

Kentucky 58

Big Sandy Rural Electric
Cooperative Corporation

Paintsville, Kentucky

Audited Financial Statements
December 31, 2016 and 2015

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Independent Auditor's Report

To the Board of Directors
Big Sandy Rural Electric Cooperative
Paintsville, Kentucky

Report on the Financial Statements

I have audited the accompanying financial statements of Big Sandy Rural Electric Cooperative, 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
Big Sandy Rural Electric Cooperative

Opinion

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Big Sandy Rural Electric Cooperative 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 January 18, 2017, on my consideration of Big Sandy Rural Electric Cooperative'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
January 18, 2017

Big Sandy Rural Electric Cooperative Corporation
Balance Sheets, December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
<u>Assets</u>		
Electric Plant, at original cost:		
In service	\$ 52,612,854	\$ 51,786,741
Under construction	9,702	(71,702)
	52,622,556	51,715,039
Less accumulated depreciation	19,412,457	18,821,124
	33,210,099	32,893,915
Investments in Associated Organizations	15,648,826	14,825,489
Current Assets:		
Cash and cash equivalents	451,012	513,115
Accounts receivable, less allowance for 2016 of \$107,394 and 2015 of \$115,065	3,088,439	2,726,685
Other receivables	612,371	887,046
Material and supplies, at average cost	275,659	274,598
Other current assets	40,431	47,571
	4,467,912	4,449,015
Total	\$ 53,326,837	\$ 52,168,419
<u>Members' Equities and Liabilities</u>		
Members' Equities:		
Memberships	\$ 227,285	\$ 227,660
Patronage capital	25,667,470	24,749,152
Other equities	728,440	492,628
Accumulated other comprehensive income	(2,253,569)	(2,401,385)
	24,369,626	23,068,055
Long Term Debt	20,624,330	21,003,927
Accumulated Postretirement Benefits	3,678,035	3,749,502
Current Liabilities:		
Accounts payable	2,349,375	2,052,808
Current portion of long term debt	1,375,000	1,350,000
Consumer deposits	618,198	640,413
Accrued expenses	300,679	283,788
	4,643,252	4,327,009
Consumer Advances	11,594	19,926
Total	\$ 53,326,837	\$ 52,168,419

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

Big Sandy Rural Electric Cooperative Corporation
Statements of Revenue and Comprehensive Income
for the years ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Operating Revenues		
Sale of electricity	\$ 23,629,021	\$ 24,229,996
Other electric revenue	<u>786,771</u>	<u>779,757</u>
	<u>24,415,792</u>	<u>25,009,753</u>
Operating Expenses:		
Cost of power	16,239,864	17,190,536
Distribution - operations	996,251	1,081,338
Distribution - maintenance	1,686,356	1,563,328
Consumer accounts	885,558	871,842
Customer services	19,009	50,027
Sales	3,785	2,471
Administrative and general	1,343,115	1,324,858
Depreciation, excluding \$156,128 in 2016 and \$134,522 in 2015 charged to clearing account:	2,289,840	2,245,342
Taxes, other than income	32,952	34,619
Other interest charges	68,947	52,202
Interest on long-term debt	678,717	705,710
Other deductions	<u>20,775</u>	<u>13,941</u>
	<u>24,265,169</u>	<u>25,136,214</u>
Operating Marings	<u>150,623</u>	<u>(126,461)</u>
Nonoperating Margins and Capital Credits		
Interest income	173,286	174,792
Other non operating margins	13,873	19,521
G&T capital credits	800,000	1,573,030
Other Capital Credits	<u>59,673</u>	<u>69,707</u>
	<u>1,046,832</u>	<u>1,837,050</u>
Net Margins	1,197,455	1,710,589
Comprehensive income:		
Accumulated postretirement benefits	<u>147,816</u>	<u>147,816</u>
Net Comprehensive Income	<u>\$ 1,345,271</u>	<u>\$ 1,858,405</u>

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

Big Sandy Rural Electric Cooperative Corporation
Statement of Changes in Members' Equity
for the years ended December 31, 2015 and 2016

