GRAYSON RURAL ELECTRIC COOPERATIVE CORPORATION

FINANCIAL REPORT

MAY 31, 2019

C O N T E N T S

JNM

Jones, Nale & Mattingly PLC

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Grayson Rural Electric Cooperative Corporation
Grayson, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of Grayson Rural Electric Cooperative Corporation, which comprise the balance sheet as of May 31, 2019, and the related statement of revenue and comprehensive income, changes in members' equities, and cash flows for the year 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

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

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

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

Certified Public Accountants and Advisors
642 South Fourth Street, Suite 300 Louisville, Kentucky 40202 tel: 502.583.0248 fax: 502.589-1680 www.jnmcpa.com

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Grayson Rural Electric Cooperative Corporation as of May 31, 2019, and the results of its operations and its cash flows for the year 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*, we have also issued our report dated August 16, 2019, on our consideration of Grayson Rural Electric Cooperative Corporation's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering internal control over financial reporting and compliance.

Prior Period Financial Statements

The financial statements of Grayson Rural Electric Cooperative Corporation, as of and for the year ended May 31, 2018 were audited by other auditors whose report dated July 26, 2018 expressed an unmodified opinion on those statements.

Jones, Nale & Mattingly PLC

Louisville, Kentucky
August 16, 2019

GRAYSON RURAL ELECTRIC COOPERATIVE CORPORATION
BALANCE SHEETS
May 31, 2019 and 2018

Assets	2019	2018
Electric Plant, at original cost:		
In service	$ 81,340,601	$ 77,640,285
Under construction	88,043	1,392,058
	81,428,644	79,032,343
Less accumulated depreciation	25,975,553	24,528,610
	55,453,091	54,503,733
Investments in Associated Organizations and Others	17,434,255	16,453,749
Current Assets:		
Cash and cash equivalents	88,516	87,012
Accounts receivable, less allowance for 2019 of $70,374 and 2018 of $81,820	2,658,074	2,827,061
Other receivables	261,642	260,539
Material and supplies, at average cost	1,370,853	254,114
Other current assets	500,486	475,683
Total current assets	4,879,571	3,904,409
Deferred Debits	1,251,178	1,405,170
Total	$ 79,018,095	$ 76,267,061
Members' Equities and Liabilities		
Members' Equities:		
Memberships	$ 154,395	$ 154,415
Patronage capital	26,901,553	26,455,325
Other equities	220,891	215,590
Accumulated other comprehensive (loss)	(408,825)	(432,236)
	26,868,014	26,393,094
Long Term Debt, less current portion	42,034,172	38,913,114
Accumulated Postretirement Benefits	3,208,998	3,123,011
Current Liabilities:		
Short term borrowings	550,000	1,609,000
Accounts payable	1,848,850	1,820,638
Current portion of long term debt	1,878,000	2,056,000
Consumer deposits	1,486,999	1,229,769
Accrued expenses	1,053,870	1,030,019
Total current liabilities	6,817,719	7,745,426
Consumer Advances	89,192	92,416
Total	$ 79,018,095	$ 76,267,061

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

GRAYSON RURAL ELECTRIC COOPERATIVE CORPORATION
STATEMENTS OF REVENUE AND COMPREHENSIVE INCOME
Years Ended May 31, 2019 and 2018

	2019	2018
Operating Revenues:		
Sale of electric energy	$ 29,491,020	$ 28,991,469
Other electric revenues	1,052,874	1,053,601
	30,543,894	30,045,070
Operating Expenses:		
Cost of power	17,663,313	18,146,334
Distribution - operations	1,144,254	1,371,826
Distribution - maintenance	3,809,397	3,360,487
Consumer accounts	1,175,896	1,105,770
Customer services	189,574	230,186
Sales	9,075	21,415
Administrative and general	2,035,798	2,102,218
Depreciation, excluding $205,408 in 2019 and $211,301 in 2018 charged to clearing accounts	3,619,045	3,534,829
Taxes, other than income	32,505	41,105
Interest on long-term debt	1,271,753	1,040,077
Other interest expense	81,705	54,695
Other deductions	13,705	15,240
Total cost of electric service	31,046,020	31,024,182
Operating (Deficits)	(502,126)	(979,112)
Nonoperating Margins:		
Interest income	30,738	29,854
Others	1,870	78,841
	32,608	108,695
Patronage Capital Credits:		
Generation and transmission capital credits	923,463	504,926
Others	143,388	216,063
	1,066,851	720,989
Net Margins (Deficits)	597,333	(149,428)
Other Comprehensive Income:		
Postretirement benefits	23,411	429,010
Comprehensive Income	$ 620,744	$ 279,582

