OWENSBORO MUNICIPAL UTILITIES

ELECTRIC LIGHT AND POWER SYSTEM
&
WATER WORKS SYSTEM

FINANCIAL STATEMENTS
& SUPPLEMENTARY INFORMATION
Years Ended May 31, 2015 and 2014

(With Independent Auditor's Report Thereon)

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Riney Hancock CPAs PSC

INDEPENDENT AUDITOR'S REPORT

City Utility Commission
City of Owensboro, Kentucky

We have audited the accompanying financial statements of the Owensboro Municipal Utilities Electric Light and Power System (Electric System) of the City of Owensboro, Kentucky, as of and for the years ended May 31, 2015 and 2014, and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Owensboro Municipal Utilities Electric Light and Power System of the City of Owensboro, Kentucky, as of May 31, 2015 and 2014, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

www.rineyhancock.com - info@rineyhancock.com
2900 Veach Road, Suite 2 - Owensboro, Kentucky 42303 - 270-926-4540 - Fax: 270-926-1494
313 Southeast First Street - Evansville, Indiana 47713 - 812-423-0300 - Fax: 812-423-6282
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Emphasis of Matter

As discussed in Note 1 to the financial statements, in 2015 the Electric System adopted new accounting guidance, GASB Statement No. 68, *Accounting and Financial Reporting for Pensions.* Our opinion is not modified with respect to this matter.

As discussed in Note 1, the financial statements present only the Electric System, an enterprise fund of the City of Owensboro, Kentucky, and do not purport to, and do not, present fairly the financial position of the City of Owensboro, Kentucky, as of May 31, 2015 and 2014, the changes in its financial position or, where applicable, its cash flows, for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 6, the Schedule of Proportionate Share of the Net Pension Liability on page 36, and the Schedule of Contributions on page 37, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The schedule of revenues and expenses is presented for purposes of additional analysis and is not a required part of the financial statements.

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

Riney Hancock CPAs PSC

Owensboro, Kentucky
September 8, 2015

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of the Owensboro Municipal Utilities Electric Light and Power System (Electric System) financial performance provides an overview of the Electric System's financial activities for the fiscal year ended May 31, 2015. Please read it in conjunction with the Electric System's financial statements, which begin on page 7.

Overview of the Financial Statements

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

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

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

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

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

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

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

Financial Summary

The following table summarizes the financial condition and operations of the Electric System for 2015 and 2014.

Assets and Deferred Outflows of Resources	**2015**	**2014**
Utility plant, net	$ 187,030,810	$ 191,109,570
Restricted assets	100,276,282	110,332,631
Current assets	58,200,541	44,664,771
Other noncurrent assets	4,374,109	7,321,304
Deferred outflows of resources	10,739,974	21,440,542
	$ 360,621,716	$ 374,868,818
Liabilities, Deferred Inflows of Resources, and Net Position		
Net position		
Net investment in capital assets	$ 13,697,693	$ 37,246,490
Restricted	61,425,657	52,245,528
Unrestricted	18,208,856	25,504,699
Total net position	93,332,206	114,996,717
Long-term debt	204,022,904	203,784,767
Current liabilities	24,968,266	33,667,373
Other noncurrent liabilities	22,319,437	8,267,252
Deferred inflows of resources	15,978,903	14,152,709
	$ 360,621,716	$ 374,868,818
Revenues, Expenses and Changes in Net Position		
Operating revenues	$ 139,814,866	$ 137,401,276
Operating expenses	122,183,834	119,647,751
Operating income	17,631,032	17,753,525
Interest and debt expense	(10,331,770)	(9,546,328)
Interest and other income	940,056	1,269,665
Net nonoperating expenses	(9,391,714)	(8,276,663)
Income before transfers	8,239,318	9,476,862
Transfers out - dividends to City of Owensboro	(8,527,030)	(8,414,463)
Change in net position	$ (287,712)	$ 1,062,399

FINANCIAL HIGHLIGHTS

- Total net position declined $21.7 million in 2015, or 18.8%, primarily due to the cumulative effect of implementation of GASB Statement No. 68, "Accounting and Financial Reporting for Pensions" (GASB 68), as discussed in the accompanying notes to the financial statements. GASB 68 required the Electric System to record its proportionate share of the net pension liability of the County Employees Retirement System (CERS) of the Commonwealth of Kentucky, of which it is a participant. As a result, in 2015 the Electric System also recorded a net pension liability of $20.5 million, as measured by an actuary, as well as certain pension deferred inflows and outflows.

- Net assets decreased by $287,712 in 2015 versus an increase of $1,062,399 in 2014 as the result of changes in operating revenues, operating expenses, interest and transfers, as discussed below.

- Operating revenues increased $2.4 million, or 1.8%, in 2015 when compared to 2014. Although retail sales volumes declined, retail revenues increased by $3.1 million, or 4.3%, primarily due to an increase in recovery of energy costs from retail customers through the energy cost adjustment. The adjustment provides for the Electric System to adjust charges to its retail customers for fluctuations in energy costs. Average wholesale energy prices declined in 2015, resulting in a reduction in energy costs recovery from wholesale customers, thus increasing the recovery requirement from retail customers. Wholesale sales volumes increased by approximately 10% in 2015; however, as a result of depressed wholesale energy prices, operating revenues declined $859,813, or 1.3%.

- Operating expenses in 2015 increased $2.5 million, or 2.1%, versus 2014, largely the result of increases in production costs. Production costs increased $3.5 million, or 4.1%, primarily due to increased fuel costs, which were partially offset by decreases in purchased power and other production costs. Fuel costs increased $6.2 million, or 10.4%, from increased power generation as a result of no scheduled maintenance outages in 2015 versus two scheduled outages in 2014. The lack of outages in 2015 resulted in a reduction in purchased power of $1.6 million, or 18.1%, and decreased maintenance costs of $1.0 million, or 6.6%. Additionally, general and administrative costs declined $1.8 million of 13.6% in 2015, versus 2014, due to reductions in health insurance and pension costs, which partially offset the increase in production costs. Employee health insurance costs declined largely due to a new health insurance administration contact and pension cost declined primarily as a result of implementation of GASB 68, as discussed above. Rather than recording pension expense based on required contributions to the CERS, GASB 68 requires recognition of pension expense based on the change in the Electric System's proportionate share of the CERS net pension liability, as well as changes in certain CERS deferred inflows and outflows. The actuarial valuation of the CERS net pension liability, as well as better than expected investment earnings on the CERS plan assets, resulted in a pension expense which was less than the required contribution to the CERS in 2015.

FINANCIAL HIGHLIGHTS, Continued

- Net nonoperating expenses increased by $1.1 million, or 13.5%, in 2015 when compared to 2014. Interest expense increased by $785,442, or 8.2%, primarily the result of discontinuation of interest capitalization on the 2013 Series bonds in January 2015. The 2013 Series bond issuance included funds for interest through December 2014, thus interest was capitalized through that date and thereafter began being expensed.
- Dividend transfers to the City of Owensboro increased by $112,567 in 2015, or 1.3%, due primarily to an increase in actual cash transfers to the City.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of 2015, the Electric System had $187.0 million invested in a broad range of assets, including power plant facilities and equipment, substation facilities and equipment, transformers, poles, wiring, street lighting, traffic signal equipment, communication equipment, fiber optic cable and equipment, buildings and other equipment. This represents a net decrease of $4.1 million over 2014, or 2.1%, due to depreciation of capital assets. In addition to routine capital additions during 2015, the Electric System incurred $2.2 million on installation of a dry sorbent injection system and environmental design services to comply with enacted EPA mercury compliance rules, $839,000 on renovation of the distribution office building and $590,000 on a mobile equipment purchase for loading coal. The following table summarizes capital assets, net of accumulated depreciation, at the end of 2015 and 2014:

	2015	2014
Production plant	$ 115,030,429	$ 123,799,596
Transmission plant	14,590,022	14,353,461
Distribution plant	33,799,887	33,505,649
General plant	7,877,245	7,834,403
Unclassified plant and construction in progress	15,733,227	11,616,461
	$ 187,030,810	$ 191,109,570

Debt

At the end of 2015, the Electric System had $206.8 million in bonds outstanding versus $206.4 million in 2014, for an increase of $408,137, or 0.2%. The increase is attributable to compounding of interest on the 1991-B Series deferred interest bonds which exceeded scheduled principle reductions on other debt.

Outlook

We expect the 2016 net operating results to improve from 2015 results, with overall revenue increases anticipated to outpace cost increases. Revenues from retail customers are expected to increase as an electric base rate increase was effective June 1, 2015, and is anticipated to increase retail revenues by approximately 10%. On the cost side, production costs are expected to increase as two maintenance outages are scheduled in 2016, versus no such scheduled outages in 2015. Also increases in employee benefit and information technology costs are expected to contribute to additional general and administrative costs.

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OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM

STATEMENTS OF NET POSITION

May 31, 2015 and 2014

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	2015	2014
Utility plant, net	$ 187,030,810	$ 191,109,570
Restricted assets	100,276,282	110,332,631
Current assets:		
Cash and cash equivalents	38,053,568	24,977,368
Investments	499,620	-
Receivables:		
Retail accounts receivable, less allowance for doubtful accounts of $62,172 for 2015 and $47,903 for 2014	9,407,995	8,895,341
Wholesale accounts receivable	3,457,593	2,280,438
City of Owensboro	176,731	593,216
Other	537,202	449,438
Materials and supplies	3,459,155	3,541,047
Prepayments	392,973	354,059
Other	2,215,704	3,573,864
Total current assets	58,200,541	44,664,771
Other noncurrent assets:		
Unamortized debt expense	1,663,602	1,855,777
Other noncurrent assets	2,710,507	5,465,527
Total other noncurrent assets	4,374,109	7,321,304
Total assets	349,881,742	353,428,276
Deferred outflows of resources:		
Accumulated decrease in fair value of hedging derivatives	4,985,469	16,976,917
Deferred pension outflows	2,308,965	-
Unamortized loss on debt refunding	3,255,908	3,966,288
Net unrealized loss on investments	189,632	497,337
Total deferred outflows of resources	10,739,974	21,440,542
Total assets and deferred outflows of resources	$ 360,621,716	$ 374,868,818

