

Kentucky 56
Licking Valley Rural Electric
Cooperative Corporation
West Liberty, Kentucky
Audited Financial Statements
October 31, 2017 and 2016

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Independent Auditor's Report

To the Board of Directors
Licking Valley Rural Electric Cooperative
West Liberty, Kentucky

Report on the Financial Statements

I have audited the accompanying financial statements of Licking Valley Rural Electric Cooperative, which comprise the balance sheets as of October 31, 2017 and 2016, 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
Licking Valley Rural Electric Cooperative

Opinion

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Licking Valley Rural Electric Cooperative as of October 31, 2017 and 2016, 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 December 20, 2017, on my consideration of Licking Valley Rural Electric Cooperative's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering internal control over financial reporting and compliance.

Alan Zumstein

Alan M. Zumstein, CPA
December 20, 2017

Licking Valley Rural Electric Cooperative Corporation
Balance Sheets, October 31, 2017 and 2016

<u>Assets</u>	<u>2017</u>	<u>2016</u>
Electric Plant, at original cost:		
In service	\$ 72,397,849	\$ 69,389,566
Under construction	1,276,979	1,688,973
	<u>73,674,828</u>	<u>71,078,539</u>
Less accumulated depreciation	27,563,443	26,541,828
	<u>46,111,385</u>	<u>44,536,711</u>
Investments in Associated Organizations	<u>16,695,019</u>	<u>15,431,532</u>
Current Assets:		
Cash and cash equivalents	421,627	49,234
Accounts receivable, less allowance for 2017 of \$252,226 and 2016 of \$112,439	3,918,259	4,005,767
Other receivables	115,538	158,938
Material and supplies, at average cost	515,377	429,669
Other current assets	37,251	45,646
	<u>5,008,052</u>	<u>4,689,254</u>
Total	<u>\$ 67,814,456</u>	<u>\$ 64,657,497</u>
<u>Members' Equities and Liabilities</u>		
Members' Equities:		
Memberships	\$ 216,810	\$ 215,010
Patronage capital	31,858,978	31,170,961
Other equities	119,593	115,874
Accumulated other comprehensive income	(676,978)	(721,618)
	<u>31,518,403</u>	<u>30,780,227</u>
Long Term Debt	<u>27,485,519</u>	<u>24,928,974</u>
Accumulated Postretirement Benefits	<u>3,201,334</u>	<u>3,147,093</u>
Current Liabilities:		
Accounts payable	1,928,139	2,178,358
Current portion of long term debt	1,310,000	1,295,000
Consumer deposits	1,314,023	1,296,668
Accrued expenses	852,525	788,356
	<u>5,404,687</u>	<u>5,558,382</u>
Consumer Advances	<u>204,513</u>	<u>242,821</u>
Total	<u>\$ 67,814,456</u>	<u>\$ 64,657,497</u>

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

Licking Valley Rural Electric Cooperative Corporation
 Statements of Operations and Comprehensive Income
 for the years ended October 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Operating Revenues		
Sale of electricity	\$ 25,824,877	\$ 26,216,829
Other electric revenue	348,846	339,450
	<u>26,173,723</u>	<u>26,556,279</u>
Operating Expenses:		
Cost of power	16,871,359	17,743,385
Distribution - operations	1,657,042	1,783,162
Distribution - maintenance	3,049,701	2,486,838
Consumer accounts	913,963	903,795
Customer services	(19,361)	(8,010)
Administrative and general	1,347,145	1,340,538
Depreciation, excluding \$180,539 in 2017 and \$187,643 in 2016 charged to clearing accounts	2,354,524	2,251,393
Taxes, other than income	36,449	36,959
Interest on long-term debt	571,994	465,000
Interest expense - other	10,819	8,882
Other deductions	21,793	(5,919)
	<u>26,815,428</u>	<u>27,006,023</u>
Patronage Capital and Operating Margins	<u>(641,705)</u>	<u>(449,744)</u>
Nonoperating Margins:		
Interest income	29,826	29,882
Others	557	1,216
	<u>30,383</u>	<u>31,098</u>
Patronage Capital Credits		
G & T	1,232,105	1,266,962
Other associated organizations	67,234	68,473
	<u>1,299,339</u>	<u>1,335,435</u>
Net Margins	688,017	916,789
Accumulated other comprehensive income:		
Accumulated postretirement benefits	44,640	44,640
Total Accumulated Other Comprehensive Income	<u>\$ 732,657</u>	<u>\$ 961,429</u>

