Heartland Consumers Power District

Independent Auditor's Report
and Financial Statements

December 31, 2015 and 2014

BKD LLP
CPAs & Advisors

Heartland Consumers Power District

December 31, 2015 and 2014

Contents

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Independent Auditor's Report

Board of Directors
Heartland Consumers Power District
Madison, South Dakota

Report on the Financial Statements

We have audited the accompanying basic financial statements, which are comprised of balance sheets as of December 31, 2015 and 2014, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended and the related notes to the basic financial statements, as listed in the table of contents, of Heartland Consumers Power District (the District).

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Heartland Consumers Power District as of December 31, 2015 and 2014, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Notes 1 and 9 to the financial statements, in 2015 the District implemented the provisions of Governmental Accounting Standards Board Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27*, as amended by GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment of GASB Statement No. 68*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

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

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the District's basic financial statements. The accompanying schedule of expenditures of federal awards required by Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, as listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the basic 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 basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Information

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the District's basic financial statements. The schedules of transmission operation and maintenance expenses and of administrative and general expenses listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 31, 2016, on our consideration of the District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

BKD, LLP

Lincoln, Nebraska
March 31, 2016

MANAGEMENT'S DISCUSSION AND ANALYSIS

This discussion and analysis of Heartland Consumers Power District's (Heartland or HCPD) financial statements provides the reader an overview of the financial activities for 2015, 2014 and 2013. Heartland's financial statements are comprised of three components: (1) Management's Discussion and Analysis, (2) financial statements, and (3) notes to the financial statements. Please read this in conjunction with the audited financial statements and footnotes contained herein.

Overview of Financial Statements

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

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

	Net Position as of December 31,			Fiscal Year-to-Year Percentage Change	
	2015	2014	2013*	From 2014 to 2015	From 2013 to 2014
Current assets	$ 25,552	$ 19,254	$ 19,180	32.7%	0.4%
Capital assets, net	20,260	19,862	19,481	2.0%	2.0%
Other noncurrent assets	8,601	22,833	18,619	(62.3)%	22.6%
Total assets	54,413	61,949	57,280	(12.2)%	8.2%
Deferred outflows of resources	536	570	-	(6.0)%	100.0%
Total assets and deferred outflows of resources	$ 54,949	$ 62,519	$ 57,280	(12.1)%	9.1%
Current liabilities	$ 14,464	$ 16,344	$ 11,715	(11.5)%	39.5%
Noncurrent liabilities	12,667	28,980	36,159	(56.3)%	(19.9)%
Total liabilities	27,131	45,324	47,874	(40.1)%	(5.3)%
Deferred inflows of resources	426	1,546	1,089	(72.4)%	42.0%
Net investment in capital assets	4,789	(969)	(1,769)	(594.2)%	(45.2)%
Restricted for debt service	6,668	10,660	4,707	(37.4)%	126.5%
Restricted for pensions	370	697	-	(46.9)%	100.0%
Unrestricted	15,565	5,261	5,379	195.9%	(2.2)%
Total net position	27,392	15,649	8,317	75.0%	88.2%
Total liabilities, deferred inflows of resources and net position	$ 54,949	$ 62,519	$ 57,280	(12.1)%	9.1%

* Condensed financials for 2013 have not been restated for the implementation of GASB Statement No. 68 as this information is not available.

Heartland's overall net position increased in 2015, 2014 and 2013 by $11,742,652, $6,997,741 and $1,291,439, respectively. Heartland had reductions in power supply contracts in 2015 that resulted in less cost of power and an increase in net position in 2015. The increase in net position in 2014 was the result of increased customer revenues and decreased expenses. The increase in net position in 2013 was the result of increased customer and off-system sales revenue.

The increased customer revenue in 2015, 2014, and 2013 is attributed to increase in wholesale electric demand and energy rates. The demand and energy rates were increased to meet the costs of power supply generation and maintenance, other operating expenses, debt service, and other financial metrics. Generation and transmission facilities represent 95% of Heartland's total capital assets. The remaining 5% of capital assets includes Heartland's headquarters building, transportation equipment, and office equipment. The level of assets should remain reasonably stable until such time as Laramie River Station (LRS) requires substantial capital improvements.

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

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

Results of Operations

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

				Fiscal Year-to-Year Percentage Change	
	2015 Actual	**2014 Actual**	**2013* Actual**	**From 2014 to 2015**	**From 2013 to 2014**
Power sales					
Customer energy (MWh)	855,651	862,805	869,871	(0.8)%	(0.8)%
Customer cumulative demand (kW)	1,433,896	1,452,937	1,457,163	(1.3)%	(0.3)%
Revenues					
Customer revenue	$ 62,717	$ 60,953	$ 60,018	2.9%	1.6%
Contracted requirements revenue	12,609	16,462	15,724	(23.4)%	4.7%
Surplus sales revenue	2,976	3,588	6,974	(17.1)%	(48.6)%
Other operating revenue	969	1,079	1,157	(10.2)%	(6.7)%
Total operating revenue	79,271	82,082	83,873	(3.4)%	(2.1)%
Expenses					
LRS production & O&M	8,470	9,230	8,576	(8.2)%	7.6%
Cost of power	46,543	53,153	62,696	(12.4)%	(15.2)%
Transmission	5,439	5,254	4,372	3.5%	20.2%
Depreciation	1,242	1,188	1,110	4.5%	7.0%
Taxes	199	185	192	7.6%	(3.6)%
Administration and general	4,264	4,021	3,864	6.0%	4.1%
Amortization	203	195	324	4.1%	(39.8)%
Total operating expenses	66,360	73,226	81,134	(9.4)%	(9.7)%
Operating income	12,911	8,856	2,739	45.8%	223.3%
Total nonoperating expenses, net	(1,168)	(1,858)	(1,448)	(37.1)%	28.3%
Change in net position	11,743	6,998	1,291	67.8%	442.1%
Net position, beginning of year (as restated - 2015 and 2014)	15,649	8,651	7,026		
Net position, end of year	$ 27,392	$ 15,649	$ 8,317		

* Condensed financials for 2013 have not been restated for the implementation of GASB Statement No. 68 as this information is not available.