See Notes to Financial Statements

LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION	2015	2014
Net position:		
Net investment in capital assets	$ 13,697,693	$ 37,246,490
Restricted for capital projects, net of related debt	5,323,512	4,933,791
Restricted for debt service	12,468,189	12,448,714
Restricted for other purposes	43,633,956	34,863,023
Unrestricted	18,208,856	25,504,699
Total net position	93,332,206	114,996,717
Long-term debt	204,022,904	203,784,767
Current liabilities (payable from restricted assets):		
Current maturities of long-term debt	2,780,000	2,610,000
Accrued interest payable	3,082,909	3,151,857
Accounts payable	5,545,120	6,455,229
	11,408,029	12,217,086
Current liabilities (payable from current assets):		
Accounts payable	4,111,595	7,084,692
Other	9,448,642	14,365,595
	13,560,237	21,450,287
Total current liabilities	24,968,266	33,667,373
Other noncurrent liabilities:		
Net pension liability	20,520,943	-
Other	1,798,494	8,267,252
	22,319,437	8,267,252
Commitments and contingencies (Note 9)		
Total liabilities	251,310,607	245,719,392
Deferred inflows of resources:		
Accumulated increase in fair value of hedging derivatives	4,798,482	8,297,836
Deferred pension inflows	2,290,634	-
Deferred revenue	1,886,549	2,292,598
Deferred energy cost adjustment	7,003,238	3,562,275
Total deferred inflows of resources	15,978,903	14,152,709
Total liabilities, deferred inflows of resourses, and net position	$ 360,621,716	$ 374,868,818

See Notes to Financial Statements

OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

Years Ended May 31, 2015 and 2014

	2015	2014
Operating revenues:		
Charges for services:		
Residential	$ 24,650,499	$ 22,995,721
Commercial	5,828,846	5,500,947
Industrial	41,309,466	40,239,608
Water Works System	787,580	719,708
City of Owensboro	2,071,206	2,116,223
Supplemental power	1,495,293	2,700,565
Other wholesale	62,351,667	61,877,554
Build America Bond subsidy	540,256	532,827
Other	780,053	718,123
Total operating revenues	139,814,866	137,401,276
Operating expenses:		
Production:		
Fuel for electric generation	65,620,480	59,449,211
Purchased power	7,409,652	9,048,348
Other	14,554,570	15,575,734
Transmission and distribution	7,397,846	7,295,393
Customer service and information	1,465,083	1,385,522
General and administrative	11,115,142	12,865,935
Telecommunications	417,088	545,158
Depreciation	14,203,973	13,482,450
Total operating expenses	122,183,834	119,647,751
Operating income	17,631,032	17,753,525
Nonoperating revenues (expenses):		
Interest and debt expense	(10,331,770)	(9,546,328)
Interest income on investments	1,516,861	1,052,320
Loss on investment derivatives	(714,922)	-
Other, net	138,117	217,345
Net increase (decrease) in fair value of investments	307,705	(236,814)
Deferred net change in fair value of investments	(307,705)	236,814
Total nonoperating revenues (expenses)	(9,391,714)	(8,276,663)
Income before transfers	8,239,318	9,476,862
Transfers out - dividends to City of Owensboro	(8,527,030)	(8,414,463)
Change in net position	(287,712)	1,062,399
Net position, beginning of year, before restatement	114,996,717	113,934,318
Cumulative effect of change in accounting principle	(21,376,799)	-
Net position, beginning of year, as restated	93,619,918	-
Net position, end of year	$ 93,332,206	$ 114,996,717

OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM

STATEMENTS OF CASH FLOWS

Years Ended May 31, 2015 and 2014

	2015	2014
Cash flows from operating activities:		
Receipts from customers, including collections as agent for third parties	$ 161,505,836	$ 168,145,388
Customer remittances to third parties	(19,145,549)	(19,075,866)
Payments to suppliers	(94,581,656)	(97,392,302)
Payments to employees	(13,031,945)	(13,263,289)
Net cash provided by operating activities	34,746,686	38,413,931
Cash flows from noncapital financing activities:		
Transfers out - dividends to City of Owensboro	(8,527,030)	(8,414,463)
Cash flows from capital and related financing activities:		
Capital expenditures	(10,844,768)	(26,075,889)
Payments on long-term debt	(2,610,000)	(2,455,000)
Interest paid on long-term debt	(7,599,144)	(5,932,524)
Issuance of debt	-	46,732,097
Refunding bonds issued	-	42,848,278
Payment to refunded bond escrow agent	-	(46,877,988)
Debt issuance cost	-	(873,039)
Net cash provided by (used in) capital and related financing activities	(21,053,912)	7,365,935
Cash flows from investing activities:		
Purchase of investments	(6,414,922)	(15,302,995)
Proceeds from sale and maturities of investments	6,341,653	8,961,342
Interest on investments	1,523,764	1,066,016
Net cash provided by (used in) investing activities	1,450,495	(5,275,637)
Net increase in cash and cash equivalents	6,616,239	32,089,766
Cash and cash equivalents, beginning of year	97,053,960	64,964,194
Cash and cash equivalents, end of year	$ 103,670,199	$ 97,053,960
Included in the following balance sheet captions:		
Restricted assets	$ 65,616,631	$ 72,076,592
Cash and cash equivalents	38,053,568	24,977,368
	$ 103,670,199	$ 97,053,960

OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM

STATEMENTS OF CASH FLOWS, Concluded

Years Ended May 31, 2015 and 2014

	2015	2014
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 17,631,032	$ 17,753,525
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	14,466,717	13,719,456
Other revenues	138,117	217,345
Change in assets and liabilities:		
Decrease (increase) in assets:		
Restricted assets:		
Fuel inventory	2,741,376	(2,734,675)
Other	15,313	(4,625)
Receivables	(1,764,007)	(411,991)
Materials and supplies	81,892	87,337
Prepayments	(38,914)	(124,217)
Other noncurrent assets	451,700	8,204,593
Deferred outflow of resources	230,702	-
Increase (decrease) in liabilities:		
Accounts payable	(1,905,130)	(1,642,691)
Other current liabilities	767,863	191,957
Other noncurrent liabilities	(3,395,523)	
Deferred inflow of resources	5,325,548	3,157,917
Net cash provided by operating activities	$ 34,746,686	$ 38,413,931
Noncash investing, capital and financing activities:		
Accretion of interest expense on long-term debt	$ 3,374,931	$ 3,341,820
Amortization of debt premium (discount) and expense and deferred loss on debt defeasance	$ 545,761	$ 544,200
Deferred gain (loss) on hedging derivatives	$ (186,987)	$ (8,679,081)

See Notes to Financial Statements

1. Organization and Summary of Significant Accounting Policies

General Information

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

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

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

System of Accounts and Basis of Accounting

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

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

1. Organization and Summary of Significant Accounting Policies, Continued

System of Accounts and Basis of Accounting, Continued

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

Utility Plant and Depreciation

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

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

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

Depreciation of utility plant and unclassified plant in service is provided using the straight-line composite rate method over the estimated service lives of the depreciable assets of the Electric System, excluding ESGS, and on the sinking fund method for ESGS depreciable assets. Estimated service lives of assets depreciated using the composite method range from 5 to 60 years. The sinking fund method was adopted for ESGS as a result of the terms of a power sale contract. Depreciation expense during 2015 and 2014 was approximately 3.4% and 3.3%, respectively, of the average original cost of depreciable utility plant in service.

Restricted Assets

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

1. Organization and Summary of Significant Accounting Policies, Continued

Cash and Investments

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

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

Inventories

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

Bond Issuance Costs

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

The Electric System's rate making methodology allows for future recovery of debt costs, including bond issuance costs, in its rate making process. Accordingly, under FASB ASC 980, *Regulated Operations,* debt issuance costs are deferred and amortized using the straight-line method over the lives of the bond issues.

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

Pensions

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the County Employees Retirement System (CERS) and additions to/deduction from CERS's fiduciary net position have been determined on the same basis as they are reported by CERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

Income Taxes

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

1. Organization and Summary of Significant Accounting Policies, Continued

Estimates

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

Hedging Derivative Instruments

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

Change in Accounting Principle

In 2015, the Electric System adopted GASB Statement No. 68, "Accounting and Financial Reporting for Pensions" (GASB 68). GASB 68 establishes standards for measuring and recognizing liabilities, deferred outflows of resources, and deferred inflows of resources, and expense/expenditures. For defined benefit pensions, GASB 68 identifies the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. The Electric System implemented GASB 68 effective June 1, 2014, and has restated its net position to conform to the statement. The effect of this change as of June 1, 2014, is a decrease in net position of $21,376,799, an increase in deferred pension outflows of $2,539,667, and an increase in net pension liability of $23,916,466.

Management has not retrospectively applied this change to prior years' financial statements because the County Employees Retirement System (CERS) completed its first actuarial valuation to comply with GASB 68 as of June 30, 2014. That valuation was used for valuing pension-related balances as of May 31, 2015. Such actuarial valuations were not completed for prior years, therefore, the information was not available to apply GASB 68 retrospectively. As a result of this change, the current period's financial statements are not comparable with those of any prior periods.

2. Utility Plant

Electric utility plant activity for the year ended May 31, 2015, was as follows:

	Beginning Balance	Additions	Retirements	Ending Balance
Utility plant:				
Production plant	$ 310,157,726	$ 1,343,597	$ (2,455,703)	$ 309,045,620
Transmission plant	30,451,018	1,124,729	(36,761)	31,538,986
Distribution plant	75,750,036	3,024,728	(965,510)	77,809,254
General plant	19,765,106	972,212	(359,439)	20,377,879
Unclassified plant in service	3,606,293	4,485,542	-	8,091,835
Total, at original cost	439,730,179	10,950,808	(3,817,413)	446,863,574
Accumulated depreciation:				
Production plant	(186,358,130)	(10,112,764)	2,455,703	(194,015,191)
Transmission plant	(16,097,557)	(884,228)	32,821	(16,948,964)
Distribution plant	(42,244,387)	(2,562,262)	797,282	(44,009,367)
General plant	(11,930,703)	(907,463)	337,532	(12,500,634)
Total accumulated depreciation	(256,630,777)	(14,466,717)	3,623,338	(267,474,156)
Construction in progress	8,010,168	(368,776)	-	7,641,392
Utility plant, net	$ 191,109,570	$ (3,884,685)	$ (194,075)	$ 187,030,810

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

	2015	2014
Electric utility plant	$ 14,025,582	$ 13,309,301
Telecommunications	178,391	173,149
	14,203,973	13,482,450
Transportation and stores depreciation charged to construction activities or other operating expenses	262,744	237,006
	$ 14,466,717	$ 13,719,456

3. Restricted Assets

Restricted assets at May 31 consists of the following:

	2015	2014
Cash and cash equivalents	$ 65,616,631	$ 72,076,592
Investments	27,135,748	27,969,316
Accrued interest receivable	348,783	354,914
Fuel and other inventories, at cost	6,446,360	9,187,736
Other	728,760	744,073
	$ 100,276,282	$ 110,332,631

The above balances are contained in the following funds:

	2015	2014
Operation and Maintenance Fund	$ 8,753,163	$ 11,341,610
Construction Fund	19,762,324	37,118,592
Depreciation Fund	4,967,714	4,313,250
Sinking Funds	24,660,860	25,588,737
Facility Charge Fund	7,550,669	7,292,112
Reserve and Contingency Fund	34,581,552	24,678,330
	$ 100,276,282	$ 110,332,631

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

OMU follows GASB Statement No. 31, "Accounting and Financial Reporting for Certain Investments and for External Investments Pools" (GASB 31), which requires certain investments to be carried at fair value in the balance sheets and changes in the fair value of investments to be reported in the statements of revenues, expenses and changes in fund net position. In accordance with GASB 31, OMU recorded unrealized gains (losses) of $307,705 and $(236,814) for the years ended May 31, 2015 and 2014, respectively. OMU's rate making methodology does not consider unrealized gains or losses on marketable securities in its rate making process. Accordingly, under FASB ASC 980, *Regulated Operations*, the unrealized gains (losses) for the years ended May 31, 2015 and 2014, have been deferred.

