

South Kentucky Rural Electric Cooperative Corporation
Financial Statements
Years Ended December 31, 2021 and 2020

South Kentucky Rural Electric Cooperative Corporation
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Years Ended December 31, 2021 and 2020

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Independent Auditor's Report

To the Board of Directors
South Kentucky Rural Electric Cooperative Corporation

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of South Kentucky Rural Electric Cooperative Corporation (the "Cooperative") which comprise the balance sheets as of December 31, 2021 and 2020, and the related statements of income and comprehensive income, changes in members' and patrons' equities and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Cooperative as of December 31, 2021 and 2020, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America ("GAAS") and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Cooperative, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Cooperative's ability to continue as a going concern for one year after the date that the financial statements are issued.

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Independent Auditor's Report (Continued)

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Cooperative's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Cooperative's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the audit.

Supplementary Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Cooperative's basic financial statements. The Schedule of Expenditures of Federal Awards, as required by *Title 2 U.S. Code of Federal Regulations ("CFR") Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* ("Uniform Guidance"), are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The Schedule of Expenditures of Federal Awards is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards general accepted in the United States of America. In our opinion, the Schedule of Expenditures of Federal Awards is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Independent Auditor's Report (Continued)

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated April 14, 2022, 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 solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of 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.

MCM CPAs & Advisors LLP

Louisville, Kentucky

April 14, 2022

South Kentucky Rural Electric Cooperative Corporation
Balance Sheets
December 31, 2021 and 2020

	<u>2021</u>	<u>2020</u>
Assets		
Electric plant in service, net	\$ 204,261,958	\$ 200,483,473
Investments		
Investments in associated organizations	8,213,797	8,981,114
Investment in East Kentucky Power Cooperative	81,537,084	78,184,434
Total investments	89,750,881	87,165,548
Current assets		
Cash and equivalents	7,636,716	13,753,434
Accounts receivable - customers (net of allowance for doubtful accounts of \$851,883 and \$875,148 in 2021 and 2020, respectively)	8,246,522	5,310,558
Accounts receivable - unbilled	7,411,005	8,598,597
Other receivables	2,623,292	2,127,483
Materials and supplies	1,798,502	1,440,355
Prepayments and other	491,233	621,428
Total current assets	28,207,270	31,851,855
Regulatory assets, net	1,123,374	1,310,602
Deferred debits		
Prepayment	911,767	1,332,582
General plant clearing	-	6,137
Total deferred debits	911,767	1,338,719
Total assets	<u>\$ 324,255,250</u>	<u>\$ 322,150,197</u>
Members' and patrons' equities and liabilities		
Members' and patrons' equities		
Memberships	\$ 1,196,930	\$ 1,184,440
Patronage capital	147,813,512	144,185,588
Equities	12,315,367	8,349,041
Accumulated other comprehensive loss	(4,845,476)	(3,998,048)
Total members' and patrons' equities	156,480,333	149,721,021
Long-term debt and other liabilities		
Long-term debt, less current maturities	129,727,820	138,502,813
Accrued compensated absences	1,248,410	1,282,423
Postretirement benefits obligation	10,663,877	9,833,691
Total Long-term debt and other liabilities	141,640,107	149,618,927
Current liabilities		
Current portion of long-term debt	9,329,947	7,607,892
Accounts payable	13,444,791	12,034,307
Accrued interest	160,806	196,861
Customer guaranty deposits	1,761,127	1,728,026
Other current liabilities	973,678	828,724
Total current liabilities	25,670,349	22,395,810
Deferred credits		
Consumer advances for construction	464,128	414,284
Other	333	155
Total deferred credits	464,461	414,439
Total members' and patrons' equities and liabilities	<u>\$ 324,255,250</u>	<u>\$ 322,150,197</u>

See accompanying notes.

