HOPKINSVILLE ELECTRIC SYSTEM

OF THE

CITY OF HOPKINSVILLE, KENTUCKY

FINANCIAL STATEMENTS

AND

SUPPLEMENTARY INFORMATION

FOR THE YEARS ENDED

JUNE 30, 2011 AND 2010

AND

AUDITORS' REPORTS

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY

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INDEPENDENT AUDITORS' REPORT

To the Board of the
Hopkinsville Electric System of the
City of Hopkinsville, Kentucky
Hopkinsville, Kentucky

We have audited the accompanying financial statements of the Hopkinsville Electric System of the City of Hopkinsville, Kentucky (HES), as of and for the years ended June 30, 2011 and 2010, as listed in the table of contents. These financial statements are the responsibility of the Hopkinsville Electric System of the City of Hopkinsville, Kentucky's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Hopkinsville Electric System of the City of Hopkinsville, Kentucky as of June 30, 2011 and 2010, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 21, 2011, on our consideration of the Hopkinsville Electric System of the City of Hopkinsville, Kentucky's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

American Institute of Certified Public Accountants ~ Kentucky Society of Certified Public Accountants

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Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 12 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.

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Hopkinsville Electric System's financial statements as a whole. The accompanying financial information listed as supplementary information is presented for purposes of additional analysis and is not a required part of the financial statements. Such information 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. The information has been subjected to the auditing procedures applied in the audits 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 information is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

Kem, Duguid & Associates, P.S.C.

Kem, Duguid & Associates, P.S.C.

Certified Public Accountants
Hopkinsville, Kentucky

November 21, 2011

MANAGEMENT'S DISCUSSION AND ANALYSIS

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2011

The management of Hopkinsville Electric System of the City of Hopkinsville (HES, the "System") offers Management's Discussion and Analysis to provide an overview and analysis of the System's financial activities for the year ended June 30, 2011. To fully understand the entire scope of the System's financial activities, this information should be read in conjunction with the financial statements provided in this document.

FINANCIAL HIGHLIGHTS

- The assets of HES exceeded its liabilities at the close of the 2011 fiscal year by $19,873,969 (*net assets*). Of this amount, $2,452,909 (*unrestricted net assets*) may be used to meet the System's ongoing obligations to citizens and creditors.

- The System's total net assets increased by $865,078 during the period. This increase was primarily due to monthly TVA Fuel Cost Adjustment (FCA) increases and increased purchase power cost due to increases in FCA.

- Total operating revenues for the 2011 fiscal year increased by $3,501,455 or about 10.32% compared to the previous period. This increase in operating revenues was principally due to retail rate increases in the form of FCA pass through as well as an increase in wireless internet sales.

- FY 2011 operating expenses totaled $36,408,587 which was $4,418,562 or about 13.81% more than the previous year's amount. This increase in operating expenses was principally due to increased purchased power cost due to increases in FCA.

OVERVIEW OF FINANCIAL STATEMENTS

The discussion and analysis is intended to serve as an introduction to the System's basic financial statements. The System operates as a utility enterprise and presents its financial statements using the economic resources measurement focus and the full accrual basis of accounting. In layman's terms, this presentation means that financial information is reported using the accounting methods similar to those followed by private sector companies. The statements offer both short-term and long-term financial information about the activities of Hopkinsville Electric System. And to further aid the reader with their analysis and comprehension of the information presented, financial data for two years is provided.

The basic financial statements provide information about the System's business-type activities. The financial statements are prepared in accordance with U.S. generally accepted accounting principles as promulgated by the Governmental Accounting Standards Board (GASB).

HOPKINSVILLE ELECTRIC SYSTEM
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MANAGEMENT'S DISCUSSION AND ANALYSIS
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REQUIRED FINANCIAL STATEMENTS FOR BUSINESS-TYPE ACTIVITIES

In reporting on the operations of its enterprise fund, the System's basic financial statements include a Statement of Net Assets; a Statement of Revenues, Expenses and Changes in Net Assets; and a Statement of Cash Flows. And to help provide our users with a contextual frame of reference, comparative information from the financial statements of the previous fiscal year is also provided. The financial statements also include notes that are considered essential to a full understanding of the data that is being presented on the face of the statements. The primary purpose of the notes is to provide additional discussion, enhanced disclosures and tabular presentation of data to further explain information in the financial statements and to provide more detailed data.

The information contained on the Statement of Net Assets represents all of the System's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and obligations to the System's creditors (liabilities). It also provides the basis for computing rate of returns, evaluation the capital structure of the System, and assessing the liquidity and financial flexibility of the System.

All of the current year's revenues and expenses are accounted for in the Statement of Revenues, Expenses and Changes in Net Assets. This statement measures the success of the System's operations over the past year and can be used to determine whether HES has successfully recovered all of its costs through user fees and other charges. It provides the user with basic financial information about the profitability and credit worthiness of the System.

The final required financial statement is the Statement of Cash Flows. The primary purpose of this statement is to provide information about the System's cash receipts and cash payments during the fiscal year. The statement reports cash receipts, cash payments and net changes in cash resulting from operating; capital and related financing; and investing activities. Again to put it into layman's terms, the purpose of this statement is to tell the user where the System's cash came from, what the cash was used for, and by how much the cash balance changed over the course of the fiscal year.

When analyzing the financial statements of Hopkinsville Electric System's business-type activities, the primary consideration should be whether the System as a whole is financially better off or worse off as a result of the year's activities. The Statement of Net Assets and the Statement of Revenues, Expenses and Changes in Net Assets are designed to report information about the System's activities that will help the user determine how good or bad a year it was from a financial perspective. These two statements report the net assets of the System and changes in them.

One can think of the System's net assets (i.e., the difference between assets and liabilities) as one way to measure financial health or financial position. Over time, increases or decreases in the System's net assets are a general indicator of whether its financial health is improving or deteriorating. In addition to the relative change in net assets, one will also have to take into consideration the impact on operations of other non-financial factors and external influences. These would include, but are not limited to, economic conditions, population growth, changes in governmental legislation, and the issuance of new regulations and the utilization of new technologies.

HOPKINSVILLE ELECTRIC SYSTEM
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MANAGEMENT'S DISCUSSION AND ANALYSIS
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Financial Analysis of the Fiscal Year Ended June 30, 2011

Considering the negative financial impact of the recession, the overall general direction of the System's financial operations remained positive during its fiscal year ended June 30, 2011. Over the past year, total assets of the System increased by $1,213,578 while total liabilities increased by $348,500. And for the current period, the operating income of the System totaled $865,078. Operating revenues include $634,641 from Electric and $230,437 from Telecommunications.

Condensed Statements of Net Assets

The Statement of Net Assets, shown in tabular format below, represents information on all of the System's assets and liabilities with the difference between the two reported as net assets. The System's total net assets increased from the prior year by $865,078 or about 4.55% for the period.

Given the significant budgetary problems that have been plaguing most governmental entities over the past couple of years, it is a significant accomplishment that the net worth of the System actually increased $865,079 during the 2011 fiscal year. Our analysis that follows focuses on the System's net assets (shown in Table 1) and the changes in net assets (shown in Table 2) during the year.

TABLE 1
Condensed Statements of Net Assets

	Fiscal Year		Change in FY 2010 to FY 2011	
	2011	2010	Amount	Percent
Current and other assets	$ 11,590,921	$ 13,565,137	$ (1,974,216)	-14.55%
Capital assets	30,857,826	27,670,032	3,187,794	11.52%
Total assets	42,448,747	41,235,169	1,213,578	2.94%
Current liabilities	8,641,239	7,512,903	1,128,336	15.02%
Long-term liabilities	13,933,539	14,713,375	(779,836)	-5.30%
Total liabilities	22,574,778	22,226,278	348,500	1.57%
Invested in utility plant, net of related debt	17,033,252	12,872,898	4,160,354	32.32%
Restricted for debt service	387,808	387,663	145	0.04%
Unrestricted	2,452,909	5,748,330	(3,295,421)	-57.33%
Total net assets	$ 19,873,969	$ 19,008,891	$ 865,078	4.55%

Analysis of Net Assets

To better understand the System's actual financial positions and its ability to deliver services in future periods, the reader will need to review the various components of the net asset category and obtain an understanding of how each relate specifically to the business activities that we perform. For example, the vast majority of the net assets ($17,033,252 or 85.71% of total net assets) represent investment in plant assets, which is the lifeblood to the provision of electric and telecommunication services.