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

Licking Valley Rural Electric Cooperative Corporation
Statement of Changes in Members' Equity
for the years ended October 31, 2016 and 2017

	<u>Memberships</u>	<u>Patronage Capital</u>	<u>Other Equities</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Total Members' Equity</u>
Balance-October 31, 2015	\$ 213,015	\$ 30,254,172	\$ 104,018	\$ (766,258)	\$ 29,804,947
Comprehensive income:					
Net margins		916,789			916,789
Postretirement benefit obligation					
Amortization				44,640	
Adjustments				-	44,640
Total comprehensive income					961,429
Net change in memberships	1,995				1,995
Returns to patrons		-			-
Other equities			11,856		11,856
Balance-October 31, 2016	215,010	31,170,961	115,874	(721,618)	30,780,227
Comprehensive income:					
Net margins		688,017			688,017
Postretirement benefit obligation					
Amortization				44,640	
Adjustments				-	44,640
Total comprehensive income					732,657
Net change in memberships	1,800				1,800
Returns to patrons		-			-
Other equities			3,719		3,719
Balance-October 31, 2017	<u>\$ 216,810</u>	<u>\$ 31,858,978</u>	<u>\$ 119,593</u>	<u>\$ (676,978)</u>	<u>\$ 31,518,403</u>

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

Licking Valley Rural Electric Cooperative Corporation
 Statements of Cash Flows
 for the years ended October 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Cash Flows from Operating Activities:		
Net margins	\$ 688,017	\$ 916,789
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation:		
Charged to expense	2,354,524	2,251,393
Charged to clearing accounts	180,539	187,643
Patronage capital credits assigned	(1,299,339)	(1,335,435)
Accumulated postretirement benefits	98,881	114,964
Change in assets and liabilities:		
Receivables	130,908	88,811
Material and supplies	(85,708)	(74,180)
Other assets	8,395	(4,331)
Payables	(250,219)	396,166
Consumer deposits and advances	(20,953)	(39,403)
Accrued expenses	64,169	226,888
	<u>1,869,214</u>	<u>2,729,305</u>
Cash Flows from Investing Activities:		
Plant additions	(3,672,408)	(2,916,923)
Plant removal costs	(387,265)	(451,569)
Salvage recovered from retired plant	(50,064)	(65,818)
Receipts from other investments, net	35,852	31,311
	<u>(4,073,885)</u>	<u>(3,402,999)</u>
Cash Flows from Financing Activities:		
Net increase in memberships	1,800	1,995
Increase in other equities	3,719	11,856
Payments on long term debt	(1,283,455)	(1,223,121)
Advances of long term debt	3,855,000	1,580,000
	<u>2,577,064</u>	<u>370,730</u>
Net increase (decrease) in cash	372,393	(302,964)
Cash and cash equivalents		
Beginning of year	49,234	352,198
End of year	<u>\$ 421,627</u>	<u>\$ 49,234</u>
Supplemental cash flows information:		
Interest paid on long-term debt	\$ 554,393	\$ 461,330

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

Licking Valley Rural Electric Cooperative
Notes to Financial Statements, continued

Note 1. Summary of Significant Accounting Policies

Licking Valley Rural Electric Cooperative (“Licking Valley”) 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>2017</u>	<u>2016</u>
Distribution plant	\$66,819,300	\$63,886,636
General plant	<u>5,502,930</u>	<u>5,502,930</u>
Total	<u>\$72,322,230</u>	<u>\$69,389,566</u>

Depreciation Provision has been made for depreciation on the basis of the estimated lives of assets, using the straight-line method. Depreciation rates range from 2.2% to 6.67% for distribution plant and from 3% to 15% for general plant.