3. Restricted Assets, Continued

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

	2015	2014
Net realized gains (losses) on sales of investments	$ -	$ -
Net unrealized gains (losses) on investments	307,705	(236,814)
	$ 307,705	$ (236,814)

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

4. Cash Deposits and Investments

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

	2015	2014
Deposits in financial institutions	$ 103,670,199	$ 98,395,613
Investments other than deposits	27,635,368	26,627,663
	$ 131,305,567	$ 125,023,276

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

	2015	2014
Cash and cash equivalents	$ 38,053,568	$ 24,977,368
Temporary investments	499,620	-
Restricted assets:		
Cash and cash equivalents	65,616,631	72,076,592
Investments	27,135,748	27,969,316
	$ 131,305,567	$ 125,023,276

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

4. Cash Deposits and Investments, Continued

Custodial Credit Risk. Custodial credit risk is the risk that, in the event of a bank failure, the Electric System's deposits may not be returned to it. The Electric System's deposit and investment policy permits uncollateralized deposits only if issued by institutions ranked in one of the three highest categories by a nationally recognized rating agency. As of May 31, 2015, $105,379,725 of the Electric System's bank balance of $105,755,602 was exposed to custodial credit risk as follows:

Uninsured and uncollateralized	$	-
Uninsured with collateral held by pledging bank's agent		105,379,725
Total	$	105,379,725

As of May 31, 2015, the Electric System had the following investments. Investments are reported at fair values with the exception of repurchase agreements, which are reported at cost.

Investments	Maturities		
Repurchase agreements	12/31/2019	$	8,900,000
Farm Federal Credit Bank – Callable	05/31/2019		1,998,480
Federal Home Loan Bank – Callable	04/17/2020		3,697,983
Federal Home Loan Bank – Callable	11/01/2022		5,570,877
Federal Home Loan Bank – Callable	01/30/2023		7,468,028
		$	27,635,368

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

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

Concentration of Credit Risk. Other than the prudent-person rule, the Electric System's deposit and investment policy places no limit on the amount the Electric System may invest in any one issuer. The Electric System's investments are in U.S. agency securities and repurchase agreements at May 31, 2015.

5. Hedging Transactions

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

The Electric System enters into electricity and fuel hedging transactions at various fixed prices and notional amounts. Each electricity short hedging transaction provides for the Electric System to pay a floating price and for the contract counterparty to pay a fixed price, and each fuel hedging transaction provides for the Electric System to pay a fixed price and the contract counterparty to pay a floating price for the notional amount of each type of contract. Furthermore, the Electric System from time to time will remove an electricity short hedge position by entering into a long hedging transaction to pay a fixed price, and for the contract counterparty to pay a floating price for a like notional amount as the original hedging transaction. The notional amount of each electricity and fuel hedging transaction is measured in megawatt hours (MWh) and gallons, respectively, with the floating price based on a specific published index (spot price) for the relevant contract month.

The Electric System entered into electricity hedging transactions with notional amounts totaling 1,238,180 and 4,940,850 MWh in 2015 and 2014, respectively. Hedging transactions with notional amounts totaling 3,734,900 and 2,524,800 MWh were settled in 2015 and 2014, respectively, with a resulting loss of $757,980 and $11,959,948 in 2015 and 2014, respectively, which are reflected in other wholesale revenue. At May 31, 2015, the Electric System's outstanding electricity hedging swap transactions were as follows:

5. Hedging Transactions, Continued

Execution Date Range	Maturity Date	Notional Amount (MWh)		Fair Market Value
Short Hedge Positions:				
Fiscal 2013-2015	Fiscal 2016	1,138,530	$	(51,401)
Fiscal 2014-2015	Fiscal 2017	694,850		537,121
Fiscal 2015	Fiscal 2018	256,850		640,871
		2,090,230		1,126,591
Long Hedge Positions:				
Fiscal 2015	Fiscal 2016	154,800		(108,476)
		2,245,030	$	1,018,115

Additionally, at May 31, 2015, the Electric System had outstanding put and call options with notional amounts totaling 280,000 MWh, which expire in fiscal 2016. The Electric System received $16,757 upon execution of the options and the total fair value of the options at May 31, 2015, was $58,039.

The Electric System entered into fuel hedging transactions with notional amounts totaling 5,334,000 and 2,982,000 gallons in 2015 and 2014, respectively. Hedging transactions with notional amounts totaling 3,108,000 and 2,016,000 gallons were settled in 2015 and 2014, respectively, with resulting losses of $1,242,216 and $39,249 in 2015 and 2014, respectively. The resulting losses are reflected in the statements of revenues, expenses and changes in net position as follows:

		2015		2014
Fuel for electric generation (effective hedges)	$	(572,501)	$	(39,249)
Loss on investment derivatives (ineffective hedges)		(669,715)		-
	$	(1,242,216)	$	(39,249)

Additionally, the Electric System entered into derivative natural gas transactions with notional amounts totaling 1,480,000 million British thermal units (MMBTU) in 2015. These transactions, which also settled in 2015, resulted in losses of $45,207, which is included in loss on investment derivatives.

5. Hedging Transactions, Continued

At May 31, 2015, the Electric System's outstanding fuel hedging swap transactions were as follows:

Execution Date Range	Maturity Date	Notional Amount (Gallons)		Fair Market Value
Diesel Long Positions:				
Fiscal 2015	Fiscal 2016	1,008,000	$	(836,236)
Fiscal 2015	Fiscal 2017	588,000		(423,688)
		1,596,000		(1,259,924)
Heating Oil Long Positions:				
Fiscal 2015	Fiscal 2017	210,000		12,831
Fiscal 2015	Fiscal 2018	294,000		24,948
		504,000		37,779
		2,100,000	$	(1,222,145)

Additionally, at May 31, 2015, the Electric System had outstanding heating oil average priced call options, with rights to purchase 84,000 gallons (long position) per month for the months from June 2015 through December 2016. The total cost of the call options was $88,160 and the fair value at May 31, 2015, was ($40,906).

The electricity and fuel hedging transactions are settled by cash payments that are equal to the difference between the contract price and the settlement price (financially settled). These financially settled hedging transactions are hedging derivative instruments as defined by GASB 53. Accordingly, the Electric System's unrealized gains and losses on its outstanding hedging transactions are reported at fair value in other current assets, other noncurrent assets, other current liabilities and other noncurrent liabilities in its May 31, 2015 and 2014 statements of net position. The fair market value for each of the Electric System's hedging transactions have been determined by computing the difference between the contractual forward price and the published forward price at the respective market's settlement point at market closing as of May 31, 2015 and 2014. The Electric System's

5. Hedging Transactions, Continued

electricity hedging transactions settle and are valued at the AEP-Dayton Hub, the PJM West Hub and the Indiana Hub, which are settlement hubs in the PJM and MISO energy markets, respectively. The heating oil hedging transactions settle and are valued at the heating oil futures index of the New York Mercantile Exchange (NYMEX) and the diesel hedging transactions settle and are valued at the NYMEX Energy Information Administrations (EIA) Flat Tax On-Highway Diesel Futures index. The outstanding electricity hedging transactions had a fair value of $1,076,154 and ($8,645,422) at May 31, 2015 and 2014, respectively. The fuel hedging transactions had a fair value of ($1,263,051) and ($33,659) at May 31, 2015 and 2014, respectively.

Credit Risk: The Electric System is exposed to credit risk on hedging transactions that are in an asset position. To minimize the Electric System's exposure to loss related to credit risk, the Electric System requires certain counterparties to post collateral equal to all or a portion of the fair value of hedging transactions in asset positions (net of the effect of applicable netting arrangements) should the fair value of the netted contracts exceed contractually agreed upon parameters or if the credit rating of a certain counterparty or, an affiliated guarantor of the counterparty, is at, or falls below, contractually agreed-upon levels. Collateral posted is in the form of a letter of credit or US dollars held by the Electric System. At May 31, 2015, the Electric System's rated counterparties, or affiliated guarantors, had credit ratings ranging from A to BBB+ as established by a nationally recognized rating organization. The Electric System also had two counterparties that were not rated but each had provided either a cash deposit or a letter of credit for the purpose of establishing credit for the counterparty.

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

The aggregate fair value of outstanding Hedging Transactions in asset positions with counterparties that the Electric System had a net asset position with at May 31, 2015, was $3,393,903. The asset positions represent the maximum loss that would be incurred at the reporting date if all counterparties failed to perform as contracted. This maximum exposure is reduced by $816,846 of collateral held and $2,207,576 of outstanding Hedging Transactions in a liability position included in netting arrangements with those counterparties, resulting in a net exposure to credit risk of $369,481.

5. Hedging Transactions, Continued

Basis Risk: The Electric System is exposed to basis risk on its hedging transactions because the price of the expected physical commodity sale being hedged will be priced at pricing points (South Import PJM Interface or LG&E MISO Interface), which are different than the pricing points at which the hedging transactions will settle (AEP-Dayton Hub, PJM West Hub or Indiana Hub). Management believes this risk is not material based on quantitative analysis.

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

Commitments: Hedging transactions provide that the Electric System post collateral in the event that 1) OMU's credit profile falls below contractually agreed-upon parameters or 2) the fair value of the Electric System's hedging transactions are in a liability position (net of the effect of applicable netting arrangements) should the fair value of the netted contracts exceed contractually agreed-upon parameters. When collateral is posted, it is in US dollars in the amount of the fair value of the hedging derivative instruments in liability positions (net of the effect of applicable netting arrangements). If the Electric System does not post collateral, the aggregate outstanding hedging transactions may be terminated by the counterparty. If the collateral posting requirements related to OMU's credit profile had been triggered at May 31, 2015, the Electric System would have been required to post collateral with its counterparties in the amount of $191,400.

