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Salt River Electric
Cooperative Corporation
Bardstown, Kentucky
Audited Financial Statements
December 31, 2017 and 2016

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Independent Auditor's Report

To the Board of Directors
Salt River Electric Cooperative Corporation
Bardstown, Kentucky

Report on the Financial Statements

I have audited the accompanying financial statements of Salt River Electric Cooperative Corporation, which comprise the balance sheets as of December 31, 2017 and 2016, and the related statements of revenue and comprehensive income, changes in member's 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
Salt River Electric Cooperative Corporation

Opinion

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Salt River Electric Cooperative Corporation as of December 31, 2017 and 2016, and the results of its 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 February 24, 2018, on my consideration of Salt River Electric Cooperative Corporation'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
February 24, 2018

Salt River Electric Cooperative Corporation
Balance Sheets, December 31, 2017 and 2016

<u>Assets</u>	<u>2017</u>	<u>2016</u>
Electric Plant, at original cost:		
In service	\$ 153,901,327	\$ 150,263,292
Under construction	1,149,317	1,017,994
	<u>155,050,644</u>	<u>151,281,286</u>
Less accumulated depreciation	82,914,614	77,947,264
	<u>72,136,030</u>	<u>73,334,022</u>
Investments and Other Assets:		
Associated organizations	61,629,779	59,299,199
Others	19,934	619,508
	<u>61,649,713</u>	<u>59,918,707</u>
Current Assets:		
Cash and cash equivalents	27,242,433	29,343,634
Accounts receivable, less allowance for 2017 of \$300,000 and 2016 of \$300,000	11,464,464	10,476,557
Material and supplies, at average cost	833,706	900,675
Prepayments	192,807	137,230
	<u>39,733,410</u>	<u>40,858,096</u>
Pension Asset	<u>3,973,126</u>	<u>2,081,723</u>
Total	<u>\$ 177,492,279</u>	<u>\$ 176,192,548</u>
<u>Members Equities and Liabilities</u>		
Members' Equities:		
Memberships	\$ 2,248,440	\$ 2,177,965
Patronage capital	99,479,820	96,814,194
Other equities	5,036,509	4,706,539
Accumulated comprehensive income (loss)	(4,859,912)	(5,584,369)
	<u>101,904,857</u>	<u>98,114,329</u>
Long Term Debt	<u>57,893,931</u>	<u>61,445,725</u>
Accumulated Operating Provisions	<u>894,416</u>	<u>903,096</u>
Current Liabilities:		
Accounts payable	9,392,700	8,952,855
Current portion of long term debt	2,650,000	2,600,000
Consumer deposits	2,773,142	2,762,831
Accrued expenses	1,560,572	1,017,920
	<u>16,376,414</u>	<u>15,333,606</u>
Consumer Advances for Construction	<u>422,661</u>	<u>395,792</u>
Total	<u>\$ 177,492,279</u>	<u>\$ 176,192,548</u>

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

Salt River Electric Cooperative Corporation
 Statements of Revenue and Comprehensive Income
 for the years ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Operating Revenues		
Electric sales	\$ 98,860,686	\$ 100,793,592
Other electric revenue	1,435,456	2,040,515
	100,296,142	102,834,107
Operating Expenses:		
Cost of power	79,252,908	81,187,942
Distribution - operations	2,626,464	2,684,806
Distribution - maintenance	2,780,456	2,756,716
Consumer accounts	1,783,112	1,725,458
Customer service and information	222,713	218,160
Sales	(82,237)	2,631
Administrative and general	3,403,016	3,162,955
Depreciation, excluding \$435,601 in 2017 and \$420,188 in 2016 charged to clearing accounts	6,198,883	6,082,634
Taxes, other than income	124,231	117,748
Interest on long-term debt	2,337,482	2,177,657
Other interest and deductions	23,533	15,955
Total cost of electric service	98,670,561	100,132,662
Operating margins	1,625,581	2,701,445
Nonoperating Margins:		
Interest income	847,181	756,742
Others	226,790	2,856,000
	1,073,971	3,612,742
Patronage Capital assigned from:		
East Kentucky Power Cooperative	2,281,982	5,450,513
Other organizations	302,546	234,363
	2,584,528	5,684,876
Net Margins	5,284,080	11,999,063
Items of Comprehensive Income:		
Pension plan	717,827	1,974,272
Accumulated postretirement benefits	6,630	56,626
Net Comprehensive Income	\$ 6,008,537	\$ 14,029,961