Operating revenues include firm power sales to Heartland's wholesale rate customers, other contracted sales, short-term energy sales on the surplus market, and other revenues. Demand and energy sales for 2015 were 1,443 MW and 855,651 MWh, respectively. The 2015 peak demand of Heartland's long-term wholesale customers was 135.7 MW. Heartland's wholesale customer demand and energy sales for 2014 were 1,453 MW and 862,805 MWh. Heartland's customer demand and energy sales for 2013 were 1,457 MW and 869,871 MWh, respectively. Heartland's wholesale customer peak demand for 2014 and 2013 were 138.3 MW and 141.9 MW, respectively.

Heartland has other energy sales contracts, in addition to its wholesale customers. The contracted requirements revenue mitigates exposure to the surplus market for excess power and the contracts typically contain fixed pricing and quantities. Many of these contracts are unit contingent and Heartland is not required to provide replacement power. These revenues decreased in 2015 due to scheduled and unscheduled unit outages exceeding 2014. Contracted requirements revenue increased in 2014 due to additional energy available for a unit contingent contract and increased pricing.

Surplus energy sales are the sales of energy produced by Heartland's resources in excess of the energy required by Heartland's customers and other contracts. These sales are considered short term and non-firm. The quantity of surplus energy and revenue is dependent upon multiple factors including availability of resources, customer and other contract requirements, and market and contractual pricing. Heartland has contracted with other parties for a lot of its excess energy and the market prices have declined resulting in less 2015 surplus sales compared to 2014. The decrease in 2014 is due to less excess energy being available for sale due to a contract with Nebraska Public Power District for Cooper Nuclear Station ending in 2013.

The operating expenses fluctuated in some areas. Production expenses (the cost for coal, transportation, and operations and maintenance at Laramie River Station (LRS)) decreased 8.2% in 2015. The largest reason for the decrease was a reduction in generation compared to 2014. LRS unit 1 did not generate as many MWh in 2015 due to maintenance outages and decreased market dispatch. Production expenses increased by 7.6% in 2014, primarily due to increased operations and maintenance at LRS. Unit 2 and 3 had unscheduled preventative maintenance to repair their low pressure turbines.

Heartland purchases power, in addition to its ownership share in LRS, to meet the total contract resource obligations to its customers. The purchased power contracts include base-load resources, renewable generation facilities, short-term purchases during peak conditions or during an outage, and additional capacity purchases required to comply with the resource reserve requirements for maintaining regional reliability.

Heartland is a member of Public Power Generation Agency (PPGA), an interlocal agency created under Nebraska statute to build WEC2, a 220 megawatt coal-fired project near Hastings, Nebraska. Heartland's participation in PPGA is for 80 megawatts and Whelan Energy Center 2 (WEC2) became commercial in May of 2011. PPGA financed construction of WEC2 directly, rather than obtaining funding from its members. Heartland has a contract with Hastings Utilities for an additional share of WEC2. This contract decreases annually. Heartland also has a contract with North Iowa Municipal Electric Cooperative Association (NIMECA) in which NIMECA purchases output of WEC2 for the life of the unit. NIMECA's contract includes all owners' costs and increases annually until 2019. The combination of the Hastings Utilities contract reduction and the NIMECA contract increases resulted in reduced cost of power in 2015. The expiration of the contract for Cooper Nuclear Station significantly contributed to the cost of power decreasing by 15% in 2014 compared 2013.

Transmission credits for PPGA's investment in Nebraska Public Power District's transmission system were passed on to PPGA's partners. These credits started on the commercial operation of WEC2 and were fully utilized in 2013. This resulted in increased 2014 transmission expense compared to 2013.

The nonoperating revenues/expenses include interest on bonds, investment income, and amortization of deferred gains and losses on refunding from earlier bonds issues. Heartland's debt service coverage (as defined in the senior bond resolution) for 2015 and 2014 was 3.21 and 5.22, respectively. The debt service coverage was 2.80 in 2013. The minimum coverage required by the bond resolutions was increased to 1.35 in 2010.

In March 2015, Heartland completed a transaction to defease the remainder of its Electric System Revenue Bonds, Series 1992. Heartland used fully funded reserve accounts, previously established, to pay the final two years of debt service of the Series 1992, bond to defease the remaining $9,760,000. In addition to the defeasance, Heartland made payments of $4,645,590 on revenue bonds and notes. Principal payments in 2014 and 2013 were $703,401 and $674,017, respectively. Additions to plant in service were primarily the result of improvements to the Missouri Basin Power Project, which includes LRS and various associated transmission facilities. There were no significant additions in 2015, 2014, or 2013.

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

Contact Information

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

Heartland Consumers Power District

Balance Sheets

December 31, 2015 and 2014

Assets and Deferred Outflows of Resources

	2015	2014 (As Restated- See Note 1)
Current Assets		
Cash and cash equivalents	$ 4,030,999	$ 2,152,093
Restricted cash and cash equivalents	6,951,367	2,648,430
Short-term investments	2,387,702	2,735,488
Accounts receivable	8,082,970	7,663,980
Notes receivable, current portion	427,767	354,769
Plant operation assets	3,560,089	3,596,365
Prepaid expenses and other current assets	111,072	102,953
Total current assets	25,551,966	19,254,078
Noncurrent Assets		
Notes receivable, net of allowance of $326,772 for 2015 and $316,414 for 2014	2,816,366	1,846,569
Restricted deposits and investments	-	16,124,350
Long-term investments	2,327,533	834,155
Capital assets, net	20,260,272	19,861,910
Costs recoverable from future billings	2,792,435	3,035,209
Net pension asset	370,005	697,294
Other noncurrent assets	295,000	295,000
Total noncurrent assets	28,861,611	42,694,487
Deferred Outflows of Resources		
Deferred outflows for pensions	429,423	570,556
Deferred loss on debt defeasance	106,244	-
Total deferred outflows of resources	535,667	570,556
Total assets and deferred outflows of resources	$ 54,949,244	$ 62,519,121