South Kentucky Rural Electric Cooperative Corporation
Statements of Income and Comprehensive Income
Years Ended December 31, 2021 and 2020

	<u>2021</u>	<u>%</u>	<u>2020</u>	<u>%</u>
Operating revenue				
Sale of electric energy				
Residential	\$ 88,027,419	65.81 %	\$ 79,602,997	66.81 %
Commercial	41,101,873	30.73	35,779,278	30.03
Public authorities and outdoor lighting	1,781,510	1.33	1,509,494	1.27
Total sale of electric energy	130,910,802	97.87	116,891,769	98.11
Other revenue	2,841,209	2.13	2,259,728	1.89
Total operating revenue	133,752,011	100.00	119,151,497	100.00
Operating expenses				
Cost of power	96,010,219	71.78	82,678,137	69.39
Distribution expense	12,133,756	9.07	12,201,296	10.24
Customer accounts expense	3,993,783	2.99	2,602,163	2.18
Customer services and information expense	617,042	0.46	643,491	0.54
Administrative and general expense	4,046,421	3.03	3,883,660	3.26
Depreciation and amortization	9,627,826	7.20	9,295,542	7.80
Taxes	155,255	0.12	160,956	0.14
Total operating expenses	126,584,302	94.65	111,465,245	93.55
Net operating income	7,167,709	5.35	7,686,252	6.45
Non-operating (expense) income				
Interest expense	(5,239,774)	(3.92)	(5,517,896)	(4.63)
Other margins	3,943,727	2.95	1,596,354	1.34
Patronage capital	3,559,110	2.66	5,245,543	4.40
Total non-operating income	2,263,063	1.69	1,324,001	1.11
Net margins	9,430,772	7.04	9,010,253	7.56
Other comprehensive income				
Change in post-retirement benefit obligation	(847,428)	(0.63)	(1,208,766)	(1.01)
Comprehensive income	<u>\$ 8,583,344</u>	<u>6.41 %</u>	<u>\$ 7,801,487</u>	<u>6.55 %</u>

See accompanying notes.

South Kentucky Rural Electric Cooperative Corporation
Statements of Changes in Members' and Patrons' Equities
Years Ended December 31, 2021 and 2020

	<u>Memberships</u>	<u>Patronage capital</u>	<u>Equities</u>	<u>Accumulated other comprehensive loss</u>	<u>Total members' and patrons' equities</u>
Balance January 1, 2020	\$ 1,155,100	\$ 138,914,541	\$ 7,157,724	\$ (2,789,282)	\$ 144,438,083
Comprehensive income	-	7,413,899	1,596,354	(1,208,766)	7,801,487
Net change in memberships	29,340	-	-	-	29,340
Refunds to estates	-	(344,043)	246,036	-	(98,007)
General retirement refund	-	(1,579,768)	620,601	-	(959,167)
Recapture of bad debt	-	(2,036,195)	545,480	-	(1,490,715)
Transfers to other equity and prior year's income	-	1,817,154	(1,817,154)	-	-
Balance December 31, 2020	1,184,440	144,185,588	8,349,041	(3,998,048)	149,721,021
Comprehensive income	-	5,487,045	3,943,727	(847,428)	8,583,344
Net change in memberships	12,490	-	-	-	12,490
Refunds to estates	-	(442,928)	529,810	-	86,882
General retirement refund	-	(2,898,751)	1,039,620	-	(1,859,131)
Recapture of bad debt	-	(113,796)	49,523	-	(64,273)
Transfers to other equity and prior year's income	-	1,596,354	(1,596,354)	-	-
Balance, December 31, 2021	<u>\$ 1,196,930</u>	<u>\$ 147,813,512</u>	<u>\$ 12,315,367</u>	<u>\$ (4,845,476)</u>	<u>\$ 156,480,333</u>

See accompanying notes.