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

Salt River Electric Cooperative Corporation
Statement of Changes in Members' Equities
for the years ended December 31, 2016 and 2017

	<u>Patronage Capital</u>					<u>Total</u>	<u>Other</u> <u>Equities</u>	<u>Accumulated</u> <u>Comprehensive</u> <u>Income</u>	<u>Total</u> <u>Members'</u> <u>Equities</u>
	<u>Memberships</u>	<u>Assigned</u>	<u>Assignable</u>	<u>Retirements</u>	<u>Unassigned</u>				
Balance - December 31, 2015	\$ 2,107,765	\$ 110,699,695	\$ 7,796,863	\$ (31,479,384)	\$ 277,595	\$ 87,294,769	\$ 4,391,390	\$ (7,615,267)	\$ 86,178,657
Comprehensive income:									
Net margins			11,999,063			11,999,063			11,999,063
Assigned margins		7,796,863	(7,796,863)			-			-
Pension plan									
Amortization								547,638	
Adjustment								1,426,634	1,974,272
Postretirement benefit obligation									
Amortization								6,630	
Adjustment								49,996	56,626
Total comprehensive income									14,029,961
Net change in memberships	70,200								70,200
Refunds of capital credits				(2,479,638)		(2,479,638)			(2,479,638)
Other equities							315,149		315,149
Balance - December 31, 2016	2,177,965	118,496,558	11,999,063	(33,959,022)	277,595	96,814,194	4,706,539	(5,584,369)	98,114,329
Comprehensive income:									
Net margins			5,284,080			5,284,080			5,284,080
Assigned margins		11,999,063	(11,999,063)			-			-
Pension plan									
Amortization								910,594	
Adjustment								(192,767)	717,827
Postretirement benefit obligation									
Amortization								6,630	
Adjustment								-	6,630
Total comprehensive income									6,008,537
Net change in memberships	70,475								70,475
Refunds of capital credits				(2,618,454)		(2,618,454)			(2,618,454)
Other equities							329,970		329,970
Balance - December 31, 2017	\$ 2,248,440	\$ 130,495,621	\$ 5,284,080	\$ (36,577,476)	\$ 277,595	\$ 99,479,820	\$ 5,036,509	\$ (4,859,912)	\$ 101,904,857

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

Salt River Electric Cooperative
 Statements of Cash Flows
 for the years ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Cash Flows from Operating Activities:		
Net margins	\$ 5,284,080	\$ 11,999,063
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation		
Charged to expense	6,198,883	6,082,634
Charged to clearing accounts	435,601	420,188
Patronage capital credits	(2,584,528)	(5,684,876)
Accumulated operating provisions	(1,175,626)	(609,755)
Change in assets and liabilities:		
Receivables	(987,907)	(1,198,827)
Material and supplies	66,969	(227,420)
Prepayments	(55,577)	271,358
Payables	439,845	1,604,594
Consumer deposits	10,311	159,828
Accrued expenses and advances	569,521	230,164
	<u>8,201,572</u>	<u>13,046,951</u>
Cash Flows from Investing Activities:		
Construction of plant	(5,451,122)	(3,966,418)
Salvage, net of removal costs	14,630	29,195
Purchase of other investments, net of receipts	853,522	1,530,032
	<u>(4,582,970)</u>	<u>(2,407,191)</u>
Cash Flows from Financing Activities:		
Net increase in memberships	70,475	70,200
Retirements of capital credits	(2,618,454)	(2,479,638)
Other equities	329,970	315,149
Additional borrowings	6,000,000	-
Principal payments on long-term debt	(3,129,619)	(2,416,096)
Cushion of credit applied (payment)	(6,372,175)	2,235,393
	<u>(5,719,803)</u>	<u>(2,274,992)</u>
Net increase in cash	(2,101,201)	8,364,768
Cash and cash equivalents - beginning of period	<u>29,343,634</u>	<u>20,978,866</u>
Cash and cash equivalents - end of period	<u>\$ 27,242,433</u>	<u>\$ 29,343,634</u>
Supplemental cash flows information:		
Interest paid on long-term debt	\$ 2,331,107	\$ 2,177,863

