Kentucky 27
Inter-County Energy Cooperative Corporation
Danville, Kentucky

Audited Financial Statements
December 31, 2016 and 2015

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C O N T E N T S

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Independent Auditor's Report

To the Board of Directors
Inter-County Energy Cooperative Corporation

Report on the Financial Statements

I have audited the accompanying financial statements of Inter-County Energy Cooperative Corporation, which comprise the balance sheets as of December 31, 2016 and 2015, and the related statements of revenue and comprehensive income, changes in equities, and cash flows for the years then ended, and the related notes to the financial statements.

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

My responsibility is to express an opinion on these financial statements based on my audits. I conducted my 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 I 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, I 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.

I believe the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

To the Board of Directors
Inter-County Energy Cooperative Corporation

Opinion

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Inter-County Energy Cooperative Corporation as of December 31, 2016 and 2015, and the results of their operations and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, I have also issued a report dated March 23, 2017, on my consideration of Inter-County Energy Cooperative Corporation's internal control over financial reporting and my 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 my 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 internal control over financial reporting and compliance.

Alan Zumstein
Alan M. Zumstein, CPA
March 23, 2017

Inter-County Energy Cooperative Corporation
Balance Sheets, December 31, 2016 and 2015

Assets	2016	2015
Electric Plant, at original cost:		
In service	$ 123,023,224	$ 119,251,421
Under construction	572,564	569,750
	123,595,788	119,821,171
Less accumulated depreciation	34,582,692	32,490,026
	89,013,096	87,331,145
Investments in Associated Organizations	26,913,935	24,799,438
Current Assets:		
Cash and cash equivalents	3,392,164	6,117,535
Accounts receivable, less allowance for 2016 of $290,891 and 2015 of $142,229	5,290,342	3,793,912
Other receivables	140,816	114,035
Material and supplies, at average cost	408,943	414,063
Other current assets	428,498	375,653
	9,660,763	10,815,198
Deferred Pension Costs	1,351,950	1,568,262
Total	$ 126,939,744	$ 124,514,043
Members' Equities and Liabilities		
Members' Equities:		
Memberships	$ 1,041,235	$ 1,028,860
Patronage capital	45,020,873	44,001,748
Other equities	752,715	778,230
Accumulated other comprehensive income	(642,635)	(681,135)
	46,172,188	45,127,703
Long Term Debt	66,750,035	65,828,970
Accumulated Postretirement Benefits	3,997,405	3,868,293
Current Liabilities:		
Notes payable	1,000,000	1,600,000
Accounts payable	4,288,082	3,405,460
Current portion of long term debt	3,175,000	3,100,000
Consumer deposits	591,876	553,603
Accrued expenses	965,158	1,030,014
	10,020,116	9,689,077
Total	$ 126,939,744	$ 124,514,043

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

Inter-County Energy Cooperative Corporation
Statements of Revenue and Patronage Capital
for the years ended December 31, 2016 and 2015

	2016	2015
Operating Revenues:		
Sale of electric energy	$ 46,995,531	$ 46,540,387
Other electric revenue	1,398,739	1,442,543
	48,394,270	47,982,930
Operating Expenses:		
Cost of power	33,246,100	33,200,218
Distribution - operations	2,930,934	2,783,927
Distribution - maintenance	2,414,533	1,902,310
Consumer accounts	1,804,041	1,691,699
Customer services	331,369	400,208
Administrative and general	2,166,899	2,221,057
Depreciation, excluding $285,004 in 2016 and $280,396 in 2015 charged to clearing accounts	4,097,318	4,006,638
Taxes	61,372	66,721
Interest on long-term debt	1,478,995	1,584,962
Other interest expense	11,741	4,603
Other deductions	18,966	21,619
Total cost of electric service	48,562,268	47,883,962
Operating margins (deficits)	(167,998)	98,968
Nonoperating Margins		
Interest income	83,314	65,647
Others	18,942	124,735
	102,256	190,382
Patronage Capital Credits		
Generation & Transmission	2,123,792	2,269,082
Others	146,381	207,863
	2,270,173	2,476,945
Net Margins	2,204,431	2,766,295
Accumulated Other Comprehensive Income:		
Postretirement benefits	38,500	(519,459)
Total Comprehensive Income	$ 2,242,931	$ 2,246,836