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

GRAYSON RURAL ELECTRIC COOPERATIVE CORPORATION
STATEMENTS OF CHANGES IN MEMBERS' EQUITIES
Years Ended May 31, 2019 and 2018

		Patronage Capital						Accumulated	Total
	Memberships	Assignable	Assigned	Prior Losses	Retirements	Total	Other Equities	Comprehensive Income	Members' Equities
Balance - May 31, 2017	$ 154,375	$ (574,647)	$ 30,267,806	$ (48,662)	$ (2,850,197)	$ 26,794,300	$ 206,425	$ (861,246)	$ 26,293,854
Assign patronage		574,647	1,473,837	(2,048,484)		- -			
Comprehensive income:									
Net margins (deficits)		(149,428)				(149,428)			(149,428)
Postretirement benefit obligation									
Amortization								14,586	
Adjustments								414,424	429,010
Total comprehensive income									279,582
Net change in memberships	40								40
Refunds to estates					(189,547)	(189,547)			(189,547)
Other equities							9,165		9,165
Balance - May 31, 2018	154,415	(149,428)	31,741,643	(2,097,146)	(3,039,744)	26,455,325	215,590	(432,236)	26,393,094
Assign patronage		149,428	(222,853)	73,425		-			
Comprehensive income:									
Net margins		597,333				597,333			597,333
Postretirement benefit obligation									
Amortization								23,411	
Adjustments								- -	23,411
Total comprehensive income									620,744
Net change in memberships	(20)								(20)
Refunds to estates					(124,923)	(124,923)			(124,923)
Other equities			(26,182)			(26,182)	5,301		(20,881)
Balance - May 31, 2019	$ 154,395	$ 597,333	$ 31,492,608	$ (2,023,721)	$ (3,164,667)	$ 26,901,553	$ 220,891	$ (408,825)	$ 26,868,014

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

GRAYSON RURAL ELECTRIC COOPERATIVE CORPORATION
STATEMENTS OF CASH FLOWS
Years Ended May 31, 2019 and 2018

	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Net margins (deficits)	$ 597,333	$ (149,428)
Adjustments to reconcile net margins to net cash provided by operating activities:		
Depreciation:		
Charged to expense	3,619,045	3,534,829
Charged to clearing accounts	205,408	211,301
Patronage capital credits assigned	(1,066,851)	(720,989)
Accumulated postretirement benefits	109,398	147,630
Change in assets and liabilities:		
Receivables	167,884	1,607,582
Material and supplies	(1,116,739)	(2,891)
Other assets	(24,803)	(450)
Prepaid pension costs	153,992	(27,375)
Payables	28,212	73,724
Consumer deposits and advances	254,006	11,499
Accrued expenses	23,851	119,514
Net cash provided by operating activities	2,950,736	4,804,946
CASH FLOWS FROM INVESTING ACTIVITIES		
Plant additions	(4,233,205)	(3,365,404)
Plant removal costs	(696,139)	(469,732)
Salvage recovered from retired plant	155,533	19,911
Receipts from other investments, net	86,345	88,359
Net cash (used in) investing activities	(4,687,466)	(3,726,866)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase (decrease) in memberships	(20)	40
Refund of patronage capital to members	(151,105)	(189,547)
Increase in other equities	5,301	9,165
Principal payments on long term debt	(2,056,942)	(2,247,353)
Advances of long term debt	5,000,000	- -
Short term borrowings (repayments)	(1,059,000)	1,299,000
Net cash provided by (used in) financing activities	1,738,234	(1,128,695)
Net increase (decrease) in cash and cash equivelants	1,504	(50,615)
Cash and cash equivalents, beginning of year	87,012	137,627
Cash and cash equivalents, end of year	$ 88,516	$ 87,012
Supplemental cash flows information:		
Cash payments for interest	$ 1,311,185	$ 1,057,104