	Patronage Capital						Other Equity	Accumulated Other Comprehensive Income	Total Members' Equity
	<u>Memberships</u>	<u>Assigned</u>	<u>Assignable</u>	<u>Prior Deficits</u>	<u>Retirements</u>	<u>Total</u>			
Balance-December 31, 2014	\$ 231,950	\$ 24,043,771	\$ 2,137,905	\$ (483,029)	\$ (2,593,743)	\$ 23,104,904	\$474,957	\$ (2,549,201)	\$ 21,262,610
Allocate margins		1,936,204	(2,137,905)	201,701		-			-
Comprehensive income:									
Net margins			1,710,589			1,710,589			1,710,589
Postretirement benefit obligation									
Amortization							147,816		
Adjustments							-		147,816
Total comprehensive income								-	1,858,405
Net change in memberships	(4,290)								(4,290)
Refunds to estates					(66,341)	(66,341)			(66,341)
Other equities							17,671		17,671
Balance-December 31, 2015	227,660	25,979,975	1,710,589	(281,328)	(2,660,084)	24,749,152	492,628	(2,401,385)	23,068,055
Allocate margins		1,672,738	(1,710,589)	37,851		-			-
Comprehensive income:									
Net margins			1,197,455			1,197,455			1,197,455
Postretirement benefit obligation									
Amortization							147,816		
Adjustments							-		147,816
Total comprehensive income								-	1,345,271
Net change in memberships	(375)								(375)
Refunds to estates					(63,421)	(63,421)			(63,421)
Other equities		(215,716)				(215,716)	235,812		20,096
Balance-December 31, 2016	<u>\$ 227,285</u>	<u>\$ 27,436,997</u>	<u>\$ 1,197,455</u>	<u>\$ (243,477)</u>	<u>\$ (2,723,505)</u>	<u>\$ 25,667,470</u>	<u>\$ 728,440</u>	<u>\$ (2,253,569)</u>	<u>\$ 24,369,626</u>

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

Big Sandy Rural Electric Cooperative Corporation
 Statements of Cash Flows
 for the years ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Cash Flows from Operating Activities:		
Net margins (deficit)	\$ 1,197,455	\$ 1,710,589
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation:		
Charged to expense	2,289,840	2,245,342
Charged to clearing accounts	156,128	134,522
Patronage capital credits assigned	(859,673)	(1,642,737)
Accumulated postretirement benefits	76,349	111,166
Change in assets and liabilities:		
Receivables	(87,079)	169,009
Material and supplies	(1,061)	15,760
Other assets	7,140	153
Payables	296,567	(172,515)
Consumer deposits and advances	(30,547)	(42,051)
Accrued expenses	16,891	(95,631)
	<u>3,062,010</u>	<u>2,433,607</u>
Cash Flows from Investing Activities:		
Plant additions	(2,373,867)	(2,172,038)
Plant removal costs	(466,353)	(344,882)
Salvage recovered from retired plant	78,068	60,472
Receipts from other investments, net	36,336	55,534
	<u>(2,725,816)</u>	<u>(2,400,914)</u>
Cash Flows from Financing Activities:		
Net increase in memberships	(375)	(4,290)
Refund of patronage capital to members	(63,421)	(66,341)
Increase in other equities	20,096	17,671
Payments on long term debt	(1,354,597)	(1,188,122)
Advances of long term debt	1,000,000	-
Advance payments	-	(149,985)
	<u>(398,297)</u>	<u>(1,391,067)</u>
Net increase in cash	(62,103)	(1,358,374)
Cash and cash equivalents, beginning of year	513,115	1,871,489
Cash and cash equivalents, end of year	<u>\$ 451,012</u>	<u>\$ 513,115</u>
Supplemental cash flows information:		
Interest paid on long-term debt	\$ 680,749	\$ 707,698

The accompanying notes are an integral part of the financial state

Big Sandy Rural Electric Cooperative
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies

Big Sandy Rural Electric Cooperative (“Big Sandy”) 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:

	<u>2016</u>	<u>2015</u>
Distribution plant	\$46,580,201	\$45,673,125
General plant	6,032,653	6,113,616
Total	\$52,612,854	\$51,786,741

Depreciation Provision has been made for depreciation on the basis of the estimated lives of assets, using the straight-line method. Depreciation rates range from 2.2% to 6.67%, with a composite rate of 4.7% for distribution plant. General plant rates range from 2.5% to 17%.