Componet of Net Assets

	Fiscal Year		Change FY 2010 to FY 2011	
	2011	2010	Amount	Percent
Invested in capital assets, net of related debt	$ 17,033,252	$ 12,872,898	$ 4,160,354	32.32%
Restricted for debt service	387,808	387,663	145	0.04%
Unrestricted	2,452,909	5,748,330	(3,295,421)	-57.33%
	$ 19,873,969	$ 19,008,891	$ 865,078	4.55%

For the 2011 fiscal year, *Net Assets Invested in Capital Assets, Net of Related Debt* increased by $4,160,354 or 32.32% compared to previous year. The increase in this category is primarily due to the an increase in Construction Work in Progress (Electric) of $2,362,370. The amount shown in this category is calculated by taking the depreciated value of our capital assets and subtracting the associated bond debt. The significance of this increase on future operations is that it represents additional equity that the System has accumulated in its plant, equipment and infrastructure.

In comparing the total amount of *Restricted Net Assets* with the previous fiscal year, there was a slight increase of $145 or .04%. The components of this category consists of the 1998A Sinking Fund and other Debt Service Funds.

Compared to the prior year's balance, there was a decrease in the *Unrestricted Net Assets* category of $3,295,421 or 57.33%. The decrease in this component is directly linked to the increase that occurred in the *Net Assets Invested in Capital Assets, Net of Related Debt* category.

Unrestricted net assets consist of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt".

Analysis of Current Assets

The textbook definition of "current assets" is balance sheet items which equal the sum of cash and cash equivalents, accounts receivable, inventory, marketable securities, prepaid expenses, and other assets that could be converted to cash in less than one year. Current assets are important in any financial analysis because it is from current assets that a business funds its ongoing, day-to-day operations. A comparison of the June 30, 2011 and 2010 balances by asset classification is shown in the table below.

	Fiscal Year		Change from FY 2010 to FY 2011	
	2011	2010	Amount	Percent
Cash and cash equivlaents	$ 2,185,455	$ 2,235,643	$ (50,188)	-2.24%
Accounts receivable (net)	3,162,818	3,700,251	(537,433)	-14.52%
Unbilled revenue	1,217,720	1,339,513	(121,793)	-9.09%
Inventories	764,427	678,591	85,836	12.65%
Prepaid expenses	84,848	96,138	(11,290)	-11.74%
Other	65,256	61,207	4,049	6.62%
	$ 7,480,524	$ 8,111,343	$ (630,819)	-7.78%

Analysis of Noncurrent Assets

Noncurrent assets represent assets that are not reasonably expected to be realized in cash or sold or consumed during the next fiscal year. When making the distinction between whether an asset should be considered current or noncurrent, liquidity or nearness to cash is not the proper basis for determining the classification. In making this determination, any encumbrances on the use of the asset must be considered. Thus, cash investments intended for liquidation or liabilities due beyond the one-year period are noncurrent assets, as would assets segregated or restricted for the liquidation of long-term debts (including amounts due within the next operating cycle). Assets designated to be used to acquire, construct, or improve capital assets would also be noncurrent.

In the following table, the Noncurrent Assets of the System at June 30, 2011 and 2010 are compared to major classification. As indicated by the tabular information, total noncurrent assets increased by $1,844,397 or 5.57% during the 2011 fiscal year.

	Fiscal Year		Change from FY 2010 to FY 2011	
	2011	2010	Amount	Percent
Restricted:				
Investments - special funds	$ 2,775,545	$ 4,318,761	$ (1,543,216)	-35.73%
Nonutility property	33,958	33,958	0	0.00%
Deferred charges	1,300,894	1,101,075	199,819	18.15%
Capital assets (net)	30,857,826	27,670,032	3,187,794	11.52%
	$ 34,968,223	$ 33,123,826	$ 1,844,397	5.57%

The table above demonstrates the relatively large investment that the System has made in capital assets. At the end of the 2011 fiscal year, capital assets represented about 88.25% of the noncurrent assets.

In examining the balance for the Restricted Noncurrent Assets category at June 30, 2011, it shows a decrease of $1,543,216 or 35.73% compared to the previous fiscal year.

Analysis of Liabilities

In financial accounting, the term "liability" is defined as an obligation of an entity arising from past transactions or events, the settlement of which may result in the transfer or use of assets, provision of services or other yielding of economic benefits in the future. To put it in more simplistic terms, this section analyzes the various claims that creditors have against the System's assets.

Current Liabilities Payable from Unrestricted Assets had a net increase in its various components of $1,157,133 or about 15.40% compared to the previous fiscal year's balance. Of that amount, $2,283,413 represents an increase in accounts payable purchased power and a decrease of accounts payable other of $1,356,750. Other categories of current liabilities remained constant with a slight increase of $230,470.

In the *Long-Term Liabilities Outstanding* category, the balance decreased by $779,836 or about 5.30% from the previous fiscal year. There were no new bond issues during the current year. The entire decrease represents normal principal reduction of debt.

As the reader of the financial statements might surmise from the preceding discussion, an argument can certainly be made that the System's financial position has indeed improved over that of the previous year. Management feels that each of the positive indicators discussed above speak to the continued financial viability of the System's operations.

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2011

Condensed Statements of Revenues, Expenses and Changes in Net Assets

As indicated in Table 2, the change in net assets for the fiscal year ended June 30, 2011 was $865,078. While that amount compares somewhat unfavorably with the previous year's increase of $1,416,624 in net assets, one needs to consider the adverse impact that the recession has had on the System's operations.

TABLE 2
Condensed Statements of Revenues, Expenses and Changes in Net Assets

	Fiscal Year		Change From FYE 2010 To FYE 2011	
	2011	2010	Amount	Percent
Operating revenues:				
Electric revenues	$ 35,557,762	$ 32,326,876	$ 3,230,886	9.99%
Telecom revenues	1,872,628	1,602,059	270,569	16.89%
Total operating revenues	37,430,390	33,928,935	3,501,455	10.32%
Operating expenses:				
Purchased power	28,790,302	25,013,112	3,777,190	15.10%
Other expenses	7,618,285	6,976,913	641,372	9.19%
Total operating expenses	36,408,587	31,990,025	4,418,562	13.81%
Net operating income	1,021,803	1,938,910	(917,107)	-47.30%
Non-operating income, net	(156,725)	(141,153)	(15,572)	11.03%
Change in net assets	865,078	1,797,757	(932,679)	-51.88%
Net assets, beginning of year	19,008,891	17,592,267	1,416,624	8.05%
Prior period adjustment	-	(381,133)	381,133	-100.00%
Net assets, beginning of year, restated	19,008,891	17,211,134	1,797,757	10.45%
Net assets, end of year	$ 19,873,969	$ 19,008,891	$ 865,078	4.55%

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2011

Analysis of Revenue

For the 2011 fiscal year, the *Operating Revenues* of the System totaled $37,430,390. This amount represented an increase of 10.32% more than the previous year's total of $33,928,935.

In analyzing the increase in the ***electric*** revenue for the year, there are a number of different factors that had a direct impact on the resulting revenues. In April 2011, the Tennessee Valley Authority changed its wholesale rate calculation from one based on actual Retail Customer Usage to one based on Demand and Energy metered at the wholesale delivery point. At the same time, TVA implemented rates that change seasonally four times a year, Summer and Winter rates and the transition period in-between.

Included in the *Non-Operating Revenues (net)* are interest income and other miscellaneous revenues totaling $64,825. These revenues decreased by $4,506 during the fiscal year.

Analysis of Expenses

The *Total Operating Expenses* for FY 2011 were $36,408,587. That amount represents an increase of $4,418,562 or about 13.81% more than the prior fiscal year total of $31,990,025. The eight major categories of Operating Expenses are shown in the chart below.

	Fiscal Year		Change from FY 2010 to FY 2011	
	2011	2010	Amount	Percent
Cost of power	$ 28,790,302	$ 25,013,112	$ 3,777,190	15.10%
Cost of sales - telecom	210,946	158,690	52,256	32.93%
Distribution:				
operation	1,191,036	1,168,114	22,922	1.96%
maintenance	917,981	744,254	173,727	23.34%
Transmission - maintenance	-	13,045	(13,045)	-100.00%
Customer accounts	813,515	727,041	86,474	11.89%
Sales	95,413	105,459	(10,046)	-9.53%
Administrative and general	1,937,316	1,783,289	154,027	8.64%
Depreciation	898,118	861,262	36,856	4.28%
Taxes	1,553,960	1,415,759	138,201	9.76%
	$ 36,408,587	$ 31,990,025	$ 4,418,562	13.81%

As indicated by the comparative information presented above, *Cost of Power* increased by $3,777,190 or 15.10% compared to the prior year. This accounted for the bulk of this fiscal year's increase in operating expenses.