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

Off Balance Sheet Risk Licking Valley 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.

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 Licking Valley records revenue as billed to its consumers based through the 20th of each month. All consumers are required to pay a refundable deposit, which may be waived under certain circumstances. Licking Valley’s sales are concentrated in an eight county area of eastern Kentucky. There were no consumers whose individual account balance exceeded 10% of outstanding accounts receivable at October 31, 2017 or 2016. Consumers must pay their bill within 20 days of billing, at which time a 5% discount is forfeited, 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.

Licking Valley 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. Licking Valley’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.

Licking Valley Rural Electric Cooperative
Notes to Financial Statements, continued

Note 1. Summary of Significant Accounting Policies, continued

Cost of Power Licking Valley is one of sixteen (16) members of East Kentucky Power Cooperative (“East Kentucky”). Under a wholesale power agreement, Licking Valley 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.

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 Licking Valley’s cash and cash equivalents, receivables, inventories, accounts payable, accrued expenses, and liabilities approximate fair value due to their short maturity. Investments in associated organizations are not considered a financial instrument because they represent nontransferable interests in associated organizations. Other assets and liabilities are not considered financial instruments because they represent activities specifically related to Licking Valley. 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.

Licking Valley 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.

Income Tax Status Licking Valley is exempt from federal and state income taxes under provisions of Section 501(c)(12). Accordingly, the financial statements for Licking Valley include no provision for income taxes. Licking Valley’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 Licking Valley has no uncertain tax positions resulting in an accrual of tax expense or benefit. Licking Valley recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. Licking Valley did not recognize any interest or penalties during the years ended October 31, 2017 and 2016. Licking Valley’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.

Licking Valley Rural Electric Cooperative
Notes to Financial Statements, continued

Note 1. Summary of Significant Accounting Policies, continued

Advertising Licking Valley expenses advertising costs as incurred.

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.

Risk Management Licking Valley 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.

Contingencies Licking Valley is occasionally 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.

Subsequent Events Management has evaluated subsequent events through December 20, 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

Licking Valley 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 2022 to 2080.

Investments in associated organizations consist of:

	<u>2017</u>	<u>2016</u>
East Kentucky, patronage capital	\$15,134,575	\$13,902,470
CFC, patronage capital	192,681	187,144
CFC, CTC's	656,316	657,565
Others	<u>711,447</u>	<u>684,353</u>
Total	<u>\$16,695,019</u>	<u>\$15,431,532</u>

Note 3. Patronage Capital

Under provisions of the long-term debt agreement, return to patrons of capital contributed by them is limited to amounts which would not allow the total equities and margins to be less than 30% of total assets, except that distributions may be made to estates of deceased patrons. The debt agreement provides, however, that should such distributions to estates not exceed 25% of the net margins for the next preceding year, Licking Valley may distribute the difference between 25% and the payments made to such estates. The equity at October 31, 2017 was 47% of total assets. Nonoperating margins are used to offset the prior year losses. Patronage capital consists of:

	<u>2017</u>	<u>2016</u>
Assigned to date	\$34,835,280	\$33,603,174
Assignable margins	(822,116)	(619,506)
Unassigned	19,739	19,739
Prior year losses	<u>(2,173,925)</u>	<u>(1,832,446)</u>
Total	<u>\$31,858,978</u>	<u>\$31,170,961</u>

Licking Valley Rural Electric Cooperative
Notes to Financial Statements, continued

