

Kentucky 52  
Fleming-Mason Energy Cooperative, Inc.  
Flemingsburg, Kentucky

Audited Financial Statements  
December 31, 2016 and 2015

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**Independent Auditor's Report**

To the Board of Directors  
Fleming-Mason Energy Cooperative, Inc.

**Report on the Financial Statements**

I have audited the accompanying financial statements of Fleming-Mason Energy Cooperative, Inc., 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  
Fleming-Mason Energy Cooperative, Inc.

### **Opinion**

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Fleming-Mason Energy Cooperative, Inc. 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 16, 2017, on my consideration of Fleming-Mason Energy Cooperative, Inc.'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 16, 2017

Fleming-Mason Energy Cooperative, Inc.  
Balance Sheets, December 31, 2016 and 2015

<u>Assets</u>	<u>2016</u>	<u>2015</u>
Electric Plant, at original cost:		
In service	\$ 102,656,283	\$ 100,266,546
Under construction	229,736	361,887
	<u>102,886,019</u>	<u>100,628,433</u>
Less accumulated depreciation	35,487,140	33,477,736
	<u>67,398,879</u>	<u>67,150,697</u>
Investments in Associated Organizations	<u>45,731,882</u>	<u>41,769,812</u>
Current Assets:		
Cash and cash equivalents	2,266,648	128,285
Accounts receivable, less allowance for 2016 of \$127,484 and 2015 of \$130,872	7,410,236	6,170,212
Other receivables	2,136,543	1,480,551
Material and supplies, at average cost	480,851	434,920
Other current assets	128,950	103,443
	<u>12,423,228</u>	<u>8,317,411</u>
Total	<u>\$ 125,553,989</u>	<u>\$ 117,237,920</u>
<u>Members' Equities and Liabilities</u>		
Members' Equities:		
Memberships	\$ 237,220	\$ 235,220
Patronage capital	60,441,418	54,863,434
Other equities	52,353	48,341
Accumulated other comprehensive income	(4,431,726)	(3,673,144)
	<u>56,299,265</u>	<u>51,473,851</u>
Long Term Liabilities:		
Long term debt	44,471,491	44,896,064
Accumulated operating provisions	7,779,834	6,949,236
	<u>52,251,325</u>	<u>51,845,300</u>
Current Liabilities:		
Short term borrowings	4,000,000	2,750,000
Accounts payable	6,844,101	5,912,933
Current portion of long term debt	2,960,000	2,500,000
Consumer deposits	771,245	791,740
Accrued expenses	2,423,128	1,959,658
	<u>16,998,474</u>	<u>13,914,331</u>
Consumer Energy Prepayments	<u>4,925</u>	<u>4,438</u>
Total	<u>\$ 125,553,989</u>	<u>\$ 117,237,920</u>

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

Fleming-Mason Energy Cooperative, Inc.  
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 electric energy	\$ 71,748,268	\$ 68,469,115
Other electric revenue	1,109,838	1,020,710
	<u>72,858,106</u>	<u>69,489,825</u>
Operating Expenses:		
Cost of power	58,716,259	56,077,535
Distribution - operations	1,949,123	1,791,691
Distribution - maintenance	3,052,771	2,886,872
Consumer accounts	1,472,179	1,622,358
Customer services	125,535	123,416
Sales	(30,704)	15,020
Administrative and general	1,567,716	1,501,843
Depreciation, excluding \$227,457 in 2016 and \$255,845 in 2015 charged to clearing accounts	3,414,078	3,384,372
Taxes, other than income	82,783	83,935
Long-term debt	768,453	807,058
Other	53,627	105,787
Other deductions	21,864	22,001
Total cost of electric service	<u>71,193,684</u>	<u>68,421,888</u>
Operating margins before interest charges	<u>1,664,422</u>	<u>1,980,782</u>
Nonoperating Margins		
Interest income	43,620	42,607
Others	(18,424)	70,338
	<u>25,196</u>	<u>112,945</u>
Patronage Capital Credits		
Generation and transmission	3,883,948	3,882,999
Other associated organizations	201,005	105,230
	<u>4,084,953</u>	<u>3,988,229</u>
Net Margins	5,774,571	5,169,111
Other Comprehensive Income:		
Pension plan	(758,582)	(244,481)
Postretirement benefits	-	81,160
Total Comprehensive Income	<u>\$ 5,015,989</u>	<u>\$ 5,005,790</u>

