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Meade County Rural Electric
Cooperative Corporation
Brandenburg, Kentucky
Audited Financial Statements
October 31, 2017 and 2016

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Independent Auditor's Report

To the Board of Directors
Meade County Rural Electric Cooperative
Brandenburg, Kentucky

Report on the Financial Statements

I have audited the accompanying financial statements of Meade County 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
Meade County Rural Electric Cooperative

Opinion

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Meade County 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 14, 2017, on my consideration of Meade County 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 14, 2017

Meade County Rural Electric Cooperative Corporation
Balance Sheets, October 31, 2017 and 2016

	2017	2016
<u>Assets</u>		
Electric Plant, at original cost:		
In service	\$ 120,960,306	\$ 118,320,217
Under construction	1,668,989	1,163,307
	122,629,295	119,483,524
Less accumulated depreciation	39,467,851	37,340,744
	83,161,444	82,142,780
Investments in Associated Organizations	2,207,894	2,149,764
Current Assets:		
Cash and cash equivalents	5,724,804	8,572,122
Accounts receivable, less allowance for 2017 of \$148,150 and 2016 of \$169,030	4,370,381	3,972,644
Unbilled revenues	618,289	614,359
Other receivables	180,466	497,823
Material and supplies, at average cost	648,250	690,517
Other current assets	266,867	284,883
	11,809,057	14,632,348
Prepaid retirement costs	966,442	1,132,117
Total	\$ 98,144,837	\$ 100,057,009
<u>Members' Equities and Liabilities</u>		
Members' Equities:		
Memberships	\$ 73,184	\$ 76,372
Patronage capital	32,276,289	32,626,036
Other equities	1,294,353	1,095,938
Accumulated other comprehensive income	(96,481)	(111,839)
	33,547,345	33,686,507
Long Term Debt	54,905,473	56,614,837
Accumulated Postretirement Benefits	1,623,239	1,575,172
Current Liabilities:		
Accounts payable	3,333,840	2,900,978
Current portion of long term debt	2,170,000	2,190,000
Consumer deposits	1,053,099	1,016,172
Accrued expenses	1,023,656	1,518,537
	7,580,595	7,625,687
Consumer Advances	488,185	554,806
Total	\$ 98,144,837	\$ 100,057,009

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

Meade County Rural Electric Cooperative Corporation
 Statements of Revenue and Comprehensive Income
 for the years ended October 31, 2017 and 2016

	2017	2016
Operating Revenues		
Sale of electricity	\$ 52,273,042	\$ 46,933,680
Other electric revenue	1,331,307	1,204,881
	53,604,349	48,138,561
Operating Expenses:		
Cost of power	37,516,127	31,437,412
Distribution - operations	2,976,315	2,726,898
Distribution - maintenance	2,856,088	3,169,574
Consumer accounts	1,632,197	1,681,596
Customer services	230,544	217,393
Administrative and general	1,571,326	1,617,004
Depreciation, excluding \$317,289 in 2017 and \$360,541 in 2016 charged to clearing accounts	4,146,048	4,000,880
Taxes, other than income	62,437	75,083
Interest on long-term debt	1,687,964	1,668,195
Interest expense - other	5,923	3,118
Other deductions	14,980	12,986
	52,699,949	46,610,139
Patronage Capital and Operating Margins	904,400	1,528,422
Nonoperating Margins		
Interest income	159,553	317,995
Others	41,445	23,302
	200,998	341,297
Patronage Capital Credits	86,017	78,939
Net Margins	1,191,415	1,948,658
Items of comprehensive income:		
Accumulated postretirement benefits	15,358	15,358
Net Comprehensive Income	\$ 1,206,773	\$ 1,964,016