Liabilities, Deferred Inflows of Resources and Net Position

	2015	2014 (As Restated- See Note 1)
Current Liabilities		
Current maturities of long-term debt	$ 6,023,832	$ 5,374,224
Line of credit	-	448,826
Accounts payable	6,548,434	6,964,321
Accrued expenses	412,409	389,032
Accrued interest payable	287,531	763,996
Unearned revenue	1,191,877	2,404,062
Total current liabilities	14,464,083	16,344,461
Noncurrent Liabilities		
Line of credit	4,000,000	-
Long-term debt, net	8,432,331	26,939,540
Unearned revenue	-	1,191,877
Other noncurrent liabilities	235,065	848,859
Total noncurrent liabilities	12,667,396	28,980,276
Total liabilities	27,131,479	45,324,737
Deferred Inflows of Resources		
Deferred inflows for pensions	350,782	807,584
Deferred gain on refunding	75,533	156,513
Reductions of future billings	-	581,489
Total deferred inflows of resources	426,315	1,545,586
Net Position		
Net investment in capital assets	4,789,036	(969,109)
Restricted for debt service	6,667,805	10,659,211
Restricted for pensions	370,005	697,294
Unrestricted	15,564,604	5,261,402
Total net position	27,391,450	15,648,798
Total liabilities, deferred inflows of resources and net position	$ 54,949,244	$ 62,519,121

Heartland Consumers Power District

Statements of Revenues, Expenses and Changes in Net Position

Years Ended December 31, 2015 and 2014

	2015	2014 (As Restated- See Note 1)
Operating Revenues		
Customer requirements	$ 62,716,984	$ 60,952,730
Other contracted requirements	12,609,096	16,461,543
Surplus sales revenue	2,976,217	3,588,241
Other operating revenue	968,729	1,079,019
Total operating revenues	79,271,026	82,081,533
Operating Expenses		
Cost of power	55,013,347	62,383,290
Depreciation and amortization	1,445,041	1,382,110
Transmission	5,439,290	5,254,002
Other	4,462,499	4,205,879
Total operating expenses	66,360,177	73,225,281
Operating Income	12,910,849	8,856,252
Nonoperating Revenues (Expenses)		
Investment income	149,080	443,496
Interest expense	(802,421)	(1,561,793)
Amortization expense	(205,969)	(169,186)
Grant revenue	300,000	-
BNSF settlement (See Note 4)	-	(605,462)
Other	(608,887)	34,434
Net nonoperating expenses	(1,168,197)	(1,858,511)
Change in Net Position	11,742,652	6,997,741
Net Position, Beginning of Year (As Previously Reported)	15,648,798	8,317,397
Adjustment for Implementation of GASB 68		333,660
Net Position, Beginning of Year (As Restated)		8,651,057
Net Position, End of Year	$ 27,391,450	$ 15,648,798

Heartland Consumers Power District

Statements of Cash Flows

Years Ended December 31, 2015 and 2014

	2015	2014 (As Restated- See Note 1)
Operating Activities		
Receipts from customers	$ 63,084,525	$ 60,926,942
Receipts from others	15,766,286	21,370,492
Payments to suppliers	(66,958,232)	(74,496,249)
Payments to employees	(1,345,693)	(1,209,946)
Net cash provided by operating activities	10,546,886	6,591,239
Noncapital Financing Activities		
Advances on revolving line of credit	1,615,718	6,689,731
Payments on revolving line of credit	(2,064,544)	(6,240,905)
Federal grants received	300,000	-
Proceeds from issuance of promissory notes	1,225,000	-
Payments on promissory notes	(175,158)	(175,134)
Remittance of BNSF settlement funds	(628,380)	-
Net cash provided by noncapital financing activities	272,636	273,692
Capital and Related Financing Activities		
Purchase of capital assets	(1,606,250)	(1,450,666)
Payments on revenue bonds and notes	(4,645,590)	(703,401)
Net payments for debt defeasance and refunding	(10,050,000)	-
Interest paid	(1,280,182)	(1,651,780)
Payments for future power projects	-	(190,127)
Net cash used in capital and related financing activities	(17,582,022)	(3,995,974)
Investing Activities		
Proceeds from sales and maturities of investment securities	13,830,000	9,169,189
Purchases of investment securities	(7,190,627)	(7,585,729)
Issuance of notes receivable	(1,600,000)	(150,000)
Repayments of notes receivable	546,847	401,371
Investment income received	188,975	195,340
Net cash provided by investing activities	5,775,195	2,030,171
Change in Cash and Cash Equivalents	(987,305)	4,899,128
Cash and Cash Equivalents, Beginning of Year	10,103,630	5,204,502
Cash and Cash Equivalents, End of Year	$ 9,116,325	$ 10,103,630
Composition of Cash and Cash Equivalents		
Cash and cash equivalents	$ 4,030,999	$ 2,152,093
Restricted cash and cash equivalents	6,951,367	2,648,430
Restricted deposits and investments	-	16,124,350
Total	10,982,366	20,924,873
Less investments not classified as cash equivalents	1,866,041	10,821,243
Total cash and cash equivalents	$ 9,116,325	$ 10,103,630

Heartland Consumers Power District

Statements of Cash Flows - Continued

Years Ended December 31, 2015 and 2014

	2015	2014 (As Restated- See Note 1)
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating income	$ 12,910,849	$ 8,856,252
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation and amortization	1,445,041	1,382,110
Amortization of advance payment received under energy purchase contract	(2,404,062)	(2,404,061)
Changes in balance sheet operating items		
Accounts receivable	(418,990)	215,901
Plant operation assets	35,440	(1,032,097)
Prepaid expenses and other assets	(18,775)	131,317
Net pension asset	327,289	(424,414)
Deferred outflows for pensions	141,133	(509,776)
Accounts payable	(1,052,200)	(354,076)
Accrued liabilities	37,963	(77,501)
Deferred inflows for pensions	(456,802)	807,584
Net Cash Provided by Operating Activities	$ 10,546,886	$ 6,591,239
Supplemental Cash Flows Information		
Capital asset acquisitions included in accounts payable	$ 151,947	$ 117,435
Change in allowance for notes receivable	$ (10,358)	$ 9,434
Recovery of bad debt	$ -	$ 25,000

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

Nature of Operations

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

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

Reporting Entity

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

Basis of Accounting

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

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

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

Use of Estimates

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

Cash Equivalents

Heartland considers all highly liquid investments with an original maturity of three months or less at the date of purchase to be cash equivalents. At December 31, 2015 and 2014, cash equivalents consisted of money market funds.

Investments and Investment Income

Heartland maintains various debt service reserve accounts that are available for debt service obligations. The reserve accounts consist of bank deposits and investments. Investments in money market mutual funds, U.S. Treasury securities and U.S. agency obligations are carried at fair value. Fair value is determined based on quoted market prices or yields currently available on comparable securities of issuers with similar credit ratings.