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

Fleming-Mason Energy Cooperative, Inc.  
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
	Memberships	Assigned	Unassigned	Prior Deficits	Retirements	Total			
Balance - December 31, 2014	\$ 233,645	\$ 53,083,514	\$ 5,266,109	\$ (3,196,929)	\$ (5,240,411)	\$ 49,912,283	\$ 47,315	\$ (3,509,823)	\$ 46,683,420
Allocate margins		5,222,353	(5,266,109)	43,756		-			-
Comprehensive income:									
Net margins			5,169,111			5,169,111			5,169,111
Pension plan									
Amortization								183,657	
Adjustment								(428,138)	(244,481)
Postretirement benefit obligation									
Amortization								(5,154)	
Adjustment								86,314	81,160
Total comprehensive income									5,005,790
Net change in memberships	1,575								1,575
Refunds of capital credits					(217,960)	(217,960)			(217,960)
Other equities						-	1,026		1,026
Balance - December 31, 2015	235,220	58,305,867	5,169,111	(3,153,173)	(5,458,371)	54,863,434	48,341	(3,673,144)	51,473,851
Allocate margins		5,126,504	(5,169,111)	42,607		-			-
Comprehensive income:									
Net margins			5,774,571			5,774,571			5,774,571
Pension plan									
Amortization								216,800	
Adjustment								(975,382)	(758,582)
Postretirement benefit obligation									
Amortization								-	-
Adjustment								-	-
Total comprehensive income									5,015,989
Net change in memberships	2,000								2,000
Refunds of capital credits					(196,587)	(196,587)			(196,587)
Other equities						-	4,012		4,012
Balance - December 31, 2016	\$ 237,220	\$ 63,432,371	\$ 5,774,571	\$ (3,110,566)	\$ (5,654,958)	\$ 60,441,418	\$ 52,353	\$ (4,431,726)	\$ 56,299,265

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

Fleming-Mason Energy Cooperative, Inc.  
 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	\$ 5,774,571	\$ 5,169,111
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation:		
Charged to expense	3,414,078	3,384,372
Charged to clearing accounts	227,457	255,845
Patronage capital credits assigned	(4,084,953)	(3,988,229)
Accumulated postretirement benefits	72,016	130,042
Change in assets and liabilities:		
Receivables	(1,896,016)	1,403,792
Material and supplies	(45,931)	(31,931)
Other assets	(25,507)	24,103
Payables	931,168	(533,112)
Consumer deposits and advances	(20,008)	(16,288)
Accrued expenses	463,470	287,658
	<u>4,810,345</u>	<u>6,085,363</u>
Cash Flows from Investing Activities:		
Plant additions	(3,453,535)	(4,209,043)
Plant removal costs	(439,559)	(235,468)
Salvage recovered from retired plant	3,377	(281)
Receipts from other investments, net	122,883	67,217
	<u>(3,766,834)</u>	<u>(4,377,575)</u>
Cash Flows from Financing Activities:		
Net increase in memberships	2,000	1,575
Refund of patronage capital to members	(196,587)	(217,960)
Increase in other equities	4,012	1,026
Advances of long term debt	3,000,000	3,380,000
Payments on long term debt	(2,964,573)	(2,694,892)
Short term borrowings (repayments)	1,250,000	(2,980,000)
	<u>1,094,852</u>	<u>(2,510,251)</u>
Net increase in cash	2,138,363	(802,463)
Cash and cash equivalents, beginning of year	128,285	930,748
Cash and cash equivalents, end of year	<u>\$ 2,266,648</u>	<u>\$ 128,285</u>
Supplemental cash flows information:		
Interest paid on long-term debt	\$ 769,027	\$ 807,670

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



Fleming-Mason Energy Cooperative, Inc.  
Notes to Financial Statements

**Note 1. Summary of Significant Accounting Policies**

Fleming-Mason Energy Cooperative, Inc. (“Fleming-Mason”) 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	\$92,338,697	\$89,911,133
General plant	<u>10,317,586</u>	<u>10,355,413</u>
Total	<u>\$102,656,283</u>	<u>\$100,266,546</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 1.44% to 10.0%, with a composite rate of 3.64% for distribution plant. General plant rates are as follows:

Structures and improvements	2.5%
Transportation equipment	10% - 20%
Other general plant	5% - 10%

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

**Off Balance Sheet Risk** Fleming-Mason has off-balance sheet risk in that they maintain cash deposits in financial institutions in excess of the amounts insured by the Federal Deposit Insurance Corporation (FDIC). At December 31, 2016, the financial institutions reported deposits in excess of the \$250,000 FDIC insured limit several times during the audit period. These financial institutions have strong credit ratings and management believes that the credit risk related to the accounts is minimal.

