# Warren Rural Electric Cooperative Corporation

# FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION

June 30, 2017 and 2016



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**Independent Auditors' Report** 

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Board of Directors Warren Rural Electric Cooperative Corporation Bowling Green, Kentucky

#### **Report on the Financial Statements**

We have audited the accompanying consolidated financial statements of the Warren Rural Electric Cooperative Corporation (the "Cooperative") which comprise the consolidated balance sheet as of June 30, 2017, and the related consolidated statements of income, equities, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

#### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

#### Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated 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 circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating

the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

#### Opinion

In our opinion, the 2017 consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Cooperative as of June 30, 2017, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

#### **Adjustments to Prior Period Financial Statements**

The consolidated financial statements of the Cooperative as of June 30, 2016, were audited by other auditors whose opinion dated October 21, 2016, on those statements was unmodified. As discussed in Note 13, the Cooperative has restated its 2016 consolidated financial statements during the current year to correct the 2016 unbilled revenue calculations, in accordance with accounting principles generally accepted in the United States of America. The other auditors reported on the 2016 consolidated financial statements before the restatement.

As part of our audit of the 2017 consolidated financial statements, we also audited adjustments described in Note 13 that were applied to restate the 2016 consolidated financial statements. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 2016 consolidated financial statements of the Cooperative other than with respect to the adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 2016 consolidated financial statements as a whole.

#### **Other Matters**

#### Other Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The information in the consolidating statements is presented for purposes of additional analysis, and it is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements the method is statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally

accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

#### Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 31, 2017, on our consideration of the Cooperative's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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 the Cooperative's internal control over financial reporting and compliance.

Can, Rigge & Ingram, L.L.C.

CARR, RIGGS & INGRAM, LLC Bowling Green, Kentucky October 31, 2017

# **FINANCIAL STATEMENTS**

Warren Rural Electric Cooperative Corporation Balance Sheets

June 30,	2017	2016
Assets		
Utility plant		
Plant in service	\$ 286,312,009	\$ 270,858,821
Construction in progress	11,602,155	10,085,945
Less accumulated depreciation	(131,162,899)	(124,745,810
Net utility plant	166,751,265	156,198,956
Other property and investments		
Non-utility plant, net of accumulated depreciation	1,043,149	1,286,201
Investments in associated companies	2,140,575	1,869,267
Other investments	309,751	251,071
Goodwill	503,260	1,180,761
Total other property and investments	3,996,735	4,587,300
Current assets		
Cash and cash equivalents	20,393,465	23,920,428
Accounts receivable, net of allowance	14,118,291	12,328,869
Other accounts receivable	721,854	940,150
Materials and supplies	2,983,373	2,822,221
Prepaid expenses	1,189,523	1,210,287
Total current assets	39,406,506	41,221,955
Other assets		
TVA Energy Services loans receivable	7,160	14,593
Deferred debits	491,806	407,766
Total other assets	498,966	422,359
Total assets	\$ 210,653,472	\$ 202,430,570

Warren Rural Electric Cooperative Corporation Balance Sheets

June 30,	2017		2016
Equities and Liabilities			
Equities			
Membership fees	\$ 551,605	\$	539,660
Patronage capital	99,908,485	5	91,786,092
Other equities	107,658	6	80,177
Total equities	100,567,748	5	92,405,929
Long-term liabilities			
Long-term debt - net of current portion	67,457,977	,	69,897,422
Accrued post-retirement benefits	3,787,539	)	3,715,937
Total other liabilities	71,245,516		73,613,359
Current liabilities			<b>0</b> 4 660 6 <b>7</b> 0
Accounts payable - purchased power	23,555,448		21,669,672
Accounts payable - other	2,422,841		2,216,331
Self-insured fund	247,742		99,996
Customer deposits	3,568,733		3,382,714
Accrued interest	177,182		190,871
Accrued vacation and sick leave	1,476,329		1,500,165
Current portion of post-retirement liability	252,000		266,000
Accrued taxes and other current liabilities	1,731,990		1,718,651
Current portion of long-term debt	4,145,695		4,335,373
Total current liabilities	37,577,960	)	35,379,773
Other liabilities			
Advances for TVA Energy Services loans	7,836	,	15,269
Deferred income taxes	248,055	;	202,024
Deferred credits	1,006,357		814,216
Total other liabilities	1,262,248	}	1,031,509
Total equities and liabilities	\$ 210,653,472	2 \$	202,430,570

# Warren Rural Electric Cooperative Corporation Statements of Income

For the years ended June 30,	2017	2016
Operating revenues		
Electric sales	\$ 185,148,187	\$ 170,743,665
Forfeited discounts	1,054,487	1,009,665
Rent from electric property	2,133,170	2,000,468
Other electric revenues	641,602	676,192
Natural gas sales	664,580	570,971
Propane and related sales	1,987,875	2,047,124
Total operating revenue	191,629,901	177,048,085
Durchased neuron and evinences		
Purchased power and expenses Purchased power	141,759,822	131,512,882
Operation	6,475,213	6,327,325
Maintenance	6,169,740	6,460,731
Facilities rental	102,987	110,785
Customer accounts	3,101,009	3,005,244
Customer service and information	795,622	894,725
Administrative and general	5,199,056	5,633,306
Depreciation and amortization	10,549,589	9,419,586
Taxes and tax equivalents	5,257,972	4,842,486
Natural gas purchases	440,971	319,802
Propane gas and related cost of goods sold	903,070	832,091
Total purchased power and expenses	180,755,051	169,358,963
Total operating income	10,874,850	7,689,122
	10,874,830	7,005,122
Other revenues		
Interest income	195,863	221,908
Income (loss) of unconsolidated entities	3,736	(2,504
Miscellaneous	633,756	445,214
Total other revenues	833,355	664,618
Other deductions		
Interest on long-term debt	3,211,140	3,443,512
Post-retirement benefits	252,000	266,000
Total other deductions	3,463,140	3,709,512