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

GRAYSON RURAL ELECTRIC COOPERATIVE CORPORATION
NOTES TO FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

Grayson Rural Electric Cooperative Corporation ("Grayson") 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 for distribution plant. Gain or loss is recognized on disposition of general plant items. Electric plant consists of:

	2019	2018
Distribution plant	$74,559,480	$70,949,688
General plant	6,781,121	6,690,597
Total	$81,340,601	$77,640,285

Depreciation Provision has been made for depreciation on the basis of the estimated lives of assets, using the straight-line method. Depreciation rates are as follows:

Distribution plant	2.89% - 6.67%
Structures and improvements	2%
Transportation equipment	16%
Other general plant items	6% - 16%

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

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

Revenue Grayson records revenue as billed to its consumers based on meter-readings taken on the 2nd of each month using Automated Metering Information ("AMI") technology. All consumers are required to pay a refundable customer deposit; however, it may be waived under certain circumstances. Grayson's sales are concentrated in a six county area of eastern Kentucky. 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. There were no customers whose individual account balance exceeded 10% of outstanding accounts receivable at May 31, 2019 or 2018.

Grayson is required to collect, on behalf of the Commonwealth 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. Grayson' policy is to exclude these taxes from revenue when collected and expenses when paid and instead, record collection and payment of taxes through a liability account.

Note 1. Summary of Significant Accounting Policies, continued

Cost of Power Grayson is one of sixteen (16) members of East Kentucky Power Cooperative ("East Kentucky"). Under a wholesale power agreement, Grayson 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 energy is consumed, based upon billings from East Kentucky.

Fair Value Measurements FASB ASC 820, *Fair Value Measurements and Disclosures* requires that Grayson to disclose estimated fair values of its financial instruments. Fair value estimates, methods, and assumptions are set forth below for Grayson' financial instruments.

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

Grayson may, and also does, invest idle funds in local banks. These investments are classified as held-to-maturity in accordance with provisions of the *Financial Instruments Topic* of FASB ASC 320. Held-to-maturity securities are presented at amortized cost. The fair value of held-to-maturity securities approximates cost at 2019 and 2018.

Risk Management Grayson 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.

Estimates The preparation of financial statements in accordance 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.

Advertising Grayson expenses advertising costs as incurred.

Income Tax Status Grayson is exempt from federal and state income taxes under provisions of Section 501(c)(12). Accordingly, the financial statements for Grayson include no provision for income taxes. Grayson'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 Grayson has no uncertain tax positions resulting in an accrual of tax expense or benefit. Grayson recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. Grayson did not recognize any interest or penalties during the years ended May 31, 2019 and 2018. Grayson's income tax return is subject to possible examination by taxing authorities until the expiration of related statues of limitations on the return, which is generally three years.

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.

NOTES TO FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies, continued

Subsequent Events Management has evaluated subsequent events through August 16, 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

Investments in associated organizations consist of:

	2019	2018
East Kentucky, patronage capital	$15,796,407	$14,872,945
CFC, patronage capital	196,199	178,656
CFC, CTC's	620,722	622,441
Others	820,927	779,707
Total	$17,434,255	$16,453,749

Grayson records patronage capital assigned by associated organizations in the year in which such assignments are received. The CTC's from CFC are a condition of borrowing loan funds.

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, Grayson may distribute the difference between 25% and the payments made to such estates. At May 31, 2019, the equities and margins were 34% of total assets.