6. Long-Term Debt

Long-term debt activity for the year ended May 31, 2015, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Bonds payable:					
Series of 1991-B	$ 47,730,312	$ 3,374,931	$ -	$ 51,105,243	$ -
Series of 2002-A	18,375,000	-	(2,610,000)	15,765,000	2,780,000
Series of 2010-A	10,070,000	-	-	10,070,000	-
Series of 2010-B	31,425,000	-	-	31,425,000	-
Series of 2010-C	8,935,000	-	-	8,935,000	-
Series of 2013-A	8,875,000	-	-	8,875,000	-
Series of 2013-B	77,100,000	-	-	77,100,000	-
	202,510,312	3,374,931	(2,610,000)	203,275,243	2,780,000
Add unamortized debt premium (discount)	3,884,455	-	(356,794)	3,527,661	-
Total long-term debt	$ 206,394,767	$ 3,374,931	$ (2,966,794)	$ 206,802,904	$ 2,780,000

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

	2015	2014
Series of 1991-B: Deferred interest bonds including interest compounded semi-annually at 6.70% to 6.95%, principal and interest due from 2017 to 2020 (original principal of outstanding bonds at May 31, 2015, was $10,269,998)	$ 51,105,243	$ 47,730,312
Series of 2002-A: 6.34% due 2020, subject to annual pro rata sinking fund redemption from 2016 to 2020	15,765,000	18,375,000
Series of 2010-A: Current interest bonds, 4.88% to 5.03%, due from 2021 to 2022	10,070,000	10,070,000
Series of 2010-B: Current interest bonds, 4.88% to 5.58%, due from 2021 to 2025	31,425,000	31,425,000

6. Long-Term Debt, Continued

Series of 2010-C:		
Current interest bonds, 5.00%, due from 2021 to 2022	8,935,000	8,935,000
Series of 2013-A:		
Current interest bonds, 3.40% to 3.65%, due from 2021 to 2022	8,875,000	8,875,000
Series of 2013-B:		
Current interest bonds, 3.00% to 5.00%, due from 2022 to 2027	77,100,000	77,100,000
Total long-term debt	203,275,243	202,510,312
Less current maturities	(2,780,000)	(2,610,000)
Add unamortized debt premium (discount)	3,527,661	3,884,455
	$204,022,904	$203,784,767

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

Year Ending May 31:	Principal	Interest	Total
2016	$ 2,780,000	$ 7,398,982	$ 10,178,982
2017	18,680,000	7,222,730	25,902,730
2018	18,865,000	7,035,383	25,900,383
2019	19,065,000	6,836,307	25,901,307
2020	19,275,000	6,624,551	25,899,551
2021 – 2025	101,785,000	22,952,963	124,737,963
2026 – 2030	34,620,000	1,966,700	36,586,700
	$ 215,070,000	$ 60,037,616	$ 275,107,616

The scheduled principal maturities include $11,794,757 of interest scheduled to be incurred in future years on deferred interest bonds, which will be compounded and added to the original principal amounts.

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

6. Long-Term Debt, Continued

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

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

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

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

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

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

On November 18, 2010, the City issued $10,070,000 of Electric Light and Power System Revenue Bonds, Taxable 2010-A Series, $31,425,000 of Electric Light and Power System Revenue Bonds, Taxable 2010-B Series (Build America Bonds) and $8,935,000 of Electric Light and Power System Refunding Revenue Bonds, Tax-Exempt 2010-C Series, each dated November 4, 2010. The 2010 Bonds were issued to fund various capital improvement expenditures for the Electric System and to refund the 2002-B series bonds. The in-substance defeasance of the 2002-B Bonds was accomplished by placing approximately $9,274,976 in proceeds from the 2010-C Bonds and $170,826 in funds from the 2002-B Bond Sinking Fund in an irrevocable escrow fund to be used solely for satisfying scheduled debt service payments of the 2002-B Bonds. Accordingly, the 2002-B Bonds in the amount of $9,230,000, net of unamortized discount and issuance costs of $123,543 and accrued interest payable of $164,248, were extinguished resulting in the accounting recognition of a

6. Long-Term Debt, Continued

loss from defeasance of $175,097, reported in the accompanying financial statements as a reduction of long-term debt. The City advance refunded the 2002-B bonds to extend the repayment period of the bond, reduce its near term annual debt payments and reduce the effective rate on the debt. The advance refunding resulted in an economic gain (difference between the present value of the debt service payment on the old and new debt) of $558,382.

The 2010-B Series bonds (Build America Bonds – Direct Payment) were issued in connection with the American Recovery and Reinvestment Act of 2009 (Act). Under the Act, state and local governments were authorized to issue taxable bonds to finance capital expenditures for which they could otherwise issue tax-exempt bonds, and receive from the IRS a direct interest subsidy totaling 35% of the total coupon interest paid to investors. Due to current federal budget sequestration, the direct interest subsidy is currently reduced to 32% of the total coupon interest. Interest subsidy received for fiscal years 2015 and 2014 was $540,256 and $532,827, respectively. Remaining interest subsidies scheduled through maturities of the bonds, before budget sequestration reductions, are as follows:

Year Ending May 31:		
2016	$	578,846
2017		578,846
2018		578,846
2019		578,846
2020		578,846
2021 – 2025		1,950,694
	$	4,844,924

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

On June 25, 2013, the City issued $8,875,000 of Electric Light and Power System Revenue Bonds, Taxable 2013-A Series and $77,100,000 of Electric Light and Power System Revenue Bonds, Tax-Exempt 2013-B Series, each dated June 25, 2013. The 2013 Bonds

6. Long-Term Debt, Continued

were issued to fund various capital improvement expenditures for the Electric System and to refund certain 1991-B series bonds. The in-substance defeasance of the 1991-B Bonds was accomplished by placing $40,325,905 in proceeds from the 2013-B Bonds and $6,552,083 in funds from the 1991-B Bond Sinking Fund in an irrevocable escrow fund to be used solely for satisfying scheduled debt service payments of the 1991-B Bonds. Accordingly, the 1991-B Bonds in the amount of $42,597,295, net of unamortized discount and issuance costs of $211,974, were extinguished resulting in the accounting recognition of a loss from defeasance of $4,492,667, reported in the accompanying financial statements as a deferred outflow. The City advance refunded the 1991-B bonds to extend the repayment period of the bond and reduce its near term annual debt payments. The advance refunding resulted in an economic loss (difference between the present value of the debt service payment on the old and new debt) of $2,993,589.

The 2013-A and B series are subject to redemption prior to maturity in whole or in part on any date on or after January 1, 2020, at the redemption price (expressed as a percentage of principal amount to be redeemed) of 100%, plus accrued interest to the redemption date.

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

7. Dividends - City of Owensboro

Under the terms of City ordinances authorizing the Electric System bonds, whenever all specified or required transfers and payments have been set aside and paid into the restricted asset funds and there is a balance in excess of the amount to be set aside and paid into the restricted asset funds during the next succeeding two months (approximately $21,981,000 at May 31, 2015), the City Utility Commission may withdraw and transfer from such excess to the general fund of the City in any fiscal year an amount not to exceed 10% of the value of the City's ownership (net assets) exclusive of interest accumulated on deposits in the Reserve and Contingency Fund ($10,590,437 at May 31, 2015) and amounts in the Facility Charge Fund ($7,705,172 at May 31, 2015) as shown on the Electric System's books on the first day of the fiscal year. The Ordinance also allows for the transfer to the City of a sum equal to the dollar value of services purchased by the City from the Electric System in the fiscal year, not to exceed, however, $700,000 for the fiscal year ended June 30, 1985, and thereafter increasing at a compound rate of 5% per annum. Transfers to the City under this ordinance and agreement were $8,527,030 and $8,414,463 for 2015 and 2014, respectively.

8. Pension Plan

Plan Description

The Electric System contributes to the County Employees Retirement System (CERS), which is a cost-sharing multiple-employer defined benefit pension plan administered by Kentucky Retirement Systems (KRS) that covers all regular full-time members employed in nonhazardous positions of each participating county, city, and school board, and any additional eligible local agencies electing to participate in CERS. Kentucky Revised Statute Section 61.645 assigns the authority to establish and amend benefit provisions to the Board of Trustees of Kentucky Retirement Systems (Board). CERS issues a publicly available financial report that can be obtained at www.kyret.ky.gov.

Benefits Provided

CERS provides for retirement, disability, and death benefits to system members. Retirement benefits may be extended to beneficiaries of members under certain circumstances. Retirement benefits are determined using a formula which considers the member's final compensation; benefit factors set by statute which vary depending upon the type / amount of service, participation date, and retirement date; and years of service. Plan members with a participation date prior to September 1, 2008, are eligible to retire with full benefits at any time with 27 or more years of service credit, or at age 65 with at least 48 months of service credit. Plan members with a participation date on or after September 1, 2008, are eligible to retire with full benefits at age 57 if the member's age and years of service equal 87, or at age 65 with at least 60 months of service credit.

Contributions

Per Kentucky Revised Statues Section 78.545(33), contribution requirements of the active employees and the participating employers are established and may be amended by the KRS Board. Plan members who began participating in CERS prior to September 1, 2008, are required to contribute 5% of their annual creditable compensation. For Plan members who began participating in CERS on or after September 1, 2008, the contribution rate is 6%. The Electric System's actuarially determined contribution rate as of May 31, 2015, was 17.67% of annual creditable compensation. Contributions to CERS by the Electric System were $2,507,504 for the year ended May 31, 2015.

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

At May 31, 2015, the Electric System reported a liability of $20,520,943 for its proportionate share of the net pension liability. The net pension liability was measured as of

8. Pension Plan, Continued

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

June 30, 2014, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Water System's proportion of the net pension liability was based on a projection of the Water System's long-term share of contributions to the pension plan relative to the projected contributions of all participating entities, actuarially determined. At June 30, 2014, the Electric System's proportion was 0.632508%.

For the year ended May 31, 2015, the Electric System recognized pension expense of $1,633,317. At May 31, 2015, the Electric System reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Net difference between projected and actual earnings on plan investments	$ -	$ 2,290,634
Electric System contributions subsequent to the measurement date	2,308,965	-
Total	$ 2,308,965	$ 2,290,634

The $2,308,965 of deferred outflows of resources resulting from the Electric System's contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ending May 31, 2016. Other amounts reported as deferred inflows of resources will be recognized in pension expense as follows:

Year ending May 31,	
2016	$ 572,659
2017	572,658
2018	572,659
2019	572,658
	$ 2,290,634

8. Pension Plan, Continued

Actuarial Assumptions

The total pension liability in the June 30, 2014, actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.5 %
Salary increases	4.5% average, including inflation
Investment rate of return	7.75%, net of pension plan investment expense, including inflation

Mortality rates were based on the 1983 Group Annuity Mortality Table for all retired members and beneficiaries as of June 30, 2006, and the 1994 Group Annuity Mortality Table for all other members.