**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.

**Revenue** Fleming-Mason records revenue as billed to its consumers based on monthly meter-reading cycles. All consumers are required to pay a refundable deposit that may be waived under certain circumstances. Fleming-Mason’s sales are concentrated in an eight county area of eastern Kentucky. Consumers must pay their bill within 20 days of billing, at which time a disconnect notice is sent with payment to be within 10 days. If not paid, then consumers are subject to disconnect. Accounts are written off when they are deemed to be uncollectible. The allowance for uncollectible accounts is based on the aging of receivables. There was one customer whose individual account balance exceeded 10% of outstanding accounts receivable at December 31, 2016 and 2015. See Note 8 for additional information.

Fleming-Mason Energy Cooperative, Inc.  
Notes to Financial Statements

**Note 1. Summary of Significant Accounting Policies**, continued

**Sales Taxes** Fleming-Mason 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. Fleming-Mason'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** Fleming-Mason is one of sixteen (16) members of East Kentucky Power Cooperative ("East Kentucky"). Under a wholesale power agreement, Fleming-Mason 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. There are certain surcharges, clauses, and credits that East Kentucky includes to Fleming-Mason that are passed on to consumers using a methodology prescribed by the Commission.

**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 Fleming-Mason's cash and cash equivalents, receivables, inventories, other assets, trade accounts payable, and accrued 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 Fleming-Mason. 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.

Fleming-Mason 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.

**Advertising** Fleming-Mason expenses advertising costs as incurred.

Fleming-Mason Energy Cooperative, Inc.  
Notes to Financial Statements

**Note 1. Summary of Significant Accounting Policies, continued**

**Income Tax Status** Fleming-Mason is exempt from federal and state income taxes under provisions of Section 501(c)(12). Accordingly, the financial statements for Fleming-Mason include no provision for income taxes. Fleming-Mason'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 Fleming-Mason has no uncertain tax positions resulting in an accrual of tax expense or benefit. Fleming-Mason recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. Fleming-Mason did not recognize any interest or penalties during the years ended December 31, 2016 and 2015. Fleming-Mason'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.

**Risk Management** Fleming-Mason 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.

**Subsequent Events** Management has evaluated subsequent events through March 16, 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:

	<u>2016</u>	<u>2015</u>
East Kentucky, patronage capital	\$43,599,962	\$39,702,935
CFC, CTC's	827,478	828,831
CFC, patronage capital	280,233	282,621
Others	1,024,209	955,425
Total	<u>\$45,731,882</u>	<u>\$41,769,812</u>

Fleming-Mason 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 0%, 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, Fleming-Mason may distribute the difference between 25% and the payments made to such estates. The equity at December 31, 2016 was 45% of total assets. Prior years' losses are being carried forward and are offset with future years' non operating margins.

Fleming-Mason Energy Cooperative, Inc.  
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 Cooperative (“CoBank”) under a joint mortgage agreement. Long term debt consists of:

	<u>2016</u>	<u>2015</u>
FFB, 0.274% and 2.192%	\$28,254,548	\$27,441,369
RUS, advance payment earns 5% interest	(15,059)	(14,940)
RUS, Economic Development Loan, 0%	1,622,797	779,025
CFC, 3.1% to 4.05%	1,748,253	1,924,542
CoBank, 3.73%	2,729,707	3,411,729
CoBank, 3.26%	13,091,245	13,854,339
	47,431,491	47,396,064
Less current portion	2,960,000	2,500,000
Long term portion	\$44,471,491	\$44,896,064

The interest rates on the notes to CFC are subject to change every seven years from the repricing date for each individual note. The long term debt is due in quarterly and monthly installments of varying amounts through 2039. Fleming-Mason has loan funds approved from FFB in the amount of \$5,000,000, which will be used for future plant additions. RUS assess 12.5 basis points to administer the FFB loans. During 2015, Fleming-Mason refinanced \$13,854,339 of RUS loans with the 3.26% notes from CoBank.