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

Inter-County Energy Cooperative Corporation
Statement of Changes in Members' Equity
for the years ended December 31, 2015 and 2016

		Patronage Captial							Accumulated Other	Total
	Memberships	Assigned	Assignable	Unassigned	Prior Deficits	Retirements	Total	Other Equity	Comprehensive Income	Members' Equity
Balance - December 31, 2014	$ 1,019,466	$ 46,139,279	$ 4,550,064	$ 150,817	$ (226,285)	$ (9,170,810)	$ 41,443,065	$ 507,796	$ (161,676)	$ 42,808,651
Allocate margins 2014		4,355,389	(4,550,064)		194,675		-			-
Comprehensive income:										
Net margins			2,766,295				2,766,295			2,766,295
Postretirement benefit obligation										
Amortization									38,485	
Adjustments									(557,944)	(519,459)
Total comprehensive income										2,246,836
Net change in memberships	9,394									9,394
Refunds to estates						(207,612)	(207,612)			(207,612)
General retirements							-			-
Other equities								270,434		270,434
Balance - December 31, 2015	1,028,860	50,494,668	2,766,295	150,817	(31,610)	(9,378,422)	44,001,748	778,230	(681,135)	45,127,703
Allocate margins 2015		2,734,685	(2,766,295)		31,610		-			-
Comprehensive income:										
Net margins			2,204,431				2,204,431			2,204,431
Postretirement benefit obligation										
Amortization									38,500	
Adjustments										38,500
Total comprehensive income										2,242,931
Net change in memberships	12,375									12,375
Refunds to estates						(249,302)	(249,302)			(249,302)
General retirements						(936,004)	(936,004)			(936,004)
Other equities								(25,515)		(25,515)
Balance - December 31, 2016	$ 1,041,235	$ 53,229,353	$ 2,204,431	$ 150,817	$ -	$ (10,563,728)	$ 45,020,873	$ 752,715	$ (642,635)	$ 46,172,188

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

Inter- CorporationCounty Energy Cooperative
Statements of Cash Flows
for the years ended December 31, 2016 and 2015

	2016	2015
Cash Flows from Operating Activities:		
Net margins	$ 2,204,431	$ 2,766,295
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation:		
Charged to expense	4,097,318	4,006,638
Charged to clearing accounts	285,004	280,396
Patronage capital credits assigned	(2,270,173)	(2,476,945)
Accumulated postretirement benefits	167,612	117,927
Change in assets and liabilities:		
Receivables	(1,523,211)	1,916,324
Material and supplies	5,120	(28,185)
Other assets	163,467	256,987
Payables	882,622	(540,512)
Consumer deposits	38,273	33,446
Accrued expenses	(64,856)	11,170
	3,985,607	6,343,541
Cash Flows from Investing Activities:		
Plant additions	(5,459,894)	(5,831,301)
Plant removal costs	(684,505)	(635,379)
Salvage recovered from retired plant	80,126	110,438
Receipts from other investments, net	155,676	73,607
	(5,908,597)	(6,282,635)
Cash Flows from Financing Activities:		
Net increase in memberships	12,375	9,394
Refund of patronage capital to members	(1,185,306)	(207,612)
Increase (decrease) in other equities	(25,515)	270,434
Advances (repayments) of short term borrowings	(600,000)	1,100,000
Advances of long term debt	5,018,900	5,023,686
(Advance) applied payments	(830,989)	670,395
Payments on long term debt	(3,191,846)	(3,085,266)
	(802,381)	3,781,031
Net increase (decrease) in cash	(2,725,371)	3,841,937
Cash and cash equivalents, beginning of year	6,117,535	2,275,598
Cash and cash equivalents, end of year	$ 3,392,164	$ 6,117,535
Supplemental cash flows information:		
Interest paid on long-term debt	$ 1,479,800	$ 1,587,528

