

Kentucky 58

Big Sandy Rural Electric
Cooperative Corporation

Paintsville, Kentucky

Audited Financial Statements
December 31, 2018 and 2017

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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, 2018 and 2017, 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, 2018 and 2017, 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, 2019, 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, 2019

Big Sandy Rural Electric Cooperative Corporation
Balance Sheets, December 31, 2018 and 2017

	2018	2017
<u>Assets</u>		
Electric Plant, at original cost:		
In service	\$ 54,915,104	\$ 53,992,602
Under construction	9,935	86
	54,925,039	53,992,688
Less accumulated depreciation	22,227,032	20,660,636
	32,698,007	33,332,052
Investments in Associated Organizations	16,971,320	16,275,649
Current Assets:		
Cash and cash equivalents	630,888	917,392
Accounts receivable, less allowance for 2018 of \$126,211 and 2017 of \$123,948	3,176,063	3,214,988
Other receivables	560,784	390,959
Material and supplies, at average cost	291,034	266,120
Other current assets	32,163	33,219
	4,690,932	4,822,678
Total	\$ 54,360,259	\$ 54,430,379
<u>Members' Equities and Liabilities</u>		
Members' Equities:		
Memberships	\$ 225,225	\$ 226,470
Patronage capital	27,009,568	25,744,790
Other equities	760,272	744,528
Accumulated other comprehensive income	(2,509,093)	(2,105,753)
	25,485,972	24,610,035
Long Term Debt	20,027,095	21,186,929
Accumulated Postretirement Benefits	4,138,858	3,575,297
Current Liabilities:		
Notes payable	150,000	-
Accounts payable	2,441,056	2,570,791
Current portion of long term debt	1,160,000	1,485,000
Consumer deposits	604,819	607,249
Accrued expenses	346,698	386,730
	4,702,573	5,049,770
Consumer Advances	5,761	8,348
Total	\$ 54,360,259	\$ 54,430,379

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, 2018 and 2017

	2018	2017
Operating Revenues		
Sale of electricity	\$ 24,519,877	\$ 22,147,096
Other electric revenue	800,352	764,152
	25,320,229	22,911,248
Operating Expenses:		
Cost of power	16,283,925	15,297,334
Distribution - operations	1,191,301	1,055,596
Distribution - maintenance	1,709,063	1,640,467
Consumer accounts	950,005	897,453
Customer services	93,080	61,816
Sales	39	285
Administrative and general	1,395,934	1,520,550
Depreciation, excluding \$189,410 in 2018 and \$182,893 in 2017 charged to clearing accounts	2,389,078	2,340,042
Taxes, other than income	31,526	32,194
Interest on long-term debt	758,324	704,187
Other interest charges	76,618	66,756
Other deductions	(1,319)	4,591
Total cost of electric service	24,877,574	23,621,271
Operating Margins	442,655	(710,023)
Nonoperating Margins and Capital Credits		
Interest income	174,384	174,438
Other non operating margins	(26,603)	13,472
G&T capital credits	668,553	595,783
Other Capital Credits	64,752	63,783
	881,086	847,476
Net Margins	1,323,741	137,453
Comprehensive income:		
Accumulated postretirement benefits	(403,340)	147,816
Net Comprehensive Income	\$ 920,401	\$ 285,269

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

Big Sandy Rural Electric Cooperative Corporation
Statement of Changes in Members' Equities
for the years ended December 31, 2017 and 2018

	Patronage Capital					Total	Other Equities	Accumulated Other Comprehensive Income	Total Members' Equities
	Memberships	Assigned	Assignable	Prior Deficits	Retirements				
Balance-December 31, 2016	\$ 227,285	\$ 27,436,997	\$ 1,197,455	\$ (243,477)	\$ (2,723,505)	\$ 25,667,470	\$ 728,440	\$ (2,253,569)	\$ 24,369,626
Allocate margins		1,010,297	(1,197,455)	187,158		-			-
Comprehensive income:									
Net margins			137,453			137,453			137,453
Postretirement benefit obligation									
Amortization							147,816		
Adjustments							-		147,816
Total comprehensive income							-		285,269
Net change in memberships	(815)								(815)
Refunds to estates					(60,133)	(60,133)			(60,133)
Other equities						-	16,088		16,088
Balance-December 31, 2017	226,470	28,417,294	137,453	(26,319)	(2,783,638)	25,744,790	744,528	(2,105,753)	24,610,035
Allocate margins		588,000	(137,453)	(450,547)		-			-
Comprehensive income:									
Net margins			1,323,741			1,323,741			1,323,741
Postretirement benefit obligation									
Amortization							(403,340)		
Adjustments							-		(403,340)
Total comprehensive income							-		920,401
Net change in memberships	(1,245)								(1,245)
Refunds to estates					(58,963)	(58,963)			(58,963)
Other equities						-	15,744		15,744
Balance-December 31, 2017	\$ 225,225	\$ 29,005,294	\$ 1,323,741	\$ (476,866)	\$ (2,842,601)	\$ 27,009,568	\$ 760,272	\$ (2,509,093)	\$ 25,485,972