The actuarial assumptions used in the June 30, 2014, valuation were based on the results of an actuarial experience study for the period July 1, 2005 – June 30, 2008.

The long-term expected rate of return on pension plan investments is reviewed as part of the regular experience studies prepared every five years. The most recent analysis, performed for the period covering fiscal years 2005 through 2008, is outlined in a report dated August 25, 2009. Several factors are considered in evaluating the long-term rate of return assumption including long-term historical data, estimates inherent in current market data, and a log-normal distribution analysis in which best-estimate ranges of expected future real rates of return (expected return, net of investment expense, and inflation) were developed by the investment consultant for each major asset class. These ranges were 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 then adding expected inflation. The capital market assumptions developed by the investment consultant are intended for use over a 10-year horizon and may not be useful in setting the long-term rate of return for funding pension plans which cover a longer time frame. The assumption is intended to be a long-term assumption and is not expected to change absent a significant change in the asset allocation, a change in the inflation assumption, or a fundamental change in the market that alters expected returns in future years. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

8. Pension Plan, Continued

Actuarial Assumptions, Continued

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Domestic equity	30%	8.45%
International equity	22%	8.85%
Emerging market equity	5%	10.5%
Private equity	7%	11.25%
Real estate	5%	7%
Core US fixed income	10%	5.25%
High-yield US fixed income	5%	7.25%
Non US fixed income	5%	5.5%
Commodities	5%	7.75%
TIPS	5%	5%
Cash	1%	3.25%
Total	100%	

Discount Rate

The discount rate used to measure the total pension liability was 7.75%. The projection of cash flows used to determine the discount rate assumed that local employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 29-year amortization period of the unfunded actuarial accrued liability. Based on those assumptions, the Plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on Plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the Electric System's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate

The following presents the Electric System's proportionate share of the net pension liability calculated using the discount rate of 7.75%, as well as what the Electric System's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.75%) or 1-percentage-point higher (8.75%) than the current rate:

8. Pension Plan, Continued

Sensitivity of the Electric System's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate, Continued

	Discount rate	Electric System's proportionate share of net pension liability
1% decrease	6.75%	$27,004,181
Current discount rate	7.75%	$20,520,943
1% increase	8.75%	$14,792,840

Plan Fiduciary Net Position

Detailed information about the CERS fiduciary net position is available in the separately issued Kentucky Retirement Systems Comprehensive Annual Financial Report.

Payables to the Pension Plan

At May 31, 2015, the Electric System reported a payable of $376,386 for the outstanding amount of contributions due to CERS for the year.

9. Commitments and Contingencies

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

2016	$ 58,247,054
2017	47,772,862
2018	25,240,042
2019	2,276,042
2020	1,348,958
	$ 134,884,958

OMU is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. OMU manages its risks through coverages provided by private insurance carriers for various risks of losses to which it is exposed, including directors and officers, employee dishonesty, boiler and machinery, workers' compensation, and other property risks. The boiler and machinery

9. Commitments and Contingencies, Continued

policy contains a deductible of $500,000 and excludes acts of terrorism from its coverage. OMU is self-insured for group health and limits its risks of loss by purchasing reinsurance coverage.

OMU has been identified by the United States Environmental Protection Agency as one of numerous parties that may be liable for damages under federal law with respect to a superfund hazardous waste site. Through May 31, 2014, OMU has paid $57,500, plus legal costs, related to this matter. Based upon the opinion of its outside legal counsel, management does not anticipate additional costs to be material, however, the ultimate resolution of this matter and the related financial impact on OMU, if any, cannot be determined at this time.

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

10. Rate Matters

Effective June 1, 2015, the Electric System enacted a electric base rate increase for retail customers which was anticipated to increase retail revenues by approximately 10%.

11. Reclassifications

Certain amounts on the prior year financial statements have been reclassified in order to conform to the current year's presentation.

OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM

SCHEDULE OF PROPORTIONATE SHARE OF THE NET PENSION LIABILITY
COUNTY EMPLOYEES RETIREMENT SYSTEM

Last 10 Fiscal Years *

	2015
Electric System's proportion of the net pension liability	0.632508%
Electric System's proportionate share of the net pension liability	$ 20,520,943
Electric System's covered-employee payroll	$ 14,612,052
Electric System's proportionate share of the net pension liability as a percentage of its covered employee payroll	140.44%
Plan fiduciary net position as a percentage of the total pension liability	66.80%

* Presented for those years for which the information is available.

OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM

SCHEDULE OF CONTRIBUTIONS
COUNTY EMPLOYEES RETIREMENT SYSTEM

Last 10 Fiscal Years

	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006
Contractually required contributions	$ 2,507,504	2,752,131	2,743,833	2,546,790	2,278,131	2,097,279	1,706,711	1,784,838	1,384,414	1,113,886
Contributions in relation to the contractually required contributions	(2,507,504)	(2,752,131)	(2,743,833)	(2,546,790)	(2,278,131)	(2,097,279)	(1,706,711)	(1,784,838)	(1,384,414)	(1,113,886)
Contribution deficiency (excess)	$ -	-	-	-	-	-	-	-	-	-
Electric System's covered-employee payroll	$ 14,199,426	14,593,066	14,072,730	13,668,513	13,542,641	13,277,309	12,290,269	11,345,229	10,766,863	10,509,703
Contributions as a percentage of covered-employee payroll	17.66%	18.86%	19.50%	18.63%	16.82%	15.80%	13.89%	15.73%	12.86%	10.60%

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OWENSBORO MUNICIPAL UTILITIES
ELECTRIC LIGHT AND POWER SYSTEM

SCHEDULE OF REVENUES AND EXPENSES

Year Ended May 31, 2015 (with comparative totals for 2014)

	Retail Electric System	Wholesale Power Marketing
Operating revenues:		
Charges for services:		
Residential	$ 24,650,499	$ -
Commercial	4,915,918	-
Industrial	41,309,466	
Water Works System	749,302	-
City of Owensboro	2,066,106	-
Supplemental power	-	1,495,293
Other wholesale	-	62,297,999
Electric Light and Power System	-	-
Build America Bond subsidy	395,760	-
Other	884,043	-
Total operating revenues	74,971,094	63,793,292
Operating expenses:		
Production:		
Fuel for electric generation	-	-
Purchased power	48,608,742	64,380,196
Other	-	-
Transmission and distribution	4,244,509	3,150,412
Customer service and information	1,396,821	-
General and administrative	3,473,047	1,322,955
Telecommunications	-	-
Depreciation	3,475,861	-
Total operating expenses	61,198,980	68,853,563
Operating income (loss)	13,772,114	(5,060,271)
Nonoperating revenues (expenses):		
Interest and debt expense	(1,484,174)	-
Interest income on investments	528,783	8,946
Interest income on Elmer Smith Generating Station investments allocated to:		
Electric System	979,132	-
Loss on investment derivative instruments	-	(714,922)
Other, net	51,999	-
Net increase (decrease) in fair value of investments	(380)	-
Deferred net change in fair value of investments	380	-
Total nonoperating revenues (expenses)	75,740	(705,976)
Income before transfers	13,847,854	(5,766,247)
Transfers out - dividends to City of Owensboro	(8,527,030)	-
Change in net position	$ 5,320,824	$ (5,766,247)

Elmer Smith Generating Station	Telecommunications	Eliminations	Total	2014 Total
$ -	$ -	$ -	$ 24,650,499	$ 22,995,721
-	912,928	-	5,828,846	5,500,947
-	-	-	41,309,466	40,239,608
-	38,278	-	787,580	719,708
-	5,100	-	2,071,206	2,116,223
-	-	-	1,495,293	2,700,565
-	-	53,668	62,351,667	61,877,554
105,540,576	129,388	(105,669,964)	-	-
144,496	-	-	540,256	532,827
-	-	(103,990)	780,053	718,123
105,685,072	1,085,694	(105,720,286)	139,814,866	137,401,276
65,528,102	-	92,378	65,620,480	59,449,211
-	-	(105,579,286)	7,409,652	9,048,348
14,568,940	-	(14,370)	14,554,570	15,575,734
96,735	-	(93,810)	7,397,846	7,295,393
-	68,262		1,465,083	1,385,522
6,180,096	264,242	(125,198)	11,115,142	12,865,935
-	417,088	-	417,088	545,158
10,549,721	178,391	-	14,203,973	13,482,450
96,923,594	927,983	(105,720,286)	122,183,834	119,647,751
8,761,478	157,711	-	17,631,032	17,753,525
(8,847,596)	-	-	(10,331,770)	(9,546,328)
979,132	-	-	1,516,861	1,052,320
(979,132)	-	-	-	-
-	-	-	(714,922)	-
86,118	-	-	138,117	217,345
308,085	-	-	307,705	(236,814)
(308,085)	-	-	(307,705)	236,814
(8,761,478)	-	-	(9,391,714)	(8,276,663)
-	157,711	-	8,239,318	9,476,862
-	-	-	(8,527,030)	(8,414,463)
$ -	$ 157,711	$ -	$ (287,712)	$ 1,062,399

INDEPENDENT AUDITOR'S REPORT

City Utility Commission
City of Owensboro, Kentucky

We have audited the accompanying financial statements of the Owensboro Municipal Utilities Water Works System (Water System) of the City of Owensboro, Kentucky, as of and for the years ended May 31, 2015 and 2014, and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

www.rineyhancock.com - info@rineyhancock.com
2900 Veach Road, Suite 2 - Owensboro, Kentucky 42303 - 270-926-4540 - Fax: 270-926-1494
313 Southeast First Street - Evansville, Indiana 47713 - 812-423-0300 - Fax: 812-423-6282

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Owensboro Municipal Utilities Water Works System of the City of Owensboro, Kentucky, as of May 31, 2015 and 2014, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1 to the financial statements, in 2015 the Water System adopted new accounting guidance, GASB Statement No. 68, *Accounting and Financial Reporting for Pensions.* Our opinion is not modified with respect to this matter.

As discussed in Note 1 to the financial statements, the financial statements present only the Water System, an enterprise fund of the City of Owensboro, Kentucky, and do not purport to, and do not, present fairly the financial position of the City of Owensboro, Kentucky, as of May 31, 2015 and 2014, the changes in its financial position or, where applicable, its cash flows, for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 42 through 45, the Schedule of Proportionate Share of the Net Pension Liability on page 67, and the Schedule of Contributions on page 68, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Riney Hancock CPAs PSC

Owensboro, Kentucky
September 8, 2015

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of the Owensboro Municipal Utilities Water Works System (Water System) financial performance provides an overview of the Water System's financial activities for the fiscal year ended May 31, 2015. Please read it in conjunction with the Water System's financial statements, which begin on page 46.