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

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

	<u>Patronage Capital</u>						<u>Other Equity</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Total Members' Equity</u>
	<u>Memberships</u>	<u>Assigned</u>	<u>Assignable</u>	<u>Unassigned</u>	<u>Retired</u>	<u>Total</u>			
Balance - October 31, 2015	\$ 79,767	\$ 39,001,651	\$ 1,490,088	\$ 5,399,604	\$ (13,560,013)	\$ 32,331,330	\$ 967,578	\$ (127,197)	\$ 33,251,478
Assign prior year margins		1,413,261	(1,878,114)	464,853		-			-
Comprehensive income:									
Net margins			1,948,658			1,948,658			1,948,658
Postretirement benefit obligation									
Amortization							15,358		
Adjustments								-	15,358
Total comprehensive income									1,964,016
Net change in memberships	(3,395)								(3,395)
Refunds of capital credits					(1,653,952)	(1,653,952)			(1,653,952)
Other equities							128,360		128,360
Balance - October 31, 2016	76,372	40,414,912	1,560,632	5,864,457	(15,213,965)	32,626,036	1,095,938	(111,839)	33,686,507
Assign prior year margins		1,413,261	(1,878,114)	464,853		-			-
Comprehensive income:									
Net margins			1,191,415			1,191,415			1,191,415
Postretirement benefit obligation									
Amortization							15,358		
Adjustments								-	15,358
Total comprehensive income									1,206,773
Net change in memberships	(3,188)								(3,188)
Refunds of capital credits					(1,541,162)	(1,541,162)			(1,541,162)
Other equities							198,415		198,415
Balance - October 31, 2017	\$ 73,184	\$ 41,828,173	\$ 873,933	\$ 6,329,310	\$ (16,755,127)	\$ 32,276,289	\$ 1,294,353	\$ (96,481)	\$ 33,547,345

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

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

	2017	2016
Cash Flows from Operating Activities:		
Net margins	\$ 1,191,415	\$ 1,948,658
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation:		
Charged to expense	4,146,048	4,000,880
Charged to clearing accounts	317,289	360,541
Patronage capital credits assigned	(86,017)	(78,939)
Accumulated postretirement benefits	63,425	60,170
Change in assets and liabilities:		
Receivables	(84,310)	(474,700)
Material and supplies	42,267	(5,434)
Other assets	18,016	79,995
Deferred assets	165,675	165,676
Payables	432,862	293,580
Consumer deposits and advances	(29,694)	(41,023)
Accrued expenses	(494,881)	510,640
	5,682,095	6,820,044
Cash Flows from Investing Activities:		
Plant additions	(4,967,370)	(5,086,891)
Plant removal costs	(592,235)	(690,640)
Salvage recovered from retired plant	77,604	64,982
Receipts from other investments, net	27,887	31,094
	(5,454,114)	(5,681,455)
Cash Flows from Financing Activities:		
Net increase in memberships	(3,188)	(3,395)
Refund of patronage capital to members	(1,541,162)	(1,653,952)
Increase in other equities	198,415	128,360
Payments on long term debt	(2,090,695)	(2,101,753)
Advances of long term debt	-	-
Advance payment on long term debt	361,331	3,155,437
	(3,075,299)	(475,303)
Net increase (decrease) in cash	(2,847,318)	663,286
Cash and cash equivalents, beginning of year	8,572,122	7,908,836
Cash and cash equivalents, end of year	\$ 5,724,804	\$ 8,572,122
Supplemental cash flows information:		
Interest paid on long-term debt	\$ 1,691,160	\$ 1,662,494

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

Meade County Rural Electric Cooperative
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies

Meade County Rural Electric Cooperative (“Meade County”) 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	\$112,181,159	\$109,979,318
General plant	<u>8,779,147</u>	<u>8,340,899</u>
Total	<u>\$120,960,306</u>	<u>\$118,320,217</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. General plant rates are as follows:

Structures and improvements	2.5% - 3%
Transportation equipment	12.5% - 25%
Other general plant	5% - 14.3%

Cash and Cash Equivalents Meade County considers all short-term, highly liquid investments with original maturities of three months or less to be cash equivalents. Meade County 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 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 Meade County records revenue as billed to its consumers based on monthly meter-reading cycles. All consumers are required to pay a refundable deposit, however, it may be waived under certain circumstances. Meade County’s sales are concentrated in a six county area of western 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, 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.

Meade County Rural Electric Cooperative
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies, continued

Sales Tax Meade County is required to collect, on behalf of the State of Kentucky, sales taxes based on 6 percent of gross sales from non-residential consumers, a 3 percent school tax from certain counties on most gross sales, and franchise fees in certain cities. Meade County's policy is to exclude sales tax from revenue when collected and expenses when paid and instead, record collection and payment of sales taxes through a liability account.

Cost of Power Meade County is one of three (3) members of Big Rivers Electric Corporation, Inc. ("Big Rivers"). Under a wholesale power agreement, Meade County is committed to purchase its electric power and energy requirements from Big Rivers until 2043. The rates charged by Big Rivers 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 Big Rivers.

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

Meade County may, and also does, invest idle funds in local banks and in National Rural Utilities Cooperative Finance Corporation ("CFC") commercial paper. The inputs used to measure idle funds are Level 1 measurements, as these funds are exchange traded funds in an active market.