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, 2018 and 2017

	2018	2017
Cash Flows from Operating Activities:		
Net margins (deficit)	\$ 1,323,741	\$ 137,453
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation:		
Charged to expense	2,389,078	2,340,042
Charged to clearing accounts	189,410	182,893
Patronage capital credits assigned	(733,305)	(659,566)
Accumulated postretirement benefits	160,221	45,078
Change in assets and liabilities:		
Receivables	(130,900)	94,863
Material and supplies	(24,914)	9,539
Other assets	1,056	7,212
Payables	(129,735)	221,416
Consumer deposits and advances	(5,017)	(14,195)
Accrued expenses	(40,032)	86,051
	2,999,603	2,450,786
Cash Flows from Investing Activities:		
Plant additions	(1,613,097)	(2,212,866)
Plant removal costs	(395,303)	(490,499)
Salvage recovered from retired plant	63,957	58,477
Receipts from other investments, net	37,634	32,743
	(1,906,809)	(2,612,145)
Cash Flows from Financing Activities:		
Net increase in memberships	(1,245)	(815)
Refund of patronage capital to members	(58,963)	(60,133)
Increase in other equities	15,744	16,088
Short term borrowings (net)	150,000	-
Payments on long term debt	(1,484,834)	(1,327,401)
Advances of long term debt	-	2,000,000
Advance payments made (applied)	-	-
	(1,379,298)	627,739
Net increase (decrease) in cash	(286,504)	466,380
Cash and cash equivalents, beginning of year	917,392	451,012
Cash and cash equivalents, end of year	\$ 630,888	\$ 917,392
Supplemental cash flows information:		
Interest paid on long-term debt	\$ 762,804	\$ 684,363

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

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>2018</u>	<u>2017</u>
Distribution plant	\$48,510,165	\$47,611,852
General plant	<u>6,404,939</u>	<u>6,380,750</u>
Total	<u><u>\$54,915,104</u></u>	<u><u>\$53,992,602</u></u>

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. Management believes that credit risk related to these 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, 2018 or 2017. 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, trade accounts payable, 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 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.

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.

Big Sandy Rural Electric Cooperative
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies, continued

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, 2018 and 2017. 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, 2019, 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>2018</u>	<u>2017</u>
East Kentucky, patronage capital	\$15,779,536	\$15,110,983
CFC, CTC's	458,410	465,305
CFC, patronage capital	216,509	205,894
Other associated organizations	516,865	493,467
Total	<u>\$16,971,320</u>	<u>\$16,275,649</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, 2018 was 47% of total assets. Prior years' deficits will be offset with future years' non operating margins.

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 \$7,000,000. These funds will be used for future plant additions.

Big Sandy Rural Electric Cooperative
Notes to Financial Statements

Note 4. Long Term Debt, continued

First mortgage notes consist of:

	<u>2018</u>	<u>2017</u>
RUS, 0.875% to 4.25%	\$1,333,485	\$1,428,370
Advance payments at 5%	<u>(3,000,000)</u>	<u>(3,000,000)</u>
	<u>(1,666,515)</u>	<u>(1,571,630)</u>
FFB, 0.50% and 4.472%	<u>16,124,515</u>	<u>16,639,518</u>
CoBank, 3.26%	<u>453,935</u>	<u>649,301</u>
CFC:		
6.46% notes	301,061	317,205
Refinance RUS loans 5.70%	0	344,756
Refinance RUS loans 2.95% to 4.30%	<u>5,974,099</u>	<u>6,292,779</u>
	<u>6,275,160</u>	<u>6,954,740</u>
	21,187,095	22,671,929
Less current portion	<u>1,160,000</u>	<u>1,485,000</u>
Long term portion	<u><u>\$20,027,095</u></u>	<u><u>\$21,186,929</u></u>

During 2017 Big Sandy refinanced \$6,292,779 of higher rate RUS notes with proceeds from CFC.