Note 4. Long Term Debt

All assets, except vehicles, are pledged as collateral on the long term debt to RUS, Federal Financing Bank (“FFB”), and CFC under a joint mortgage agreement. The long term debt is due in quarterly and monthly installments of varying amounts through 2041. RUS assess 12.5 basis points to administer the FFB loans. The interest rates on notes payable to CFC at 5.50% are subject to change every seven years. The 2.90% interest rate notes to CFC adjusts monthly and may be converted to a fixed rate at any time upon board approval by Licking Valley. Licking Valley has unadvanced loan funds from FFB in the amount of \$5,802,000, which can be advanced upon future construction projects. Long term debt consists of:

	<u>2017</u>	<u>2016</u>
RUS, 0.50% to 5.375%	<u>\$3,966,693</u>	<u>\$4,276,951</u>
FFB, 1.014% and 6.48%	<u>22,787,657</u>	<u>19,745,523</u>
CFC:		
5.50% fixed rate notes	1,918,772	2,049,794
2.75% variable rate	<u>122,397</u>	<u>151,706</u>
	<u>2,041,169</u>	<u>2,201,500</u>
	28,795,519	26,223,974
Less current portion	<u>1,310,000</u>	<u>1,295,000</u>
Long term portion	<u><u>\$27,485,519</u></u>	<u><u>\$24,928,974</u></u>

As of October 31, 2017, the annual principal portion of long term debt outstanding for the next five years are as follows: 2018 - \$1,310,000; 2019 - \$1,340,000; 2020 - \$1,370,000; 2021 - \$1,400,000; 2022 - \$1,435,000.

Note 5. Short Term Borrowings

At October 31, 2017, Licking Valley had a short term line of credit of \$2,000,000 available from CFC. At October 31, 2017, Licking Valley had repaid all advances against the line of credit.

Note 6. Savings Plan

All eligible employees of Licking Valley participate in the NRECA Retirement and Security Program, a defined contribution pension plan qualified under section 401(k) and tax-exempt under section 501(a) of the Internal Revenue Code. Licking Valley makes annual contributions to the Program equal to the amounts accrued for pension expense. There have been no significant changes that affect the comparability of 2017 and 2016. Contributions to this plan were \$258,594 for 2017 and \$258,887 for 2016. In this multiemployer plan, which is available to all member corporations of NRECA, the accumulated benefits and plan assets are not determined or allocated separately by individual employer. A portion of this cost is allocated to construction of electric plant.

Note 7. Postretirement Benefits

Licking Valley sponsors a defined benefit plan that provides medical insurance coverage to retirees by contributing 50% of the cost of the policy. For measurement purposes, an annual rate of increase of 6%, then decreasing by 0.25% per year until 5% per year, in the per capita cost of covered health care benefit was assumed. The discount rate used in determining the accumulated postretirement benefit obligation was 4.50%. There have been no significant changes that affect the comparability of 2017 and 2016. A portion of the net periodic benefit cost is allocated to construction of electric plant.

Licking Valley Rural Electric Cooperative
Notes to Financial Statements, continued

Note 7. Postretirement Benefits, continued

Licking Valley does not fund the plan. The unfunded status is as follows:

	<u>2017</u>	<u>2016</u>
Projected benefit obligation	(3,201,334)	(\$3,147,093)
Plan assets at fair value	-	-
Funded status	<u>(\$3,201,334)</u>	<u>(\$3,147,093)</u>

The reconciliation of the benefits obligations of postretirement benefits are as follows:

	<u>2017</u>	<u>2016</u>
Benefit obligation - beginning of period	<u>\$3,147,093</u>	<u>\$3,076,769</u>
Net periodic benefit cost:		
Service cost	65,809	68,923
Interest cost	<u>158,711</u>	<u>155,597</u>
	224,520	224,520
Actuarial adjustment	-	-
Benefit payments to participants	<u>(170,279)</u>	<u>(154,196)</u>
Benefit obligation - end of period	<u>\$3,201,334</u>	<u>\$3,147,093</u>
Amounts included in accumulated comprehensive income:		
Unrecognized actuarial gain (loss)	<u>(\$676,978)</u>	<u>(\$721,618)</u>
Effect of 1% increase in the health care trend:		
Postemployment benefit obligation	\$3,375,000	
Net periodic benefit cost	\$167,000	

Projected retiree benefit payments for the next five years are expected to be as follows: 2018 - \$170,000; 2019 - \$160,000; 2020 - \$145,000; 2021 - \$140,000; 2022 - \$130,000.

