

**GRAYSON RURAL ELECTRIC  
COOPERATIVE CORPORATION  
KENTUCKY 61**

**FINANCIAL REPORT**

**MAY 31, 2020**

## **C O N T E N T S**

	<b>Page</b>
INDEPENDENT AUDITOR'S REPORT	1-2
FINANCIAL STATEMENTS	
Balance sheets	3
Statements of revenue and comprehensive income	4
Statements of changes in members' equities	5
Statements of cash flows	6
Notes to financial statements	7-17
REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH <i>GOVERNMENT AUDITING STANDARDS</i>	18-19
INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH ASPECTS OF CONTRACTUAL AGREEMENTS AND REGULATORY REQUIREMENTS FOR ELECTRIC BORROWERS	20-21



*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 sheets as of May 31, 2020 and 2019, and the related statements of revenue and comprehensive income, changes in members' 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**

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our 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 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.

## **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, 2020 and 2019, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

## **Emphasis of a Matter**

As discuss in Note 2, Grayson Rural Electric Cooperative Corporation has adopted Financial Accounting Standards Update 2014-09, *Revenue from Contracts with Customers*. Our opinion is not modified with respect to this matter.

## **Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated October 21, 2020, 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 Grayson Rural Electric Cooperative Corporation's internal control over financial reporting and compliance.

*Jones, Nale & Mattingly PC*

Louisville, Kentucky  
October 21, 2020



**GRAYSON RURAL ELECTRIC COOPERATIVE CORPORATION**  
**BALANCE SHEETS**  
**May 31, 2020 and 2019**

<u>Assets</u>	<u>2020</u>	<u>2019</u>
Electric Plant, at original cost		
In service	\$ 86,886,550	\$ 81,340,601
Under construction	74,868	88,043
	86,961,418	81,428,644
Less accumulated depreciation	28,878,012	25,975,553
	58,083,406	55,453,091
Investments in Associated Organizations	18,479,733	17,434,255
Current Assets		
Cash and cash equivalents	8,721,435	88,516
Accounts receivable, less allowance for 2020 of \$107,323 and 2019 of \$70,374	1,965,044	2,658,074
Other receivables	347,436	261,642
Material and supplies, at average cost	303,044	1,370,853
Other current assets	468,703	500,486
Total current assets	11,805,662	4,879,571
Deferred Debits	1,073,286	1,251,178
Total	\$ 89,442,087	\$ 79,018,095
<u>Members' Equities and Liabilities</u>		
Members' Equities		
Memberships	\$ 156,085	\$ 154,395
Patronage capital	29,326,943	26,901,553
Other equities	228,370	220,891
Accumulated other comprehensive (loss)	(385,181)	(408,825)
	29,326,217	26,868,014
Long-Term Liabilities		
Long-term debt, less current portion	50,859,778	42,034,172
Accumulated postretirement benefits	3,325,592	3,208,998
	54,185,370	45,243,170
Current Liabilities		
Short-term notes payable	--	550,000
Current portion of long-term debt	2,013,145	1,878,000
Accounts payable	1,457,776	1,848,850
Consumer deposits	1,386,083	1,486,999
Accrued expenses	959,955	1,053,870
Total current liabilities	5,816,959	6,817,719
Consumer Advances for Construction	113,541	89,192
Total	\$ 89,442,087	\$ 79,018,095

The Notes to Financial Statements are an integral part of these statements.

**GRAYSON RURAL ELECTRIC COOPERATIVE CORPORATION**  
**STATEMENTS OF REVENUE AND COMPREHENSIVE INCOME**  
**Years Ended May 31, 2020 and 2019**