Cash and Cash Equivalents Big Sandy considers all short-term, highly liquid investments with original maturities of three months or less to be cash equivalents. Big Sandy 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 credit risk related to the accounts is minimal.

Revenue Big Sandy records revenue as billed to its consumers based on monthly meter-readings through the end of the month. All consumers are required to pay a refundable deposit, however, it may be waived under certain circumstances. Big Sandy’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.

Big Sandy 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. Big Sandy’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 Big Sandy is one of sixteen members of East Kentucky Power Cooperative, Inc. (“East Kentucky”). Under a wholesale power agreement, Big Sandy 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.

Advertising Big Sandy expenses advertising costs as incurred.

Big Sandy Rural Electric Cooperative
Notes to Financial Statements

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 Big Sandy's cash and cash equivalents, other receivables, investments, inventories, other assets, trade accounts payable, accrued expenses and liabilities, and other 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 Big Sandy. Long term debt cannot be traded in the market, and is specifically for electric cooperatives and, therefore, a value other than its outstanding principal cannot be determined.

Big Sandy 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.

Risk Management Big Sandy 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.

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.

Big Sandy Rural Electric Cooperative
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies, continued

Contingencies Big Sandy 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.

Income Tax Status Big Sandy is exempt from federal and state income taxes under provisions of Section 501(c)(12). Accordingly, the financial statements for Big Sandy include no provision for income taxes. Big Sandy'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 Big Sandy has no uncertain tax positions resulting in an accrual of tax expense or benefit. Big Sandy recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. Big Sandy did not recognize any interest or penalties during the years ended December 31, 2016 and 2015. Big Sandy's income tax return is subject to possible examination by taxing authorities until the expiration of related statutes of limitations on the return, which is generally three years.

Subsequent Events Management has evaluated subsequent events through January 18, 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

Big Sandy 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.

Investments in associated organizations consist of:

	<u>2016</u>	<u>2015</u>
East Kentucky, patronage capital	\$14,507,417	\$13,707,417
CFC, CTC's	472,200	479,095
CFC, patronage capital	203,107	199,494
Other associated organizations	<u>466,102</u>	<u>439,483</u>
Total	<u><u>\$15,648,826</u></u>	<u><u>\$14,825,489</u></u>

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, Big Sandy may distribute the difference between 25% and the payments made to such estates. The equity at December 31, 2016 was 46% of total assets. Prior years' deficits will be offset with future years' non operating margins.

Big Sandy Rural Electric Cooperative
Notes to Financial Statements

Note 4. Long Term Debt

All assets, except vehicles, are pledged as collateral on the long term debt to RUS, Federal Financing Bank (“FFB”), CFC, and National Bank for Cooperatives (“CoBank”) under a joint mortgage agreement.

The long term debt is due in quarterly and monthly installments of varying amounts through 2039. The 3.35% to 6.46% notes due CFC are available for repricing every 7 years to either a variable or fixed rate. RUS assess 12.5 basis points to administer the FFB loans. Big Sandy has loan funds available from FFB in the amount of \$9,000,000. These funds will be used for future plant additions.

First mortgage notes consist of:

	<u>2016</u>	<u>2015</u>
RUS, 0.56% to 4.93%	\$7,999,248	\$8,264,518
Advance payments at 5%	(3,012,250)	(3,012,250)
	4,986,998	5,252,268
FFB, 0.274% and 4.472%	15,144,531	14,662,638
CoBank, 3.26%	838,564	1,021,915
CFC:		
3.35% to 6.46% notes	339,726	382,839
Refinance RUS loans 5.65% to 5.70%	689,511	1,034,267
	1,029,237	1,417,106
	21,999,330	22,353,927
Less current portion	1,375,000	1,350,000
Long term portion	\$20,624,330	\$21,003,927

As of December 31, 2016, the annual principal portion of long term debt outstanding for the next five years are as follows: 2017 - \$1,375,000; 2018 - \$1,385,000; 2019 - \$1,050,000; 2020 - \$1,075,000; 2021 - \$950,000.