Included in the *Non-Operating Revenues (net)* are interest on long-term debt of $173,561, other interest of $37,753 and amortization of debt expense of $10,236. These expenses increased by $11,066 during the fiscal year.

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2011

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

Hopkinsville Electric System's investment in capital assets as of June 30, 2011 was $30,857,826 (net of accumulated depreciation), as shown in the following table.

Schedule of Capital Assets (Net of Depreciation)

	Fiscal Year 2011	Fiscal Year 2010	Increase (Decrease)
Land	$ 425,715	$ 425,715	$ -
Construction in progress-elec	3,507,306	1,144,936	2,362,370
Construction in progress-tele	2,737,603	8,833,683	(6,096,080)
Transmission plant	391,101	408,233	(17,132)
Distribution plant	13,442,040	13,001,098	440,942
General plant	1,642,962	1,794,850	(151,888)
Telecommunications plant	8,711,099	2,061,517	6,649,582
Total Capital Assets	$ 30,857,826	$ 27,670,032	$ 3,187,794

Additional detailed information concerning the System's capital assets can be found in Note 2 in the notes to the financial statements.

Long-term Debt

At June 30, 2011, the System had roughly $13.8 million in debt outstanding, a decrease of $972,560 or approximately 6.57% less than the previous fiscal year. The System's debt is comprised of various bonds and notes. A comparative schedule at June 30, 2011 and 2010 is shown in the tabular information provided below.

	Fiscal Year 2011	Fiscal Year 2010	Increase (Decrease)
Revenue bond	$ 750,000	$ 980,000	$ (230,000)
KY League of Cities leases	10,836,727	11,579,287	(742,560)
KIA loan	2,237,847	2,237,847	-
	$ 13,824,574	$ 14,797,134	$ (972,560)

Additional detailed information concerning the System's liabilities can be found in the notes to the financial statements, Note 8.

Economic Factors

Although the System had a healthy income margin this year, the future financial condition of the System will be affected by two factors in the future: weather conditions and the length of the current recession. Weather is a tremendous driver in kWh sales – extreme hot conditions and extreme cold conditions will drive up kWh sales and mild temperatures drive down usage.

Also affecting the System's financial condition is the recent change to Seasonal Demand and Energy rates put in place by TVA. These rates were implemented April 1, 2011, and until we go through a complete twelve month cycle, it is too early to determine how these rates will affect our financial statements. TVA is trending toward all utilities being billed under Time-of-Use (TOU) rates. When this will be mandatory is still a huge question. When this rate is applied, the ability to measure our customers' retail use under TOU will place a financial burden on the System.

HES EnergyNet continues to gain high speed broadband customers. EnergyNet had cumulative positive net income this year. Because of expenditures for expanding the network operations center next year, monthly net income could go negative in the near term but should be positive in the long run. As we demonstrate financial responsibility, we continue to strive to deliver the highest quality of services to our community at the lowest feasible cost.

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the Hopkinsville Electric System's finances for all those with an interest in the government's finances. Questions or requests for additional information may be addressed to Austin Carroll, Manager, Hopkinsville Electric System, 1820 East Ninth Street, Hopkinsville, KY 42240.

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FINANCIAL STATEMENTS

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
STATEMENTS OF NET ASSETS
JUNE 30, 2011 AND 2010

ASSETS

	2011	2010
Utility plant	$ 45,024,630	$ 41,216,413
Less accumulated depreciation	14,166,804	13,546,381
Net utility plant	30,857,826	27,670,032
Restricted assets		
Investments - special funds	2,775,545	4,318,761
Other assets		
Nonutility property	33,958	33,958
Current assets		
Cash - general funds	2,185,455	2,235,643
Accounts receivable (less accumulated provision for uncollectible accounts of $25,195 in 2011 and $23,179 in 2010)	3,162,818	3,700,251
Unbilled revenue	1,217,720	1,339,513
Inventories (at weighted-average cost)	764,427	678,591
Prepaid expenses	84,848	96,138
Other current assets	65,256	61,207
Total current assets	7,480,524	8,111,343
Deferred charges	1,300,894	1,101,075
Total assets	42,448,747	41,235,169

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

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
STATEMENTS OF NET ASSETS, continued
JUNE 30, 2011 AND 2010

LIABILITIES	2011	2010
Current liabilities		
Current maturities of long-term debt	1,029,602	994,565
Accounts payable - purchased power	4,942,450	2,659,037
Accounts payable - other	711,095	2,067,845
Customer deposits	1,179,853	1,095,967
Accrued taxes	388,437	366,980
Accrued interest	18,584	18,586
Other current & accrued liabilities	371,218	309,923
Total current liabilities	8,641,239	7,512,903
Noncurrent liabilities		
Long-term debt	12,794,972	13,802,569
Advances from others:		
Conservation advances - TVA	1,138,567	910,806
Total noncurrent liabilities	13,933,539	14,713,375
Total liabilities	22,574,778	22,226,278
NET ASSETS		
Invested in capital assets, net of related debt	17,033,252	12,872,898
Restricted for debt service	387,808	387,663
Unrestricted	2,452,909	5,748,330
Total net assets	$ 19,873,969	$ 19,008,891

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

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010

	2011	2010
OPERATING REVENUES	$ 37,430,390	$ 33,928,935
OPERATING EXPENSES		
Cost of power	28,790,302	25,013,112
Cost of sales - telecommunications	210,946	158,690
Distribution - operation	1,191,036	1,168,114
- maintenance	917,981	744,254
Transmission - maintenance	-	13,045
Customer accounts	813,515	727,041
Sales	95,413	105,459
Administrative and general	1,937,316	1,783,289
Depreciation	898,118	861,262
Taxes	1,553,960	1,415,759
Total operating expenses	36,408,587	31,990,025
Net operating revenues	1,021,803	1,938,910
NONOPERATING REVENUES (EXPENSES)		
Interest on long-term debt	(173,561)	(166,305)
Other interest	(37,753)	(33,943)
Amortization of debt expense	(10,236)	(10,236)
Interest income	55,964	69,708
Other revenue (expenses)	8,861	(377)
Net nonoperating revenues (expenses)	(156,725)	(141,153)
CHANGE IN NET ASSETS	865,078	1,797,757
NET ASSETS, BEGINNING OF YEAR	19,008,891	17,592,267
Prior period adjustment	-	(381,133)
NET ASSETS, BEGINNING OF YEAR, restated	19,008,891	17,211,134
NET ASSETS, END OF YEAR	$ 19,873,969	$ 19,008,891

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

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010

	2011	2010
Cash flows from operating activities		
Receipts from customers and users	$ 38,085,567	$ 33,377,973
Payments to suppliers	(30,488,000)	(26,648,715)
Payments to employees	(2,373,874)	(1,901,163)
Payments of taxes	(1,532,503)	(1,370,840)
Net cash provided (used) by operating activities	3,691,190	3,457,255
Cash flows from capital financing activities		
Expenditures for utility plant	(4,104,208)	(1,612,538)
Net cost of retiring plant	(79,040)	(12,424)
Prior period adjustment	-	(381,133)
Principal payments on long-term debt	(972,560)	(953,612)
Conservation advances from TVA	227,761	211,549
Proceeds from debt issuance	-	201,900
Interest paid	(202,717)	(195,771)
Net cash provided (used) by capital financing activities	(5,130,764)	(2,742,029)
Cash flows from investing activities		
Conservation loan receivable	(218,658)	(201,350)
Purchases/maturities of investments	1,543,216	1,217,454
Interest and other revenues	64,829	69,333
Net cash provided (used) by investing activities	1,389,387	1,085,437
Net increase (decrease) in cash	(50,188)	1,800,663
Cash, beginning of year	2,235,643	434,980
Cash, end of year	$ 2,185,455	$ 2,235,643

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

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
STATEMENTS OF CASH FLOWS, continued
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010

	2011	2010
Reconciliation of operating income to net cash provided by operating activities:		
Net operating revenues	$ 1,021,803	$ 1,938,910
Adjustments to reconcile net operating revenues to net cash provided by operating activities:		
Depreciation	995,453	969,329
Changes in assets and liabilities:		
Receivables	537,433	(1,004,777)
Unbilled revenues	121,793	456,823
Materials and supplies	(85,836)	(85,726)
Prepaid expenses and other current assets	7,241	(38,912)
Accrued purchased power	-	(1,111,402)
Accounts payable	926,663	2,496,692
Accrued taxes	21,457	44,918
Other current and accrued liabilities	61,295	(244,193)
Customer deposits	83,888	35,593
Total adjustments	2,669,387	1,518,345
	$ 3,691,190	$ 3,457,255

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

NOTES TO FINANCIAL STATEMENTS

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011 AND 2010

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Financial Reporting Entity

The Electric Plant Board of the City of Hopkinsville (d.b.a. Hopkinsville Electric System) was created by Ordinance No. 382, passed June 2, 1942, pursuant to authority conferred upon the City by Chapter 119 of the General Assembly of Kentucky, 1932, amended.