Note 4. Long Term Debt

All assets, except vehicles, are pledged as collateral on the long-term debt to Federal Financing Bank (FFB), National Bank for Cooperative's (CoBank), and CFC under a joint mortgage agreement

First mortgage notes consist of:

	2019	2018
FFB, 2.403% (1.738% in 2018)	$27,986,302	$23,854,431
CoBank (refinance RUS loans) 4.62%	6,936,847	7,515,844
CFC, 3.10% to 3.25%	371,216	458,878
CFC (refinance RUS loans) 3.0% to 3.70%	8,617,807	8,963,329
CFC, Finance NRECA benefits 2.20%	- -	176,632
	43,912,172	40,969,114
Less current portion	1,878,000	2,056,000
Long term portion	$42,034,172	$38,913,114

The long-term debt payable to FFB, CoBank, and CFC are due in quarterly and monthly installments of varying amounts through 2039. RUS assess 125 basis points to administer the FFB loans. During 2011 and 2017 Grayson refinanced RUS loans with proceeds from CoBank and CFC, respectively. During 2013, Grayson advanced the 2.2% interest rate notes from CFC to finance the accelerated pension payment to NRECA.

NOTES TO FINANCIAL STATEMENTS

Note 4. Long Term Debt, continued

Grayson has unadvanced loan funds in the amount of $10,325,000 from FFB. These funds will be used for future construction projects.

As of May 31, 2019, annual current principal due for the next five years are as follows: 2020 - $1,878,000; 2021 - $1,898,000; 2022 - $1,922,000; 2023 - $1,950,000; 2024 - $1,980,000.

Note 5. Short Term Borrowings

Grayson has executed a short term line of credit agreement with CFC in the amount of $6,000,000 and from CoBank in the amount of $2,000,000. At May 31, 2019, Grayson advanced $550,000 from CoBank of at an interest rate of 4.53%.

Note 6. Pension Plan

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

Grayson's contributions to the R&S Plan in 2019 and 2018 represent less than 5 percent of the total contributions made to the plan by all participating employers. Grayson made contributions to the plan of $737,342 in 2019 and $715,904 in 2018. There have been no significant changes that affect the comparability of 2019 and 2018.

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 85 percent funded at January 1, 2019 and 2018 based on the PPA funding target and PPA actuarial value of assets on those dates. Because the provisions of the PPA do not apply to the R&S Plan, funding improvement plans and surcharges are not applicable. Future contribution requirements are determined each year as part of the actuarial valuation of the plan and may change as a result of plan experience.

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

Two prepayment options were available to participating cooperatives:

1. Use current assets to make the prepayment over a period of not more than 4 years, or,

Note 6. Pension Plan, continued

2. Borrow funds sufficient to make the prepayment in a lump sum, with the prepayment of the borrowed amount determined by the loan's amortization schedule.

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

Section 6.13(e) of the RUS Loan Contract limits the amount of unsecured debt that a borrower may incur to 15% on Net Utility Plant if the equity level of the borrower, after considering such unsecured debt, is below 30% of its Total Assets, unless the borrower obtains RUS consent. RUS will consider any unsecured debt associated with the R&S Plan prepayment to be "Permitted Debt" and accordingly, it will be excluded from the application of Section 6.13(e). On March 15, 2013, the Cooperative made a prepayment of $1,701,130 to the R&S Plan. The amount is being amortized over 15 years.

Note 7. Postretirement Benefits

Grayson sponsors a defined benefit plan that provides medical insurance coverage for retired employees and their spouses. Grayson pays all the premiums for retirees and their dependents. For measurement purposes, an annual rate of increase of 5% in 2019, then decreasing by 0.25% per year until 3% per year, in the per capita cost of covered health care benefit was assumed. The discount rate used in determining the accumulated postretirement benefit obligation was 4.5% in 2019 and 2018. There have been no significant changes that affect the comparability of 2019 and 2018.