	2020	2019
Operating Revenues		
Sales of electric energy	\$ 30,132,186	\$ 29,491,020
Other electric revenues	918,865	1,052,874
	<u>31,051,051</u>	<u>30,543,894</u>
Operating Expenses		
Cost of power	16,779,735	17,663,313
Distribution - operations	934,362	1,144,254
Distribution - maintenance	3,560,083	3,809,397
Consumer accounts	1,138,207	1,175,896
Customer services	116,747	189,574
Sales	3,003	9,075
Administrative and general	1,926,203	2,035,798
Depreciation, excluding \$191,861 in 2020 and \$205,408 in 2019 charged to clearing accounts	3,905,902	3,619,045
Taxes, other than income	44,571	32,505
Interest on long-term debt	1,122,913	1,271,753
Other interest expense	96,843	81,705
Other deductions	10,947	13,705
Total cost of electric service	<u>29,639,516</u>	<u>31,046,020</u>
Operating Margins (Deficits)	<u>1,411,535</u>	<u>(502,126)</u>
Nonoperating Margins		
Interest income	34,709	30,738
Others	5,628	1,870
	<u>40,337</u>	<u>32,608</u>
Patronage Capital Credits		
Generation and transmission capital credits	1,008,272	923,463
Other capital credits	135,082	143,388
	<u>1,143,354</u>	<u>1,066,851</u>
Net Margins	2,595,226	597,333
Other Comprehensive Income		
Postretirement benefits amortization of net loss	23,644	23,411
Comprehensive Income	<u>\$ 2,618,870</u>	<u>\$ 620,744</u>

The Notes to Financial Statements are an integral part of these statements.

**GRAYSON RURAL ELECTRIC COOPERATIVE CORPORATION**  
**STATEMENTS OF CHANGES IN MEMBERS' EQUITIES**  
Years Ended May 31, 2020 and 2019

	Memberships	Patronage Capital					Other Equities	Accumulated Other Comprehensive Income (Loss)	Total Members' Equities
		Assignable	Assigned	Prior Losses	Retirements	Total			
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									
Total comprehensive income									
Net change in memberships	(20)							23,411	23,411
Refunds to estates					(124,923)	(124,923)			(20)
Other equities			(26,182)			(26,182)	5,301		(124,923)
									(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
Assign patronage		(597,333)	590,198	7,135	--	--			
Comprehensive income:									
Net margins		2,595,226				2,595,226			2,595,226
Postretirement benefit obligation									
Amortization									
Total comprehensive income								23,644	23,644
Net change in memberships	1,690								2,618,870
Refunds to estates					(138,500)	(138,500)			1,690
Other equities			(31,336)			(31,336)	7,479		(138,500)
									(23,857)
Balance - May 31, 2020	\$ 156,085	\$ 2,595,226	\$ 32,051,470	\$ (2,016,586)	\$ (3,303,167)	\$ 29,326,943	\$ 228,370	\$ (385,181)	\$ 29,326,217

The Notes to Financial Statements are an integral part of these statements.



**GRAYSON RURAL ELECTRIC COOPERATIVE CORPORATION**  
**STATEMENTS OF CASH FLOWS**  
**Years Ended May 31, 2020 and 2019**

	2020	2019
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net margins	\$ 2,595,226	\$ 597,333
Adjustments to reconcile net margins to net cash provided by operating activities:		
Depreciation:		
Charged to expense	3,905,902	3,619,045
Charged to clearing accounts	191,861	205,408
Patronage capital credits assigned	(1,143,354)	(1,066,851)
Amortization of postretirement actuarial adjustment	23,644	23,411
Change in assets and liabilities:		
Accounts and other receivables	607,236	167,884
Material and supplies	1,067,809	(1,116,739)
Other assets	31,783	(24,803)
Prepaid pension costs	177,892	153,992
Accounts payable	(391,074)	28,212
Consumer deposits	(76,567)	254,006
Accumulated postretirement benefits	116,594	85,987
Accrued expenses	(93,915)	23,851
Net cash provided by operating activities	<u>7,013,037</u>	<u>2,950,736</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Plant additions	(6,393,768)	(4,233,205)
Plant removal costs	(343,440)	(696,139)
Salvage recovered from retired plant	9,130	155,533
Receipts from other investments, net	97,876	86,345
Net cash (used in) investing activities	<u>(6,630,202)</u>	<u>(4,687,466)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net increase (decrease) in memberships	1,690	(20)
Refund of patronage capital to members	(169,836)	(151,105)
Increase in other equities	7,479	5,301
Principal payments on long-term debt	(2,039,249)	(2,056,942)
Advances of long-term debt	11,000,000	5,000,000
Principal payments on short-term notes payable	(550,000)	(1,059,000)
Net cash provided by financing activities	<u>8,250,084</u>	<u>1,738,234</u>
Net increase in cash and cash equivalents	8,632,919	1,504
Cash and cash equivalents, beginning of year	<u>88,516</u>	<u>87,012</u>
Cash and cash equivalents, end of year	<u>\$ 8,721,435</u>	<u>\$ 88,516</u>
<b>SUPPLEMENTAL CASH FLOW INFORMATION</b>		
Cash payments for interest	\$ 1,315,840	\$ 1,311,185