South Kentucky Rural Electric Cooperative Corporation
Statements of Cash Flows
Years Ended December 31, 2021 and 2020

	<u>2021</u>	<u>2020</u>
Cash flows from operating activities		
Net margins	\$ 9,430,772	\$ 9,010,253
Non-cash expenses included in net margins		
Patronage capital assigned but not paid		
by associated organizations	(3,559,110)	(5,245,543)
Depreciation and amortization	9,627,826	9,295,542
Bad debt expense	111,392	(1,148,100)
Bad debt recapture - patronage capital	(64,273)	(1,490,715)
Loss (gain) on disposition of electric plant in service	177,821	(51,236)
PPP loan forgiveness income	(3,087,600)	-
Changes in current and non-current assets and liabilities		
Accounts receivable	(1,909,287)	(886,367)
Other receivables	(495,809)	1,825,748
Materials and supplies	(358,147)	(21,499)
Prepayments and other	130,195	(134,138)
Accounts payable	1,410,484	948,655
Customer guaranty deposits	33,101	45,130
Accrued interest and other current liabilities	108,899	(60,646)
Accrued compensated absences	(34,013)	156,048
Postretirement benefits obligation	(17,242)	7,320
	<u>11,505,009</u>	<u>12,250,452</u>
Cash flows from investing activities		
(Increase) decrease in deferred debits	426,951	529,344
Increase (decrease) in deferred credits	50,022	(32,771)
Interest income - other margins	(918,739)	(1,391,660)
(Increase) decrease in advance loan payments unapplied	24,415	26,157
(Increase) decrease in economic development loan funds	891,663	1,699,223
Proceeds from sale of electric plant in service	143,049	63,197
Additions to electric plant in service	(12,337,579)	(11,572,026)
Removal cost, net	(1,202,373)	(1,234,698)
Patronage capital received from associated organizations	82,114	841,347
	<u>(12,840,477)</u>	<u>(11,071,887)</u>
Cash flows from financing activities		
Proceeds from long-term notes payable	-	17,000,000
Payment of principal on long-term notes payable	(6,158,614)	(8,295,215)
Membership fees (reimbursement), net	12,490	29,340
Refund of patronage capital to members	(3,341,679)	(1,923,811)
Changes in other patronage capital and equities	1,618,953	1,412,117
Proceeds from PPP loan	3,087,600	-
	<u>(4,781,250)</u>	<u>8,222,431</u>
(Decrease) increase in cash and equivalents during the year	(6,116,718)	9,400,996
Cash and equivalents, beginning of year	<u>13,753,434</u>	<u>4,352,438</u>
Cash and equivalents, end of year	<u>\$ 7,636,716</u>	<u>\$ 13,753,434</u>
Supplemental disclosures of cash flow information		
Interest paid	\$ 5,275,829	\$ 5,539,849

See accompanying notes.

South Kentucky Rural Electric Cooperative Corporation
Notes to Financial Statements
Years Ended December 31, 2021 and 2020

Note A - Nature of Operations

South Kentucky Rural Electric Cooperative Corporation (the "Cooperative") is engaged in distributing power to its member consumers throughout eleven south central Kentucky counties and two northern Tennessee counties. The audited financial statements are prepared in accordance with policies prescribed or permitted by the Kentucky Public Service Commission ("PSC") and the United States Department of Agriculture Rural Utilities Services ("RUS"), which conform with generally accepted accounting principles as applied to regulated enterprises. The more significant of these policies are as follows.

Note B - Summary of Significant Accounting Policies

1. Basis of Accounting: The financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. The Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") is the sole source of authoritative accounting technical literature. The significant accounting policies are described below to enhance the usefulness of the financial statements to the reader.
2. Electric Plant in Service: Electric plant is stated at original cost, which is the cost when first dedicated to public service. Maintenance and repairs, including the cost of renewals of minor items of property, are charged to maintenance expense accounts. Replacements of property, exclusive of minor items, are charged to the electric plant accounts.