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

Salt River Electric Cooperative
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies

Salt River Electric Cooperative Corporation (“Salt River”) 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	\$139,620,263	\$136,194,371
General plant	<u>14,281,064</u>	<u>14,068,921</u>
Total	<u>\$153,901,327</u>	<u>\$150,263,292</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 5.0%, with a composite rate of 4.28% for distribution plant. General plant rates are as follows:

Structures and improvements	2.5%
Transportation equipment	16%
Other general plant	6% - 16%

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

Off Balance Sheet Risk Salt River has off-balance sheet risk in that they maintain cash deposits in financial institutions in excess of the amounts insured by the Federal Deposit Insurance Salt River (FDIC). At December 31, 2017, several financial institutions reported deposits in excess of the \$250,000 FDIC insured limit several times during the audit period. Deposits and repurchase agreements in excess of the FDIC limits are 100% secured with collateral from the financial institution that provides the majority of banking functions. Management believes that the credit risk related to those accounts is minimal.

Revenue Salt River records revenue as billed to its consumers based on monthly meter-reading cycles. Consumers may be required to pay a refundable deposit which can be waived under certain circumstances. Salt River’s sales are concentrated in a ten county area of central Kentucky. Consumers must pay their bill within 20 days of billing, then are subject to disconnect after another 10 days. Accounts are written off when they are deemed to be uncollectible. The allowance for uncollectible accounts is based on the aging of receivables. There were no customers whose individual account balance exceeded 10% of outstanding accounts receivable at December 31, 2017 or 2016.

Salt River 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. Salt River’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.

Salt River Electric Cooperative
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies, continued

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

Regulatory Asset/Liability Included on the current power bill from East Kentucky are amounts for fuel adjustment and environmental surcharge. These amounts are passed on to Salt River’s consumers using the methodology prescribed by the PSC. There is a billing lag between the time Salt River pays East Kentucky and the time Salt River bills its consumers. When the net is a credit, it creates a regulatory liability, when there is a net charge, a regulatory assets is created.

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

Salt River 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.

Environmental Contingency Salt River 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 Salt River 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 Salt River’s financial position or its future cash flows.

Salt River Electric Cooperative
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies, continued

Risk Management Salt River 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.

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

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.

Advertising Salt River 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 its pension plan and accumulated postretirement benefit obligation.

Significant Revenue Events During 2016 Salt River sold its old warehouse and approximately 70 acres of land to the local school district. Salt River recognized a gain of approximately \$2,540,000 on the transaction. In addition, Salt River accepted the Kentucky Information Highway's offer of a One Time Payment Option for joint use pole attachments for the next 30 years in the amount of \$553,973.

Subsequent Events Management has evaluated subsequent events through February 16, 2018, the date the financial statements were available to be issued. There were no significant subsequent events to report.

Note 2. Investments in Associated Organizations

Investments in associated organizations consist of:

	<u>2017</u>	<u>2016</u>
East Kentucky, patronage capital	\$57,463,858	\$54,823,435
National Bank for Cooperatives (CoBank)		
Patronage capital	1,133,181	1,162,012
CFC, CTC's and patronage capital	955,707	955,707
CFC, Member Capital Security	1,000,000	1,000,000
Other associated organizations	1,077,033	1,358,045
	<u>\$61,629,779</u>	<u>\$59,299,199</u>

Salt River Electric Cooperative
Notes to Financial Statements

Note 2. Investments in Associated Organizations, continued

Salt River 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 3% and 5% and are scheduled to mature at varying times from 2020 to 2080. Member Capital Securities have a 7.5% fixed interest rate and mature 35 years from the issuance date. Interest is paid each April 1 and October 1.