The Notes to Financial Statements are an integral part of these statements.



## GRAYSON RURAL ELECTRIC COOPERATIVE CORPORATION

### NOTES TO FINANCIAL STATEMENTS

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

##### Description of business

Grayson Rural Electric Cooperative Corporation (Grayson) provides distribution electric services to residential, business, and commercial consumers concentrated in a six-county area of eastern Kentucky. Grayson maintains its records in accordance with the policies 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 the following as of May 31, 2020 and 2019:

	2020	2019
Distribution plant	\$ 80,122,697	\$ 74,559,480
General plant	6,763,853	6,781,121
	<u>\$ 86,886,550</u>	<u>\$ 81,340,601</u>

##### 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	2.00%
Transportation equipment	16.00%
Other general plant items	6.00% - 16.00%

##### Cash and cash equivalents

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

## NOTES TO FINANCIAL STATEMENTS

### Note 1. Summary of Significant Accounting Policies (Continued)

#### Sales Tax

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's policy is to exclude taxes from revenue when collected and expenses when paid and instead, record collection and payment of taxes through a liability account.

#### Cost of Power

Grayson is one of 16 members of East Kentucky Power Cooperative, Inc. (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 the energy is consumed, based upon billings from East Kentucky. The power bill includes a fuel adjustment and environmental surcharge component that is passed on to Grayson's customers using a methodology prescribed by the PSC.

#### 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.

#### Accounts receivable

Accounts receivable consists of amounts due for sales of electric which were not collected at year-end. Accounts receivable are recorded at net realizable value consisting of the carrying amount less an allowance for uncollectible accounts. Grayson uses the allowance method to account for uncollectible accounts receivable balances. Management charges off uncollectible receivables to the allowance when it is determined the amounts will not be realized.

#### Advertising

Grayson expenses advertising costs as incurred. Advertising expenses were \$607 and \$1,387 for the years ended May 31, 2020 and 2019, respectively.



## NOTES TO FINANCIAL STATEMENTS

### Note 1. Summary of Significant Accounting Policies (Continued)

#### Materials and supplies

Grayson values materials and supplies at the lower of average cost or net realizable value.

#### Comprehensive income (loss)

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

#### Credit risk

Grayson grants credit to residents of local counties. Concentrations of credit risk with respect to accounts receivables are limited due to its large number of customers.

#### 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, 2020 and 2019. Grayson'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.

#### Pension accounting pronouncement

In May 2017, the Financial Accounting Standards Board (FASB) issued ASU 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. The standard specifies how the amount of pension costs and costs for post-retirement benefits other than pensions (PBOP) should be presented on the income statement under accounting principles generally accepted in the United States of America, and what components of those costs are eligible for capitalization in assets. This standard is effective for years beginning after December 15, 2018. The Federal Energy Regulatory Commission issued Docket No. AI18-1-000 that allowed jurisdictional public utilities to continue to record PBOP costs in their entirety, less amounts capitalized, without change. Pension and PBOP costs are made up of several components: service cost, interest cost, actual return on plan assets, gain or loss, amortization of prior service cost or credit, and amortization of ASC Subtopic 715-30. Though pension and PBOP costs are computed using the aggregate total of these various components, the PSC's longstanding policy is to consider the amount as a singular cost to the employer. This cost is calculated based on Statement of Financial Accounting Standards No. 106 and reported as an expense under net margins from continuing operations.