Fleming-Mason is participating in a RUS sponsored program which provides economic development funds to businesses in Fleming-Mason’s service area. Fleming-Mason serves as a conduit for these funds and is contingently liable if the recipient fails to repay the loan.

As of December 31, 2016, the annual principal payments for the next five years are as follows: 2017 - \$2,960,000; 2018 - \$3,000,000; 2019 - \$3,100,000; 2020 - \$3,200,000; 2021 - \$3,300,000.

**Note 5. Short Term Borrowings**

At December 31, 2016, Fleming-Mason had a short term line of credit of \$10,000,000 available from CFC. The outstanding balance under the line of credit at December 31, 2016 and 2015 was \$4,000,000 and \$2,750,000, respectively. The interest rate at December 31, 2016 and 2015 was 2.50%, respectively. Fleming-Mason also has a line of credit with CoBank in the amount of \$10,000,000. There were no advances against this line of credit during the audit period.

**Note 6. Pension Plan**

Fleming-Mason has a noncontributory defined benefit pension plan covering substantially all employees who meet minimum age and service requirements. The plan has pay-related pension benefit formula. Fleming-Mason’s policy is to fund such plans in accordance with the requirements of the Employee Retirement Income Security Act (“ERISA”) of 1974. The plan is measured as of December 31, 2016 and 2015. Effective January 1, 2010, the benefit level changed from 2.0 to 1.8 and lump-sum payments will be discontinued. Benefits accrued prior to January 1, 2010 will not be affected. There have been no significant changes that affect the comparability of 2016 and 2015.

Fleming-Mason Energy Cooperative, Inc.  
Notes to Financial Statements

**Note 6. Pension Plan**, continued

The following is an assessment of the noncontributory defined benefit plan:

	<u>2016</u>	<u>2015</u>
Change in Benefit Obligation:		
Beginning of year	\$9,912,737	\$9,251,441
Service cost	521,369	486,916
Interest cost	467,951	396,377
Actuarial (gain)/loss	852,575	(188,144)
Benefits paid	<u>(457,227)</u>	<u>(33,853)</u>
End of year	<u>11,297,405</u>	<u>9,912,737</u>
Change in Plan Assets:		
Beginning of year	4,871,170	4,595,181
Actual return on assets	262,412	(90,158)
Employer contributions	430,000	400,000
Benefits paid	<u>(457,227)</u>	<u>(33,853)</u>
End of year	<u>5,106,355</u>	<u>4,871,170</u>
Funded status of plan	<u>(\$6,191,050)</u>	<u>(\$5,041,567)</u>
Accumulated benefit obligation in plan	<u>\$7,852,143</u>	<u>\$6,860,809</u>

The amounts recognized in the statement of financial position are as follows:

	<u>2016</u>	<u>2015</u>
Accumulated comprehensive income	(\$4,448,500)	(\$3,689,918)
Accrued benefit liability	<u>(1,742,550)</u>	<u>(1,351,649)</u>
Amount recognized in financial statements	<u>(\$6,191,050)</u>	<u>(\$5,041,567)</u>

The net periodic pension benefit cost was calculated as follows:

	<u>2016</u>	<u>2015</u>
Service cost	\$521,369	\$486,916
Interest cost	467,951	396,377
Expected return on plan assets	(385,219)	(363,804)
Amortization of actuarial (gain)/loss	<u>216,800</u>	<u>183,657</u>
Net periodic benefit cost	<u>\$820,901</u>	<u>\$703,146</u>

Assumptions used to develop the projected benefit obligation are as follows:

	<u>2016</u>	<u>2015</u>
Discount rate	4.25%	4.25%
Rate of increase in compensation level	3.50%	3.50%
Expected long-term rate of return on assets	8.00%	8.00%

The expected long term rate of return on plan assets for determining net periodic pension cost for each fiscal year is chosen from the best range determined by applying anticipated long term returns for various asset categories to the target asset allocation of the plan, as well as taking into account historical returns.