Note 3. Other Assets

The economic development loans are secured by either/or a portion of the assets pledged by Salt River’s consumers, or guarantees from local banks. The note to Nelson County is secured by land at an industrial site. Payments will be made to Salt River at the time real estate, or a portion thereof, is sold or leased, at which time, based on the value of the property sold or leased, in proportion to the contribution value of the entire property. During 2016 the note was paid in full. The note to Spencer-Washington Economic Development Authority (“SWEDA”) has been set up as a 30 year amortization, with a 15 year balloon; however, it is SWEDA’s goal to pay off the loan in less than 15 years. Other assets consist of:

	<u>2017</u>	<u>2016</u>
Economic development loans, no interest, various due in 108 months, from date of loan	\$19,934	\$26,005
Springfield-Washington Economic Development Authority note dated October 1, 2011, monthly payment of \$3,589 with an interest rate of 3.75%	-	593,503
	\$19,934	\$619,508

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% 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, Salt River may distribute the difference between 25% and the payments made to such estates. At December 31, 2017, the equities and margins were 57% of total assets.

Note 5. Long Term Debt

All assets, except vehicles, are pledged as collateral on the long term debt to RUS, Federal Financing Bank (FFB), CoBank, and CFC under a joint mortgage agreement. The long term debt payable to RUS and CoBank is due in quarterly and monthly installments of varying amounts through 2039. RUS assesses 1.25 basis points to administer the FFB loans. Salt River has unadvanced loan funds from FFB in the amount of \$6,000,000 that will be used for future plant additions.

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

Salt River Electric Cooperative
Notes to Financial Statements

Note 5. Long Term Debt, continued

Long term debt consists of:

	<u>2017</u>	<u>2016</u>
First mortgage notes due RUS:		
3.00% to 5.75%	\$33,072,420	\$34,191,564
Advance payment, earns 5% interest	<u>(13,405,025)</u>	<u>(6,457,523)</u>
	19,667,395	27,734,041
First mortgage notes due FFB:		
1.065% (0.274% in 2016)	29,298,992	24,128,663
First mortgage notes due CoBank:		
2.72% to 7.40%	11,452,679	12,034,360
Economic development loans, no interest	<u>124,865</u>	<u>148,661</u>
	60,543,931	64,045,725
less current portion of debt	<u>2,650,000</u>	<u>2,600,000</u>
	<u>\$57,893,931</u>	<u>\$61,445,725</u>

As of December 31, 2017, annual current principal due for the next five years are as follows: 2018 - \$2,650,000; 2019 - \$2,750,000; 2020 - \$2,855,000; 2021 - \$2,965,000; 2022 - \$3,083,000.

Note 6. Short Term Borrowings

At December 31, 2017, Salt River has a short term line of credit of \$4,000,000 available from both CoBank and CFC. There were no advances against either line of credit during the year.

Note 7. Savings Plan

All eligible employees of Salt River 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. Salt River 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.

Salt River sponsors a savings plan covering all employees who are covered by a collective bargaining agreement and who meet certain length of service requirements. This salary deferral plan provides a 2.50% contribution by Salt River based on eligible employee wages. Salt River contributed \$90,625 in 2017 and \$87,454 in 2016 to this plan.

Salt River also sponsors a plan covering all eligible employees not covered by a collective bargaining agreement which allows an employee salary deferral and also provides a 6% Salt River contribution based on eligible employee wages. Salt River's contribution is made on behalf of the employee regardless of their decision to participate with elective salary deferral contributions. Salt River contributed \$115,369 in 2017 and \$115,879 in 2016.