The Board was established for the purpose of owning and operating all properties, real, personal, and mixed tangible or intangible, acquired or used or held for use, in connection with the electric plant acquired by purchase from Kentucky – Tennessee Light and Power Company.

The Board consists of four appointed members, the term of one expiring each year, and a fifth member from the City's governing body, presently represented by Wesley Grimes, a member of the Common Council. The Hopkinsville Electric System elects its own officers and management.

Basis of Presentation and Accounting

The accounting records of the Hopkinsville Electric System (the "System") are maintained in accordance with provisions of the power contract with the Tennessee Valley Authority and are consistent with requirements of the Federal Energy Regulatory Commission's system of accounts. Revenues and expenses are recognized on the accrual basis.

Under Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary and Other Governmental Entities That Use Proprietary Fund Accounting*, the System has elected to apply all Financial Accounting Standards Board (FASB) Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements, to the System's accounting and financial reporting.

All activities of the System are accounted for within a single proprietary (enterprise) fund. Proprietary funds are used to account for operations that are (a) financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the cost (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred and/or net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes.

The accounting and financial reporting treatment applied to the System is determined by its measurement focus. The transactions of the System are accounted for on a flow of economic resources measurement focus. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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.

Cash and Cash Equivalents

For the purposes of the statements of cash flows, the System considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Material and Supplies Inventory

Material and supplies inventory (which consists of wire, poles, and other supplies) is valued at cost determined by the weighted-average method.

Utility Plant

Utility plant is stated at original cost, which includes payroll related costs such as taxes, fringe benefits, and administrative and general costs. Interest expense incurred during a construction period is capitalized. Construction work in progress has been included in the rate base for determining retail customer rates. The System has not recorded any significant allowance for funds used during construction.

When property subject to depreciation is retired or otherwise disposed of in the normal course of business, its original cost, together with its cost of removal less salvage, is charged to the accumulated provision for depreciation. The System charges maintenance and repairs, including the cost of renewals of minor items of property, to maintenance expense accounts or applicable clearing accounts. Placements of property (exclusive of minor items of property) are capitalized to utility plant accounts.

Depreciation

Property and equipment in plant accounts are recorded at cost with depreciation being computed at rates recommended by the Tennessee Valley Authority. The rates used throughout the current year were consistent with those in use in the prior year.

Compensated Absences

Full-time employees are allowed to carryover a maximum of forty (40) hours accumulated annual leave. Upon retirement from Hopkinsville Electric System, the employee is entitled to payment for unused accumulated annual leave time. Accrued vacation leave was $282,018 and $237,018 for the years ended June 30, 2011 and 2010, respectively.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

Impairment of Capital Assets

In accordance with GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, management evaluates prominent events or changes in circumstances affecting capital assets to determine whether impairment of a capital asset has occurred. A capital asset is generally considered impaired if both (a) the decline in service utility of the capital asset is large in magnitude, and (b) the event or change in circumstance is outside the normal life cycle of the capital asset. No impairment losses were recognized in the years ended June 30, 2011 and 2010.

Revenues and Expenses

Revenues and expenses are distinguished between operating and non-operating items. Operating revenues generally result from providing services, producing, and delivering goods in connection with the System's principal ongoing operations. The principal operating revenues of the System are charges to customers for sales and services. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Net Assets

GASB 34 requires the classification of net assets into three components - invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- *Invested in Capital Assets, Net of Related Debt* – This component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds.

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

- *Unrestricted Net Assets* – This component of net assets consists of net assets that do not meet the definition of "invested in capital assets, net of related debt" or "restricted".

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

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

Income Tax Status

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

Subsequent Events

Subsequent events have been evaluated through November 21, 2011, which is the date the financial statements were available to be issued.

NOTE 2 – UTILITY PLANT AND DEPRECIATION PROCEDURES

A summary of changes in major classifications of the utility plant in service is as follows:

	Balance June 30, 2010	Additions	Reclassifications/ Retirements	Balance June 30, 2011
Utility plant not depreciated:				
Land	$ 425,715	$ -	$ -	$ 425,715
Construction in progress-electric	1,144,936	2,362,370	-	3,507,306
Construction in progress-telecom	8,833,683	-	6,096,080	2,737,603
Total utility plant not depreciated	10,404,334	2,362,370	6,096,080	6,670,624
Utility plant depreciated:				
Transmission plant	635,276	-	-	635,276
Distribution plant	21,064,909	813,697	263,736	21,614,870
General plant	4,905,320	74,239	4,350	4,975,209
Telecommunications plant	4,206,574	6,949,982	27,905	11,128,651
Total utility plant depreciated	30,812,079	7,837,918	295,991	38,354,006
Accumulated depreciation	(13,546,381)	(995,453)	375,030	(14,166,804)
Total utility plant depreciated, net	17,265,698	6,842,465	(79,039)	24,187,202
Total utility plant	$ 27,670,032	$ 9,204,835	$ 6,017,041	$ 30,857,826

Transmission Plant depreciation rates have been applied on a straight-line basis and are as follows:

Towers and fixtures	2.00%
Poles and fixtures	3.00

HOPKINSVILLE ELECTRIC SYSTEM
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NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011 AND 2010

NOTE 2 – UTILITY PLANT AND DEPRECIATION PROCEDURES, continued

Provision has been made for depreciation of Distribution Plant on a straight-line basis and rates are as follows:

Station equipment	4.00%
Poles, towers, and fixtures	4.00
Overhead conductors and devices	1.75
Underground equipment	4.00
Line transformers	2.00
Services	5.25
Meters	2.00
Security lighting	6.00
Street lighting and signal systems	3.75

General Plant depreciation rates have been applied on a straight-line basis and are as follows:

Structures and improvements	3.00%
Office furniture	VAR
Transportation equipment	25.00
Laboratory equipment	8.00

Transactions through the Accumulated Provision for Depreciation account for the years ended June 30, 2011 and 2010 are summarized as follows:

	2011	2010
Accumulated provision for depreciation, July 1	$ 13,546,381	$ 12,906,681
Add:		
Depreciation charged directly to expense	898,117	861,262
Depreciation charged to transportation - clearing	97,336	108,067
Subtotal	14,541,834	13,876,010
Deduct:		
Original cost of plant retired	295,990	317,205
Cost of removal less salvage	79,040	12,424
Total charges against provision	375,030	329,629
Accumulated provision for depreciation, June 30	$ 14,166,804	$ 13,546,381

NOTE 3 – INVESTMENTS – SPECIAL FUNDS

Investments - Special Funds at June 30 consisted of:

	2011	2010
Operation and maintenance fund	$ 700,000	$ 700,000
Revenue bond sinking fund	148,816	148,840
Debt service reserve fund	238,992	238,823
Depreciation reserve fund	492,274	491,926
2007 Telecom bond issue fund	744,418	744,322
Savings Account - BB&T	389,967	1,933,816
Construction fund	61,078	61,034
Total investments - special funds	$ 2,775,545	$ 4,318,761

Excess monies in the above funds have been invested in certificates of deposit at local banks and in trust for short-term U.S. Government securities.

The operation and maintenance fund, established by the bond ordinance, is a reserve for extraordinary costs of operating and maintaining the plant over and above ordinary operation and maintenance.

In order to provide for the payment of the Debt Service on the Series 1998-A bonds, the Revenue Bond Sinking Fund was established. The total amount required in the Sinking Fund was $114,273 for the 1998-A bonds at June 30, 2011, and $114,419 at June 30, 2010.

The Debt Service Fund was established for security in the event monies on deposit in the sinking fund are insufficient to pay principal and interest when due on the Series 1998-A bonds. The bond ordinance required the reserve fund to accumulate "an amount equal to not less than the maximum amount of principal and interest requirements falling due in any twelve-month period on all of the outstanding bonds or such lesser amount equal to 10% of the principal amount issued of all bonds." At June 30, 2011, the required reserve balance was $75,000. The actual reserve balance was $238,992 resulting in an overfunding of $163,992 in the reserve fund.