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

Accounts and Notes Receivable

Accounts receivable are stated at the amount billed to customers. Accounts receivable are ordinarily due 20 days after the issuance of the invoice. Delinquent receivables are charged off as they are deemed uncollectible. Management does not believe an allowance for doubtful accounts is necessary for accounts receivable at December 31, 2015 and 2014, as there were no delinquent accounts. Notes receivable relate to Heartland's economic development program (see Note 3), and amounts due generally follow amortization schedules contained within the related note agreements. Management has established an allowance for doubtful accounts for notes receivable of $326,772 and $316,414 at December 31, 2015 and 2014, respectively.

Plant Operation Assets

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

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

Capital Assets

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

Compensated Absences

Employees earn vacation days at varying rates depending on years of service. In the event of termination, an employee is reimbursed for accumulated vacation time, with no maximum accumulation. Expense and the related liability are recognized when earned and vacation benefits are redeemable as time off or in cash. Employees earn sick leave at the rate of approximately one day per month. Upon normal retirement, an employee can use any accumulated sick time to pay for certain qualified medical expenses. Expense and the related liability for sick leave benefits are recognized when earned to the extent the employee is expected to realize the benefit in cash determined using the termination payment method. Compensated absences expected to be used during the next fiscal year are classified as a current liability in accrued expenses. The remaining balance is reflected as a noncurrent liability.

Regulated Operations

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

Pensions

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

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

Net Position Classification

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

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

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

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

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

Classification of Revenues

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

Income Taxes

Heartland is exempt from federal income taxes as it is a political subdivision of the state of South Dakota. Heartland may be subject to franchise taxes in states in which it operates. Tax expense was $9,660 and $13,680 in 2015 and 2014, respectively.

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

Implementation of New Accounting Principles

In 2015, Heartland implemented the provisions of GASB Statements No. 68, *Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27,* as amended by GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment of GASB Statement No. 68*. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. This Statement establishes standards for measuring and recognizing assets and liabilities, deferred outflows of resources, deferred inflows of resources, and expenses. Note disclosures and required supplementary information requirements about pensions are also addressed. As Heartland's employees participate in the South Dakota Retirement System, implementation of this standard required the District to record its portion of the financial statement items mentioned above in relation to the System, through restatement of its 2014 financial statements. Restatement for adoption of GASB 68 resulted in an increase of $333,660 in net position as of January 1, 2014 and an increase of $126,606 in the change in net position for the year ended December 31, 2014.

In 2015, Heartland also implemented the provisions of GASB Statement No. 69, *Government Combinations and Disposals of Government Operations*. This Statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. As used in this Statement, the term *government combinations* includes a variety of transactions referred to as mergers, acquisitions, and transfers of operations. This Statement requires disclosures to be made about government combinations and disposals of government operations to enable financial statement users to evaluate the nature and financial effects of those transactions. The implementation of this standard did not have a significant impact on Heartland's financial statements.

Note 2: Deposits, Investments and Investment Return

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

Deposits

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

Note 2: Deposits, Investments and Investment Return - Continued

Investments

At December 31, 2015 and 2014, Heartland had the following investments and maturities:

	Fair Value	Maturities in Years: Less Than 1	1-5	6-10	More Than 10	Credit Ratings (Moody's)
December 31, 2015						
Money market mutual funds	$ 9,694,910	$ 9,694,910	$ -	$ -	$ -	Aaa-mf
U.S. Treasury securities	4,382,433	2,385,013	1,997,420	-	-	N/A
U.S. agency obligations	332,800	-	-	-	332,800	Aaa
	$ 14,410,143	$ 12,079,923	$ 1,997,420	$ -	$ 332,800	
December 31, 2014						
Money market mutual funds	$ 9,145,772	$ 9,145,772	$ -	$ -	$ -	Aaa-mf
U.S. Treasury securities	9,151,931	2,642,543	6,509,388	-	-	N/A
U.S. agency obligations	2,761,275	1,151,325	1,110,402	60,660	438,888	Aaa
	$ 21,058,978	$ 12,939,640	$ 7,619,790	$ 60,660	$ 438,888	

Interest Rate Risk

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

Credit Risk

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

Custodial Credit Risk

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

Note 2: Deposits, Investments and Investment Return - Continued

Concentration of Credit Risk

Concentration of credit risk is the risk associated with the amount of investments Heartland has with any one issuer that exceeds 5% or more of its total investments. Investments issued or explicitly guaranteed by the U.S. Government are excluded from this requirement. Heartland's investment policy limits the amount of its investment portfolio that may be invested in any one issuer, other than U.S. government securities, to 10%. No investments at December 31, 2015 or 2014 exceeded 5%.

Summary of Carrying Values

The carrying values of deposits and investments shown above are included in the balance sheets at December 31, 2015 and 2014 as follows:

	2015	2014
Carrying value		
Deposits	$ 1,287,458	$ 3,435,538
Investments	14,410,143	21,058,978
	$ 15,697,601	$ 24,494,516

Included in the deposits shown above is $2,475,000 of certificates of deposits as of December 31, 2014. There were no certificates of deposits as of December 31, 2015.

Included in the following balance sheet captions:

	2015	2014
Current Assets		
Cash and cash equivalents		
Operating funds	$ 297,163	$ 138,843
General reserve funds	2,531,755	2,991
Revolving loan fund program accounts	1,140,292	821,695
Rate stabilization fund	61,789	1,188,564
Total	4,030,999	2,152,093
Restricted cash and cash equivalents		
Energy efficiency and incentive grant fund	59,577	59,524
Wessingtion PPA collateral account	850,000	850,000
General reserve funds	-	797,775
Debt service funds	6,041,790	941,131
Total	6,951,367	2,648,430
Short-term investments - rate stabilization fund	2,387,702	2,735,488

Note 2: Deposits, Investments and Investment Return - Continued

Summary of Carrying Values - Continued

	2015	2014
Noncurrent Assets		
Restricted deposits and investments		
Reserve and contingency account	$ -	$ 803,727
Debt service funds	-	9,735,660
Debt reserve funds	-	5,584,963
Total	-	16,124,350
Long-term investments - rate stabilization fund	2,327,533	834,155
	$ 15,697,601	$ 24,494,516

Investment Return

Investment return for the years ended December 31, 2015 and 2014 consisted of interest income and realized gains of $115,807 and $403,931, respectively. Unrealized gains and losses on restricted investments are deferred and reported as reductions of future billings shown as a deferred inflow of resources in accordance with the regulated operations provisions of GASB Statement No. 62.