## NOTES TO FINANCIAL STATEMENTS

### Note 1. Summary of Significant Accounting Policies (Continued)

#### Recent accounting pronouncements

In February 2016, the FASB issued ASU 2016-02, *Leases*. The standard requires all leases with lease terms over 12 months to be capitalized as a right-of-use asset and lease liability on the balance sheet at the date of lease commencement. Leases will be classified as either finance or operating. This distinction will be relevant for the pattern of expense recognition in the statement of revenue and comprehensive income. This standard will be effective for the year ending May 31, 2023.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments-Credit Losses*. The standard requires a financial asset (including trade receivables) measured at amortized cost basis to be presented at the net amount expected to be collected. Thus, the statement of revenue and comprehensive income will reflect the measurement of credit losses for newly recognized financial assets as well as the expected increases or decreases of expected credits losses that have taken place during the period. This standard will be effective for the year ending May 31, 2024.

Grayson is currently in the process of evaluating the impact of the adoption of these ASUs on the financial statements.

#### Reclassifications

Certain reclassifications have been made to the 2019 financial statement presentation to correspond to the 2020 presentation.

#### Subsequent events

Management has evaluated subsequent events through October 21, 2020, the date the financial statements were available to be issued.

### Note 2. Revenue Recognition

#### *Adoption of accounting pronouncement*

Grayson adopted ASU 2014-09, *Revenue from Contracts with Customers* as of June 1, 2019. The new standard replaces existing revenue recognition rules with a single comprehensive model to use in accounting for revenue arising from contracts with customers. The standard was adopted using the modified retrospective method and had no effect on Grayson's financial position or results of operations. Under ASU 2014-09, the timing of recognition of revenue for each performance obligation may differ from the timing of the customer billing, creating a contract asset or contract liability. Short-term contract liabilities are classified as consumer deposits. Grayson has no contract assets or long-term contract liabilities.

## NOTES TO FINANCIAL STATEMENTS

### Note 2. Revenue Recognition (Continued)

#### *Revenue from contracts*

Grayson is engaged in the distribution and sales of electricity to residential and commercial customers in six counties in eastern Kentucky. Revenue from these activities is generated from tariffs approved by the PSC. Grayson satisfies their performance obligation upon the delivery of electricity to customers. Revenue is recognized over time as the customer simultaneously receives and consumes the benefits provided by Grayson. The amount of revenue recognized is the billed volume of electricity multiplied by a tariff rate per-unit of energy, plus any applicable fixed or additional regulatory charges. Customers are billed monthly and outstanding amounts are typically due within 15 days of the date of the bill.

#### *Significant judgements*

Grayson has two billing cycles that process customer bills on approximately the same day each month. The amounts billed are based on actual meter reading of kilowatt hours used for the billing period. The amount of revenue recorded each month represent a full month of kilowatt hour usage. There are no significant judgements for over or under-billed revenues because each month's revenue is based on actual meter readings. This method of revenue recognition presents fairly, Grayson's transfer of electricity to customers as the amount recognized is based on actual volumes delivered and the tariff rate per-unit of energy plus any applicable fixed charges as set by the PSC.

#### *Performance obligations*

Grayson customers generally have no minimum purchase commitments. Revenue is recognized as each performance obligation is satisfied. Performance obligations are limited to the service requested and received to date. Accordingly, there is no unsatisfied performance obligation to recognize as of May 31, 2020 and 2019.

#### *Disaggregation of revenue*

The following table shows revenues from contracts with customers disaggregated by customer class for the years ended May 31, 2020 and 2019:

	2020	2019
Residential	\$ 23,250,214	\$ 22,582,558
Large commercial	2,823,753	2,858,981
Small commercial	2,271,122	2,240,755
Industrial	1,778,090	1,800,930
Other	9,007	7,796
	<u>\$ 30,132,186</u>	<u>\$ 29,491,020</u>

#### *Contract assets and cost liabilities*

Contract cost liabilities include consumer deposits. The balance in contract liabilities was \$1,386,083 and \$1,486,999 as of May 31, 2020 and 2019, respectively.