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

Note 1. Summary of Significant Accounting Policies

Inter-County Energy Cooperative Corporation ("Inter-County") maintains its records in accordance with the policies prescribed or permitted by the Kentucky Public Service Commission ("PSC") and the United States Department of Agriculture, Rural Utilities Service ("RUS"), which conform in all material respects with generally accepted accounting principles. The more significant of these policies are as follows:

Electric Plant Electric plant is stated at original cost, which is the cost when first dedicated to public service. Such amount includes applicable supervisory and overhead cost including any construction period interest and taxes. There was no interest required to be capitalized during the year.

The cost of maintenance and repairs, including renewals of minor items of property, is charged to operating expense. The cost of replacement of depreciable property units, as distinguished from minor items, is charged to electric plant. The units of property replaced or retired, including cost of removal, net of any salvage value, is charged to accumulated depreciation. Electric plant consists of:

	2016	2015
Distribution plant	$108,135,161	$104,185,066
General plant	14,888,063	15,066,355
Total	$123,023,224	$119,251,421

Depreciation Provision has been made for depreciation on the basis of the estimated lives of assets, using the straight-line method. Distribution plant depreciation is based on a composite rate of 3.35% per annum. General plant rates range from 2.5% to 18%.

Cash and Cash Equivalents Inter-County considers all short-term, highly liquid investments with original maturities of three months or less to be cash equivalents.

Off Balance Sheet Risk Inter-County maintains its cash balances, which may exceed the federally insured limit, with several financial institutions. These financial institutions have strong credit ratings and management believes that the credit risk related to the accounts is minimal.

Revenue Inter-County records revenue as billed to its consumers based on monthly meter-reading cycles. All consumers are required to pay a refundable deposit, however, it may be waived under certain circumstances. Inter-County's sales are concentrated in a six county area of southeastern Kentucky. There were no consumers whose individual account balance exceeded 10% of outstanding accounts receivable at December 31, 2016 or 2015. Consumers must pay their bill within 20 days of billing, then are subject to disconnect after another 10 days. Accounts are written off when they are deemed to be uncollectible. The allowance for uncollectible accounts is based on the aging of receivables.

Inter-County is required to collect, on behalf of the State of Kentucky, sales taxes based on 6 percent of gross sales from non-residential consumers, a 3 percent school tax from certain counties on most gross sales, and franchise fees in certain cities. Inter-County's policy is to exclude sales tax from revenue when collected and expenses when paid and instead, record collection and payment of sales taxes through a liability account.

Cost of Power Inter-County is one of sixteen members of East Kentucky Power Cooperative, Inc. ("East Kentucky"). Under a wholesale power agreement, Inter-County is committed to purchase its electric power and energy requirements from East Kentucky until 2051. The rates charged by East Kentucky are subject to approval of the PSC. The cost of purchased power is recorded monthly during the period in which the energy is consumed, based upon billings from East Kentucky.

Note 1. Summary of Significant Accounting Policies, continued

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

Fair Value Measurements The Fair Value Measurements and Disclosures Topic of the FASB ASC 820, *Fair Value Measurements and Disclosures,* defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal, or most advantageous, market for the asset or liability in an orderly transaction between market participants at the measurement date. The Fair Values Measurements Topic establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of observable inputs when possible. The three levels of inputs used to measure fair value are as follows:

> Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities
>
> Level 2: Quoted prices in markets that are not considered to be active or financial instruments for which all significant inputs are observable, either directly or indirectly.
>
> Level 3: Prices or valuations that require inputs that are both significant to the fair value measure and unobservable.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

The carrying amounts of Inter-County's cash and cash equivalents, receivables, payables, and accrued expenses and liabilities approximate fair value due to their short maturity. Investments in associated organizations are not considered a financial instrument because they represent nontransferable interests in associated organizations. Other assets and liabilities are not considered financial instruments because they represent activities specifically related to Inter-County. Long term debt can not be traded in the market, and is specifically for electric cooperatives and, therefore, a value other than its outstanding principal cannot be determined.