Risk Management Meade County 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.

Meade County Rural Electric Cooperative
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies, continued

Environmental Contingency Meade County 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 Meade County 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 Meade County's financial position or its future cash flows.

Generation and Transmission Corporation As discussed in the preceding notes, Meade County purchases electric power from Big Rivers, a generation and transmission cooperative association. The membership of Big Rivers is comprised of Meade County and two other distribution cooperatives.

Meade County has elected to value the non-cash allocations received from Big Rivers at zero for financial accounting purposes, a practice it has followed since Big Rivers emerged from bankruptcy in 1998 during which all previous booked non-cash allocations were reduced to zero. Meade County will continue to make memorandum entries in its patronage subsidiary ledger of the face amount of the allocations received from Big Rivers. Refer to the subsequent footnote for the income tax treatment of these non-cash allocations.

Advertising Meade County expenses advertising costs as incurred.

Income Tax Status Meade County is exempt from federal and state income taxes under provisions of Section 501(c)(12). When applying the 85 percent test of IRC 501(c)(12), Meade County excludes the Big Rivers non-cash allocations from "gross income". Accordingly, the financial statements for Meade County include no provision for income taxes. Meade County'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 Meade County has no uncertain tax positions resulting in an accrual of tax expense or benefit. Meade County recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. Meade County did not recognize any interest or penalties during the years ended October 31, 2017 and 2016. Meade County'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.

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

Subsequent Events Management has evaluated subsequent events through December 14, 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

Meade County records patronage capital assigned by associated organizations in the year in which such assignments are received.

The Capital Term Certificates ("CTCs") of CFC are recorded at cost. The CTCs were purchased from CFC as a condition of obtaining long-term financing. The CTCs bear interest at 0%, 3%, and 5% and are scheduled to mature at varying times from 2020 to 2080.

Meade County Rural Electric Cooperative
Notes to Financial Statements

Note 2. Investments in Associated Organizations, continued

Investments in associated organizations consist of:

	<u>2017</u>	<u>2016</u>
CFC, patronage capital	\$387,153	\$382,801
CFC, CTC's	871,787	874,337
Others	<u>948,954</u>	<u>892,626</u>
Total	<u><u>\$2,207,894</u></u>	<u><u>\$2,149,764</u></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, Meade County may distribute the difference between 25% and the payments made to such estates. The equity at October 31, 2017 was 34% of total assets.

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. Meade County has unadvanced loan funds available from FFB in the amount of \$18,049,000 at October 31, 2017. RUS assess 12.5 basis points to administer the FFB loans.

Long term debt consists of:

	<u>2017</u>	<u>2016</u>
RUS:		
0.77% to 4.86%	\$28,760,115	\$29,746,717
Advance payments unapplied	<u>(2,942,005)</u>	<u>(3,303,336)</u>
	<u>25,818,110</u>	<u>26,443,381</u>
FFB, 1.014% to 6.049%	<u>28,446,867</u>	<u>29,311,004</u>
CFC, 2.75% to 3.85% fixed rate	<u>2,810,496</u>	<u>3,050,452</u>
	57,075,473	58,804,837
Less current portion	<u>2,170,000</u>	<u>2,190,000</u>
Long term portion	<u><u>\$54,905,473</u></u>	<u><u>\$56,614,837</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 - \$2,170,000; 2019 - \$2,250,000; 2020 - \$2,335,000; 2021 - \$2,425,000; 2022 - \$2,500,000.

Note 5. Short Term Borrowings

At October 31, 2017, Meade County had a short term line of credit of \$5,000,000 available from CFC. There were no advances against this line of credit during the audit period.

Meade County Rural Electric Cooperative
Notes to Financial Statements

Note 6. Pension Plan

All eligible employees of Meade County 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. Eligible employees include employees hired prior to August 31, 2002. Non-eligible employees are those hired after August 31, 2002. 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.

Meade County’s contributions to the R&S Plan in 2017 and 2016 represent less than 5 percent of the total contributions made to the plan by all participating employers. Meade County made contributions to the plan of \$377,339 in 2017 and \$419,986 in 2016. There have been no significant changes that affect the comparability of 2017 and 2016.

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 approximately 80 percent funded at January 1, 2017 and 2016 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,
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 of its 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”).