Note 8. Pension Plan

Salt River has a noncontributory defined benefit pension plan covering substantially all employees who meet minimum age and service requirements. The plan has pay-related pension benefit formula. Salt River's policy is to fund such plans in accordance with the requirements of the Employee Retirement Income

Salt River Electric Cooperative
Notes to Financial Statements

Note 8. Pension Plan, continued

Security Act (“ERISA”). The plan is measured as of December 31, 2017 and 2016. There have been no significant changes that affect the comparability of 2017 and 2016.

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

	<u>2017</u>	<u>2016</u>
Projected benefit obligation	(\$21,182,500)	(\$19,992,725)
Fair value of plan assets	<u>25,155,626</u>	<u>22,074,448</u>
Funded status	<u>\$3,973,126</u>	<u>\$2,081,723</u>
Accumulated benefit obligation included in plan	<u>\$18,028,988</u>	<u>\$17,429,545</u>
Amount recognized as asset (accrued liability)	<u>\$3,973,126</u>	<u>\$2,081,723</u>

The calculation of net periodic benefit cost, change in projected benefit obligation, and change in fair value of plan assets are as follows:

	<u>2017</u>	<u>2016</u>
<u>Net Periodic Benefit Cost</u>		
Service cost	\$802,953	\$885,259
Interest cost	847,675	775,005
Expected return on assets	(1,734,798)	(1,426,313)
SFAS 88 Settlement	540,430	-
Amortization (gain) loss	<u>370,164</u>	<u>547,638</u>
Net periodic benefit cost	<u>\$826,424</u>	<u>\$781,589</u>
<u>Change in Projected Benefit Obligation</u>		
Projected benefit obligation at beginning of year	\$19,992,725	\$19,602,483
Service cost	767,953	815,259
Interest cost	847,675	775,005
Settlement	(1,906,109)	-
Disbursements	(55,748)	(681,034)
Actuarial (gain) loss	<u>1,536,004</u>	<u>(518,988)</u>
Projected benefit obligation at end of year	<u>\$21,182,500</u>	<u>\$19,992,725</u>
<u>Change in Fair Value of Plan Assets</u>		
Fair value of plan assets, beginning of year	\$22,074,448	\$19,091,523
Actual return on plan assets	3,076,055	2,297,457
Employer contributions	2,000,000	1,400,000
Settlement/Special termination benefits	(1,906,109)	-
Benefits paid	(55,748)	(681,034)
Administrative costs	<u>(33,020)</u>	<u>(33,498)</u>
Projected benefit obligation at end of year	<u>\$25,155,626</u>	<u>\$22,074,448</u>

Salt River Electric Cooperative
Notes to Financial Statements

Note 8. Pension Plan, continued

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

	<u>2017</u>	<u>2016</u>
Discount rate	4.75%	4.50%
Rate of increase in compensation level	3.50%	3.50%
Expected long-term rate of return on assets	8.50%	8.50%

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

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

Expected retiree pension benefit payments are projected to be as follows: 2018 - \$671,000; 2019 - \$1,965,000; 2020 - \$1,437,000; 2021 - \$1,211,000; 2022 - \$2,517,000.

Contributions for 2018 are expected to be approximately \$2,000,000.

Note 9. Postretirement Benefits

Salt River sponsors a noncontributory defined benefit plan that provides medical insurance coverage for retired employees under age 65, and have worked 30 or more years for Salt River. The plan for retirees is a continuation of the fully insured program now in place for active employees.

The funded status of the plan is as follows:

	<u>2017</u>	<u>2016</u>
Projected benefit obligation	(\$894,416)	(\$903,096)
Fair value of plan assets	-	-
Funded status	<u>(\$894,416)</u>	<u>(\$903,096)</u>

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

	<u>2017</u>	<u>2016</u>
Benefit obligation at beginning of year	<u>\$903,096</u>	<u>\$951,066</u>
Components of net periodic benefit cost:		
Service cost	8,757	6,733
Interest cost	<u>40,685</u>	<u>42,709</u>
Net periodic benefit cost	49,442	49,442
Actuarial (gain) loss	-	(49,996)
Benefits paid	<u>(58,122)</u>	<u>(47,416)</u>
Benefit obligation at end of year	<u>\$894,416</u>	<u>\$903,096</u>