Inter-County may, and also does, invest idle funds in local banks and in National Rural Utilities Cooperative Finance Corporation ("CFC") commercial paper. The inputs used to measure idle funds are Level 1 measurements, as these funds are exchange traded funds in an active market.

Income Tax Status Inter-County is exempt from federal and state income taxes under provisions of Section 501(c)(12). Accordingly, the financial statements for Inter-County include no provision for income taxes. Inter-County's accounting policy provides that a tax expense/benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits. Management believes Inter-County has no uncertain tax positions resulting in an accrual of tax expense or benefit. Inter-County recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. Inter-County did not recognize any interest or penalties during the years ended December 31, 2016 and 2015. Inter-County's income tax return is subject to possible examination by taxing authorities until the expiration of related statues of limitations on the return, which is generally three years.

Note 1. Summary of Significant Accounting Policies, continued

Comprehensive Income Comprehensive income includes both net margin and other comprehensive income. Other comprehensive income represents the change in funded status of the accumulated postretirement benefit obligation.

Risk Management Inter-County is exposed to various forms of losses of assets associated with, but not limited to, fire, personal liability, theft, vehicular accidents, errors and omissions, fiduciary responsibility, workers compensation, etc. Each of these areas is covered through the purchase of commercial insurance.

Advertising Inter-County expenses advertising costs as incurred.

Subsequent Events Management has evaluated subsequent events through March 23, 2017, the date the financial statements were available to be issued. There were no significant subsequent events to report.

Note 2. Investments in Associated Organizations

Investments in associated organizations consist of:

	2016	2015
East Kentucky, patronage capital	$24,573,305	$22,449,513
CFC, patronage capital and CTCs	1,282,079	1,273,757
Others	1,058,551	1,076,168
Total	$26,913,935	$24,799,438

Inter-County records patronage capital assigned by associated organizations in the year in which such assignments are received.

The Capital Term Certificates ("CTCs") of CFC are recorded at cost. The CTCs were purchased from CFC as a condition of obtaining long-term financing. The CTCs bear interest at 3% and 5% and are scheduled to mature at varying times from 2020 to 2080.

Note 3. Patronage Capital

Under provisions of the long-term debt agreement, return to patrons of capital contributed by them is limited to amounts which would not allow the total equities and margins to be less than 30% of total assets, except that distributions may be made to estates of deceased patrons. The debt agreement provides, however, that should such distributions to estates not exceed 25% of the net margins for the next preceding year, Inter-County may distribute the difference between 25% and the payments made to such estates.
The equity at December 31, 2016 was 39% of total assets.

Note 4. Long Term Debt

The long term debt is due in quarterly and monthly installments of varying amounts through 2045. The 6.05% to 6.50% notes due CFC are available for repricing every 7 years to either a variable or fixed rate. RUS assesses 12.5 basis points to administer the Federal Financing Bank ("FFB") loans. Inter-County has unadvanced loan funds available from FFB in the amount of $10 million. During 2016 Inter-County refinanced $17,952,269 of RUS notes with proceeds from National Bank for Cooperatives ("CoBank"). The 2.25% interest rate notes to CoBank are for the accelerated R&S payment to NRECA as described in Note 6.