The existence of the Depreciation Reserve Fund is in accordance with the 1998-A bond ordinance, which established a fund "to provide monies which will be available for necessary and anticipated renewals, replacements, extensions, improvements, acquisitions and additions to the Plant". The ordinances call for $71,200 to be set aside each fiscal year until the sum of $356,000 is reached. At June 30, 2011 this requirement was met and no additional deposits were needed.

At year end, the amount of total investments held in banks was $2,775,545, all of which was covered by collateral held in safekeeping by agents of the respective banks or by government backed securities.

NOTE 3 – INVESTMENTS - SPECIAL FUNDS, continued

The System has invested Other Special Funds in repurchase agreements with local banks. Securities investments that the company has the positive intent and the ability to hold to maturity are classified as held-to-maturity securities and are recorded in investments and other assets at amortized cost, which approximates fair value.

Included in total investments of $2,775,545 are the following held-to-maturity investments. The remaining funds of $2,075,545 are invested in cash equivalents.

	Cost	Fair Value	Unrealized Gain	Unrealized Loss
Held-to-maturity securities repurchase agreements	$ 700,000	$ 700,000	$ -	$ -

Investment income included in the Statement of Revenues and Expenditures is summarized as follows:

	2011	2010
Listed	$ 51,771	$ 62,269
Deposits	4,193	7,439
	$ 55,964	$ 69,708

Interest Rate Risk

The System does not have a formal investment policy that limits its investment maturities as a means of managing its exposure to losses arising from changes in interest rates. In general, certificates of deposit are not subject to interest rate risk.

Custodial Credit Risk

Under Kentucky Revised Statutes Section 66.480, the System is authorized to invest in obligations of the United States and its agencies and instrumentalities, obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States or of its agencies, obligations of any corporation of the United States government, certificates of deposit, commercial paper rated in one of the three highest categories by nationally recognized rating agencies and shares in mutual funds. For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the System will not be able to recover the value of its investments held in possession of an outside party. The System does not have an investment policy that would further limit its investment choices. In general, certificates of deposit are not subject to investment credit risk.

NOTE 4 – CASH - GENERAL FUND

The carrying amounts are reflected in the financial statements as follows:

	2011	2010
Change funds	$ 1,750	$ 2,000
Checking accounts	2,182,377	2,232,345
TVA power bill early payment	78	47
Other	1,250	1,250
Total	$ 2,185,455	$ 2,235,643

Custodial Credit Risk

Custodial credit risk is the risk that, in the event of a depository institution failure, the System's deposits may not be returned to it. The System does not have a policy regarding custodial credit risk for deposits.

State law requires collateralization of all deposits with federal depository insurance; bonds and other obligations of the U.S. Treasury, U.S. agencies or instrumentalities of the State of Kentucky; bonds of any city, county, school district or special road district of the State of Kentucky; bonds of any state; or a surety bond having an aggregate value at least equal to the amount of deposits.

At June 30, 2011, the Board's deposits in depository institutions had a carrying amount of $2,182,377 and bank balances of $2,256,820. At June 30, 2011, the deposits were covered entirely by FDIC insurance or a properly executed collateral security agreement. At June 30, 2010, the System's deposits in depository institutions had a carrying amount of $2,232,345 and bank balances of $2,308,462. At June 30, 2010, the deposits were covered entirely by FDIC insurance or a properly executed collateral security agreement.

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
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NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011 AND 2010

NOTE 5 – RECEIVABLES

Net receivables include the following at June 30:

	2011	2010
Accounts Receivable		
Electric	$ 3,124,382	$ 3,275,584
TVA - line loss true-up	-	395,499
	3,124,382	3,671,083
Other Receivables		
Employee appliance/computer loans	27,332	15,454
FEMA receivable	25,597	25,597
Other miscellaneous	11,422	11,296
	64,351	52,347
Total Receivables	3,188,733	3,723,430
Less: Reserve for Uncollectible Accounts	(25,915)	(23,179)
Total	$ 3,162,818	$ 3,700,251

Electric accounts and miscellaneous accounts together with the current billing for home insulation, heat pump, and wood burning stove loans, were aged as follows:

	June 30, 2011		June 30, 2010	
	Amount	Percent	Amount	Percent
Accounts Having Discount Dates After June 30	$ 2,748,911	86.21	$ 3,477,419	93.39
Accounts With Credit Balances	-	-	-	-
Accounts Less Than One Month Past Due	-	-	-	-
Accounts 31 to 60 Days Past Due	67,727	2.12	78,341	2.10
Accounts 61 to 90 Days Past Due	34,774	1.10	20,942	0.56
Accounts Over 90 Days Past Due	337,321	9.86	146,728	3.94
	$ 3,188,733	99.29	$ 3,723,430	100.00

NOTE 5 – RECEIVABLES, continued

A reserve for uncollectible electric accounts is maintained by means of monthly charges to operations. Lists of accounts considered to be worthless are charged to the reserve account annually, with the last such list having been prepared as of June 30, 2011. Accounts charged off are turned over to various agencies for collection as authorized by HES.

A summary of the reserve's transactions for each year is as follows:

	2011	2010
Beginning balance	$ 23,179	$ 18,214
Monthly additions and adjustments	169,258	89,000
Charge-off of bad accounts	(170,550)	(119,118)
Recoveries	4,028	35,083
Balance, June 30	$ 25,915	$ 23,179

NOTE 6 – MATERIAL AND SUPPLIES

The values of electric materials at balance sheet dates were ascertained by reference to perpetual inventory records. Hopkinsville Electric System personnel make physical counts of stock at the end of each year and adjust the perpetual inventory records to actual count. The adjustment to the general ledger control is made to bring it into conformity with perpetual stock records. This amount is charged against stores expense (clearing) in January of each year. The positive (negative) adjustments required were ($880) and $3,796 as of June 30, 2011 and 2010, respectively.

NOTE 7 – DEFERRED CHARGES

Deferred Charges at June 30 consisted of:

	2011	2010
Deferred costs on bond issue-2004	$ 2,208	$ 2,464
Deferred costs on bond issue-2007	120,592	130,572
Unamortized debt discount-1998	6,933	9,749
Unamortized debt discount-2004	23,553	26,674
Unamortized debt discount-2007	32,210	34,876
Customers energy conservation loans-TVA	1,115,398	896,740
Total	$ 1,300,894	$ 1,101,075

NOTE 8 – BONDED INDEBTEDNESS

On August 1, 1999, the System issued Series 1998-A revenue bonds in the amount of $2,945,000 for the purpose of refunding certain outstanding obligations and improving its electric plant distribution system. Payments of interest are paid semi-annually and payments of principal are paid annually with the last principal payment scheduled for February 1, 2014. The debt is secured by revenues of the electric system.

On January 27, 2004, the System entered into a lease with Kentucky League of Cities Funding Trust to fund an electric substation/transformer. Payments of principal and interest are paid monthly with the last principal payment scheduled for February 15, 2019. The interest rate is 3.45 percent. This debt is secured by the property.

On August 1, 2008, the System entered into a lease with Kentucky League of Cities Funding Trust in the amount of $10,189,560 for refunding of the $4,000,000 Electric Revenue Bond Anticipation Notes, Series 2007A and $6,000,000 Electric Revenue Bond Anticipation Notes, Series 2007B. The proceeds of the notes were used to acquire improvements to the electric plant and distribution system, including broadband and telecommunications improvements and to pay issuance costs of the obligations. Payments of principal and interest are paid monthly with the last principal payment schedule for August 1, 2023. The lease is to bear interest at a rate of 3.62% per annum. The debt is secured by revenues of the electric system. Interest paid on the 2007 bonds is capitalized during the construction phase. Capitalized interest for each year is $398,533 and $434,372 for June 30, 2011 and 2010, respectively.

On February 1, 2008, the System entered into a loan agreement with Kentucky Infrastructure Authority in the amount of $3,000,000 to assist in funding the construction of a fiber optic communication line from Hopkinsville, Kentucky to Bowling Green, Kentucky. The loan is to bear interest at 0.7% semi-annually. Interest payment dates for the loan are December 1 or June 1 succeeding the first draw which is at least three months, but no more than nine months, after the first draw. Principal payments will commence on June 1 or December 1 immediately succeeding the date of the last draw of funds. The loan is for ten years. The debt is secured by revenues of the telecommunications system. As of June 30, 2011, the System has received $2,237,847 in loan draws. The project is expected to be completed in the fiscal year 2012. Upon completion of the project, the loan will be converted to a permanent loan.