Overview of the Financial Statements

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

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

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

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

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

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

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

Financial Summary

The following table summarizes the financial condition and operations of the Water System for 2015 and 2014.

Assets and Deferred Outflows of Resources	2015	2014
Utility plant, net	$ 45,845,286	$ 44,824,333
Restricted assets	7,958,238	3,759,026
Current assets	4,696,392	4,279,701
Other noncurrent assets	1,003,828	822,373
Deferred outflow of resources	839,529	469,197
	$ 60,343,273	$ 54,154,630
Liabilities, Deferred Inflows of Resources, and Net Position		
Net position		
Net investment in capital assets	$ 24,246,494	$ 24,845,499
Restricted	728,685	610,971
Unrestricted	(402,166)	3,202,519
Total net position	24,573,013	28,658,989
Long-term debt	28,525,188	23,272,389
Current liabilities	2,121,749	1,708,106
Other noncurrent liabilities	4,303,826	250,574
Deferred inflows of resources	819,497	264,572
	$ 60,343,273	$ 54,154,630
Revenues, Expenses and Changes in Net Position		
Operating revenues	$ 10,253,198	$ 9,469,396
Operating expenses	8,597,576	8,892,534
Operating income	1,655,622	576,862
Interest expense	(1,431,994)	(1,321,748)
Interest and other income	93,038	41,592
Net nonoperating expenses	(1,338,956)	(1,280,156)
Income (loss) before contributions and transfers	316,666	(703,294)
Capital contributions	39,673	567,566
Transfers out - dividends to City of Owensboro	(169,469)	(163,316)
Change in net position	$ 186,870	$ (299,044)

FINANCIAL HIGHLIGHTS

- Total net position declined $4.1 million in 2015, or 14.2%, primarily due to the cumulative effect of implementation of GASB Statement No. 68, "Accounting and Financial Reporting for Pensions" (GASB 68), as discussed in the accompanying notes to the financial statements. GASB 68 required the Water System to record its proportionate share of the net pension liability of the County Employees Retirement System (CERS) of the Commonwealth of Kentucky, of which it is a participant. As a result, in 2015 the Water System also recorded a net pension liability of $4.1 million, as measured by an actuary, as well as certain pension deferred inflows and outflows.

- The income before contributions and transfers was $316,666 in 2015 versus a loss of $703,294 in 2014, as a result of changes in operating revenues, operating expenses, and interest, as discussed below.

- Operating revenues increased by $783,802 in 2015 when compared to 2014, or 8.3%. The increase in revenues in 2015 is primarily attributable to a retail rate increase effective June 1, 2014, which consisted of a volume-based increase and an increase in the monthly customer charge.

- Operating expenses decreased $294,958 in 2015 when compared to 2014, or 3.3%, primarily due to a reduction in general and administrative costs, which declined $371,216, or 15.7%, as a result or reductions in employee health and pension costs. Employee health insurance costs declined largely due to a new health insurance administration contact and pension cost declined primarily as a result of implementation of GASB 68, as discussed above. Rather than recording pension expense based on required contributions to the CERS, GASB 68 requires recognition of pension expense based on the change in the Water System's proportionate share of the CERS net pension liability, as well as changes in certain CERS deferred inflows and outflows. The actuarial valuation of the CERS net pension liability, as well as better than expected investment earnings on the CERS plan assets, resulted in a pension expense which was less than the required contribution to the CERS in 2015. The reduction in general and administrative costs were partially offset by general cost increases in other areas.

- Interest expense increased by $110,246, or 8.3%, due to issuance of the 2014 Series bonds, as discussed below, and interest income increased $41,946, or 100.9%, due primarily to higher rates received on bank balances as a result of a new banking contract in 2015 and from increased construction funds as a result of the 2014 Series bond issue.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of 2015, the Water System had $45.8 million invested in a broad range of assets, including wells, treatment facilities and equipment, storage tanks, buildings and water mains. This amount represents a slight increase from 2014 due to capital asset additions. The following table summarizes capital assets, net of accumulated depreciation, at the end of 2015 and 2014.

CAPITAL ASSET AND DEBT ADMINISTRATION, CONTINUED

Capital Assets, Continued

	2015	2014
Source of supply plant	$ 2,257,589	$ 2,277,728
Pumping plant	417,836	395,295
Water treatment plant	14,817,625	15,368,814
Transmission and distribution plant	21,704,749	22,801,267
General plant	1,444,111	1,571,841
Unclassified plant and construction in progress	5,203,376	2,409,388
	$ 45,845,286	$ 44,824,333

In addition to the Water System's routine additions and replacement of distribution plant, the Water System incurred $1.0 million on construction of replacement wells and $500,000 on renovation of the distribution office building.

Debt

At the end of 2015, the Water System had $29.3 million in bonds outstanding versus $23.9 million in 2014, for an increase of 22.4%. The increase is attributable to issuance of the 2014 Series Water System Revenue and Improvements Bonds that totaled $9.7 million. The bonds were issued to provide funds for various capital improvement expenditures and to refinance $1.3 million of 1991 Series bonds and $2.5 million of 2003 Series bonds. The 1991 and 2003 Series bonds were refinanced to reduce the effective rate on the debt. The Water System's bonds are insured and, as a result, Standard and Poor's Rating Services has assigned a rating of "AA" and Moody's Investors Service has assigned an underlying rating of A1 to the bonds.

Outlook

We expect the 2016 results to be down as compared to 2015, largely as a result of general cost increases, which are anticipated to outpace increased revenues. The Water System implemented a rate adjustment effective June 1, 2015, which is expected to increase retail operating revenues by approximately 9% from 2015. However, the increased revenues should be more than offset by increases in expenses. The largest increases are anticipated for production and purification, general and administrative, and depreciation expenses. Production and purification cost is expected to increase due to general cost increases and outside professional services and employee benefit costs increases are expected to contribute to additional general and administrative costs. Finally, depreciation expense is expected to increase as a result of recent capital additions, as discussed above.

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OWENSBORO MUNICIPAL UTILITIES
WATER WORKS SYSTEM

STATEMENTS OF NET POSITION

May 31, 2015 and 2014

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	2015	2014
Utility plant, net	$ 45,845,286	$ 44,824,333
Restricted assets	7,958,238	3,759,026
Current assets:		
Cash and cash equivalents	2,241,669	1,957,220
Accounts receivable, less allowance for doubtful accounts of $8,982 for 2015 and $8,644 for 2014	1,826,500	1,710,604
Materials and supplies	506,004	487,713
Prepayments	122,219	124,164
Total current assets	4,696,392	4,279,701
Other noncurrent assets	1,003,828	822,373
Total assets	59,503,744	53,685,433
Deferred outflows of resources:		
Deferred pension outflows	461,522	-
Unamortized loss on debt refunding	330,222	384,359
Net unrealized loss on investments	47,785	84,838
Total deferred outflows of resources	839,529	469,197
Total assets and deferred outflows of resources	$ 60,343,273	$ 54,154,630

See Notes to Financial Statements

LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION	2015	2014
Net position:		
Net investment in capital assets	$ 24,246,494	$ 24,845,499
Restricted for capital projects, net of related debt	124,420	93,052
Restricted for debt service	604,265	517,919
Unrestricted	(402,166)	3,202,519
Total net position	24,573,013	28,658,989
Long-term debt	28,525,188	23,272,389
Current liabilities (payable from restricted assets):		
Current maturities of long-term debt	725,000	620,000
Accrued interest payable	266,066	242,918
Accounts payable	491,876	-
	1,482,942	862,918
Current liabilities (payable from current assets):		
Accounts payable	638,807	789,748
Other	-	55,440
	638,807	845,188
Total current liabilities	2,121,749	1,708,106
Other noncurrent liabilities:		
Net pension liability	4,101,776	-
Customers' advances for construction	202,050	250,574
	4,303,826	250,574
Total liabilities	34,950,763	25,231,069
Deferred inflows of resources:		
Deferred pension inflows	457,857	-
Deferred revenues	361,640	264,572
	819,497	264,572
Total liabilities, deferred inflows of resources, and net position	$ 60,343,273	$ 54,154,630

See Notes to Financial Statements

OWENSBORO MUNICIPAL UTILITIES
WATER WORKS SYSTEM

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

Years Ended May 31, 2015 and 2014

	2015	2014
Operating revenues:		
Charges for services:		
Residential	$ 3,782,632	$ 3,331,432
Commercial	3,540,692	3,285,868
Water districts	1,938,608	2,004,710
Fire protection	229,530	198,703
City of Owensboro	169,469	163,316
Electric Light and Power System	411,031	303,146
Service revenues	181,236	182,221
Total operating revenues	10,253,198	9,469,396
Operating expenses:		
Production and purification	2,666,739	2,750,733
Transmission and distribution	922,390	862,382
Customer service and information	602,550	594,840
General and administrative	1,992,607	2,363,823
Depreciation	2,413,290	2,320,756
Total operating expenses	8,597,576	8,892,534
Operating income	1,655,622	576,862
Nonoperating revenues (expenses):		
Interest and debt expense	(1,431,994)	(1,321,748)
Interest income on investments	83,538	41,592
Gain on sale of utility plant	9,500	-
Net increase (decrease) in fair value of investments	37,053	(46,711)
Deferred net change in fair value of investments	(37,053)	46,711
Total nonoperating revenues (expenses)	(1,338,956)	(1,280,156)
Income (loss) before contributions and transfers	316,666	(703,294)
Capital contributions	39,673	567,566
Transfers out - dividends to City of Owensboro	(169,469)	(163,316)
Change in net position	186,870	(299,044)
Net position, beginning of year, before restatement	28,658,989	28,958,033
Cumulative effect of change in accounting principle	(4,272,846)	-
Net position, beginning of year, as restated	24,386,143	-
Net position, end of year	$ 24,573,013	$ 28,658,989