Fleming-Mason Energy Cooperative, Inc.  
Notes to Financial Statements

**Note 6. Pension Plan, continued**

The general investment objectives are to invest in a diversified portfolio, comprised of debt investments, equity investments, and fixed income investments. The diversification is designed to minimize the risk of large losses while maximizing total return within reasonable and prudent levels of risk. The investment objectives specify a targeted investment allocation for the pension plan of approximately 50% equities. The remaining may be allocated among fixed income or cash equivalent investments.

Expected retiree pension benefit payments are projected to be as follows: 2017 - \$118,000; 2018 - \$121,000; 2019 - \$1,736,000; 2020 - \$501,000; 2021 - \$574,000.

Fleming-Mason expects to contribute approximately \$603,755 during 2017. However, Fleming-Mason reserves the right to contribute more or less depending on other considerations and circumstances.

**Note 7. Postretirement Benefits**

Fleming-Mason sponsors a defined benefit plan that provides medical insurance coverage to retired employees, directors and attorney. The plan calls for benefits to be paid at retirement based primarily upon years of service with Fleming-Mason. There have been no significant changes that affect the comparability of 2016 and 2015. The following is a reconciliation of the postretirement obligation.

The status of the unfunded postretirement benefit plan is as follows:

	<u>2016</u>	<u>2015</u>
Change in Benefit Obligation:		
Beginning of year	<u>\$3,259,318</u>	<u>\$3,048,116</u>
Net periodic benefit cost:		
Service cost	81,034	127,087
Interest cost	<u>150,252</u>	<u>156,174</u>
	231,286	283,261
Actuarial (gain)/loss	0	86,314
Benefits paid	<u>(159,270)</u>	<u>(158,373)</u>
End of year	3,562,620	3,259,318
Plan assets	-	-
Funded status of plan	<u><u>(\$3,562,620)</u></u>	<u><u>(\$3,259,318)</u></u>
Amounts included in other comprehensive income:		
Unrecognized actuarial gain (loss)	<u><u>\$16,774</u></u>	<u><u>\$16,774</u></u>
Effect of 1% increase in the health care trend:		
Postemployment benefit obligation	\$3,795,000	
Net periodic benefit cost	245,000	

Projected retiree benefit payments for the next five years are expected to be as follows: 2017 - \$175,000; 2018 - \$172,000; 2019 - \$168,000; 2020 - \$161,000; 2021 - \$158,000.

The discount rate used in determining the APBO was 4.50% for 2016 and 2015. The health care cost trend rate used to compute the APBO in an 8% annual rate of increase for 2016, and decreasing gradually to 5%, and then remain at that level thereafter.

Fleming-Mason Energy Cooperative, Inc.  
Notes to Financial Statements

**Note 8. Significant Patron Information**

One (1) member accounted for approximately 18% of electric revenues for the year ended December 31, 2016. The Cooperative has a contract in place with the member. Management does not expect the business relationship to change with this member. In addition, Fleming-Mason bills and collects steam charges for East Kentucky to the industrial customer. There are no margins realized from this arrangement with East Kentucky, therefore, the amounts are not reflected in operating revenues or cost of power.

**Note 9. Related Party Transactions**

Several of the Directors of Fleming-Mason, its President & CEO, and another employee are on the boards of directors of various associated organizations.

**Note 10. Commitments**

Fleming-Mason has various other agreements outstanding with local contractors. Under these agreements, the contractors will perform construction, maintenance, and other 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. Contingencies**

Fleming-Mason, 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  
Fleming-Mason Energy Cooperative, Inc.

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 Fleming-Mason Energy Cooperative, Inc. ("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 16, 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, I 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  
Fleming-Mason Energy Cooperative, Inc.

### **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 16, 2017

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

Board of Directors  
Fleming-Mason Energy Cooperative, Inc.

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 Fleming-Mason Energy Cooperative, Inc. ("Cooperative"), which comprise the balance sheet as of December 31, 2016, and the related statements of revenue and comprehensive income, members' equities, 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 16, 2017. In accordance with *Government Auditing Standards*, I have also issued my report dated March 16, 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 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;
- 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;

Board of Directors  
Fleming-Mason Energy Cooperative, Inc.

- 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 energy prepayments	<u>\$4,925</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  
March 16, 2017