The changes in outstanding debt are as follows:

	Balance July 1, 2010	New Issues	Debt Payments and Refunds	Balance June 30, 2011
Series 1998-A	$ 980,000	$ -	$ 230,000	$ 750,000
KY League of Cities-Series 2004	2,308,056	-	231,701	2,076,355
Kentucky Infrastructure Authority	2,237,847	-	-	2,237,847
KY League of Cities - Series 2007	9,271,231	-	510,859	8,760,372
	$ 14,797,134	$ -	$ 972,560	$ 13,824,574

NOTE 8 – BONDED INDEBTEDNESS, continued

Accrued interest on the 1998-A bonded indebtedness represents the liability for the periods from February 1, the last payment date, to June 30. The accrued interest for each year is $18,584 and $18,586 for June 30, 2011 and 2010, respectively.

In accordance with the bond ordinance for Series 1998-A, the net revenues, as adjusted, of the System for any fiscal year are to equal at least 1.10 times the maximum annual debt service due in any fiscal year on the outstanding bonds; and that rates will be adjusted so as to produce the necessary revenues. The last rate increase was implemented in October 2010.

The discount associated with the issuance of the revenue bonds payable is being amortized on the straight-line method over the term of the bonds. The amount charged to interest expense for the year ending June 30 follows:

	2011	2010
Series 1998-A	$ 2,817	$ 2,817
Series 2004	3,376	3,376
Series 2007	2,666	2,666
	$ 8,859	$ 8,859

The cost of issuance associated with the issuance of the revenue bonds payable is being amortized on the straight-line method over the term of the bonds. Amortization charged to expense for the year ending June 30 follows:

	2011	2010
Series 2004	$ 256	$ 256
Series 2007	9,980	9,980
	$ 10,236	$ 10,236

NOTE 8 – BONDED INDEBTEDNESS, continued

The following represents principal and interest payments on outstanding debt (excluding the $3,000,000 KIA loan, of which only $2,237,847 has been received as of June 30, 2011. The repayment schedule will be finalized upon completion of draw down of funds.):

	Series 1998-A			Series 2004		
	Principal	Interest	Total	Principal	Interest	Total
2012	$ 240,000	$ 34,254	$ 274,254	$ 240,062	$ 87,638	$ 327,700
2013	250,000	23,334	273,334	248,724	77,183	325,907
2014	260,000	11,960	271,960	257,698	66,402	324,100
2015	-	-	-	266,997	55,201	322,198
2016	-	-	-	253,031	67,280	320,311
2017	-	-	-	310,214	8,069	318,283
2018	-	-	-	296,955	19,247	316,202
2019	-	-	-	202,675	5,716	208,391
	$ 750,000	$ 69,548	$ 819,548	$ 2,076,356	$ 386,736	$ 2,463,092

	Series 2007			All Series Combined		
	Principal	Interest	Total	Principal	Interest	Total
2012	$ 549,540	$ 388,994	$ 938,534	$ 1,029,602	$ 510,886	$ 1,540,488
2013	576,533	363,529	940,062	1,075,257	464,046	1,539,303
2014	603,048	336,896	939,944	1,120,746	415,258	1,536,004
2015	631,409	308,986	940,395	898,406	364,187	1,262,593
2016	660,575	279,872	940,447	913,606	347,152	1,260,758
2017	692,427	249,294	941,721	1,002,641	257,363	1,260,004
2018	724,559	217,300	941,859	1,021,514	236,547	1,258,061
2019	758,608	183,789	942,397	961,283	189,505	1,150,788
2020	793,985	148,760	942,745	793,985	142,019	930,861
2021-2024	2,769,687	220,528	2,990,215	2,769,687	220,528	2,990,215
	$ 8,760,371	$ 2,697,948	$ 11,458,319	$ 11,586,727	$ 3,147,491	$ 14,729,075

NOTE 9 – ADVANCES FROM OTHERS

Advances have been received from Tennessee Valley Authority for the purpose of making long-term loans to electric customers under various energy conservation programs. The balances due Tennessee Valley Authority were $1,138,567 and $910,806 as of June 30, 2011 and 2010, respectively.

NOTE 10 – PENSION PLANS

County Employee Retirement System

Plan Description: Effective August 1, 1988, the Board and the employees elected to discontinue participation in the "Electric Plant Board of the City of Hopkinsville Retirement Plan" and participate in the statewide County Employees' Retirement System (CERS) as provided under Section 78.530 of the Kentucky Revised Statutes. The County Employees' Retirement System, a component unit of the Commonwealth of Kentucky (CERS), is a cost-sharing multiple-employer defined benefit plan. The CERS provides retirement and disability benefits, annual cost-of-living adjustments, medical insurance, and death benefits to Plan members and beneficiaries. Under the provisions of the Kentucky Revised Statutes Section 61.645, the Board of Trustees of Kentucky Retirement Systems administers the CERS and has the ability to establish and amend benefit provisions. The CERS issues a publicly available financial report that includes financial statements and required supplementary information. CERS' report may be obtained by writing to Kentucky Retirement Systems, Perimeter Park West, 1260 Louisville Road, Frankfort, KY 40601-6124 or by calling (502) 564-5656.

Funding Policy: CERS plan members who began participating before September 1, 2008 are required to contribute 5% of their covered salary. Members who began participating on or after September 1, 2008 are required to contribute 6% of their covered salary. The System is required to contribute to the CERS at an actuarially determined rate. The current rate is 16.93% of annual covered payroll. For those employees hired before June 1, 1994, the Hopkinsville Electric System Board elected to pay the entire contribution up to 12.68%. The System's contributions to CERS for the years ending June 30, 2011, 2010 and 2009 were $425,952, $418,599 and $341,947, respectively, equal to the required contributions for the year.

Medical Insurance Plan

Plan Description – In addition to the pension benefits described above, Kentucky Revised Statute 61.702 requires the CERS to provide post-retirement healthcare benefits to eligible members and dependents. The CERS medical insurance benefit is a cost-sharing multiple employer defined benefit plan. Changes made to the medical plan may be made by the Board of Trustees of Kentucky Retirement Systems, the Kentucky Department of Employee Insurance and the General Assembly.

Funding Policy – The post-retirement healthcare provided by CERS is financed on a pay-as-you-go basis. In order to fund the post-retirement healthcare benefit, one and five tenths percent (1.5%) of the gross annual payroll of all active members is contributed. One-half (1/2) of this amount is derived from member contributions and one-half (1/2) from state appropriation. Also, the premiums collected from retirees as described in the plan description and investment interest help with the medical expenses of the plan.

System's Thrift Plan

Plan Description – The System's employees hired after September 1, 1969 have the option to participate in the System's Thrift Plan, which consists of a 401K plan and a 401M plan.

NOTE 10 – PENSION PLANS, continued

Funding Policy – Employees who participate in the Plan may contribute up to 100% (in multiples of 1%) of their base annual compensation. Employees who elect to also participate in the 401M plan are limited to 14% in their contributions. All such amounts were deposited with the trustee, Manulife, Clarksville, Tennessee, to be held or invested in accordance with provisions in the Thrift Plan Trust Agreement executed November 24, 1969. Employer contributions, which totaled $91,591 and $84,570 in the years ended June 30, 2011 and 2010, respectively, are charged monthly to plant and expense in the same ratio as payroll.

NOTE 11 – OTHER CURRENT AND ACCRUED LIABILITIES

Following is a summary of the amounts recorded as other current and accrued liabilities as of June 30, 2011 and 2010:

	2011	2010
Accrued pole rentals	$ 39,015	$ 35,862
Accrued payroll	50,185	37,043
Compensated absences	282,018	237,018
	$ 371,218	$ 309,923

NOTE 12 – COMMITMENTS

Under its wholesale power agreement, dated April 20, 1982, the System is committed to purchase its electric power and energy requirements from the Tennessee Valley Authority (TVA). As provided by amendment dated October 1, 1997, the contract may be terminated by either party at any time upon not less than five years prior written notice. Neither party shall exercise its right to give notice of termination before the date occurring five years after the date of the agreement. The rates paid for such purchases are subject to change periodically by the supplier. As provided by amendment effective October 1, 1999, the System has a decreasing term contract beginning on that date. The term decreases one year each year until the term levels off at five years.