Depreciation is provided using the straight-line method at rates which are designed to amortize the cost of depreciable plant, net of estimated salvage value, over its estimated useful life. Depreciation rates are within the ranges included in Bulletin 183-1 and any rate changes have been approved by RUS for the depreciation rates used by the Cooperative. The depreciation rates have also been approved by the PSC as of March 30, 2012. The composite depreciation rate for distribution plant was approximately 3.33% for 2021 and 2020. Plant is being depreciated using specific identification straight-line method as follows:

Distribution plant	2.175% - 6.67%
General plant	2.00% - 15.00%

When distribution plant is retired or otherwise disposed of in the normal course of business, an estimate of its cost, together with the cost of removal less salvage, is charged to the accumulated provision for depreciation. Gains and losses resulting from the sale or disposal of general plant are recognized in income currently.

The major classifications of electric plant in service were as follows:

	2021	2020
Distribution plant	\$ 253,377,220	\$ 244,073,807
General plant	40,597,673	40,537,318
Construction in progress	1,278,038	2,136,550
	295,252,931	286,747,675
Accumulated depreciation	90,990,973	86,264,202
Electric plant in service, net	<u>\$ 204,261,958</u>	<u>\$ 200,483,473</u>

South Kentucky Rural Electric Cooperative Corporation
Notes to Financial Statements (Continued)
Years Ended December 31, 2021 and 2020

Note B - Summary of Significant Accounting Policies (Continued)

3. Cash and Equivalents: For purposes of the statements of cash flows, the Cooperative considers short-term investments having maturities of three months or less at time of purchase to be cash equivalents.
4. Accounts Receivable: Accounts receivable-customers consists of amounts due for sales of electric energy, which were not received by the Cooperative at year-end. Based on management's evaluation of uncollected accounts receivable at the end of each year, bad debts are provided for on the allowance method.

Additionally, regulatory requirements authorized by the PSC allow the electric supplier to impose a fuel adjustment surcharge upon the Cooperative. In turn, the Cooperative is required to pass on the fuel surcharge to the consumer. Due to the regulatory requirements in calculating the surcharge the Cooperative may experience an over or under recovery of the fuel adjustment surcharge.

Similarly, the PSC has an environmental cost recovery mechanism that allows the electric supplier to recover certain costs incurred in complying with the Federal Clean Air Act as amended and those federal, state, and local environmental requirements which apply to coal combustion wastes and byproducts from facilities utilized for the production of energy from coal. In turn, the Cooperative is required to pass on this environmental cost recovery mechanism to the consumer.

Every six months and every two years, the PSC reviews the outcomes of the cost recovery mechanism for the environmental surcharge and may order an additional recovery or payback amount. The Cooperative records these amounts as a regulatory asset or liability.

The Cooperative records the under or over recovery of the fuel adjustment surcharge and the environmental surcharge on the financial statements.

In consideration of the Governor of Kentucky declaring a State of Emergency in response to the coronavirus disease 2019 ("COVID-19"), on March 16, 2020 the Kentucky Public Service Commission issued an order, PSC 2020-00085. This order mandated that utilities shall cease disconnection of service for non-payment. This order remained in effect until it was modified on September 21, 2020. At that time, utilities were to set up payment arrangement agreements lasting up to 2 years for members who had fallen behind on their utility account during this time. The 2020 accounts receivable reflect these amounts due, as well as an associated increase in estimated bad debt expense. During 2021, a significant pay down of the receivable balances was made.

5. Materials and Supplies: The Cooperative values materials and supplies at average cost.
6. Regulatory Asset: Deferred meter retirement is considered a regulatory asset in accordance with RUS Bulletin 1767B-1. RUS Bulletin 1767B-1 indicates that a regulatory asset results from a rate action of regulatory agencies. Regulatory assets arise from specific expenses or losses that would have been included in net income determinations in one period under the general requirements of the Uniform System of accounts but for it being probable that such items will be included in a different period for purposes of developing the rates the utility is authorized to charge for its utility services.