Note 4. Long Term Debt, continued

All assets, except vehicles, are pledged as collateral on the long term debt to RUS, FFB, CFC, and CoBank under a joint mortgage agreement. First mortgage notes consist of:

	2016	2015
RUS:		
0.375% - 5.125%	$3,265,122	$21,548,961
Cushion of credit, earns 5%	(849,115)	(18,128)
	2,416,007	21,530,833
FFB, 0.274% and 2.748%	41,263,916	37,662,349
CFC, 6.20% to 6.50% notes	3,570,876	3,844,303
CoBank, 4.55% and 4.48%	4,066,867	4,536,999
CoBank, 2.25%	877,384	1,239,283
CoBank, 3.80%	17,640,976	-
East Kentucky, 1.5% various 5 years	89,009	115,203
	69,925,035	68,928,970
Less current portion	3,175,000	3,100,000
Long term portion	$66,750,035	$65,828,970

As of December 31, 2016, the annual principal portion of long term debt outstanding for the next five years are as follows: 2017 - $3,175,000; 2018 - $3,245,000; 2019 - $3,320,000; 2020 - $3,400,000; 2021 - $3,485,000.

Note 5. Short Term Borrowings

At December 31, 2016, Inter-County Energy had a short term line of credit of $5,000,000 available from CFC. Inter-County Energy has advances against the line of credit with CFC in the amount of $1,000,000 with an interest rate of 2.50%.

Note 6. Pension Plan

All eligible employees of Inter-County participate in the NRECA Retirement and Security Plan ("R&S Plan"), a defined benefit pension plan qualified under section 401 and tax exempt under section 501(a) of the Internal Revenue Code. It is a multiemployer plan under the accounting standards. The Plan sponsor's identification number is 53-0116145 and the Plan Number is 333. A unique characteristic of a multiemployer plan compared to a single employer plan is that all plan assets are available to pay benefits of any plan participant. Separate asset accounts are not maintained for participating employers. This means that assets contributed by one employer may be used to provide benefits to employees of other participating employers.

Inter-County's contributions to the R&S Plan in 2016 and 2015 represent less than 5 percent of the total contributions made to the plan by all participating employers. Inter-County made contributions to the plan of $698,351 in 2016 and $640,402 in 2015. There have been no significant changes that affect the comparability of 2016 and 2015.

Note 6. Pension Plan, continued

In the R&S Plan, a "zone status" determination is not required, and therefore not determined, under the Pension Protection Act ("PPA") of 2006. In addition, the accumulated benefit obligations and plan assets are not determined or allocated separately by individual employer. In total, the R&S Plan was approximately 80 percent funded at January 1, 2016 and 2015 based on the PPA funding target and PPA actuarial value of assets on those dates. Because the provisions of the PPA do not apply to the R&S Plan, funding improvement plans and surcharges are not applicable. Future contribution requirements are determined each year as part of the actuarial valuation of the plan and may change as a result of plan experience.

At the December 2012 meeting of the I&FS Committee of the NRECA Board of Directors, the Committee approved an option to allow participating cooperatives in the Retirement Security ("R&S") Plan (a defined benefit multiemployer pension plan) to make a prepayment and reduce future required contributions. The prepayment amount is a cooperative share, as of January 1, 2013, of future contributions required to fund the R&S Plan's unfunded value of benefits earned to date using Plan actuarial valuation assumptions. The prepayment amount will typically equal approximately 2.5 times a cooperative's annual R&S Plan required contribution as of January 1, 2013. After making the prepayment, for most cooperatives the billing rate is reduced by approximately 25%, retroactive to January 1, 2013. The 25% differential in billing rates is expected to continue for approximately 15 years. However, changes in interest rates, asset returns and other plan experience different from that expected, plan assumptions changes, and other factors may have an impact on the differential in billing rates and the 15 year period.

Two prepayment options were available to participating cooperatives:

1. Use current assets to make the prepayment over a period of not more than 4 years, or,
2. Borrow funds sufficient to make the prepayment in a lump sum, with the prepayment of the borrowed amount determined by the loan's amortization schedule.