Note 3: Notes Receivable

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

Type of Notes	2014 January 1,	2014 Additions	2014 Reductions	2014 December 31,	2014 Due Within One Year
4.0% to 4.5% notes in connection with Heartland's economic development program, payable in annual installments through December 2018	$ 292,512	$ -	$ 68,434	$ 224,078	$ 63,411
3.0% to 6.25% notes in connection with the Intermediary Relending Program Promissory Note (see Note 13), due in monthly installments through January 2024	827,211	150,000	130,187	847,024	111,801
Interest-free notes in connection with the Rural Economic Development Loan Agreement and Rural Economic Development Grant Agreement (see Note 13), due in monthly installments through November 2028	1,649,402	-	202,750	1,446,652	179,557
Allowance for notes receivable	(350,850)	-	(34,434)	(316,416)	-
Total notes receivable, net	$ 2,418,275	$ 150,000	$ 366,937	$ 2,201,338	$ 354,769

Interest income on these notes totaled $33,273 and $39,565 for 2015 and 2014, respectively, and is included within investment income on the statements of revenues, expenses and changes in net position.

Note 4: Capital Assets

Capital assets at December 31, 2015 and 2014 consisted of the following:

	2015	2014
Depreciable assets		
Missouri Basin Power Project	$ 54,555,764	$ 54,566,157
Transmission Project I (TP I)	1,085,293	1,085,293
Transmission Project II (TP II)	6,752,305	6,752,305
Groton substation (TP III)	408,641	408,641
Heartland headquarters building	2,837,333	2,837,333
General plant	759,685	752,277
Total depreciable assets	66,399,021	66,402,006
Nondepreciable assets		
Land	80,402	80,402
Construction in progress	1,280,756	412,892
Total nondepreciable assets	1,361,158	493,294
	$ 67,760,179	$ 66,895,300

Capital assets activity for 2015 and 2014 was:

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

Note 4: Capital Assets - Continued

	2014				
	Beginning Balance	Additions	Retirements	Transfers	Ending Balance
Missouri Basin Power Project	$ 53,004,721	$ 25,546	$ (128,993)	$ 1,664,883	$ 54,566,157
Transmission Project I (TP I)	907,635	-	-	177,658	1,085,293
Transmission Project II (TP II)	6,752,305	-	-	-	6,752,305
Groton substation (TP III)	400,608	8,033	-	-	408,641
Heartland headquarters building	2,837,333	-	-	-	2,837,333
General plant	731,477	20,800	-	-	752,277
Land	80,402	-	-	-	80,402
Construction in progress	741,711	1,643,887	(130,165)	(1,842,541)	412,892
Total capital assets	65,456,192	1,698,266	(259,158)	-	66,895,300
Less accumulated depreciation	(45,974,812)	(1,187,571)	128,993	-	(47,033,390)
Capital assets, net	$ 19,481,380	$ 510,695	$ (130,165)	$ -	$ 19,861,910

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

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

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

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

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

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

Note 4: Capital Assets - Continued

On January 28, 2015, Western Fuels and Burlington Northern Santa Fe (BNSF) filed a joint petition with the Surface Transportation Board (STB) asking the STB to hold the rate proceeding in abeyance due to the fact that the parties had reached a settlement that called for dismissal of the case and vacation of the rate prescription ordered by STB. Heartland recorded an estimated liability of approximately $600,000 at December 31, 2014 for the estimated remittance back to BNSF, in accordance with the settlement terms. This liability is included within other noncurrent liabilities on the balance sheets as of December 31, 2014, and was remitted by Heartland during 2015.

Note 5: Credit Facilities

Line of Credit

Heartland financed certain operating payments through a revolving line of credit with a financial institution that provided for borrowings up to $4,500,000; secured by a subordinate lien on the revenues of Heartland's electric system and certain productive capacity assets. Borrowings under the line of credit bear interest at a variable rate, but not less than 4.0% (4.0% at December 31, 2014). Heartland had $448,826 of outstanding borrowings on this line at December 31, 2014. This line of credit was cancelled in March 2015, upon inception of the revolving credit agreement discussed below.

In March 2015, Heartland entered into a new revolving credit agreement with a financial institution that provides for borrowings up to $25,000,000; secured by a subordinate lien on the revenues of Heartland's electric system. The agreement expires on March 23, 2018, and can be extended at the option of Heartland. Borrowings under the credit agreement bear interest at varying rates, and cannot exceed a maximum rate, as defined in the agreement (1.17% at December 31, 2015). The agreement also provides for standby letters of credit, not to exceed $5,000,000 in the aggregate. The amount available under Heartland's revolving credit agreement is reduced by the amount of any issued standby letters of credit. Heartland had outstanding borrowings of $4,000,000 on this line at December 31, 2015.

Letter of Credit

As financial security for Heartland's performance under certain financial transmission rights and transmission congestion rights in regional transmission organizations in which Heartland participates, Heartland has obtained a standby letter of credit for $1.5 million at December 31, 2015 and 2014. The letter of credit expires September 30, 2016, and can be renewed for an additional one-year term.

Heartland Consumers Power District

Notes to Financial Statements

December 31, 2015 and 2014

Note 6: Long-term Liabilities

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

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

Note 6: Long-term Liabilities - Continued

Long-term liabilities at December 31, 2014 consisted of the following:

	2014				
Type of Debt	**January 1,**	**Additions**	**Reductions**	**December 31,**	**Due Within One Year**
6.0% Electric System Revenue Bonds, Series 1992, due annually on January 1 with a final payment due January 1, 2017	$ 14,225,000	$ -	$ -	$ 14,225,000	$ 4,465,000
4.29% Electric System Second Lien Revenue Note, Series 2010, due quarterly on January 1, April 1, July 1, and October 1 with final payment due on July 1, 2020. Callable at Heartland's option on June 1, 2013	5,385,844	-	703,401	4,682,443	734,066
4.75-5.25% Electric System Second Lien Revenue Bonds, Series 2011, with interest payments due semi-annually and principal payments due on January 1, 2016 and 2017	11,350,000	-	-	11,350,000	-
1.0% Intermediary Relending Program Promissory Note, due annually on October 16 with a final payment due October 16, 2036	650,058	-	25,337	624,721	25,591
1.0% Intermediary Relending Program Promissory Note, due annually on June 25 beginning in 2014 with a final payment due June 25, 2040	436,258	-	27,985	408,273	27,755
0% Rural Economic Development Promissory Note, with principal payments due in monthly installments of $6,852 through July 31, 2019	459,068	-	82,224	376,844	82,224
0% Rural Economic Development Promissory Note, with principal payments due in monthly installments of $3,299 through April 30, 2031	686,071	-	39,588	646,483	39,588
Total bonds and notes payable	33,192,299	-	878,535	32,313,764	5,374,224
Compensated absences	345,319	170,206	207,752	307,773	87,294
Total long-term liabilities	$ 33,537,618	$ 170,206	$ 1,086,287	$ 32,621,537	$ 5,461,518