# Warren Rural Electric Cooperative Corporation Statements of Income

For the years ended June 30,	2017	2016
Income before income taxes	8,245,065	4,644,228
Income tax expense	122,672	95,110
Net Income	\$ <b>8,122,393</b> \$	4,549,118

### For the years ended June 30, 2017 and 2016

			Patronage	Other	Total
	Me	mberships	Capital	Equities	Equities
Balance - July 1, 2015	\$	528,670	\$ 84,057,700	\$ 80,177	\$ 84,666,547
Prior period adjustment		-	3,179,274	-	3,179,274
Restated balance - July 1, 2015		528,670	87,236,974	80,177	87,845,821
Restated net income for the year		-	4,549,118	-	4,549,118
Investment from members		10,990	-	-	10,990
Restated balance - June 30, 2016		539,660	91,786,092	80,177	92,405,929
Net income for the year		-	8,122,393	-	8,122,393
Investment from members		11,945	-	27,481	39,426
Balance, June 30, 2017	\$	551,605	\$ 99,908,485	\$ 107,658	\$ 100,567,748

# Warren Rural Electric Cooperative Corporation Statements of Cash Flows

For the years ended June 30,	2017	2016
Cash flows from operating activities		
Net income	\$ 8,122,393	\$ 4,549,118
Adjustmentsto reconcile net income to net cash provided		
by operating activities:		
Depreciation and amortization	10,549,589	9,419,586
(Increase) decrease in assets:		
Receivables	(1,571,126)	2,725,949
Materials and supplies	(161,152)	(71,942)
Prepaid expenses	20,764	(345,477)
Goodwill	677,501	-
Other assets	(76,607)	(53 <i>,</i> 098)
Increase (decrease) in liabilities:		
Accounts payable	2,092,286	(578,665)
Customer deposits	186,019	423,817
Accrued expenses and other liabilities	308,268	(1,257,741)
Accretion in post-retirement benefit obligation	57,602	790,878
Provision for deferred income taxes	46,031	(38,983)
Total adjustments	12,129,175	11,014,324
Net cash provided by operating activities	20,251,568	15,563,442
Cash flows from investing activities		
Additions to utility plant, net of disposals	(20,858,846)	(12,751,285)
Increase in other investments	(58,680)	(54,841)
Change in investment in associated organizations	(271,308)	324,301
Net cash used in investing activities	(21,188,834)	(12,481,825)
Cash flows from financing activities		
Payments on principal of long-term debt	(4,290,008)	(5,936,244)
Use of (Payments for) RUS cushion of credit	1,660,885	(658,790)
Investments from (returned to) members	39,426	 10,990
Net cash used in financing activities	(2,589,697)	(6,584,044)
Decrease in cash and cash equivalents	(3,526,963)	(3,502,427)
Cash and cash equivalents – beginning of year	23,920,428	27,422,855
Cash and cash equivalents – end of year	\$ 20,393,465	\$ 23,920,428

Warren Rural Electric Cooperative Corporation Statements of Cash Flows

For the years ended June 30,	2017	2016
Supplemental disclosures of cash flow information:		
Cash paid during the year for interest	\$ 3,457,201	\$ 3,457,181
Cash paid for income taxes, net	\$ 72,000	\$ 125,000

#### NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### **Reporting Entity**

The Warren Rural Electric Cooperative Corporation ("WRECC") and its subsidiaries (hereinafter referred to collectively as "the Cooperative") were organized under Kentucky laws and exist for the purpose of distributing various utility services to its members, primarily in south central Kentucky. Counties included in its service area include Warren, Simpson, Butler, Ohio, Grayson, Logan, Edmonson, and Barren.

#### Measuring Focus, Basis of Accounting, and Financial Statement Presentation

The Cooperative's consolidated financial statements are presented on the full accrual basis of accounting. Revenues are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

The accounting policies of the Cooperative are in accordance with the system of accounts prescribed by the United States Department of Agriculture, the Rural Utility Service (RUS) and the Tennessee Valley Authority (TVA), which do not differ materially from accounting principles generally accepted in the United States of America.

The consolidated financial statements include the accounts of WRECC and its wholly-owned forprofit subsidiaries, Propane Energy Service, Inc. ("PES") and Millennium Energy, Inc. ("Millennium"). PES is involved with propane distribution and Millennium is a natural gas distributor. All significant intercompany activity has been eliminated in consolidation.

Through the business of providing services to customers, nearly all of whom are regional residents, the Cooperative grants credit to those customers, which is basically unsecured. This results in the Cooperative incurring monthly losses associated with uncollectible accounts and is reflected in the Cooperative's operating expenses.

#### Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the consolidated financial statements in the period that are determined to be necessary. Actual results could differ from the estimates.

#### NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Concentrations of Credit Risk

Financial instruments that potentially subject the Cooperative to concentrations of credit risk consist principally of cash deposits and accounts receivable. The Cooperative maintains its cash balances in institutions whose deposits are covered by the FDIC. Deposits are insured up to \$250,000 per financial institution. At June 30, 2017 and 2016, WRECC had deposits of \$1,502,241 and \$22,818,866 in excess of the FDIC insured amount, respectively. The Cooperative has a geographical concentration in accounts receivable because most of the balances are due from individuals located in the same geographical region.

#### Cash and Cash Equivalents

For the purposes of the statements of cash flows, the Cooperative considers all liquid investments with original maturities of three months or less to be cash equivalents. At June 30, 2017 and 2016, cash equivalents consisted primarily of commercial paper and repurchase agreements.

#### Accounts Receivable

Accounts receivable result from unpaid billings for service to customers and from unpaid billings related to work performed or materials sold to certain entities. Accounts receivable are stated at amounts expected to be collected from customers, less an allowance for uncollectible accounts that includes unpaid balances in excess of 90 days plus an additional amount based on management's estimation of future doubtful accounts. The allowance for doubtful accounts was \$4,380,257 and \$4,192,142 at June 30, 2017 and 2016, respectively.

Utility bills are due 15 days after the billing date, with a 5% penalty assessed for late payments. A cut-off notice is sent, allowing the customer seven days to pay before their service is disconnected. The customer then has five days to pay before the meter is read and entered to create a final bill. A collection letter is sent if the account remains unpaid after the due date of the final bill. A second collection letter is sent after ten days. The account is turned over to a collection agency ten days after the issuance of the second collection letter.

#### Materials and Supplies

All materials and supplies inventories are valued at average cost. WRECC performs semi-annual physical inventory counts.

#### Prepaid Expenses

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in the consolidated financial statements.

## Warren Rural Electric Cooperative Corporation Notes to Financial Statements

#### NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Utility Plant and Depreciation Procedures

Utility plant, which includes property, plant, equipment, and construction in progress, is stated at original cost and includes direct labor, materials, overhead, and special services (contract labor, etc.). Work orders are used to accumulate these costs, which are closed into plant when complete. Replacing only part of an installation is considered a repair and charged to maintenance expense.

Depreciation expense is computed on the composite-rate method at rates recommended by TVA and RUS. Retirements of property from service have been charged to the accumulated provision for depreciation accounts at the original cost of the units plus cost of removal. Salvage value of the units retired is returned to inventory.

#### Investments in Associated Enterprises

Investments in other cooperative's equities are carried at cost plus the Cooperative's share of allocated equities. Capital term certificates issued by the National Rural Utilities Cooperative Finance Corporation (CFC) are required investments for cooperatives that borrow funds from CFC. The required investment amount is based on a predetermined formula. Since there is not a market for these securities, management has determined that it is not practicable to estimate the fair value of these investments.

The Cooperative has a 50% investment in Penwar, Inc., which is accounted for under the equity method. Penwar provides billing and collection services for the Cooperative and one other electric utility. The Cooperative's share of income (loss) from Penwar for the years ended June 30, 2017 and 2016 was \$3,736 and (\$2,504), respectively.

#### Goodwill

The Cooperative's goodwill represents the excess of the purchase price over the fair value of assets acquired in business combinations. Goodwill is evaluated annually for impairment, or whenever impairment indicators arise.

#### Compensated Absences

It is the Cooperative's policy to permit employees to accumulate earned but unused personal benefits. Personal leave earned by employees is accrued based on years of continuous service. All personal leave pay has been accrued and is reflected as a liability in the consolidated financial statements. When an employee ceases to be employed, all benefits shall cease to accrue.

#### Unearned Revenue

Unearned revenue arises when assets are recognized before revenue recognition criteria have been satisfied.

## Warren Rural Electric Cooperative Corporation Notes to Financial Statements

#### NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### *Revenues and Purchased Power*

Revenues are recognized for power delivered but unbilled at the end of each month, which coincides with billings from TVA for purchased power in the month delivered.

#### Income Taxes

WRECC is exempt from income taxes under section 501(c)12 of the Internal Revenue Code and applicable state laws and regulations. For the Cooperative's wholly-owned, for-profit enterprises, income taxes are provided for the tax effects of transactions reported in the consolidated financial statements and consist of taxes currently due plus deferred taxes related primarily to differences between the bases of certain assets and liabilities for financial statement and income tax reporting. The deferred tax assets and liabilities represent the future tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled.

It is the Cooperative's policy to recognize interest and penalties related to income taxes in income tax expense, when applicable.

#### Subsequent Events

The Cooperative has evaluated any recognized or unrecognized subsequent events for consideration in the accompanying consolidated financial statements through October 31, 2017, which was the date the consolidated financial statements were made available.