On February 14, 2013, RUS issued a memorandum to all of its borrowers regarding the proper accounting treatment of the R&S Plan prepayment. RUS stipulated that the prepayment shall be recorded as a long term prepayment in Account 186, Miscellaneous Deferred Debits. This prepaid expense shall be amortized to Account 926, Employee Pensions and Benefits, over a ten year period. Alternatively, RUS borrowers may calculate the amortization period by subtracting the cooperative's average age of its workforce as provided by NRECA from the cooperative's normal retirement age under the R&S Plan, up to a maximum period of 20 years. If the entity choses to finance the prepayment, interest expense associated with the loan shall be recorded in the year incurred as is required under the RUS Uniform System of Accounts ("USoA").

Section 6.13(e) of the RUS Loan Contract limits the amount of unsecured debt that a borrower may incur to 15% on Net Utility Plant if the equity level of the borrower, after considering such unsecured debt, is below 30% of its Total Assets, unless the borrower obtains RUS consent. RUS will consider any unsecured debt associated with the R&S Plan prepayment to be "Permitted Debt" and accordingly, it will be excluded from the application of Section 6.13(e). On April 22, 2013 Inter-County made a prepayment of $2,163,206 to the R&S Plan. The amount is being amortized over 10 years.

Note 7. Postretirement Benefits

Inter-County sponsors a defined benefit plan that provides medical insurance coverage to retirees and their dependents. Participating retirees and dependents do not contribute to the projected cost of coverage until eligible for Medicare at which time they contribute 50% of the cost of coverage. For measurement purposes, an annual rate of increase of 8% in 2016, then decreasing by 0.5% per year until 5% per year, in the per capita cost of covered health care benefit was assumed. The discount rate used in determining the accumulated postretirement benefit obligation was 4.5%.

The funded status of the plan is as follows:

	2016	2015
Projected benefit obligation	(3,997,405)	($3,868,293)
Plan assets at fair value	-	-
Total	($3,997,405)	($3,868,293)

The components of net periodic postretirement benefit costs are as follows:

	2016	2015
Benefit obligation at beginning of year	$3,868,293	$3,230,907
Components of net periodic benefit cost:		
Service cost	122,366	109,099
Interest cost	188,414	176,671
Net periodic benefit cost	310,780	285,770
Benefits paid	(181,668)	(206,328)
Actuarial adjustment	-	557,944
Benefit obligation at end of year	$3,997,405	$3,868,293
Amounts recognized in the balance sheet consists of:		
Noncurrent liabilities	$3,997,405	$3,868,293
Amounts included in accumulated other comprehensive income:		
Unrecognized actuarial gain (loss)	($642,635)	($681,135)
Effect of 1% increase in the health care trend:		
Postemployment benefit obligation	$4,255,000	
Net periodic benefit cost	330,000	

Projected retiree benefit payments for the next five years are expected to be as follows: 2017 - $193,000; 2018 - $185,000; 2019 - $182,000; 2020 - $179,000; 2021 - $171,000.

Note 8. Commitments

Inter-County has various other agreements outstanding with local contractors. Under these agreements, the contractors will perform certain construction and maintenance work at specified hourly rates or unit cost, or on an as needed basis. The duration of these contracts are one to three years.

Note 9. Environmental Contingency

Inter-County from time to time is required to work with and handle PCBs, herbicides, automotive fluids, lubricants, and other hazardous materials in the normal course of business. As a result, there is the possibility that environmental conditions may arise which would require Inter-County to incur cleanup costs. The likelihood of such an event, or the amount of such costs, if any, cannot be determined at this time. However, management does not believe such costs, if any, would materially affect Inter-County's financial position or its future cash flows.

Note 10. Related Party Transactions

Several of the Directors of Inter-County and its President & General Manager are on the Boards of Directors of various associated organizations.