Meade County Rural Electric Cooperative
Notes to Financial Statements

Note 6. Pension Plan, continued

On March 15, 2013, the Corporation made a prepayment of \$1,656,757 to the R&S Plan. The Corporation is amortizing this amount over 10 years.

Note 7. Savings Plan

Meade County participates in the NRECA Savings Plan, a multiemployer, defined contribution master pension plan. All employees are eligible to participate in the Savings Plan upon completion of six (6) months employment. Eligible employees, as defined above, participate in the Savings Plan with Meade County contributing 3% of annual base pay, and the employee contributing from 1% to 3%. Non-eligible employees, as defined above, participate in the Savings Plan with Meade County contributing 12% of annual base pay, and the employee contributing from 1% to 3%. Employer contributions to the plan were \$336,210 for 2017 and \$317,942 for 2016, and vest immediately.

Note 8. Postretirement Benefits

Meade County sponsors a defined benefit plan that provides medical insurance coverage to retirees by contributing 50% of the cost of a single policy. For measurement purposes, an annual rate of increase of 8.5%, then decreasing by 0.5% per year until 5% per year, in the per capita cost of covered health care benefit was assumed. The discount rate used in determining the accumulated postretirement benefit obligation was 4.5%. A portion of the net periodic benefit cost is allocated to construction of electric plant. There have been no significant changes that affect the comparability of 2017 and 2016. The funded status of the plan is as follows:

	<u>2017</u>	<u>2016</u>
Projected benefit obligation	(1,623,239)	(\$1,575,172)
Plan assets at fair value	-	-
Funded status	(\$1,623,239)	(\$1,575,172)

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

	<u>2017</u>	<u>2016</u>
Benefit obligation - beginning of period	\$1,575,172	\$1,530,360
Actuarial adjustment	0	0
Net periodic benefit cost:		
Service cost	45,636	47,726
Interest cost	71,964	69,874
Net periodic benefit cost	117,600	117,600
Benefit payments to participants	(69,533)	(72,788)
Benefit obligation - end of period	\$1,623,239	\$1,575,172

Amounts included in accumulated comprehensive income:

Unrecognized actuarial gain (loss)	(\$96,481)	(\$111,839)
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Effect of 1% increase in the health care trend:

Postemployment benefit obligation	\$1,712,500	
Net periodic benefit cost	\$124,000	

Meade County Rural Electric Cooperative
Notes to Financial Statements

Note 8. Postretirement Benefits, continued

Projected retiree benefit payments for the next five years are expected to be as follows: 2018 - \$64,500; 2019 - \$60,000; 2020 - \$57,000; 2021 - \$51,000; 2022 - \$41,000.

Note 9. Related Party Transactions

Several of the Directors of Meade County and its President & CEO are on the Boards of Directors of various associated organizations. Meade County occasionally sells old vehicles to employees and others.

Note 10. Commitments

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

Note 11. Environmental Contingency

Meade County 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 Meade County 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 Meade County's financial position or its future cash flows.

Note 12. Contingencies

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

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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
Meade County Rural Electric Cooperative

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 Meade County 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 14, 2017.

Internal Control Over Financial Reporting

In planning and performing my audit of the financial statements, I considered the Cooperative's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Cooperative's internal control. Accordingly, I do not express an opinion on the effectiveness of the Cooperative's internal control.

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

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

To the Board of Directors
Meade County Rural Electric Cooperative

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Cooperative's financial statements are free of material misstatement, I 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 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 on internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the organization's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Alan Zumstein

Alan M. Zumstein, CPA
December 14, 2017

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

Board of Directors
Meade County Rural Electric Cooperative

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 Meade County 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 14, 2017. In accordance with *Government Auditing Standards*, we have also issued my report dated December 14, 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, 2013, insofar as they relate to accounting matters as enumerated below. However, my audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had I performed additional procedures, other matters may have come to my attention regarding the Cooperative's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters. In connection with my audit, I noted no matters regarding the Cooperative's accounting and records to indicate that the Cooperative did not:

- Maintain adequate and effective accounting procedures;
- Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts;
- Reconcile continuing property records to the controlling general ledger plant accounts;
- Clear construction accounts and accrue depreciation on completed construction;
- Record and properly price the retirement of plant;
- Seek approval of the sale, lease, or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap;

Board of Directors
Meade County 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.

Deferred debits are as follows:

Prepaid pension costs	<u><u>\$966,442</u></u>
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Deferred credits are as follows:

Consumer advances for construction	<u><u>\$488,185</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 14, 2017