Note 5. Short Term Borrowings

At December 31, 2016, Big Sandy had short term lines of credit of \$2,500,000 available from CFC and \$2,000,000 from CoBank. Big Sandy has repaid all advances during the audit period.

Note 6. Pension Plan

All eligible non-union employees of Big Sandy 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 considered 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.

Big Sandy Rural Electric Cooperative
Notes to Financial Statements

Note 6. Pension Plans, continued

Big Sandy'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. Big Sandy made contributions to the plan of \$270,668 in 2016 and \$235,673 in 2015. There have been no significant changes that affect the comparability of 2016 and 2015.

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 over 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.

All eligible union employees participate in the American Funds Retirement Planning Center's 401(k) Savings Plan. This plan was converted from NRECA effective January 1, 2010. Big Sandy contributes 6% of base wages to the plan. The Corporation contributions to the plan totaled \$97,947 in 2016 and \$95,202 in 2015.

Note 7. Postretirement Benefits

Big Sandy 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. 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 4.50%.

The funded status of the plan is as follows:

	<u>2016</u>	<u>2015</u>
Projected benefit obligation	(\$3,678,035)	(\$3,749,502)
Plan assets at fair value	<u>-</u>	<u>-</u>
Funded status	<u>(\$3,678,035)</u>	<u>(\$3,749,502)</u>

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

	<u>2016</u>	<u>2015</u>
Benefit obligation - beginning of period	\$3,749,502	\$3,786,152
Net periodic benefit cost:		
Service cost	20,692	29,978
Interest cost	<u>99,552</u>	<u>90,266</u>
Net period cost	120,244	120,244
Adjust comprehensive income	-	-
Benefit payments to participants	<u>191,711</u>	<u>(156,894)</u>
Benefit obligation - end of period	<u>\$4,061,457</u>	<u>\$3,749,502</u>

Projected retiree benefit payments for the next five years are expected to be as follows: 2017 - \$173,000; 2018 - \$165,000; 2019 - \$167,000; 2020 - \$169,000; 2021 - \$161,000.

Big Sandy Rural Electric Cooperative
Notes to Financial Statements

Note 8. Related Party Transactions

Several of the Directors of Big Sandy and its President & General Manager are on the Boards of Directors of various associated organizations.

Note 9. Commitments

Big Sandy 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 10. Environmental Contingency

Big Sandy 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 Big Sandy 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 Big Sandy's financial position or its future cash flows.

Note 11. Labor Force

Approximately 40% of Big Sandy's labor force is subject to a collective bargaining agreement. A two (2) year agreement was negotiated and approved for the period starting January 1, 2016 between Big Sandy and the International Brotherhood of Electric Workers ("IBEW").

Note 12. Contingencies

Big Sandy, 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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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
Big Sandy Rural Electric Cooperative

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 Big Sandy Rural Electric 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 January 18, 2017.

Internal Control Over Financial Reporting

In planning and performing my audit of the financial statements, I considered Big Sandy'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 Big Sandy's internal control. Accordingly, we do not express an opinion on the effectiveness of Big Sandy'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
Big Sandy Rural Electric Cooperative

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Big Sandy'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
January 18, 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
Big Sandy Rural Electric Cooperative

Independent Auditor's Report

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 Big Sandy Rural Electric Cooperative ("the 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 January 18, 2017. In accordance with *Government Auditing Standards*, we have also issued my report dated January 18, 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 and my schedule of findings and recommendations related to my audit 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, 2013, 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;

Board of Directors
Big Sandy Rural Electric Cooperative

- 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;
- 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.

The deferred credits are as follows:

Consumer advances for construction	<u><u>\$11,594</u></u>
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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
January 18, 2017