#### **NOTE 2: INVESTMENTS**

#### Investments in Associated Enterprises

The Cooperative had the following investments in associated enterprises at June 30, 2017 and 2016:

June 30,	2017	2016
CFC capital term certificates	\$ 2,096,877	\$ 1,829,305
Penwar, Inc.	42,698	38,962
Co-Bank stock	 1,000	1,000
	\$ 2,140,575	\$ 1,869,267

#### NOTE 2: INVESTMENTS (CONTINUED)

#### Investments in Subsidiaries

WRECC holds investments in two wholly-owned for-profit entities, PES and Millennium. PES is involved with propane distribution and Millennium is a natural gas distributor. For the years ended June 30, 2017 and 2016, PES reported a net income after tax of \$55,923 and \$17,878, respectively. For the years ended June 30, 2017 and 2016, Millennium reported a net income after tax of \$91,049 and \$31,214, respectively.

#### NOTE 3: UTILITY PLANT

June 30,	2017	2016
Electric plant in service:		
Transmission plant	\$ 26,821,788	\$ 26,263,475
Distribution plant	231,414,941	220,097,092
General plant	28,075,280	24,498,254
Total electric plant in service	286,312,009	270,858,821
Construction work in progress	11,602,155	10,085,945
Total utility plant	297,914,164	280,944,766
Accumulated depreciation	(131,162,899)	(124,745,810)
Net utility plant	\$ 166,751,265	\$ 156,198,956

Utility plant activity at June 30, 2017 and 2016 is summarized as follows:

#### NOTE 4: LINES OF CREDIT

The Cooperative has a line of credit for \$8,000,000 with CFC that renews annually each year unless terminated by either party. The note has a variable interest rate and is unsecured. The Cooperative also has a revolving line of credit with Co-Bank for \$10,000,000 that also has a variable interest rate and is unsecured. There were no outstanding balances against either of these notes at June 30, 2017 or 2016.

In addition, on February 2, 2013, RUS approved a \$13,000,000 loan commitment for the Cooperative which remains unused at June 30, 2017.

#### NOTE 5: LONG-TERM DEBT

At June 30, 2017 and 2016, long-term debt consisted of the following:

June 30,	2017	2016
Mortgage notes payable to CFC due in quarterly installments ranging from approximately \$63,000 to \$408,000 including interest at fixed rates ranging from 2.10% to 6.15%, maturing March 2016 through August 2034; secured by utility plant.	\$ 45,971,462	\$ 49,388,138
Mortgage notes payable to Federal Financing Bank, RUS, due in monthly installments of approximately \$90,000 including interest at fixed rates ranging from 3.82% to 6.14%, maturing March 2028 through December 2042; secured by utility plant.	24,813,245	25,502,943
Mortgage notes payable to CoBank due in monthly installments of approximately \$52,000 including interest at rates ranging from 2.95% to 6.78%, maturing March 2016 through February 2029; secured by all assets not otherwise securing pre-existing loans.	927,127	1,110,761
	· · · / ·	_,,
Total long-term debt	71,711,834	76,001,842
Less current maturities	4,145,695	4,335,373
Less RUS cushion of credit	108,162	1,769,047
Net long-term debt	\$ 67,457,977	\$ 69,897,422

The annual debt service requirements to maturity, including principal and interest, at June 30 are as follows:

For the year ending June 30,	
	Principal
2018	\$ 4,145,695
2019	4,433,653
2020	4,725,037
2021	4,747,243
2022	5,580,739
Thereafter	47,971,305
Total	\$ 71,603,672

#### NOTE 5: LONG-TERM DEBT (CONTINUED)

The provisions of the mortgage notes payable place certain restrictions and limitations upon the Cooperative. These include maintenance of certain financial ratios, as well as restrictions or limitations on the payment of distributions, rentals of property, and additional borrowings. The Cooperative was in compliance with these covenants at June 30, 2017 and 2016.

#### **NOTE 6: DEFERRED DEBITS AND CREDITS**

The Cooperative's deferred debits and credits as presented in the balance sheet consisted of the following items:

June 30,	2017			2016	
Deferred debits:					
Computer software, amortized over 1 to 5 years	\$	473,100	\$	406,939	
WRECC rebate program		18,059		-	
Prepaid pension asset, amortized over 17 years		-		737	
Merchandise, etc.		647		90	
	\$	491,806	\$	407,766	
Deferred credits:					
	÷	424 767	ć	400.000	
Refundable contributions	\$		Ş	490,066	
Unearned revenue		229,354		-	
Advance receipts of subdivision street light assessments		352,236		324,150	
	\$	1,006,357	\$	814,216	

#### NOTE 7: INCOME TAXES

The provision for income taxes for the years ended June 30, 2017 and 2016 consisted of the following:

For the years ended June 30,	<b>2017</b> 2016			2016
Current tax expense Deferred taxes	\$	76,641 46,031	\$	94,000 1,110
Total	\$	122,672	\$	95,110

The Cooperative has net deferred tax liabilities of \$248,055 and \$202,024 at June 30, 2017 and 2016, respectively, primarily related to the use of accelerated methods of depreciation of property and equipment for income tax purposes.

#### **NOTE 8: RETIREMENT PLANS**

#### Defined Benefit Pension Plan

The Cooperative participates in the National Rural Electrification Cooperative Association (NRECA) Retirement Security Plan (RS Plan). The NRECA RS Plan is a defined benefit pension plan qualified under Section 401 and tax-exempt under Section 501 (a) of the Internal Revenue Code. It is a multi-employer plan under accounting standards. The plan sponsor's Employer Identification Number is 53-0116145 and the Plan Number is 333.