NOTE 13 – RISK MANAGEMENT AND LITIGATION

The System is exposed to various risks of loss related torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees and natural disasters. The System carries commercial insurance for the risks of loss, including worker's compensation, and property and casualty loss insurance. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years. Limits of insurance coverage remain unchanged in the past three years.

From time to time, the System is party to various pending claims and legal proceedings. Although the outcome of such matters cannot be forecast with certainty, it is the opinion of management and legal counsel that the likelihood is remote that any such claims or proceedings will have a material adverse effect on the System's financial statements.

NOTE 14 – CONSTRUCTION WORK IN PROGRESS

The balances of construction work in progress – electric were $3,507,306 and $1,444,936 as of June 30, 2011 and 2010, respectively. Included in the June 30, 2011 balance is $2,905,378 for the automated meter infrastructure project.

The balances of construction work in progress – telecommunications were $2,737,603 and $8,833,683 as of June 30, 2011 and 2010, respectively. Included in the June 30, 2011 balance is $2,281,417 for the fiber optic communications line from Hopkinsville, KY to Bowling Green, KY.

NOTE 15 – RATE INCREASE

Wholesale Base Rates: In April 2011, the Tennessee Valley Authority changed its wholesale rate calculation from one based on actual Retail Customer Usage to one based on Demand and Energy metered at the wholesale delivery point. At the same time TVA implemented rates that change seasonally four times a year, Summer and Winter rates and the transition period in between. Also at the same time TVA separated its "base fuel cost" from its total "base rates" which had been in place since October 2006 and combined it with the current Fuel Cost Adjustment, designating the combined amount as the "Monthly Fuel Cost Adjustment" going forward. The combination of changes resulted in rate increases in the Summer and Winter periods and a rate decrease in the transition periods. As an example of the effect of this change, the wholesale Residential Base Rate for March 2011 was $0.06563 per kWh and the Residential Base Rate for April 2011 was $0.03076 per kWh. TVA increased its wholesale Base Rate effective October 2011 to $0.03176 per kWh.

Fuel Cost Adjustment: In October 2009, TVA changed from a quarterly FCA to monthly FCA. In April 2011, TVA separated its fuel cost, which had been included in its Base Rates prior to the implementation of the quarterly FCA in October 2007, and started to include it in its monthly FCA. The wholesale FCA for March 2011 was $0.00613 per kWh, after this change the wholesale FCA for April 2011 was $ 0.02376 per KwH. The FCA for October 2011 is $0.02332 per kWh.

Environmental Charge: In October 2003, TVA added a charge to its wholesale rates to recover its cost to add equipment to its generation facilities to meet government environmental standards. The charge is a fixed amount and is $0.00186 per kWh under the new Demand and Energy rate structure. The charge will automatically expire in September 2013.

Retail Adder: The System's margin is provided by a Retail Adder. The System's adder has not been changed since July 2010.

NOTE 16 – PRIOR PERIOD ADJUSTMENT

A prior period adjustment was made to prior year net assets in order to reclassify expenses from the Ice Storm of 2010 project. These expenses had originally been recorded as construction work in progress with the offsetting FEMA receivable recorded as revenues for fiscal year ending June 30, 2010. The entry was made to accommodate a matching of revenues and expenses by reclassifying the expenses from an asset to an expense. The end result was a decrease in net assets of the prior year of $381,133.

SUPPLEMENTARY INFORMATION

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
COMBINED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2011

	ELECTRIC	TELECOM	TOTAL
OPERATING REVENUES	$ 35,557,762	$ 1,872,628	$ 37,430,390
OPERATING EXPENSES			
Cost of power	28,790,302	-	28,790,302
Cost of sales - telecom	-	210,946	210,946
Distribution - operation	674,665	516,371	1,191,036
- maintenance	893,923	24,058	917,981
Transmission - maintenance	-	-	-
Customer accounts	802,882	10,633	813,515
Sales	57,504	37,909	95,413
Administrative and general	1,588,970	348,346	1,937,316
Depreciation and amortization	637,215	260,903	898,118
Taxes	1,372,666	181,294	1,553,960
Total operating expenses	34,818,127	1,590,460	36,408,587
Net operating revenues	739,635	282,168	1,021,803
NONOPERATING REVENUES (EXPENSES)			
Interest on long-term debt	(118,380)	(55,181)	(173,561)
Other interest	(37,753)	-	(37,753)
Amortization of debt expense	(10,236)	-	(10,236)
Interest income	52,514	3,450	55,964
Other income (expenses)	8,861	-	8,861
Total nonoperating revenues (expenses)	(104,994)	(51,731)	(156,725)
CHANGE IN NET ASSETS	634,641	230,437	865,078
NET ASSETS - BEGINNING OF YEAR	20,269,901	(1,261,010)	19,008,891
NET ASSETS - END OF YEAR	$ 20,904,542	$ (1,030,573)	$ 19,873,969

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
COMPARATIVE STATEMENT OF REVENUES AND EXPENSES - ELECTRIC
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010

	ELECTRIC 2011	ELECTRIC 2010	VARIANCE FAVORABLE (UNFAVORABLE)
OPERATING REVENUES	$ 35,557,762	$ 32,326,876	$ 3,230,886
OPERATING EXPENSES			
Cost of power	28,790,302	25,013,112	(3,777,190)
Distribution - operation	674,665	725,681	51,016
- maintenance	893,923	726,845	(167,078)
Transmission - maintenance	-	13,045	13,045
Customer accounts	802,882	710,689	(92,193)
Sales	57,504	63,023	5,519
Administrative and general	1,588,970	1,507,546	(81,424)
Depreciation	637,215	612,710	(24,505)
Taxes	1,372,666	1,259,838	(112,828)
Total operating expenses	34,818,127	30,632,489	(4,185,638)
Net operating revenues	739,635	1,694,387	(954,752)
NONOPERATING REVENUES (EXPENSES)			
Interest on long-term debt	(118,380)	(131,039)	12,659
Other interest	(37,753)	(33,943)	(3,810)
Amortization of debt expense	(10,236)	(10,236)	-
Interest income	52,514	62,444	(9,930)
Other revenues (expenses)	8,861	(377)	9,238
Total nonoperating revenues (expenses)	(104,994)	(113,151)	8,157
CHANGE IN NET ASSETS	$ 634,641	$ 1,581,236	$ (946,595)

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
COMPARATIVE STATEMENT OF REVENUES AND EXPENSES - TELECOMMUNICATIONS
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010

	TELECOM 2011	TELECOM 2010	VARIANCE FAVORABLE (UNFAVORABLE)
OPERATING REVENUES	$ 1,872,628	$ 1,602,059	$ 270,569
OPERATING EXPENSES			
Cost of sales - telecom	210,946	158,690	(52,256)
Distribution - operation	516,371	442,433	(73,938)
- maintenance	24,058	17,409	(6,649)
Customer accounts	10,633	16,352	5,719
Sales	37,909	42,436	4,527
Administrative and general	348,346	275,743	(72,603)
Depreciation and amortization	260,903	248,552	(12,351)
Taxes	181,294	155,921	(25,373)
Total operating expenses	1,590,460	1,357,536	(232,924)
Net operating revenues	282,168	244,523	37,645
NONOPERATING REVENUES (EXPENSES)			
Interest on long-term debt	(55,181)	(35,266)	(19,915)
Interest income	3,450	7,264	(3,814)
Total nonoperating revenues (expenses)	(51,731)	(28,002)	(23,729)
CHANGE IN NET ASSETS	$ 230,437	$ 216,522	$ 13,916

