$ 1,331,632
Investing activities	63,114	(1,013,035)
Increase (Decrease) in Cash	(17,494)	318,597
Beginning of Year	1,140,292	821,695
End of year	<u>\$ 1,122,798</u>	<u>\$ 1,140,292</u>



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## REQUIRED SUPPLEMENTARY INFORMATION

### SOUTH DAKOTA RETIREMENT SYSTEM: DECEMBER 31, 2016

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

	2016	2015	2014
Heartland's proportion of the net pension asset (liability)	0.088%	0.087%	0.097%
Heartland's proportionate share of the net pension asset (liability)	\$ (296,707)	\$ 370,005	\$ 697,294
Heartland's covered-employee payroll	\$ 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-employee payroll	-21.28%	26.61%	49.66%
Plan fiduciary net position as a percentage of the total pension liability	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, the District will present information for only those years for which information is available. Information presented in this schedule has been determined as of the District's measurement date (June 30) of the collective net pension asset (liability) in accordance with GASB 68.

#### *Schedule of Heartland Contributions*

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

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



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FINANCIALS

SHEET TITLE:  
REQUIRED  
SUPPLEMENTARY  
INFORMATION

## OTHER INFORMATION

FERC UNIFORM SYSTEM OF ACCOUNTS CLASSIFICATION: YEAR ENDED DECEMBER 31, 2016

### *Schedule of Transmission Operation and Maintenance Expenses*

	<u>Amount</u>
<b>Operation</b>	
560 - Operation Supervision and Engineering	\$ 50,061
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	-
563 - Overhead Lines Expenses	-
564 - Underground Lines Expenses	-
565 - Transmission of Electricity by Others	-
566 - Miscellaneous Transmission Expenses	21,230
567 - Rents	-
<b>Total Operation Expense</b>	<u><b>6,383,261</b></u>
<b>Maintenance</b>	
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	(40,106)
571 - Maintenance of Overhead Lines	26,983
572 - Maintenance of Underground Lines	-
572 - Maintenance of Miscellaneous Transmission Plant	30,612
<b>Total Maintenance Expense</b>	<u><b>17,399</b></u>
<b>Total Transmission O&amp;M</b>	<u><b>\$ 6,400,660</b></u>



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District

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PROJECT NO:  
2016

PROJECT:  
HEARTLAND  
CONSUMERS  
POWER DISTRICT

SECTION:  
FINANCIALS

SHEET TITLE:  
OTHER  
INFORMATION

F.8

## OTHER INFORMATION

FERC UNIFORM SYSTEM OF ACCOUNTS CLASSIFICATION: YEAR ENDED DECEMBER 31, 2016

### *Schedule of Administrative and General Expenses*

	<u>Amount</u>
<b>Customer Accounts Expenses</b>	
901 - Supervision	\$ -
902 - Meter Reading Expenses	-
903 - Customer Records and Collection Expenses	-
904 - Uncollectible Accounts	-
905 - Miscellaneous Customer Accounts Expenses	-
<b>Total Customer Accounts Expense</b>	<u>-</u>
<b>Customer Service and Informational Expenses</b>	
907 - Supervision	214,893
908 - Customer Assistance Expenses	287,214
909 - Informational Instructional Expenses	-
910 - Miscellaneous Customer Service and Informational Expenses	-
<b>Total Customer Service and Informational Expenses</b>	<u><b>502,107</b></u>
<b>Sales Expenses</b>	
911 - Supervision	-
912 - Demonstrating and Selling Expenses	-
913 - Advertising Expenses	-
916 - Miscellaneous Sales Expenses	-
<b>Sales Expenses</b>	<u>-</u>
<b>Administrative and General Expenses</b>	
920 - Administrative and General Salaries	1,220,477
921 - Office Supplies and Expenses	181,055
922 - Administrative Expenses Transferred Credit	-
923 - Outside Services Employed	420,853
924 - Propoerty Insurance	8,050
925 - Injuries and Damages	14,625
926 - Employee Pension and Benefits	553,495
927 - Franchise Requirements	-
928 - Regulatory Commission Expenses	50,920
929 - Duplicate Charges Credit	-
9301.1 - General Advertising Expenses	31,857
930.2 - Miscellaneous General Expenses	669,189
931 - Rents	-
935 - Maintenance of General Plant	195,565
<b>Administrative and General Expenses</b>	<u><b>3,347,086</b></u>
<b>Total</b>	<u><b>\$ 3,849,193</b></u>



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## KEY PROFESSIONAL RESOURCES

Auditors: BKD, LLP

Bond Counsel: Katten Muchin Rosenman

Trustee: First National Bank in Sioux Falls, SD

Paying Agent: Bank of New York

Power Supply: Burns & McDonnell



HEARTLAND

432 SE 12th Street

Madison, SD 57042

(605) 256-6536

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