A unique characteristic of a multi-employer 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.

The Cooperative made contributions to the plan of \$2,163,248 for the year ended June 30, 2017, and \$2,194,561 for the year ended June 30, 2016. There have been no significant changes that affect the comparability of 2017 and 2016 contributions.

In the RS 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 Retirement Security Plan was approximately 95 percent funded on January 1, 2016, and approximately 106 percent funded on January 1, 2015, 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 RS 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.

On July 1, 1999, the Cooperative elected to adopt an amendment to the RS Plan lowering the normal retirement age from 65 to 62. In conjunction with this amendment, the Cooperative made a lump-sum payment of \$1,221,439 which is being amortized over 17 years. At June 30, 2017 and 2016, the unamortized prepaid pension asset was \$0 and \$737 respectively.

#### Deferred Compensation Retirement Plans

The Cooperative has a 401(k) plan which is available to all employees who have completed one month of service. The Cooperative contributes 1% of the employees' base pay if the employee contributes 4%. The Cooperative made contributions to the plan of \$95,484 for 2017 and \$99,863 for 2016.

#### NOTE 8: RETIREMENT PLANS (CONTINUED)

The Cooperative also has a 457(b) Plan which is administered by Homestead Funds. The Plan is for management or highly compensated employees of the Cooperative. The Plan is for participant contributions only; the Cooperative does not contribute. The Plan's assets will remain solely the property of the Cooperative, subject only to the claims of the Cooperative's creditors until made available to the participant or beneficiary of the Plan's assets. Amounts at June 30, 2017 and 2016 were \$307,405 and \$252,874, respectively.

#### NOTE 9: POSTRETIREMENT HEALTHCARE BENEFITS

The Cooperative provides certain healthcare benefits for retired employees hired prior to January 1, 2014. In order to receive retiree medical and dental benefits, an employee must be at least 55 years of age, with a minimum of 5 years of service, and the sum of age plus years of service must be at least 75. The Cooperative will pay up to three years of benefits for the retiree, or until age 65 is attained. Employees hired after January 1, 2014, will not be eligible for postretirement healthcare benefits.

The Cooperative accrues the cost of providing postretirement benefits over the active service period of the employee. In 1994, the Cooperative recognized an accumulated liability of \$585,807. Prior to this, the Cooperative recognized postretirement benefits expenses as they were incurred. The following summarizes the postretirement benefits plan for the years ended June 30, 2017 and 2016.

For the year ended June 30,		<b>2017</b> 2016			
Reconciliation of funded status Benefit obligation at June 30 Fair value of plan assets at June 30	\$	3,732,134 -	\$	3,729,063	
Unfunded benefit obligation		3,732,134		3,729,063	
Benefits paid	\$	393,310	\$	296,709	
Employer contributions	\$	393,310	\$	296,709	
Ponofit cost	ć	265 594	ć	244 570	
Benefit cost	Ş	365,584	Ş	344,579	

#### NOTE 10: SELF-INSURANCE

The Cooperative is self-insured for a significant portion of its employee healthcare claims. During 2017 and 2016, the Cooperative paid claims of \$2,894,849 and \$3,400,825, respectively. Management has recorded an estimate for an amount it considers reasonable related to its obligation for claims incurred but not reported as of yearend. At June 30, 2017 and 2016, the Cooperative had accrued \$247,742 and \$99,996, respectively, for these projected claims.

#### NOTE 11: COMMITMENTS

The Cooperative has a wholesale power contract with Tennessee Valley Authority (TVA) whereby the electric system purchases all of its electric power from TVA. The rates paid for such purchases are subject to review periodically. A five-year notice to TVA is required to terminate the contract.

#### NOTE 12: RISK MANAGEMENT

The Cooperative is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. During the years ended June 30, 2017 and 2016, the Cooperative purchased commercial insurance for all of the above risks. The Cooperative is involved in lawsuits from time to time, which are considered to be in the normal course of business. In the opinion of management, based on information furnished by counsel, the ultimate liability, if any, will have no material effect on the financial position of the Cooperative.

#### NOTE 13: PRIOR PERIOD ADJUSTMENT / RESTATEMENTS

The beginning equity, accounts receivable, and net income for the year ended June 30, 2016 have been restated to reflect the correction of an error of the Cooperative's unbilled revenue.