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
COMPARATIVE ANALYSIS OF OPERATING EXPENSES - ELECTRIC

	For the Year Ended June 30, 2011			For the Year Ended June 30, 2010			
	Amount	Percent		Amount	Percent		Increase (Decrease)
Distribution							
Supervision & engineering	$ 96,463	0.27	%	$ 94,110	0.29	%	$ 2,353
Station expense	116,875	0.33		143,170	0.44		(26,295)
Overhead lines expense	239,456	0.67		205,870	0.64		33,586
Street light & signal system expense	29,555	0.08		31,063	0.10		(1,508)
Meter expense	86,197	0.24		144,607	0.45		(58,410)
Customer installation expense	32,654	0.09		35,736	0.11		(3,082)
Miscellaneous distribution expense	21,504	0.06		21,176	0.07		328
Rents	51,961	0.15		49,949	0.15		2,012
Total distribution	$ 674,665	1.89	%	$ 725,681	2.25	%	$ (51,016)
Maintenance expense							
Distribution:							
Supervision & engineering	$ 17,907	0.05	%	$ 17,334	0.05	%	$ 573
Substations	1,319	0.00		2,834	0.01		(1,515)
Overhead lines	807,557	2.27		649,524	2.01		158,033
Underground services	6,932	0.02		8,253	0.03		(1,321)
Transformers	40,654	0.11		29,356	0.09		11,298
Street light & signal system	19,554	0.05		19,543	0.06		11
Meters	-	0.00		-	0.00		-
Total distribution maintenance	$ 893,923	2.50	%	$ 726,845	2.25	%	$ 167,078
Transmission:							
Maintenance of overhead lines	$ -	0.00	%	$ 13,045	0.04	%	$ (13,045)
Total transmission maintenance	$ -	0.00	%	$ 13,045	0.04	%	$ (13,045)
Customer accounts							
Supervision	$ 1,036	0.00	%	$ 1,036	0.00	%	$ -
Meter reading	98,307	0.28		109,747	0.34		(11,440)
Customer records & collection expense	437,176	1.23		421,522	1.30		15,654
Uncollectible accounts	161,169	0.45		84,106	0.26		77,063
Miscellaneous customer accounting expense	3,916	0.01		3,932	0.01		(16)
Customer assistance expense	50,447	0.14		44,818	0.14		5,629
Information & instructional advertising	50,831	0.14		45,527	0.14		5,304
Total customer accounts	$ 802,882	2.25	%	$ 710,689	2.19	%	$ 92,193

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
COMPARATIVE ANALYSIS OF OPERATING EXPENSES - ELECTRIC, continued

	For the Year Ended June 30, 2011		For the Year Ended June 30, 2010		Increase
	Amount	Percent	Amount	Percent	(Decrease)
Sales expense					
Demonstrating and selling expense	$ 36,192	0.10 %	$ 43,283	0.13 %	$ (7,091)
Advertising expense	20,333	0.06	18,757	0.06	1,576
Miscellaneous	979	0.00	983	0.00	(4)
Total sales	$ 57,504	0.16 %	$ 63,023	0.19 %	$ (5,519)
Administrative and general					
Administrative & office salaries	$ 326,201	0.92 %	$ 314,273	0.97 %	$ 11,928
Office supplies & expense	149,223	0.42	132,585	0.41	16,638
Outside services employed	71,124	0.20	51,525	0.16	19,599
Property insurance	112,537	0.32	117,344	0.36	(4,807)
Injuries & damages	34,537	0.10	34,857	0.11	(320)
Employees pension & other benefits	743,335	2.09	724,860	2.24	18,475
Duplicate charges (credit)	(101,426)	(0.29)	(94,757)	(0.26)	(6,669)
Miscellaneous general expense	108,309	0.30	89,937	0.27	18,372
Maintenance	145,130	0.41	136,923	0.41	8,207
Total administrative and general	$ 1,588,970	4.47 %	$ 1,507,546	4.67 %	$ 81,424

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
COMPARATIVE ANALYSIS OF OPERATING EXPENSES - TELECOMMUNICATIONS

	For the Year Ended June 30, 2011			For the Year Ended June 30, 2010			Increase
	Amount	Percent		Amount	Percent		(Decrease)
Distribution							
Supervision & engineering	$ 83,110	4.44	%	$ 79,825	4.98	%	$ 3,284
Hub expenses	22,068	1.18		23,785	1.48		(1,717)
Overhead cable expense	240,838	12.86		186,634	11.65		54,204
Meter expense	57	0.00		13	0.00		45
Customer installation expense	128,859	6.88		112,165	7.00		16,694
Miscellaneous distribution expense	9,495	0.51		9,279	0.58		216
Underground expense	1,025	0.05		-	0.00		1,025
Rents	30,919	1.65		30,732	1.92		187
Total distribution	$ 516,371	27.57	%	$ 442,433	27.61	%	$ 73,938
Maintenance expense							
Distribution:							
Supervision & engineering	$ 11,936	0.64	%	$ 11,979	0.75	%	$ (43)
Hub expenses	4,339	0.23		-	0.00		4,339
General maintenance	7,783	0.42		5,430	0.33		2,353
Total distribution maintenance	$ 24,058	1.29	%	$ 17,409	1.08	%	$ 6,649
Customer accounts							
Billing expense	$ 1,424	0.08	%	$ 2,603	0.16	%	$ (1,179)
Customer records & collection expense	1,885	0.10		3,111	0.20		(1,226)
Customer assistance expense	7,324	0.39		10,638	0.66		(3,314)
Total customer accounts	$ 10,633	0.57	%	$ 16,352	1.02	%	$ (5,719)

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
COMPARATIVE ANALYSIS OF OPERATING EXPENSES -
TELECOMMUNICATIONS, continued

	For the Year Ended June 30, 2011		For the Year Ended June 30, 2010		Increase
	Amount	Percent	Amount	Percent	(Decrease)
Sales expense					
Demonstrating and selling expense	$ 13,666	0.73 %	$ 19,291	1.20 %	$ (5,626)
Advertising expense	24,243	1.29	23,145	1.44	1,098
Total sales	$ 37,909	2.02 %	$ 42,436	2.64 %	$ (4,528)
Administrative and general					
Administrative & office salaries	$ 58,440	3.12 %	$ 59,760	3.73 %	$ (1,320)
Office supplies & expense	23,797	1.27	19,363	1.21	4,434
Meeting expenses	1,185	0.06	2,511	0.16	(1,326)
Outside services employed	10,363	0.55	8,176	0.51	2,187
Property insurance	13,073	0.70	13,027	0.81	46
Injuries & damages	17,576	0.94	11,353	0.71	6,223
Employees pension & other benefits	136,269	7.28	117,694	7.35	18,575
Miscellaneous general expense	1,107	0.06	1,206	0.08	(99)
Maintenance	86,536	4.62	42,653	2.65	43,883
Total administrative and general	$ 348,346	18.60 %	$ 275,743	17.21 %	$ 72,604

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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PEFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of the
Hopkinsville Electric System of the
City of Hopkinsville, Kentucky
Hopkinsville, Kentucky

We have audited the financial statements of the Hopkinsville Electric System of the City of Hopkinsville, Kentucky as of and for the years ended June 30, 2011 and 2010, and have issued our report thereon dated November 21, 2011. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audits, we considered the Hopkinsville Electric System of the City of Hopkinsville, Kentucky's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Hopkinsville Electric System of the City of Hopkinsville, Kentucky's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Hopkinsville Electric System of the City of Hopkinsville, Kentucky's internal control over financial reporting.

A *deficiency in internal* control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified a certain deficiency in internal control over financial reporting, as described in the accompanying schedule of findings and responses that we consider to be a significant deficiency in internal control over financial reporting (item 2011-1). A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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Compliance and Other Matters

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

The Hopkinsville Electric System of the City of Hopkinsville, Kentucky's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. We did not audit Hopkinsville Electric System's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Board of Directors, management, others within the organization, Tennessee Valley Authority and supplemental lenders, and is not intended to be and should not be used by anyone other than these specified parties.

Kem, Duguid & Associates, P.S.C.

Kem, Duguid & Associates, P.S.C.

Certified Public Accountants
Hopkinsville, Kentucky

November 21, 2011

HOPKINSVILLE ELECTRIC SYSTEM
OF THE
CITY OF HOPKINSVILLE, KENTUCKY
SUMMARY SCHEDULE OF FINDINGS AND RESPONSES
JUNE 30, 2011

2011-01 Internal Controls

Condition: The System does not have control over the preparation of the financial statements footnote disclosures in order to prevent or detect a misstatement in the disclosures. The independent auditor cannot be a compensating control for the client.

Criteria: Statement on Auditing Standards (SAS 115) states that a control deficiency exists when an entity does not have controls in place which would prevent or detect a misstatement in the financial statements and related footnote disclosures.

Effect: Lack of accountability and possible misstatement of financial statement footnote disclosures.

Recommendation: The System should designate an individual who possesses suitable skill, knowledge, and/or experience to review the financial statements footnote disclosures, and take responsibility for these disclosures.

Response: It is not feasible for the System to invest the resources for a member of the financial accounting staff to obtain the training necessary to obtain knowledge related to Financial Accounting Standards Board (FASB) and Government Accounting Standards Board (GASB) pronouncements and to remain current with this knowledge. Management does not consider the deficiency to be imperative to the daily internal control operations of the System.