The deferred meter retirement expense was incurred by the Cooperative through a project to update its meters in conjunction with the Smart Grid Investment Grant provided by the Department of Energy. Per the guidance of the PSC, as mandated in its order dated May 11, 2012 in conjunction with Case No. 2011-00096, the Cooperative has placed the loss on the retirement of the old mechanical meters on its financial statements as a regulatory asset. This loss is to be amortized over a 15-year period. The net amount of the loss at December 31, 2021 and 2020 was \$1,123,374 and \$1,310,602, respectively. Amortization expense for the years ended December 31, 2021 and 2020 was \$187,229; deferred meter retirement is displayed on the balance sheets as a regulatory asset, net of the accumulated amortization.

South Kentucky Rural Electric Cooperative Corporation
Notes to Financial Statements (Continued)
Years Ended December 31, 2021 and 2020

Note B - Summary of Significant Accounting Policies (Continued)

7. Revenue and Cost of Purchased Power: The Cooperative records revenue as billed to its consumers based on monthly meter reading cycles. Consumers are required to pay a refundable customer deposit, which may be waived under certain circumstances. The Cooperative's sales are concentrated in an eleven-county area of south-central Kentucky and two northern Tennessee counties. 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 a percentage of the past due receivables at the end of each month.

The Cooperative 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. The Cooperative'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.

The Cooperative is one of sixteen members of East Kentucky Power Cooperative ("East Kentucky"). Under a wholesale power agreement, the Cooperative 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.

8. Advertising Costs: The Cooperative records advertising expenses as they are incurred. Advertising expense amounted to \$35,817 and \$22,907 for the years ended December 31, 2021 and 2020, respectively.
9. Investments in Associated Organizations: The Cooperative follows the method of accounting as prescribed by the RUS Uniform System of Accounts in accounting for its investment in associated organizations. This accounting method results in the Cooperative recognizing income on its pro rata share of the associated organization's net margins in the year such margins are assigned. This accounting method does not provide for similar treatment for any losses of the associated organizations. Rather, such losses would not be assigned to member organizations and no additional margins are assigned until subsequent cumulative margins exceed prior cumulative losses.
10. Accrued Compensated Absences: The Cooperative has a policy to pay available but untaken compensated absences to employees who leave service. Accrued compensated absences presented in the financial statements represent available sick leave at December 31, 2021 and 2020. Sick leave is valued at the rate it is earned and the unpaid balance is paid out in full upon termination of employment.
11. Comprehensive Income: Comprehensive income is the change in equity of an enterprise during the year from transactions and other events and circumstances arising from non-operating sources. The Cooperative's total comprehensive income includes amounts associated with the change in post-retirement benefits obligation (see Note J).
12. Use of Estimates: Management uses estimates and assumptions in preparing these financial statements in accordance with accounting principles generally accepted in the United States of America. Those estimates and assumptions affect the reported amounts of assets and liabilities, disclosure 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.

South Kentucky Rural Electric Cooperative Corporation
Notes to Financial Statements (Continued)
Years Ended December 31, 2021 and 2020

Note B - Summary of Significant Accounting Policies (Continued)

13. Revenue Recognition: On January 1, 2019, the Cooperative adopted ASU 2014-09, *Revenue from Contracts with Customers* and all subsequent amendments to the ASU (collectively, "Topic 606"). Topic 606 creates a single framework for recognizing revenue from contracts with customers that fall within its scope and supersedes nearly all existing GAAP for revenue recognition guidance. The standard's core principle is that an entity will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

The impacted revenue stream under Topic 606 primarily consists of income from the sale of electricity which constitutes the majority of the Cooperative's revenue. The Cooperative provides services to customers prior to billing and those are recognized as accounts receivable - unbilled on the balance sheets. The unbilled revenue constitutes a contract asset, which is defined as an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditioned on something other than the passage of time. The Cooperative evaluated the income from its revenue streams and determined that no adjustments were required upon adoption of this standard.