The following adjustment was made to beginning equity:

June 30,	2016
Beginning equity - as reported by other auditors	\$ 84,666,547
Effect of prior period adjustment to beginning equity: Correction in unbilled revenue and related accounts	
receivable calculations	3,179,274
Beginning equity - as restated	\$ 87,845,821

# Warren Rural Electric Cooperative Corporation Notes to Financial Statements

# NOTE 13: PRIOR PERIOD ADJUSTMENT / RESTATEMENTS (CONTINUED)

The following adjustment was made to accounts receivable:

	June 30,	2016
	Accounts receivable, net of allowance - as reported by other auditors	\$ 7,842,133
	Restatement due to correction of unbilled revenue	4,486,736
	Accounts receivable, net of allowance - as restated	\$ 12,328,869
The follow	ving adjustment was made to net income:	
	For year ended June 30,	2016
	Net income - as reported by other auditors	\$ 3,241,656
	Impact of correction for unbilled revenue	1,307,462
	Net income - as restated	\$ 4,549,118

# Warren Rural Electric Cooperative Corporation Consolidating Balance Sheets

June 30, 2017	WRECC	PES	Millennium	Eliminations	Total
Assets					
Utility plant					
Plant in service	\$ 286,312,009	\$-	\$-	\$-	\$ 286,312,009
Construction in progress	11,602,155	-	-	-	11,602,155
Less accumulated depreciation	(131,162,899)	-	-	-	(131,162,899
Net utility plant	166,751,265	-	-	-	166,751,265
Other property and investments					
Non-utility plant, net of accumulated	-	538,822	1 504,328	-	1,043,149
Investments in associated companies	4,927,844	-	-	(2,787,269)	2,140,575
Other investments	309,751	-	-	-	309,751
Goodwill	503,260	-	-	-	503,260
Total other property and investments	5,740,855	538,823	1 504,328	(2,787,269)	3,996,735
Current assets					
Cash and cash equivalents	18,584,671	1,241,900	5 566,888	-	20,393,465
Accounts receivable, net of allowance	13,974,879	70,612	2 137,720	(64,920)	14,118,291
Other accounts receivable	721,854	-	-	-	721,854
Materials and supplies	2,901,741	76,584	4 5,048	-	2,983,373
Prepaid expenses	1,017,591	123,958	8 47,974	-	1,189,523
Total current assets	37,200,736	1,513,060	0 757,630	(64,920)	39,406,506
Other assets					
TVA Energy Services loans receivable	7,160	-	-	-	7,160
Deferred debits	491,806	-	-	-	491,806
Total other assets	498,966	-	-	-	498,966
Total assets	\$ 210,191,822	\$ 2,051,883	1 \$ 1,261,958	\$ (2,852,189)	\$ 210,653,472

# Warren Rural Electric Cooperative Corporation Consolidating Balance Sheets

June 30, 2017	WRECC	PES	Millennium	Aillennium Eliminations	
Equities and Liabilities					
Equities					
Membership fees	\$ 551,605	\$ -	\$-	\$-	\$ 551,605
Patronage capital	99,908,485	-	-	-	99,908,485
Other equities	107,658	1,682,492	1,104,777	(2,787,269)	107,658
Total equities	100,567,748	1,682,492	1,104,777	(2,787,269)	100,567,748
Long-term liabilities					
Long-term debt - net of current portion	67,457,977	-	-	-	67,457,977
Accrued post-retirement benefits	3,787,539	-	-	-	3,787,539
Total other liabilities	71,245,516	-	-	-	71,245,516
Current liabilities					
Accounts payable - purchased power	23,555,448	-	-	-	23,555,448
Accounts payable - other	2,463,637	13,780	10,344	(64,920)	2,422,841
Self-insured fund	247,742	-	-	-	247,742
Customer deposits	3,561,853	-	6,880	) –	3,568,733
Accrued interest	177,182	-	-	-	177,182
Accrued vacation and sick leave	1,476,329	-	-	-	1,476,329
Current portion of post-retirement liability	252,000	-	-	-	252,000
Accrued taxes and other current liabilities	1,713,833	13,076	5,081		1,731,990
Current portion of long-term debt	4,145,695	-	-	-	4,145,695
Total current liabilities	37,593,719	26,856	22,305	(64,920)	37,577,960

# Warren Rural Electric Cooperative Corporation Consolidating Balance Sheets

June 30, 2017	WRECC	PES	Millennium	Eliminations	Total
Other liabilities					
Advances for TVA Energy Services loans	7,836	-	-	-	7,836
Deferred income taxes	-	113,179	134,876	-	248,055
Deferred credits	777,003	229,354	-	-	1,006,357
Total other liabilities	784,839	342,533	134,876	-	1,262,248
Total equities and liabilities	\$ 210,191,822	5 2,051,881	\$ 1,261,958	\$ (2,852,189)	\$ 210,653,472

# Warren Rural Electric Cooperative Corporation Consolidating Statements of Income

For the year ended June 30, 2017	WRECC	PES	Millennium	Eliminations	Total
Operating Revenues					
Electric sales	\$ 185,148,187	\$ -	\$-	\$-	\$ 185,148,187
Forfeited discounts	1,054,487	-	-	-	1,054,487
Rent from electric property	2,133,170	-	-	-	2,133,170
Other electric revenues	641,602	-	-	-	641,602
Natural gas sales	-	-	664,580	-	664,580
Propane and related sales	-	1,987,875	-	-	1,987,875
Total operating revenue	188,977,446	1,987,875	664,580	-	191,629,901
Purchased power and expenses					
Purchased power	141,759,822	-	-	-	141,759,822
Operation	5,790,849	647,232	37,132	-	6,475,213
Maintenance	6,158,190	-	11,550	-	6,169,740
Facilities rental	102,987	-	-	-	102,987
Customer accounts	3,101,009	-	-	-	3,101,009
Customer service and information	794,602	-	1,020	-	795,622
Administrative and general	5,083,045	85,966	30,045	-	5,199,056
Depreciation and amortization	10,362,439	147,507	39,643	-	10,549,589
Taxes and tax equivalents	5,177,810	43,013	37,149	-	5,257,972
Natural gas purchases	-	-	440,971	-	440,971
Propane gas and related cost of goods sold	-	903,070	-	-	903,070
Total purchased power and expenses	178,330,753	1,826,788	597,510	-	180,755,051
Total operating income	10,646,693	161,087	67,070	-	10,874,850