OWENSBORO MUNICIPAL UTILITIES
WATER WORKS SYSTEM

STATEMENTS OF CASH FLOWS

Years Ended May 31, 2015 and 2014

	2015	2014
Cash flows from operating activities:		
Receipts from customers	$ 10,217,177	$ 9,284,038
Payments to suppliers	(3,928,279)	(3,811,730)
Payments to employees	(2,505,367)	(2,459,700)
Net cash provided by operating activities	3,783,531	3,012,608
Cash flows from noncapital financing activities:		
Transfers out - dividends to City of Owensboro	(169,091)	(157,686)
Cash flows from capital and related financing activities:		
Capital expenditures	(3,064,695)	(1,988,345)
Payments on long-term debt	(620,000)	(595,000)
Interest paid on long-term debt	(1,202,185)	(1,178,239)
Proceeds from bond issuance	9,635,538	-
Payment to refunded bond agent	(3,876,502)	-
Reimbursements of customers' advances	(8,851)	(14,934)
Debt issuance cost	(114,768)	(40)
Net provided by (cash used) in capital and related financing activities	748,537	(3,776,558)
Cash flows from investing activities:		
Purchase of investments	-	(709,446)
Proceeds from sale and maturities of investments	243,860	1,060,959
Interest on investments	83,640	41,662
Net cash provided by investing activities	327,500	393,175
Net increase (decrease) in cash and cash equivalents	4,690,477	(528,461)
Cash and cash equivalents, beginning of year	3,779,034	4,307,495
Cash and cash equivalents, end of year	$ 8,469,511	$ 3,779,034
Included in the following balance sheet captions:		
Cash and cash equivalents, unrestricted	$ 2,241,669	$ 1,957,220
Cash and cash equivalents, restricted	6,227,842	1,821,814
	$ 8,469,511	$ 3,779,034

See Notes to Financial Statements

OWENSBORO MUNICIPAL UTILITIES
WATER WORKS SYSTEM

STATEMENTS OF CASH FLOWS, Concluded

Years Ended May 31, 2015 and 2014

	2015	2014
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 1,655,622	$ 576,862
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	2,513,290	2,420,756
Change in assets and liabilities:		
Decrease (increase) in assets:		
Accounts receivable	(115,989)	(102,685)
Materials and supplies	(18,291)	98,126
Prepayments	2,695	(6,761)
Other noncurrent assets	(1,198)	8,320
Deferred outflows of resources	(461,522)	-
Increase (decrease) in liabilities:		
Accounts payable	(119,491)	31,723
Other current liabilities	(55,440)	55,440
Other noncurrent liabilities	(171,070)	-
Deferred inflows	554,925	(69,173)
Net cash provided by operating activities	$ 3,783,531	$ 3,012,608
Noncash investing, capital and financing activities:		
Noncash contributions in aid of construction	$ -	$ 556,179
Unrefunded customers' advances credited to contributions in aid of construction	$ 39,673	$ 11,387
Amortization of debt discount and expense and deferred loss on debt defeasance	$ 159,178	$ 148,606

1. Organization and Summary of Significant Accounting Policies

General Information

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

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

System of Accounts and Basis of Accounting

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

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

Utility Plant and Depreciation

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

1. Organization and Summary of Significant Accounting Policies, Continued

Utility Plant and Depreciation, Continued

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

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

Depreciation of utility plant and unclassified plant in service is provided using the straight-line composite rate method over the estimated service lives of the depreciable assets. Estimated service lives of assets range from 5 to 80 years. Depreciation expense during 2015 and 2014 was approximately 3.1% of the average original cost of depreciable utility plant in service.

Restricted Assets

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

Cash and Investments

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

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

1. Organization and Summary of Significant Accounting Policies, Continued

Inventories

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

Bond Issuance Costs

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

The Water System's rate making methodology allows for future recovery of debt costs, including bond issuance costs, in its rate making process. Accordingly, under FASB ASC 980, *Regulated Operations*, debt issuance costs are deferred and amortized using the straight-line method over the lives of the bond issues.

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

Pensions

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the County Employees Retirement System (CERS) and additions to/deduction from CERS's fiduciary net position have been determined on the same basis as they are reported by CERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

Customers' Advances for Construction

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

Contributions of Contributed Property and Equipment

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

Income Taxes

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

1. Organization and Summary of Significant Accounting Policies, Continued

Estimates

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

Change in Accounting Principle

In 2015, the Water System adopted GASB Statement No. 68, "Accounting and Financial Reporting for Pensions" (GASB 68). GASB 68 establishes standards for measuring and recognizing liabilities, deferred outflows of resources, and deferred inflows of resources, and expense/expenditures. For defined benefit pensions, GASB 68 identifies the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. The Water System implemented GASB 68 effective June 1, 2014, and has restated its net position to conform to the statement. The effect of this change as of June 1, 2014, is a decrease in net position of $4,272,846, an increase in deferred pension outflows of $507,635 and an increase in net pension liability of $4,780,481.

Management has not retrospectively applied this change to prior years' financial statements because the County Employees Retirement System (CERS) completed its first actuarial valuation to comply with GASB 68 as of June 30, 2014. That valuation was used for valuing pension-related balances as of May 31, 2015. Such actuarial valuations were not completed for prior years, therefore, the information was not available to apply GASB 68 retrospectively. As a result of this change, the current period's financial statements are not comparable with those of any prior periods.

2. Utility Plant

Water utility plant activity for the year ended May 31, 2015, was as follows:

	Beginning Balance	Additions	Retirements	Ending Balance
Utility plant:				
Source of supply plant	$ 4,367,449	$ 123,183	$ -	$ 4,490,632
Pumping plant	1,115,255	51,508	-	1,166,763
Water treatment plant	29,340,319	119,492	-	29,459,811
Transmission and distribution plant	36,282,197	262,407	-	36,544,604
General plant	4,372,938	183,884	(24,440)	4,532,382
Unclassified plant in service	1,172,982	711,632	-	1,884,614
Total, at original cost	76,651,140	1,452,106	(24,440)	78,078,806

2. Utility Plant, Continued

	Beginning Balance	Additions	Retirements	Ending Balance
Accumulated depreciation:				
Source of supply plant	(2,089,721)	(143,322)	-	(2,233,043)
Pumping plant	(719,960)	(28,967)	-	(748,927)
Water treatment plant	(13,971,505)	(670,681)	-	(14,642,186)
Transmission and distribution plant	(13,480,930)	(1,358,925)	-	(14,839,855)
General plant	(2,801,097)	(311,395)	(24,221)	(3,088,271)
Total accumulated depreciation	(33,063,213)	(2,513,290)	(24,221)	(35,552,282)
Construction in progress	1,236,406	2,082,356	-	3,318,762
Utility plant, net	$ 44,824,333	$ 1,021,172	$ (219)	$ 45,845,286

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

	2015	2014
Water utility plant	$ 2,413,290	$ 2,320,756
Transportation depreciation charged to construction activities or other operating expenses	100,000	100,000
	$ 2,513,290	$ 2,420,756

3. Restricted Assets

Restricted assets at May 31 consist of the following:

	2015	2014
Cash and cash equivalents	$ 6,227,842	$ 1,821,814
Investments	1,727,215	1,934,022
Accrued interest receivable	3,181	3,190
	$ 7,958,238	$ 3,759,026

The above balances are contained in the following funds:

	2015	2014
Sinking Fund	$ 2,817,586	$ 2,450,024
Renewal and Replacement Fund	182	395
Construction Fund	5,140,470	1,308,607
	$ 7,958,238	$ 3,759,026

Under the terms of the Water Revenue Bond ordinances, interest income from the temporary investment of the Water System's restricted assets must be credited to the various restricted asset funds. In addition, whenever all specified and required payments and transfers into the

3. Restricted Assets, Continued

restricted asset funds have been made as provided in the Water Revenue Bond ordinances and there is a balance in excess of the estimated amounts required to pay current month operation and maintenance costs (approximately $560,000 at May 31, 2015), all or any part of such excess may be used for any lawful purpose related to the Water System.

The Water System follows GASB Statement No. 31, "Accounting and Financial Reporting for Certain Investments and for External Investments Pools" (GASB 31), which requires certain investments to be carried at fair value in the balance sheets and changes in the fair value of investments to be reported in the statements of revenues, expenses and changes in fund net assets. In accordance with GASB 31, the Water System recorded unrealized gains (losses) of $37,053 and ($46,711) for the years ended May 31, 2015 and 2014, respectively. The Water System's rate making methodology does not consider unrealized gains or losses on marketable securities in its rate making process. Accordingly, under FASB ASC 980, *Regulated Operations,* the unrealized losses for the years ended May 31, 2015 and 2014, have been deferred.

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

	2015	2014
Net realized gains (losses) on sales of investments	$ -	$ -
Net unrealized gains (losses) on investments	37,053	(46,711)
	$ 37,053	$ (46,711)

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

4. Cash Deposits and Investments

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

	2015	2014
Deposits in financial institutions	$ 8,469,511	$ 4,022,894
Investments other than deposits	1,727,215	1,690,162
	$ 10,196,726	$ 5,713,056

4. Cash Deposits and Investments, Continued

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

		2015		2014
Cash and cash equivalents	$	2,241,669	$	1,957,220
Restricted assets:				
Cash and cash equivalents		6,227,842		1,821,814
Investments		1,727,215		1,934,022
	$	10,196,726	$	5,713,056

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

Custodial Credit Risk. Custodial credit risk is the risk that, in the event of a bank failure, the Water System's deposits may not be returned to it. The Water System's deposit and investment policy permits uncollateralized deposits only if issued by institutions ranked in one of the three highest categories by a nationally recognized rating agency. As of May 31, 2015, $8,456,022 of the Water System's bank balance of $8,474,960 was exposed to custodial credit risk as follows:

Uninsured and uncollateralized	$	-
Uninsured with collateral held by pledging bank's agent		8,456,022
Total	$	8,456,022

As of May 31, 2015, the Water System had the following investments. Investments are reported at fair values.

Investments	Maturities		
Federal Home Loan Bank – Callable	11/01/2022	$	1,727,215

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

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

4. Cash Deposits and Investments, Continued

Concentration of Credit Risk. Other than the prudent-person rule, the Water System's deposit and investment policy places no limit on the amount the Water System may invest in any one issuer. All of the Water System's investments are in U.S. agency securities at May 31, 2015.