Note 8. Commitments

Licking Valley has various other agreements outstanding with local contractors. Under these agreements, the contractors will perform certain construction and maintenance work at specified hourly rates or unit cost, or on an as needed basis. The duration of these contracts are one to three years.

Note 9. Related Party Transactions

Several of the Directors of Licking Valley and its President & General Manager are on the Boards of Directors of various associated organizations. During 2017 Licking Valley sold two (2) vehicles to one of its Directors as the highest bidder.

Note 10. Contingencies

Meade County, on occasion, is involved in litigation arising in the normal course of business. Presently, there are no such litigations pending.

Licking Valley Rural Electric Cooperative
Notes to Financial Statements, continued

Note 11. Environmental Contingency

Licking Valley 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 Licking Valley 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 Licking Valley's financial position or its future cash flows.

Note 12. Rate Matters

During March, 2017, the KPSC approved a retail rate increase in the amount of approximately \$1.28 million, or 4.9% of base revenues.

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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
Licking Valley Rural Electric Cooperative
West Liberty, Kentucky 41472

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 Licking Valley Rural Electric Cooperative, which comprise the balance sheets as of October 31, 2017 and 2016, 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 December 20, 2017.

Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing my audit, I considered Licking Valley's internal control over financial reporting as a basis for designing my auditing procedures for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Licking Valley's internal control over financial reporting. Accordingly, I do not express an opinion on the effectiveness of Licking Valley's internal control over financial reporting.

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 over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. I did not identify any deficiencies in internal control over financial reporting that I consider to be material weaknesses, as defined previously.

To the Board of Directors
Licking Valley Rural Electric Cooperative

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Licking Valley'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 M. Zumstein

Alan M. Zumstein, CPA
December 20, 2017

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

Board of Directors
Licking Valley Rural Electric Cooperative
West Liberty, Kentucky 41472

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 Licking Valley Rural Electric Cooperative ("the Cooperative"), which comprise the balance sheet as of October 31, 2017, and the related statements of revenue and comprehensive income, patronage capital, and changes in cash flows for the year then ended, and the related notes to the financial statements, and have issued my report thereon dated December 20, 2017. In accordance with *Government Auditing Standards*, we have also issued my report dated December 20, 2017, on my consideration of the Cooperative's internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. No reports other than the reports referred to above and my schedule of findings and recommendations related to my audit have been furnished to management.

In connection with my audit, nothing came to my attention that caused me to believe that the Cooperative failed to comply with the terms, covenants, provisions, or conditions of their loan, grant, and security instruments as set forth in 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers*, §1773.33 and clarified in the RUS policy memorandum dated February 7, 2014, 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
Licking Valley Rural Electric Cooperative

- 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.

However, I recommend correction action in the following:

1. The estimated installation cost for meters is overstated due to the mass change out of automated metering information (AMI) technology. The estimated installation cost currently used is for the initial installation of a single meter. The result is that the investment in meter equipment is overstated, operation expenses are understated, and margins are overstated. I was informed the Cooperative has updated its estimated install cost for meters during the mass meter change program.

Deferred credits are as follows:

Consumer advances for construction	<u><u>\$204,513</u></u>
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My audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The detailed schedule of deferred debits and deferred credits required by 7 CFR Part 1773(h) and provided below is presented for purposes of additional analysis and is not a required part of the basic financial statements. This information has been subjected to the auditing procedures applied in my audit of the basic financial statements and, in my opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

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
December 20, 2017