Note 6: Long-term Liabilities - Continued

Debt service requirements at December 31, 2015 are as follows:

	Principal	Interest	Total
2016	$ 6,023,832	$ 442,413	$ 6,466,245
2017	5,873,962	158,526	6,032,488
2018	274,483	11,005	285,488
2019	240,734	10,478	251,212
2020	193,304	9,960	203,264
2021-2025	974,757	41,563	1,016,320
2026-2030	488,877	27,443	516,320
2031-2035	318,853	12,602	331,455
2036-2040	67,361	2,559	69,920
	$ 14,456,163	$ 716,549	$ 15,172,712

The District has executed three credit agreements with two financial institutions, two for $740,000 and the other for $1,000,000, which is renewed annually. The credit agreements allow Heartland to retain drawing capacity at least equal to the issued and outstanding amount of the Rural Economic Development Promissory Notes. There were no amounts outstanding under these credit agreements at December 31, 2015 and 2014.

The principal and interest on the revenue notes and bonds are payable solely from, and secured solely by, a pledge of and lien on: (1) the revenues of Heartland's electric system, subject to prior payments there from of operation and maintenance expense; (2) the proceeds of the sale of the notes or bonds; and (3) all accounts established under the Bond Resolution, including income, if any, from investments thereof. The total principal and interest remaining to be paid on the secured bonds and notes is approximately $11,925,563, with annual payments expected to require approximately 7% of net revenues in both 2016 and 2017. Principal and interest for the current year and total operating revenues were $5,925,772 and $79,271,026, respectively.

Debt Defeasance

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

Note 7: Power Sales Agreements

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

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

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

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

Note 8: Commitments

Western Area Power Administration (WAPA)

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

Public Power Generation Agency (PPGA)

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

Note 8: Commitments - Continued

Energy Purchase Contracts

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

Note 9: Retirement Plans

Defined Benefit Plan

Plan Description

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

Contributions

Covered employees are required by state statute to contribute a percentage of their salary (6%) to the Plan, and Heartland is required to match the employee contribution. Participating employers may also make an additional contribution of 1.50% of compensation for optional spouse coverage. The contribution requirements of plan members and Heartland are established and may be amended by the Plan's board of trustees. Contributions made to the Plan by Heartland were $99,453 and $97,153 during 2015 and 2014, respectively, and were in accordance with statutory rates. The employees' contributions during 2015 and 2014 were $82,227 and $82,923, respectively, and were in accordance with statutory rates.

Benefits

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

Note 9: Pension Plan - Continued

Defined Benefit Plan - Continued

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

At December 31, 2015 and 2014, the District reported an asset of $370,005 and $697,294, respectively, for its proportionate share of the collective net pension asset for the Plan. The net pension asset was measured as of June 30, 2015, and the total pension liability used to calculate the net pension asset was determined by an actuarial valuation as of that date. The District's proportionate share of the net pension asset was based on the District's share of contributions to the Plan relative to all employer contributions to the plan. At December 31, 2015 and 2014, the District's proportion was 0.087% and 0.097%, respectively.

For the year ended December 31, 2015, the District recognized pension expense of $11,620. For the year ended December 31, 2014, the District recognized pension revenue of $126,606. At December 31, 2015 and 2014, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	December 31, 2015		December 31, 2014	
	Deferred Outflows of Resources	Deferred Inflows of Resources	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ 75,760	$ -	$ 59,001	$ -
Net difference between projected and actual earnings on pension plan investments	-	319,919	-	807,584
Changes of assumptions	293,390	-	455,173	-
Change in Heartland's proportionate share	-	30,863	-	-
Heartland contributions subsequent to the measurement date	60,273	-	56,382	-
Total	$ 429,423	$ 350,782	$ 570,556	$ 807,584

The deferred outflows of resources related to pensions resulting from District contributions subsequent to the measurement date will be recognized as an increase of the net pension asset in the fiscal year ending December 31, 2016. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year Ending December 31,	
2016	$ 8,560
2017	8,560
2018	(56,139)
2019	57,387

Note 9: Pension Plan - Continued

Defined Benefit Plan - Continued

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

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

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

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

The actuarial assumptions used in the June 30, 2015 valuation were based on the results of an actuarial experience study, which covered the five-year period ending June 30, 2010.

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

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Global Equity	61%	4.5%
Fixed Income	27%	1.8%
Real Estate	10%	5.2%
Cash	2%	0.0%
Total	100%	

Discount rate – The discount rate used to measure the total pension liability was 7.50%. The projection of cash flows used to determine the discount rate assumed that contributions from plan members will be made at the current contribution rate, and that contributions from employers will be made at contractually required rates. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Note 9: Pension Plan - Continued

Defined Benefit Plan - Continued

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

Sensitivity of the District's proportionate share of the net pension asset (liability) to changes in the discount rate – The following presents the District's proportionate share of the net pension asset calculated using the discount rate of 7.50%, as well as what the District's proportionate share of the net pension asset would be if it were calculated using a discount rate that is one percentage point lower (6.50%) or one percentage point higher (8.50%) than the current rate.

	1% Decrease (6.50%)	Current Discount Rate (7.50%)	1% Increase (8.50%)
District's proportionate share of the net pension asset (liability)			
December 31, 2015	$ (931,298)	$ 370,005	$ 1,431,105
December 31, 2014	(689,058)	697,294	1,828,009

Pension Plan Fiduciary Net Position

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

Defined Contribution Plan

In addition to the above retirement plan, Heartland has a savings plan with the National Rural Electric Cooperative Association, which is a defined contribution plan. Employees are eligible to participate in this plan after one month of service. The National Rural Electric Cooperative Association board of directors has the authority to establish and amend provisions to the plan. Heartland matches up to 4% of participating employees' salaries; employees must contribute a minimum of 1% of their salaries. The contributions made by, and related expense of, Heartland for the years ended December 31, 2015 and 2014 were $56,878 and $54,674, respectively. The contributions made by Heartland employees for the years ended December 31, 2015 and 2014 were $82,020 and $91,560, respectively.