Salt River Electric Cooperative
Notes to Financial Statements

Note 9. Postretirement Benefits, continued

Amounts recognized in the balance sheet consist of:

Noncurrent liabilities	<u>\$894,416</u>	<u>\$903,096</u>
Amounts included in other comprehensive income:		
Unrecognized actuarial gain (loss)	<u>(\$119,342)</u>	<u>(\$125,972)</u>
Effect of 1% increase in the health care trend:		
Postemployment benefit obligation	\$952,000	
Net periodic benefit cost	52,500	

For measurement purposes, an annual rate of increase of 7% in 2017, 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 4.50% in 2017 and 2016.

Projected retiree benefit payments for the next five years are expected to be as follows: 2018 - \$53,000; 2019 - \$52,000; 2020 - \$52,000; 2021 - \$37,000; 2022 - \$27,000.

Note 10. Commitments

Salt River 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. Related Party Transactions

Several of the Directors of Salt River and its President & CEO are on the Boards of Directors of various associated organizations. The VP of Economic Development is also on the Board of Directors of one of the local banks where Salt River routinely performs its banking functions.

Note 12. Labor Force

Approximately 75% of Salt River's labor force is subject to a collective bargaining agreement. An eight (8) year agreement was negotiated and approved for the period starting June, 2012 between Salt River and the International Brotherhood of Electric Workers ("IBEW").

Note 13. Contingencies

Salt River, on occasion, is involved in litigation arising in the normal course of business. While the results of such litigation cannot be predicted with certainty, management, based upon advice of counsel, believes that the final outcome will not have a material adverse effect on the financial statements.

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Report on Internal Control Over Financial Reporting and on Compliance
and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards*

To the Board of Directors
Salt River Electric Cooperative Corporation
Bardstown, Kentucky

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 Salt River Electric Cooperative Corporation (“the Cooperative”), which comprise the balance sheets as of December 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 February 6, 2018.

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, 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.

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

To the Board of Directors
Salt River Electric Cooperative Corporation

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Cooperative's financial statements are free of material misstatement, I performed test of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

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

Alan Zumstein

Alan M. Zumstein, CPA
February 6, 2018

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

Board of Directors
Salt River Electric Cooperative Corporation
Bardstown, Kentucky

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 Salt River Electric Cooperative Corporation ("the Cooperative"), which comprise the balance sheet as of December 31, 2017, and the related statements of revenue and comprehensive income, member's equities, and changes in cash flows for the year then ended, and the related notes to the financial statements, and have issued my report thereon dated February 6, 2018. In accordance with *Government Auditing Standards*, we have also issued my report dated February 6, 2018, on my consideration of the Cooperative's internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. No reports other than the reports referred to above related to my audit have been furnished to management.

In connection with my audit, nothing came to my attention that caused me to believe that the Cooperative failed to comply with the terms, covenants, provisions, or conditions of their loan, grant, and security instruments as set forth in 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers*, §1773.33 and clarified in the RUS policy memorandum dated February 7, 2013, insofar as they relate to accounting matters as enumerated below. However, my audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had I performed additional procedures, other matters may have come to my attention regarding the Cooperative's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters. In connection with my audit, I noted no matters regarding the Cooperative's accounting and records to indicate that the Cooperative did not:

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

Board of Directors
Salt River Electric Cooperative Corporation

- 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; and
- Comply with the requirements for the detailed schedule of investments.

The deferred credits are:

Consumer advances for construction	<u><u>\$422,661</u></u>
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The Cooperative is a one-half (1/2) owner of a subsidiary, Lock 7 Hydro partners, LLC, which generates electricity through hydro methods on the Kentucky River. The investment is accounted for using the equity method of accounting. The schedule is investments are:

	<u>Investment</u>
Beginning balance	\$173,696
Income for 2017	187,670
Return of earnings	<u>(195,000)</u>
Ending balance	<u><u>\$166,366</u></u>

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
February 6, 2018