14. Recent Accounting Pronouncements: In February 2016, the FASB issued ASU 2016-02, *Leases*. The standard requires all leases with lease terms over 12 months to be capitalized as a right-of-use asset and lease liability on the balance sheet at the date of lease commencement. Leases will be classified as either financing or operating. This distinction will be relevant for the pattern of expense recognition in the statement of income and comprehensive income. This standard will be effective for the calendar year ending December 31, 2022. The Cooperative concludes adoption will not have a material impact on its financial statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments-Credit Losses*. The standard requires a financial asset (including trade receivables) measured at amortized cost basis to be presented at the net amount expected to be collected. Thus, the statement of income and comprehensive income will reflect the measurement of credit losses for newly-recognized financial assets as well as the expected increases or decreases of expected credit losses that have taken place during the period. This standard will be effective for the calendar year ending December 31, 2023. The Cooperative is currently in the process of evaluating the impact of adoption of the ASU on the financial statements.

15. Reclassifications: Certain amounts in the 2020 financial statements have been reclassified to conform to the 2021 presentation. The reclassifications had no effect on the net margins for the year.
16. Subsequent Events: Subsequent events for the Cooperative have been considered through the date of the Independent Auditor's Report which represents the date the financial statements were available to be issued (Note O).

Note C - Investments in Associated Organizations

East Kentucky Power Cooperative ("East Kentucky"):

The Cooperative's investment of \$81,537,084 and \$78,184,434 as of December 31, 2021 and 2020, respectively, in East Kentucky, the sole supplier of power to the Cooperative, represents the Cooperative's equity ownership interest (approximately 11%) in East Kentucky. The Cooperative owed East Kentucky \$10,938,849 and \$9,705,932 at December 31, 2021 and 2020, respectively. These amounts are included in accounts payable on the balance sheets.

South Kentucky Rural Electric Cooperative Corporation
Notes to Financial Statements (Continued)
Years Ended December 31, 2021 and 2020

Note C - Investments in Associated Organizations (Continued)

Associated Organizations:

Investments in other associated organizations consisted of:

	December 31,	
	2021	2020
Cooperative Finance Corporation, capital term certificates	\$ 1,521,848	\$ 1,531,334
Cooperative Finance Corporation, patronage capital	693,319	704,371
United Utility Supply	915,633	858,106
Southeastern Data Cooperative, Inc.	388,569	386,205
Other associated organizations	855,772	770,779
Rural economic development loans and grants	3,813,862	4,705,525
Non utility property	24,794	24,794
	<u>\$ 8,213,797</u>	<u>\$ 8,981,114</u>

Substantially all of such investments, which consist mainly of patronage capital in the associated organization and capital term certificates are restricted by the respective organization and are not currently available for distribution. The patronage capital will be available to the Cooperative if the Cooperative should terminate its investment in the associated organization. The capital term certificates are not available until the related debt is paid off, currently expected to be between the years 2024 and 2080.

The Capital Term Certificates ("CTC's") were purchased from CFC as a condition of obtaining long-term financing and are recorded at cost. The CTC's bear interest at varying rates between 0% and 5% per annum and are scheduled to mature at varying times from 2024 to 2080. These certificates are required to be maintained under the note agreement with the National Rural Utilities Cooperative Finance Corporation ("NRUCFC") in an amount at least equal to 5% of the original debt issued or guaranteed by NRUCFC until maturity.

United Utility Supply ("United") is a primary supplier of transformers and overhead line materials and supplies. The Cooperative's purchases from United amounted to \$2,588,333 and \$2,160,207 for the years ended December 31, 2021 and 2020, respectively. The Cooperative owed United \$291,054 and \$190,633 at December 31, 2021 and 2020, respectively. This amount is included in accounts payable on the balance sheets.

Southeastern Data Cooperative, Inc., ("Southeastern") is a primary supplier of data processing services and computer hardware and software. The Cooperative's purchases from Southeastern were \$656,179 and \$1,160,156 for the years ended December 31, 2021 and 2020, respectively. The Cooperative owed Southeastern \$0 and \$90,785 at December 31, 2021 and 2020, respectively, this amount is included in accounts payable on the balance sheets.