Note 11. Contingencies

Inter-County, on occasion, is involved in litigation arising in the normal course of business. While the results of such litigation cannot be predicted with certainty, management, based upon advice of counsel, believes that the final outcome will not have a material adverse effect on the financial statements.

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

To the Board of Directors
Inter-County Energy Cooperative Corporation

I have audited, in accordance with the 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 financial statements of Inter-County Energy Cooperative Corporation ("Cooperative"), which comprise the balance sheets as of December 31, 2016 and 2015, and the related statements of revenue and comprehensive income, members' equities and cash flows for the years then ended, and related notes to the financial statements, and have issued my report thereon dated March 23, 2017.

Internal Control Over Financial Reporting

In planning and performing my audit of the financial statements, I considered the Cooperative's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Cooperative's internal control. Accordingly, we do not express an opinion on the effectiveness of the Cooperative'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 entity'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.

My 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 my audit I did not identify any deficiencies in internal control that I consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

To the Board of Directors
Inter-County Energy Cooperative Corporation

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Cooperative's financial statements are free of material misstatement, I performed test 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 my audit, and accordingly, I do not express such an opinion. The results of my 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 my testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the organization'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 organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Alan Zumstein

Alan M. Zumstein, CPA
March 23, 2017

ALAN M. ZUMSTEIN
CERTIFIED PUBLIC ACCOUNTANT

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MEMBER
• AMERICAN INSTITUTE OF CPA'S
• KENTUCKY SOCIETY OF CPA'S
• INDIANA SOCIETY OF CPA'S
• AICPA DIVISION FOR FIRMS

Independent Auditor's Report on Compliance with Aspects of Contractual Agreements and Regulatory Requirements for Electric Borrowers

Board of Directors
Inter-County Energy Cooperative Corporation

I 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 financial statements of Inter-County Energy Cooperative Corporation ("Cooperative"), which comprise the balance sheet as of December 31, 2016, and the related statements of revenue and comprehensive income, patronage capital, and changes in cash flows for the year then ended, and the related notes to the financial statements, and have issued my report thereon dated March 23, 2017. In accordance with *Government Auditing Standards,* we have also issued my report dated March 23, 2017, on my consideration of the Cooperative's internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. No reports other than the reports referred to above have been furnished to management.

In connection with my audit, nothing came to my attention that caused me to believe that the Cooperative failed to comply with the terms, covenants, provisions, or conditions of their loan, grant, and security instruments as set forth in 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers,* §1773.33 and clarified in the RUS policy memorandum dated February 7, 2015, insofar as they relate to accounting matters as enumerated below. However, my audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had I performed additional procedures, other matters may have come to my attention regarding the Cooperative's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters. In connection with my audit, I noted no matters regarding the Cooperative's accounting and records to indicate that the Cooperative did not:

- Maintain adequate and effective accounting procedures;
- Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts;
- Reconcile continuing property records to the controlling general ledger plant accounts;
- Clear construction accounts and accrue depreciation on completed construction;
- Record and properly price the retirement of plant;
- Seek approval of the sale, lease, or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap;
- Maintain adequate control over material and supplies;

Board of Directors
Inter-County Energy Cooperative Corporation

- Prepare accurate and timely Financial and Operating Reports;
- Obtain written RUS approval to enter into any contract for the management, operation, or maintenance of the borrower's system if the contract covers all or substantially all of the electric system;
- Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles;
- Record depreciation in accordance with RUS requirements ("See RUS Bulletin 183-1, Depreciation Rates and Procedures");
- Comply with the requirements for the detailed schedule of deferred debits and deferred credits; and
- Comply with the requirements for the detailed schedule of investments, of which there were none.

Deferred debits are as follows:

Prepaid pension cost	$1,351,950

This report is intended solely for the information and use of the board of directors, management, RUS, and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distributions is not limited.

Alan Zumstein

Alan M. Zumstein, CPA
March 23, 2017