5. Long-Term Debt

Long-term debt activity for the year ended May 31, 2015, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Bonds payable:					
Series of 1999	$ 1,700,000	$ -	$ (1,700,000)	$ -	$ -
Series of 2003	2,735,000	-	(2,735,000)	-	-
Series of 2009	19,160,000	-	-	19,160,000	-
Series of 2014	-	9,730,000	-	9,730,000	725,000
	23,595,000	9,730,000	(4,435,000)	28,890,000	725,000
Add unamortized debt premium	297,389	95,339	(32,540)	360,188	-
Total bonds payable	$ 23,892,389	$ 9,825,339	$ (4,467,540)	$ 29,250,188	$ 725,000

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

	2015	2014
Series of 1999: 4.0% to 4.75%, due serially September 15, 2015 to 2017	$ -	$ 1,700,000
Series of 2003: 2.0% to 4.25%, due serially September 15, 2015 to 2023	-	2,735,000
Series of 2009: 5.0% to 5.25%, due serially September 15, 2018 to 2035	19,160,000	19,160,000
Series of 2014: 1.75% to 3.9%, due serially September 15, 2015 to 2038	9,730,000	-
Total long-term debt	28,890,000	23,595,000
Less current maturities	(725,000)	(620,000)
Add unamortized debt premium	360,188	297,389
	$ 28,525,188	$ 23,272,389

5. Long-Term Debt, Continued

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

Year Ending May 31:	Principal	Interest	Total
2016	$ 725,000	$ 1,270,771	$ 1,995,771
2017	735,000	1,257,996	1,992,996
2018	750,000	1,245,003	1,995,003
2019	770,000	1,223,021	1,993,021
2020	805,000	1,191,346	1,996,346
2021 – 2025	4,560,000	5,407,475	9,967,475
2026 – 2030	5,765,000	4,181,325	9,946,325
2031 – 2035	7,410,000	2,534,125	9,944,125
2036 – 2040	7,370,000	597,251	7,967,251
	$ 28,890,000	$ 18,908,313	$ 47,798,313

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

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

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

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

5. Long-Term Debt, Continued

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

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

On June 12, 2014, the City issued $9,730,000 of Water Revenue Refunding and Improvement Bonds, Series 2014, dated July 31, 2014. The 2014 Bonds were issued to refund all 1999 and 2003 series bonds due after September 15, 2014, and to fund various capital improvement expenditures for the Water System. The in-substance defeasance of the 1999 and 2003 Bonds was accomplished by placing $3,835,802 in proceeds from the 2014 Bonds and $40,700 in funds from the 1999 and 2003 Bond Sinking Funds in an irrevocable escrow fund to be used solely for satisfying scheduled debt service payments of the 1999 and 2003 Bonds. Accordingly, 1999 and 2003 Bonds in the amount of $1,305,000 and $2,510,000, respectively, net of unamortized discount and issuance costs of $60,176 and accrued interest payable of $47,483, were extinguished resulting in the accounting recognition of a loss from defeasance of $74,195, reported in the accompanying financial statements as a deferred outflow of resources. The City advance refunded the 1999 and 2003 bonds to reduce the effective rate on the debt. The advance refunding resulted in an economic gain (difference between the present value of the debt service payment on the old and new debt) of $252,617.

The Series 2014 Bonds maturing on and after September 15, 2023, are subject to redemption prior to maturity in whole or in part on September 15, 2022, and on any date thereafter, at the redemption price of 100% of the principal amount redeemed, plus accrued interest to the redemption date.

5. Long-Term Debt, Continued

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

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

6. Pension Plan

Plan Description

The Water System contributes to the County Employees Retirement System (CERS), which is a cost-sharing multiple-employer defined benefit pension plan administered by Kentucky Retirement Systems (KRS) that covers all regular full-time members employed in nonhazardous positions of each participating county, city, and school board, and any additional eligible local agencies electing to participate in CERS. Kentucky Revised Statute Section 61.645 assigns the authority to establish and amend benefit provisions to the Board of Trustees of Kentucky Retirement Systems (Board). CERS issues a publicly available financial report that can be obtained at www.kyret.ky.gov.

Benefits Provided

CERS provides for retirement, disability, and death benefits to system members. Retirement benefits may be extended to beneficiaries of members under certain circumstances. Retirement benefits are determined using a formula which considers the member's final compensation; benefit factors set by statute which vary depending upon the type / amount of service, participation date, and retirement date; and years of service. Plan members with a participation date prior to September 1, 2008, are eligible to retire with full benefits at any time with 27 or more years of service credit, or at age 65 with at least 48 months of service credit. Plan members with a participation date on or after September 1, 2008, are eligible to retire with full benefits at age 57 if the member's age and years of service equal 87, or at age 65 with at least 60 months of service credit.

Contributions

Per Kentucky Revised Statues Section 78.545(33), contribution requirements of the active employees and the participating employers are established and may be amended by the KRS Board. Plan members who began participating in CERS prior to September 1, 2008, are required to contribute 5% of their annual creditable compensation. For Plan members who

6. Pension Plan, Continued

Contributions, Continued

began participating in CERS on or after September 1, 2008, the contribution rate is 6%. The Water System's actuarially determined contribution rate as of May 31, 2015, was 17.67% of annual creditable compensation. Contributions to CERS by the Water System were $500,154 for the year ended May 31, 2015.

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

At May 31, 2015, the Water System reported a liability of $4,101,776 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2014, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Water System's proportion of the net pension liability was based on a projection of the Water System's long-term share of contributions to the pension plan relative to the projected contributions of all participating entities, actuarially determined. At June 30, 2014, the Water System's proportion was 0.126427%.

For the year ended May 31, 2015, the Water System recognized pension expense of $325,420. At May 31, 2015, the Water System reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Net difference between projected and actual earnings on plan investments	$ -	$ 457,857
Water System contributions subsequent to the measurement date	461,522	-
Total	$ 461,522	$ 457,857

The $461,522 of deferred outflows of resources resulting from the Water System's contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ending May 31, 2016. Other amounts reported as deferred inflows of resources will be recognized in pension expense as follows:

6. Pension Plan, Continued

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

Year ending May 31,	
2016	$ 114,464
2017	114,464
2018	114,464
2019	114,465
	$ 457,857

Actuarial Assumptions

The total pension liability in the June 30, 2014, actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.5 %
Salary increases	4.5% average, including inflation
Investment rate of return	7.75%, net of pension plan investment expense, including inflation

Mortality rates were based on the 1983 Group Annuity Mortality Table for all retired members and beneficiaries as of June 30, 2006, and the 1994 Group Annuity Mortality Table for all other members.

The actuarial assumptions used in the June 30, 2014, valuation were based on the results of an actuarial experience study for the period July 1, 2005 – June 30, 2008.

The long-term expected rate of return on pension plan investments is reviewed as part of the regular experience studies prepared every five years. The most recent analysis, performed for the period covering fiscal years 2005 through 2008, is outlined in a report dated August 25, 2009. Several factors are considered in evaluating the long-term rate of return assumption including long-term historical data, estimates inherent in current market data, and a log-normal distribution analysis in which best-estimate ranges of expected future real rates of return (expected return, net of investment expense, and inflation) were developed by the investment consultant for each major asset class. These ranges were 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 then adding expected inflation. The capital market assumptions developed by the investment consultant are intended for use over a 10-year horizon and may not be useful in setting the long-term rate of return for funding

6. Pension Plan, Continued

Actuarial Assumptions, Continued

pension plans which cover a longer time frame. The assumption is intended to be a long-term assumption and is not expected to change absent a significant change in the asset allocation, a change in the inflation assumption, or a fundamental change in the market that alters expected returns in future years. 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
Domestic equity	30%	8.45%
International equity	22%	8.85%
Emerging market equity	5%	10.5%
Private equity	7%	11.25%
Real estate	5%	7%
Core US fixed income	10%	5.25%
High-yield US fixed income	5%	7.25%
Non US fixed income	5%	5.5%
Commodities	5%	7.75%
TIPS	5%	5%
Cash	1%	3.25%
Total	100%	

Discount Rate

The discount rate used to measure the total pension liability was 7.75%. The projection of cash flows used to determine the discount rate assumed that local employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 29-year amortization period of the unfunded actuarial accrued liability. Based on those assumptions, the Plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on Plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the Water System's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate

The following presents the Water System's proportionate share of the net pension liability calculated using the discount rate of 7.75%, as well as what the Water System's

6. Pension Plan, Continued

Sensitivity of the Water System's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate, Continued

proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.75%) or 1-percentage-point higher (8.75%) than the current rate:

	Discount rate	Water System's proportionate share of net pension liability
1% decrease	6.75%	$5,397,661
Current discount rate	7.75%	$4,101,776
1% increase	8.75%	$2,956,828

Plan Fiduciary Net Position

Detailed information about the CERS fiduciary net position is available in the separately issued Kentucky Retirement Systems Comprehensive Annual Financial Report.

Payables to the Pension Plan

At May 31, 2015, the Water System reported a payable of $75,233 for the outstanding amount of contributions due to CERS for the year.

7. Dividends - City of Owensboro

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

8. Major Customers

Water revenues from three rural water district customers in Daviess County, Kentucky, under wholesale supply agreements totaled approximately $1,939,000 and $2,005,000 for 2015 and 2014, respectively.

9. Risk Management

OMU is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. OMU manages its risks through coverages provided by private insurance carriers for various risks of losses to which it is exposed, including directors and officers, employee dishonesty, workers' compensation, and other property risks. OMU is self-insured for group health and limits its risks of loss by purchasing reinsurance coverage.

10. Rate Matters

During 2014, the City Commission approved a two-step rate increase for retail customers. The first step is effective June 1, 2014, and the second step is effective June 1, 2015. These steps, each of which consists of a volume-based increase and an increase in the monthly customer charge, are anticipated to increase retail operating revenues by approximately 12% and 9%, respectively.

OWENSBORO MUNICIPAL UTILITIES
WATER SYSTEM

SCHEDULE OF PROPORTIONATE SHARE OF THE NET PENSION LIABILITY
COUNTY EMPLOYEES RETIREMENT SYSTEM

Last 10 Fiscal Years *

		2015
Water System's proportion of the net pension liability		0.126427%
Water System's proportionate share of the net pension liability	$	4,101,776
Water System's covered-employee payroll	$	2,920,692
Water System's proportionate share of the net pension liability as a percentage of its covered employee payroll		140.44%
Plan fiduciary net position as a percentage of the total pension liability		66.80%

* Presented for those years for which the information is available.

OWENSBORO MUNICIPAL UTILITIES
WATER SYSTEM

SCHEDULE OF CONTRIBUTIONS
COUNTY EMPLOYEES RETIREMENT SYSTEM

Last 10 Fiscal Years

		2015	2014	2013	2012	2011	2010	2009	2008	2007	2006
Contractually required contributions	$	500,155	551,545	552,369	498,251	446,030	414,665	340,141	363,929	284,401	229,181
Contributions in relation to the contractually required contributions		(500,155)	(551,545)	(552,369)	(498,251)	(446,030)	(414,665)	(340,141)	(363,929)	(284,401)	(229,181)
Contribution deficiency (excess)	$	-	-	-	-	-	-	-	-	-	-
Water System's covered-employee payroll	$	2,838,215	2,916,897	2,833,020	2,674,092	2,651,482	2,625,010	2,449,406	2,313,295	2,211,840	2,162,358
Contributions as a percentage of covered-employee payroll		17.62%	18.91%	19.50%	18.63%	16.82%	15.80%	13.89%	15.73%	12.86%	10.60%