The Cooperative participates in the Rural Economic Development Loan and Grant ("REDLG") program through the United States Department of Agriculture ("USDA"). The USDA via the REDLG program provides zero interest loans and grants to rural communities through RUS borrowers. REDLG assistance promotes rural economic development and job creation projects in accordance with section 313 of the RE Act 7 CFR 1703, Subpart. The Cooperative currently sponsors three local organizations with loans with a principal amount due of \$1,825,695 as of December 31, 2021. The Cooperative sponsored six local organizations with loans with a principal amount due of \$2,161,113 as of December 31, 2020.

South Kentucky Rural Electric Cooperative Corporation
Notes to Financial Statements (Continued)
Years Ended December 31, 2021 and 2020

Note C - Investments in Associated Organizations (Continued)

Additionally, the Cooperative has sponsored nine additional organizations with grant funds in the total amount of \$3,080,000. The grant funds were funded in part with funds from the Cooperative and from the USDA. The principal amount due is \$0 and \$3,342, as December 31, 2021 and 2020, respectively. The Cooperative also has a revolving loan fund in which loans are made from the repaid grant funds. There are seven organizations that have received loans with a principal amount due of \$1,988,167 as of December 31, 2021. There were nine organizations that have received loans with a principal amount due of \$2,541,070 as of December 31, 2020. The available cash balance of the rural economic development revolving loan fund was \$1,131,223 and \$572,805 as of December 31, 2021 and 2020, respectively.

Note D - Income Tax Status

The Cooperative is exempt from federal and state income taxes under §501(c)(12) of the Internal Revenue Code. The Cooperative recognizes uncertain income tax positions using the "more-likely-than-not" approach as defined in the ASC. No liability for uncertain tax positions has been recorded in the accompanying financial statements.

Note E - Lines of credit

At December 31, 2021 and 2020, the Cooperative had two executed lines-of-credit totaling \$15,000,000 with CFC. The lines-of-credit bear variable interest rates, determined by CFC at the date of draw, and mature June 2023. At December 31, 2021 and 2020, there were no outstanding balances due under the lines of credit.

Note F - Long-term Debt

Long-term debt consisted of the following:

	December 31,	
	2021	2020
RUS, 0.1250%	\$ 3,080,169	\$ 3,366,570
Less advance payment	<u>(31,065,538)</u>	<u>(30,171,214)</u>
	(27,985,369)	(26,804,644)
FFB, 0.046% to 3.699%	155,747,372	113,325,612
Less advance payment	<u>(44,000,000)</u>	<u>-</u>
	111,747,372	113,325,612
CoBank, 3.55%	43,887,983	46,712,889
Economic development loans, 0%	4,398,639	4,709,391
CFC, 4.40% to 6.70%	4,662,475	5,674,123
City of Monticello, 4.75%	<u>2,346,667</u>	<u>2,493,334</u>
	139,057,767	146,110,705
Less current maturities	<u>9,329,947</u>	<u>7,607,892</u>
	<u>\$ 129,727,820</u>	<u>\$ 138,502,813</u>

South Kentucky Rural Electric Cooperative Corporation
Notes to Financial Statements (Continued)
Years Ended December 31, 2021 and 2020

Note F - Long-term Debt (Continued)

The aggregate principal maturities of long-term debt as of December 31, 2021 are as follows:

2022	\$ 9,329,947
2023	7,504,948
2024	8,110,620
2025	7,424,084
2026	7,632,552
Thereafter	<u>99,055,616</u>
	<u>\$ 139,057,767</u>

The long-term debt as described above is payable in quarterly, monthly, and annual installments of varying amounts. Substantially all utility plant is pledged as collateral for the above notes. Under the terms of the loan agreements, the Cooperative is required to meet certain financial performance covenants. The Cooperative is in compliance with these covenants at December 31, 2021.