Note 10: Significant Estimates and Concentrations

Major Customers

Sales to two customers were approximately 51% and 47% of total operating revenues for the years ended December 31, 2015 and 2014, respectively. Approximately 57% and 59% of total accounts receivable were owed from three customers at December 31, 2015 and 2014, respectively.

Proposed Environmental Standards

In June 1999, the Environmental Protection Agency (EPA) issued final regulations for a Regional Haze Program. The purpose of the regulations is to improve visibility in the form of reduced regional haze in 156 national parks and wilderness areas across the country. The EPA's claim is that haze is formed, in part, from emissions of SO_2 (sulfur dioxide) and NO_2 (nitrogen dioxide). Heartland is impacted by these regulations through its co-ownership of Laramie River Station (LRS) in Wyoming.

As part of the EPA's Clean Air Act regulations, each state is required to submit a state implementation plan (SIP) identifying the emission control technology proposed to comply with the Regional Haze Program. The State of Wyoming submitted its SIP to the EPA in 2011, which included plans for LRS. In January 2014, the EPA issued their final ruling on this SIP, requiring installation of selective catalytic reduction (SCR) NO_2 removal technology for five coal plants in Wyoming, including the three units at LRS. MBPP is currently evaluating the impact of this decision and its options in responding to the decision.

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

Note 11: Risk Management

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

Note 12: Statutory Reporting Requirement

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

	2015	2014
Employees (unaudited)	12	12
Total salaries	$ 1,377,344	$ 1,414,132
Maintenance expense	$ 301,994	$ 174,966
Total kilowatt hours sold (unaudited)	1,497,663,374	1,475,383,678

Note 13: Segment Information

In accordance with the provisions of the Intermediary Relending Program Loan Agreements, Rural Economic Development Loan Agreement and Rural Economic Development Grant Agreement, Heartland is required to create and maintain a revolving loan fund. Heartland administers this revolving loan fund as a division within its District operations. Condensed 2015 and 2014 financial information for the revolving loan fund is presented below:

Condensed Balance Sheet

	2015	2014
Current assets	$ 1,545,902	$ 1,114,249
Other assets	2,679,193	1,685,905
Total assets	$ 4,225,095	$ 2,800,154
Liabilities		
Current liabilities	$ 277,802	$ 178,573
Noncurrent liabilities	2,832,331	1,881,163
Total liabilities	3,110,133	2,059,736
Net Position	1,114,962	740,418
Total liabilities and net position	$ 4,225,095	$ 2,800,154

Note 13: Segment Information - Continued

Condensed Statement of Revenues, Expenses and Changes in Net Position

	2015	2014
Nonoperating revenues (expenses)		
Investment income	$ 28,668	$ 31,857
Interest expense	(10,885)	(10,666)
Bad debt recoveries (expense)	(10,358)	34,434
Other	292,120	(20,122)
Capital contributions	75,000	37,500
Increase in Net Position	374,545	73,003
Net Position, Beginning of Year	740,417	667,414
Net Position, End of Year	$ 1,114,962	$ 740,417

Condensed Statement of Cash Flows

	2015	2014
Net cash provided by (used in)		
Noncapital financing activities	$ 1,331,632	$ (205,613)
Investing activities	(1,013,035)	252,843
Increase in Cash	318,597	47,230
Beginning of year	821,695	774,465
End of year	$ 1,140,292	$ 821,695

Required Supplementary Information

Heartland Consumers Power District

Schedule of Heartland's Proportionate Share of the Net Pension Asset
South Dakota Retirement System
December 31, 2015

	2015	2014
Heartland's proportion of the net pension asset	0.087%	0.097%
Heartland's proportionate share of the net pension asset	$ 370,005	$ 697,294
Heartland's covered-employee payroll	$ 1,390,734	$ 1,404,232
Heartland's proportionate share of the net pension asset as a percentage of its covered-employee payroll	26.61%	49.66%
Plan fiduciary net position as a percentage of the total pension liability	104.10%	107.29%

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

Heartland Consumers Power District

Schedule of Heartland Contributions

South Dakota Retirement System

December 31, 2015

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

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

Supplementary Information

Heartland Consumers Power District

Schedule of Expenditures of Federal Awards

Year Ended December 31, 2015

Federal Grantor/ Program or Cluster Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Passed Through to Subrecipients	Total Federal Expenditures
United States Department of Agriculture/ Intermediary Relending Program	10.767	N/A	$ -	$ 860,268
United States Department of Agriculture/Rural Economic Development Loans and Grants	10.854	N/A	$ -	2,135,652
				$ 2,995,920

Heartland Consumers Power District

Notes to Schedule of Expenditures of Federal Awards

Year Ended December 31, 2015

Note 1:

The accompanying schedule of expenditures of federal awards (the "Schedule") includes the federal award activity of Heartland Consumers Power District (the District) under programs of the federal government for the year ended December 31, 2015. The accompanying notes are an integral part of this Schedule. The information in this Schedule is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Because the Schedule presents only a selected portion of the operations of the District, it is not intended to and does not present the financial position, changes in net position or cash flows of the District.

Note 2:

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

Note 3:

The federal loan programs listed subsequently are administered directly by the District, and balances and transactions relating to these programs are included in the District's basic financial statements. Loans outstanding at the beginning of the year and loans made during the year are included in the federal expenditures presented in the Schedule. The balance of loans outstanding at December 31, 2015, consists of:

CFDA Number	Program Name	Outstanding Balance at December 31, 2015
10.767	Intermediary Relending Program	$ 631,945
10.854	Rural Economic Development Loans and Grants	$ 1,656,096