## NOTES TO FINANCIAL STATEMENTS

### Note 3. Investments in Associated Organizations

Investments in associated organizations consist of the following as of May 31, 2020 and 2019:

	2020	2019
East Kentucky, patronage capital	\$ 16,794,644	\$ 15,796,407
CFC, CTCs	618,949	620,722
CoBank, patronage capital	248,610	224,517
CFC, patronage capital	200,322	196,199
Other	617,208	596,410
	<u>\$ 18,479,733</u>	<u>\$ 17,434,255</u>

Grayson records patronage capital assigned by associated organizations in the year in which such assignments are received. Investments and purchases from National Bank for Cooperatives (CoBank) are a condition of borrowing loan funds.

### Note 4. 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 30.00% 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 25.00% of the net margins for the next preceding year, Grayson may distribute the difference between 25.00% and the payments made to such estates. Members' equity as of May 31, 2020 and 2019 was 33.00% and 34.00% of total assets, respectively.

### Note 5. Long-Term Debt

All assets, except vehicles, are pledged as collateral on the long-term debt to Federal Financing Bank (FFB), CoBank, and National Rural Utilities Cooperative Finance Corporation (CFC) under a joint mortgage agreement. The long-term debt is due in quarterly and monthly installments of varying amounts through 2040. RUS assess 12.5 basis points to administer the FFB loans. Grayson had loan funds available from FFB in the amount of zero and \$11,000,000 as of May 31, 2020 and 2019, respectively.

Long-term debt consists of the following as of May 31, 2020 and 2019:

	2020	2019
FFB notes at 0.12% to 1.58%	\$ 37,996,733	\$ 27,986,302
CoBank (refinanced RUS notes) at 4.62%	6,332,247	6,936,847
CFC notes at 3.06% to 3.15%	280,668	371,216
CFC (refinanced RUS notes) at 3.25% to 3.70%	8,263,275	8,617,807
	<u>52,872,923</u>	<u>43,912,172</u>
	2,013,145	1,878,000
	<u>\$ 50,859,778</u>	<u>\$ 42,034,172</u>



## NOTES TO FINANCIAL STATEMENTS

### Note 5. Long-Term Debt (Continued)

As of May 31, 2020 and 2019, the annual principal portion of long-term debt outstanding for the next five years and thereafter are as follows:

2021	\$ 2,013,145
2022	2,082,190
2023	2,110,960
2024	2,142,370
2025	2,177,990
Thereafter	42,346,268
	<u>\$ 52,872,923</u>

### Note 6. Short-Term Notes Payable

As of May 31, 2020 and 2019, Grayson had a short-term line of credit of \$4,200,000 with CFC and a short-term line of credit of \$2,000,000 with CoBank. As of May 31, 2020, there were no advances against either line of credit. As of May 31, 2019, Grayson had received advances of \$550,000 from CoBank at an interest rate of 4.53%. The CFC line of credit matures in March 2022 and the CoBank line of credit matures in December 2020.

### Note 7. 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 2020 and 2019 represent less than 5 percent of the total contributions made to the plan by all participating employers. Grayson made contributions to the plan of \$638,286 in 2020 and \$737,342 in 2019. There have been no significant changes that affect the comparability of 2020 and 2019.

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, 2020 and 2019 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.

## NOTES TO FINANCIAL STATEMENTS

### Note 7. Pension Plan (Continued)

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

Two prepayment options were available to participating cooperatives:

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

On February 14, 2013, RUS issued a memorandum to all 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, Grayson made a prepayment of \$1,701,130 to the R&S Plan. The amount is being amortized over 15 years.

### Note 8. 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 spouses. For measurement purposes, an annual rate of increase of 5.00% in 2020, then decreasing by 0.25% per year until 3.00% 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% in 2020 and 2019. There have been no significant changes that affect the comparability of 2020 and 2019.