# Warren Rural Electric Cooperative Corporation Consolidating Statements of Income

For the year ended June 30, 2017	WRECC	PES	Millennium	Eliminations	Total
Other revenues					
Interest income	194,780	561	522	-	195,863
Income of unconsolidated entities	3,736	-	-	-	3,736
Miscellaneous	740,324	36,191	4,213	(146,972)	633,756
Total other revenues	938,840	36,752	4,735	(146,972)	833,355
Other deductions					
Interest on long-term debt	3,211,140	-	-	-	3,211,140
Post-retirement benefits	252,000	-	-	-	252,000
Total other deductions	3,463,140	-	-	-	3,463,140
Income before income taxes	8,122,393	197,839	71,805	(146,972)	8,245,065
Income tax expense		141,916	(19,244)	-	122,672
Net Income	\$ 8,122,393 \$	55,923	\$ 91,049	\$ (146,972) \$	8,122,393



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Independent Auditors' 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* 

Board of Directors Warren Rural Electric Cooperative Corporation Bowling Green, Kentucky

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of the Warren Rural Electric Cooperative Corporation (the "Cooperative") (a nonprofit organization), which comprise the consolidated balance sheet as of June 30, 2017 and the related consolidated statements of income, equities, and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated October 31, 2017.

#### Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered the Cooperative's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated 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.

Our consideration of internal control was for the limited purpose described in the preceding paragraph 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. However, as described in the accompanying schedule of findings and recommendations, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

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 consolidated financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and recommendations to be a material weakness: 2017-001.

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. We consider the deficiencies described in the accompanying schedule of findings and recommendations to be significant deficiencies: 2017-002 and 2017-003.

#### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Cooperative's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and recommendations as items 2017-004 and 2017-005.

#### The Cooperative's Response to Findings

The Cooperative's response to the findings identified in our audit is described in the accompanying schedule of findings and recommendations. The Cooperative's response was not subjected to the auditing procedures applied in the audit of the consolidated financial statements and, accordingly, we express no opinion on it.

#### Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the 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.

Can, Rigge & Ingram, L.L.C.

CARR, RIGGS & INGRAM, LLC Bowling Green, Kentucky October 31, 2017



Independent Auditors' Report on Compliance with Aspects of Contractual Agreements and Regulatory Requirements for Electric Borrowers Carr, Riggs & Ingram, LLC

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Board of Directors Warren Rural Electric Cooperative Corporation Bowling Green, Kentucky

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Warren Rural Electric Cooperative Corporation (the "Cooperative"), which comprise the consolidated balance sheet as of June 30, 2017, and the related consolidated statements of income, equities, and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated October 31, 2017. In accordance with *Government Auditing Standards*, we have also issued our report dated October 31, 2017, on our consideration of the Cooperative's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. No reports other than the reports referred to above and our schedule of findings and recommendations related to our audit have been furnished to management.

In connection with our audit, nothing came to our attention that caused us to believe that the Cooperative failed to comply with the terms, covenants, provisions, or conditions of their loan, grant, and security instruments as set forth in 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers*, §1773.33 and clarified in the RUS policy memorandum dated February 7, 2014 insofar as they relate to accounting matters as enumerated below, except for items noted in the schedule of findings and recommendations. However, our audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding the Cooperative's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters. In connection with our audit, we noted no matters, except as noted in the schedule of findings and recommendations, 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 (see 2017-005 for finding noted in schedule of findings and recommendations);
- Record and properly price the retirement of plant;
- Seek approval of the sale, lease, or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap;
- Maintain adequate control over materials 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 consolidated 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) (see 2017-004 for finding noted in schedule of findings and recommendations);
- 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.

This report is intended solely for the information and use of the board of directors, management, and the 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 distribution is not limited.

Can, Rigge & Ingram, L.L.C.

CARR, RIGGS & INGRAM, LLC Bowling Green, Kentucky October 31, 2017

#### 2017-001 UNBILLED REVENUE

*Criteria and Condition:* The internal control structure over financial reporting should be such that material misstatements in the Cooperative's consolidated financial statements are prevented or detected and corrected on a timely basis. A proposed material prior period adjustment was made to unbilled revenue, accounts receivable, and equity to correct the Cooperative's balances.

*Cause:* The methodology of the unbilled revenue estimate was not challenged for reasonableness.

*Effect:* Consolidated financial statements could contain undetected errors.

*Recommendation:* We recommend the methodology applied to significant estimates be reviewed on an annual basis for reasonableness.