The funded status of the plan is as follows:

	2019	2018
Projected benefit obligation	(3,208,998)	($3,123,011)
Plan assets at fair value	- -	- -
Total	($3,208,998)	($3,123,011)

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

	2019	2018
Benefit obligation at beginning of year	$3,123,011	$3,404,391
Components of net periodic benefit cost:		
Service cost	114,138	147,347
Interest cost	142,470	146,867
Net periodic benefit cost	256,608	294,214
Benefits paid	(170,621)	(180,600)
Actuarial gain/loss	- -	(394,994)
Benefit obligation at end of year	$3,208,998	$3,123,011

Note 7. Postretirement Benefits, continued

	2019	2018
Amounts included in accumulated comprehensive income:		
Unrecognized actuarial gain (loss)	($408,825)	($432,236)
Effect of 1% increase in the health care trend:		
Postemployment benefit obligation	$3,417,000	
Net periodic benefit cost	$273,000	

Projected retiree benefit payments for the next five years are expected to be as follows: 2020 - $174,876; 2021 - $165,569; 2022 - $136,731; 2023 - $111,246; 2024 - $108,388.

Note 8. Commitments

Grayson 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 two years.

Note 9. Environmental Contingency

Grayson 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 Grayson 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 Grayson's financial position or its future cash flows.

Note 10. Related Party Transactions

Several of the Directors of Grayson, its President & CEO, and another employee, are on the Boards of Directors of various associated organizations.

Note 11. Contingencies

Grayson 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 12. Labor Force

Approximately 45% of Grayson's labor force is subject to a collective bargaining agreement. A five (5) year agreement was negotiated and approved for the period starting January 1, 2018 between Grayson and the International Brotherhood of Electric Workers ("IBEW").

Note 13. Rate Matters

During March 2019, the KY PSC granted Grayson an increase in base rates of approximately $1,568,000, or 5%.

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
Grayson Rural Electric Cooperative Corporation
Grayson, Kentucky

We 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 Grayson Rural Electric Cooperative Corporation (the Cooperative), which comprise the balance sheet as of May 31, 2019 and the related statements of revenue and comprehensive income, members' equities and cash flows for the year then ended, and related notes to the financial statements, and have issued our report thereon dated August 16, 2019.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we 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 our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Cooperative's internal control. Accordingly, we do not express an opinion on the effectiveness of the Cooperative's internal control.

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

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

Certified Public Accountants and Advisors
642 South Fourth Street, Suite 300 Louisville, Kentucky 40202 tel: 502.583.0248 fax: 502.589-1680 www.jnmcpa.com

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Cooperative's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations,

contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

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

Jones, Nale & Mattingly PLC

Louisville, Kentucky
August 16, 2019

Jones, Nale & Mattingly PLC

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH ASPECTS OF CONTRACTUAL AGREEMENTS AND REGULATORY REQUIREMENTS FOR ELECTRIC BORROWERS

To the Board of Directors
Grayson Rural Electric Cooperative Corporation
Grayson, Kentucky

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Grayson Rural Electric Cooperative Corporation ("the Cooperative"), which comprise the balance sheet as of May 31, 2019, and the related statements of revenue and comprehensive income, members' equities, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated August 16, 2019. In accordance with *Government Auditing Standards*, we have also issued our report dated August 16, 2019, on our consideration of the Cooperative's internal control over financial reporting and on our 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 our schedule of findings and recommendations related to our audit have been furnished to management.

In connection with our audit, nothing came to our attention that caused us 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 and Grantees*, §1773.33, insofar as they relate to accounting matters as enumerated below. However, our audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our 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 our audit, we 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;

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- 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, which are listed below; and
- Comply with the requirements for the detailed schedule of investments, of which there were none.

The deferred debits are as follows:

Accelerated pension payment	$663,178
System mapping costs	588,000
	$1,251,178

The deferred credits are as follows:

Consumer advances for construction	$89,192

The purpose of this report is solely to communicate, in connection with the audit of the financial statements, on compliance with aspects of contractual agreements and the regulatory requirements for electric borrowers based on the requirements of 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers and Grantees*. Accordingly, this report is not suitable for any other purpose.

Jones, Nale & Mattingly PLC

Louisville, Kentucky
August 16, 2019