## NOTES TO FINANCIAL STATEMENTS

### Note 8. Postretirement Benefits (Continued)

The funded status of the plan was as follows as of May 31, 2020 and 2019:

	2020	2019
Projected benefit obligation	\$ (3,325,592)	\$ (3,208,998)
Plan assets at fair value	--	--
Total	<u>\$ (3,325,592)</u>	<u>\$ (3,208,998)</u>

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

	2020	2019
Benefit obligation at beginning of year	\$ 3,208,998	\$ 3,123,011
Components of net periodic benefit cost:		
Service cost	109,580	114,138
Interest cost	147,028	142,470
Net periodic benefit cost	256,608	256,608
Benefits paid	(140,014)	(170,621)
Benefit obligation at end of year	<u>\$ 3,325,592</u>	<u>\$ 3,208,998</u>

	2020	2019
Amounts recognized in the balance sheet consists of:		
Accumulated postretirement benefits	\$ (3,325,592)	\$ (3,208,998)

Amounts included in other comprehensive income:		
Postretirement benefits amortization of net loss	\$ 23,644	\$ 23,411

Effect of 1.00% increase in the health care trend:		
Postemployment benefit obligation	\$ 3,540,000	
Net periodic benefit cost	\$ 273,000	

Projected retiree benefit payments for the next five years are expected to be as follows: 2021 - \$160,600; 2022 - \$169,400; 2023 - \$178,700; 2024 - \$188,500; 2025 - \$198,900.

### Note 9. 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.



## NOTES TO FINANCIAL STATEMENTS

### Note 10. 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 11. Related Party Transactions

Several of the directors of Grayson and its General Manager and CEO are on the boards of directors of various associated organizations.

### Note 12. 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 13. Labor Force

Approximately 45.00% of Grayson's labor force is subject to a collective bargaining agreement. A five-year agreement was negotiated and approved for the period starting January 1, 2018 between Grayson and the International Brotherhood of Electric Workers (IBEW).

### Note 14. Rate Matters

In March 2019, the KY PSC granted Grayson an increase in base rates of approximately \$1,568,000, or 5.00%.

### Note 15. Risks and Uncertainties

In March 2020, local, U.S., and world governments have encouraged self-isolation to curtail the spread of the global pandemic, coronavirus disease (COVID-19), by mandating temporary work stoppage in many sectors and imposing limitations on travel and size and duration of group meetings. Most industries are experiencing disruption to business operations and the impact of reduced consumer spending. There is unprecedented uncertainty surrounding the duration of the pandemic, its potential economic ramifications, and any government actions to mitigate them. Accordingly, while management cannot quantify the financial and other impact to Grayson as of October 21, 2020, management believes that a material impact on Grayson's financial position and results of future operations is reasonably possible.

## NOTES TO FINANCIAL STATEMENTS

### Note 16. Subsequent Event

In June 2020, Grayson applied for and was granted a \$641,100 loan under the Paycheck Protection Program (PPP) administered by a Small Business Administration (SBA) approved lender. The loan is uncollateralized and is fully guaranteed by the Federal government. The loan accrues interest at 1.00% but payments are not required to begin for six months to one year after the funding of the loan. Grayson is eligible for loan forgiveness of up to 100% of the loan upon meeting certain requirements. Grayson intends to take measures to maximize the loan forgiveness but cannot reasonably determine the portion of the loan that will ultimately be forgiven.



*Jones, Nale & Mattingly PLC*

**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, 2020 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 October 21, 2020.

**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.



## **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  
October 21, 2020



*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, 2020, 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 October 21, 2020. In accordance with *Government Auditing Standards*, we have also issued our report dated October 21, 2020, 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;

- 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	\$ 490,186
System mapping costs	583,100
	<u>\$ 1,073,286</u>

The deferred credits are as follows:

Consumer advances for construction	<u>\$ 113,541</u>
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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  
October 21, 2020