*Views of Responsible Officials and Planned Corrective Actions*: WRECC staff believed we were using the best method to estimate unbilled revenue. Only when the receivable portion of the estimation became a negative balance was it discovered that our estimation method was flawed (we believe this resulted from a significant reduction in our line losses and failure to change that input in the calculation). Staff failed to recognize this problem until discovered during the FY 2017 audit. Upon recommendation of auditor, the methodology of estimating unbilled revenue has been revised to conform to their suggested method. We believe there is still some inherent potential for misstatement, as the recommended methodology does not take into consideration changes in weather from one billing period to the next. We will be working to refine the estimation process to factor in this variable. Within twenty four months, WRECC will be fully converted to an AMI system. At that time, unbilled revenue will be calculated by the billing software more accurately.

#### 2017-002 FINANCIAL REPORTING

*Criteria and Condition:* The internal control structure over financial reporting should be such that significant misstatements in the Cooperative's consolidated financial statements are prevented or detected and corrected on a timely basis. During our audit procedures, we noted instances in which the general ledger was not properly adjusted, requiring significant audit adjustments in the areas of accounts receivable, capital assets, construction in process, goodwill, investments, accounts payable, self-insurance liability, unearned revenue, revenue, and expense.

*Cause:* The review and approval processes in place did not prevent or detect and correct significant misstatements.

*Effect:* Misstatements in the consolidated financial statements could occur and not be detected in a timely manner.

*Recommendation:* We recommend management evaluate the current control processes to strengthen internal controls over financial reporting. Some items noted that would improve the

## Warren Rural Electric Cooperative Corporation Schedule of Findings and Recommendations

internal controls include requiring a review of journal entries and bank reconciliations, as well as reviewing specific procedures over month end closings to ensure accounts are properly adjusted.

*Views of Responsible Officials and Planned Corrective Actions*: WRECC accounting staff will implement recommended controls, including more timely reviews and reconciliations of general ledger accounts and bank statements.

#### 2017-003 SEGREGATION OF DUTIES

*Criteria and Condition:* Proper segregation duties is a significant component to the internal control structure. There is a lack of segregation of duties in relation to the cash disbursements.

*Cause:* Select employees have access to the Cooperative's assets and financial records.

*Effect:* Misappropriations could occur and not be detected by the Cooperative's internal controls.

*Recommendation:* We recommend management strengthen internal controls in relation to cash disbursements by segregating access to the Cooperative's assets and financial records.

*Views of Responsible Officials and Planned Corrective Actions*: In our opinion, the Accounting department is not large enough to have full segregation of duties. The Manager of Accounting acts as backup for accounts payable, payroll and all other functions within the Accounting department. The VP of Administrative Services reviews all checks written and disburses the checks. The VP will begin use of a log of checks written to ensure that all checks are accounted for. We will regularly review authorities given to individuals to ensure only ones that should have access to certain functions have the access.

#### 2017-004 DEPRECIATION RATES

*Criteria and Condition:* The Cooperative is required to comply with the terms, covenants, provisions, and conditions of their loan with RUS as set forth in 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers*, Section 1773.33 and clarified in the RUS policy memorandum dated February 7, 2014. A specific requirement states that the Cooperative must record depreciation in accordance with RUS regulations as stated in the RUS Bulletin 183-1, Depreciation Rates and Procedures. Several depreciation rates being used by the Cooperative within the general plant, distribution plant, and transportation plant categories were not in agreement with the requirements stated in the RUS Bulletin 183-1, Depreciation Rates and Procedures.

*Cause:* RUS Bulletin 183-1, Depreciation Rates and Procedures, was not compared to the current depreciation rates utilized by the Cooperative.

*Effect:* The Cooperative is not in compliance with RUS Bulletin 183-1, Depreciation Rates and Procedures.

## Warren Rural Electric Cooperative Corporation Schedule of Findings and Recommendations

*Recommendation:* We recommend the Cooperative record depreciation in accordance with RUS regulations as stated in the RUS Bulletin 183-1, Depreciation Rates and Procedures.

*Views of Responsible Officials and Planned Corrective Actions*: As WRECC's regulator, TVA sets the depreciation rates for accounts 364, 365, 368, 369 and 370 and approves rates for all other accounts. WRECC Staff will review depreciation rates for all accounts and request changes in depreciation rates from TVA to conform to the RUS recommended range of rates.

#### 2017-005 CAPITALIZATION OF CONSTRUCTION IN PROGRESS

*Criteria and Condition:* The Cooperative is required to comply with the terms, covenants, provisions, and conditions of their loan with RUS as set forth in 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers*, Section 1773.33 and clarified in the RUS policy memorandum dated February 7, 2014. A specific requirement states that the Cooperative must clear construction accounts and accrue depreciation on completed construction within a timely manner. Two work orders totaling approximately \$4,200,000 with completed dates of June 2016 remained in the construction in progress account balance as of June 30, 2017.

*Cause:* The construction in progress account was not reviewed in accordance with RUS requirements.

*Effect:* The Cooperative is not in compliance with RUS requirements.

*Recommendation:* We recommend the Cooperative review procedures to ensure completed construction projects are capitalized and depreciated in a timely manner.

*Views of Responsible Officials and Planned Corrective Actions*: The work orders referenced by audit were for construction/renovation of two substations. As these types of work orders do not create CPR records, they do not automatically run through the normal work order closing process and must be closed manually. Accounting was not notified of completion of these work orders and, thus, did not capitalize timely. Accounting will review a list of all completed work orders monthly, looking for work order types that must be closed manually.

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