As of December 31, 2018, the annual principal portion of long term debt outstanding for the next five years are as follows: 2019 - \$1,160,000; 2020 - \$1,180,000; 2021 - \$1,050,000; 2022 - \$1,000,000; 2023 - \$1,020,000.

Note 5. Short Term Borrowings

At December 31, 2018, Big Sandy had short term lines of credit of \$2,500,000 available from CFC and \$2,000,000 from CoBank. Big Sandy advanced \$150,000 from CoBank at an interest rate of 4.61%.

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. Eligible employees include employees hired prior to August 1, 2002. Non-eligible employees are those hired after August 1, 2002. 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’s contributions to the R&S Plan in 2018 and 2017 represent less than 5 percent of the total contributions made to the plan by all participating employers. Big Sandy made contributions to the plan for eligible employees of \$253,425 in 2018 and \$274,916 in 2017. There have been no significant changes that affect the comparability of 2018 and 2017.

Big Sandy Rural Electric Cooperative
Notes to Financial Statements

Note 6. Pension Plans, 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 over 80 percent funded at January 1, 2018 and 2017 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.

Note 7. Savings Plan

Big Sandy participates in the NRECA Savings Plan, a multiemployer, defined contribution master pension plan. Non-eligible employees, as defined above, participate in the Savings Plan with Big Sandy contributing 10% of annual base pay. Employer contributions to the plan were \$36,522 for 2018 and \$33,593 for 2017, and vest immediately.

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. Employer contributions to the plan totaled \$99,344 in 2018 and \$103,629 in 2017, and vest immediately. There have been no significant changes that affect the comparability of 2018 and 2017 for either plan.

Note 8. 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 7% in 2018, 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>2018</u>	<u>2017</u>
Projected benefit obligation	(\$4,138,858)	(\$3,575,297)
Plan assets at fair value	-	-
Funded status	(\$4,138,858)	(\$3,575,297)

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

	<u>2018</u>	<u>2017</u>
Benefit obligation - beginning of period	\$3,575,297	\$3,678,035
Net periodic benefit cost:		
Service cost	83,888	24,497
Interest cost	163,200	95,747
Net period cost	247,088	120,244
Actuarial adjustment	535,398	0
Benefit payments to participants	(218,925)	(222,982)
Benefit obligation - end of period	\$4,138,858	\$3,575,297

Big Sandy Rural Electric Cooperative
Notes to Financial Statements

Amounts included in accumulated other comprehensive income:

Unrecognized actuarial gain (loss)	<u>\$2,509,093</u>	<u>\$2,105,753</u>
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Effect of 1% increase in the health care trend:

Postemployment benefit obligation	\$4,390,000
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Net periodic benefit cost	262,000
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Projected retiree benefit payments for the next five years are expected to be as follows: 2019 - \$216,000; 2020 - \$213,000; 2021 - \$206,000; 2022 - \$207,000; 2023 - \$188,000.

Note 9. 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 10. 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 11. 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 12. Labor Force

Approximately 40% of Big Sandy's labor force is subject to a collective bargaining agreement. A three (3) year agreement was negotiated and approved for the period starting January 1, 2018 between Big Sandy and the International Brotherhood of Electric Workers ("IBEW").

Note 13. Contingencies

Big Sandy occasionally 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.

Note 14. Rate Matters

The PSC granted Big Sandy an increase in base rates in the amount of approximately \$1,060,000, or 5%.

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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
Paintsville, Kentucky

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, 2018 and 2017, 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, 2019.

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, 2019

ALAN M. ZUMSTEIN
CERTIFIED PUBLIC ACCOUNTANT

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MEMBER
• AMERICAN INSTITUTE OF CPA'S
• KENTUCKY 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
Paintsville, Kentucky

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, 2018, 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, 2019. In accordance with *Government Auditing Standards*, we have also issued my report dated January 18, 2019, 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>\$5,761</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, 2019