Other Information

Heartland Consumers Power District

Schedule of Transmission Operation and Maintenance Expenses

FERC Uniform System of Accounts Classification

Year Ended December 31, 2015

	Amount
Operation	
560 – Operation Supervision and Engineering	$ 52,334
561 – Load Dispatching	-
561.1 – Load Dispatch – Reliability	-
561.2 – Load Dispatch – Monitor and Operate Transmission System	-
561.3 – Load Dispatch – Transmission Service and Scheduling	-
561.4 – Scheduling, System Control and Dispatch Services	-
561.5 – Reliability, Planning and Standards Development	-
561.6 – Transmission Service Studies	-
561.7 – Generation Interconnection Studies	-
561.8 – Reliability, Planning and Standards Development Service	-
562 – Station Expenses	18,834
563 – Overhead Lines Expenses	22,151
564 – Underground Lines Expenses	-
565 – Transmission of Electricity by Others	5,230,740
566 – Miscellaneous Transmission Expenses	18,644
567 – Rents	-
Total Operation Expense	5,342,703
Maintenance	
568 – Maintenance Supervision and Engineering	-
569 – Maintenance of Structures	-
569.1 – Maintenance of Computer Hardware	-
569.2 – Maintenance of Computer Software	-
569.3 – Maintenance of Communication Equipment	-
569.4 – Maintenance of Miscellaneous Regional Transmission Plant	-
570 – Maintenance of Station Equipment	58,041
571 – Maintenance of Overhead Lines	29,450
572 – Maintenance of Underground Lines	-
573 – Maintenance of Miscellaneous Transmission Plant	9,096
Total Maintenance Expense	96,587
Total Transmission O&M Expense	$ 5,439,290

Heartland Consumers Power District

Schedule of Administrative and General Expenses

FERC Uniform System of Accounts Classification

Year Ended December 31, 2015

	Amount
Customer Accounts Expenses	
901 – Supervision	$ -
902 – Meter Reading Expenses	-
903 – Customer Records and Collection Expenses	-
904 – Uncollectible Accounts	-
905 – Miscellaneous Customer Accounts Expenses	-
Total Customer Accounts Expense	-
Customer Service and Informational Expenses	
907 – Supervision	219,571
908 – Customer Assistance Expenses	276,521
909 – Informational and Instructional Expenses	-
910 – Miscellaneous Customer Service and Informational Expenses	-
Total Customer Service and Informational Expenses	496,092
Sales Expenses	
911 – Supervision	-
912 – Demonstrating and Selling Expenses	-
913 – Advertising Expenses	-
916 – Miscellaneous Sales Expenses	-
Sales Expenses	-
Administrative and General Expenses	
920 – Administrative and General Salaries	1,143,737
921 – Office Supplies and Expenses	211,045
922 – Administrative Expenses Transferred Credit	-
923 – Outside Services Employed	461,059
924 – Property Insurance	8,768
925 – Injuries and Damages	15,591
926 – Employee Pension and Benefits	404,877
927 – Franchise Requirements	-
928 – Regulatory Commission Expenses	360,941
929 – Duplicate Charges Credit	-
930.1 – General Advertising Expenses	27,705
930.2 – Miscellaneous General Expenses	842,524
931 – Rents	-
935 – Maintenance of General Plant	195,031
Administrative and General Expenses	$ 3,671,278

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Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards*

Board of Directors
Heartland Consumers Power District
Madison, South Dakota

We have audited, 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, the basic financial statements of Heartland Consumers Power District (the District), which comprise the balance sheet as of December, 31, 2015, and the related statements of revenues, expenses and changes in net position and cash flows for the year then ended, and the related notes to the basic financial statements, and have issued our report thereon dated March 31, 2016, which included an "Emphasis of Matter" paragraph regarding a change in accounting principle.

Internal Control Over Financial Reporting

Management of the District is responsible for establishing and maintaining effective internal control over financial reporting (internal control). In planning and performing our audit of the financial statements, we considered the District's internal control to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the District's financial statements will not be prevented or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District'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*.

Purpose of this Report

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

BKD, LLP

Lincoln, Nebraska
March 31, 2016

Report on Compliance for the Major Federal Program and Report on Internal Control Over Compliance

Independent Auditor's Report

Board of Directors
Heartland Consumers Power District
Madison, South Dakota

Report on Compliance for the Major Federal Program

We have audited Heartland Consumers Power District's (the District's) compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on the District's major federal program for the year ended December 31, 2015. The District's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, contracts and terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for the District's major federal program based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the District's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the major federal program. However, our audit does not provide a legal determination of the District's compliance.

Opinion on the Major Federal Program

In our opinion, Heartland Consumers Power District complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended December 31, 2015.

Report on Internal Control Over Compliance

Management of the District is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the District's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

BKD, LLP

Lincoln, Nebraska
March 31, 2016

Heartland Consumers Power District

Schedule of Findings and Questioned Costs

Year Ended December 31, 2015

Summary of Auditor's Results

Financial Statements

1. The type of report the auditor issued on whether the financial statements audited were prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) was:

   ☒ Unmodified ☐ Qualified ☐ Adverse ☐ Disclaimer

2. The independent auditor's report on internal control over financial reporting disclosed:

Significant deficiency(ies)?	☐ Yes	☒ None Reported
Material weakness(es)?	☐ Yes	☒ No

3. Noncompliance considered material to the financial statements was disclosed by the audit? ☐ Yes ☒ No

Federal Awards

4. The independent auditor's report on internal control over compliance for major federal awards programs disclosed:

Significant deficiency(ies)?	☐ Yes	☒ None Reported
Material weakness(es)?	☐ Yes	☒ No

5. The opinion expressed in the independent auditor's report on compliance for major federal awards was:

   ☒ Unmodified ☐ Qualified ☐ Adverse ☐ Disclaimer

6. The audit disclosed findings required to be reported by 2 CFR 200.516(a)? ☐ Yes ☒ No

Heartland Consumers Power District
Schedule of Findings and Questioned Costs - Continued
Year Ended December 31, 2015

7. The District's major program was:

Cluster/Program	CFDA Number
Intermediary Relending Program	10.767

8. The threshold used to distinguish between Type A and Type B programs was $750,000.

9. The District qualified as a low-risk auditee?

☒ Yes ☐ No

Heartland Consumers Power District

Schedule of Findings and Questioned Costs - Continued

Year Ended December 31, 2015

<u>Findings Required to be Reported by *Government Auditing Standards*</u>

Reference Number	Finding	Questioned Costs
	No matters are reportable	

<u>Findings Required to be Reported by the Uniform Guidance</u>

Reference Number	Finding	Questioned Costs
	No matters are reportable	

Heartland Consumers Power District

Summary Schedule of Prior Audit Findings

Year Ended December 31, 2015

Reference Number	Summary of Finding	Status
	No matters are reportable	