The Cooperative participates in a RUS sponsored program which provides economic development funds to businesses in Cooperative's service area. The Cooperative serves as a conduit for these funds and is contingently liable if the recipient fails to repay the loan. As such, these amounts are included in the debt service above. These loans carry a 0% interest rate to the Cooperative and the recipients. The loans are secured with bank letters of credit provided by the borrower.

Note G - Members' and Patrons' Equities

Under terms of its long-term debt agreements, return of capital contributions or patronage capital to the Cooperative's members and patrons is restricted to amounts which would not allow total equity to be less than 30% of total assets, except that distributions may be made to estates of deceased members provided that such distributions do not exceed 25% of total patronage capital and margins received in the previous year. Total equity as a percentage of assets can fall below the 30% requirement if the Cooperative has obtained the appropriate waiver from the RUS. The Cooperative is in compliance with these requirements at December 31, 2021 and 2020.

Board policy related to capital credit allocation and retirement allows that annually any member bad debt that has been written off and that remains uncollected for a period of 4 years or more, shall have the bad debt reduced by applying the member capital credit balance to the uncollectible balance. During 2020, this capital credit recapture of bad debt was accomplished for the first time for all existing bad debt written off prior to December 31, 2015. The amount of the recapture recorded as a reduction to bad debt expense in 2020 was \$1,490,715. During 2021, the recapture of bad debt was accomplished for debt written off during 2016. The amount of recapture recorded as a reduction to bad debt expense was \$64,273.

Note H - Retirement Benefits

Eligible employees of the Cooperative participate in the Retirement Security Plan ("RS Plan"), sponsored by the National Rural Electric Cooperative Association ("NRECA"). The 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 considered a multi-employer plan under the 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 the 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.

South Kentucky Rural Electric Cooperative Corporation
Notes to Financial Statements (Continued)
Years Ended December 31, 2021 and 2020

Note H - Retirement Benefits (Continued)

The Cooperative contributions to the RS Plan in 2021 and in 2020 represented less than 5 percent of the total contributions made to the RS Plan by all participating employers. The Cooperative made contributions to the RS Plan of \$2,356,552 in 2021 and \$2,313,346 in 2020.

For 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 RS Plan was over 80 percent funded on January 1, 2021 and over 80 percent funded on January 1, 2020, 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 RS Plan and may change as a result of plan experience.

In addition to the above, the Cooperative participates in the NRECA 401(k) plan. The 401(k) plan provides for the Cooperative matching a maximum of 2% of base wages. The Cooperative contributed \$188,665 and \$198,898 for 2021 and 2020, respectively. Participant contributions can be made after one (1) month of employment and vest immediately. The Cooperative makes contributions for participants after one (1) year of employment.

Note I - Deferred Debit - Prepayment

At the December 2012 meeting of the I&FS Committee of the NRECA Board of Directors, the Committee approved an option to allow participating cooperatives in the RS Plan to make a contribution prepayment and reduce future required contributions. The prepayment amount is a cooperative's share, as of January 1, 2013, of future contributions required to fund the RS Plan's unfunded value of benefits earned to date using RS Plan actuarial valuation assumptions. The prepayment amount will typically equal approximately 2.5 times a cooperative's annual RS Plan required contribution as of January 1, 2013. After making the prepayment, for most cooperatives the billing rate is reduced by approximately 25%, retroactive to the January 1st of the year in which the amount is paid to the RS Plan. The 25% differential in billing rates is expected to continue for approximately 15 years. However, unexpected changes in interest rates, asset returns and other plan experience, plan assumption changes and other factors may have an impact on the differential in billing rates and the 15-year period. At December 31, 2021 and 2020, the Cooperative's prepayment as reflected on the balance sheets is \$911,767 and \$1,332,582, respectively.

Note J - Postretirement Benefits

The Cooperative provides postretirement medical benefits to its retired employees and their dependents. The Cooperative pays the premiums for retirees based upon years of service and a percentage for dependents. "Employers' Accounting for Postretirement Benefits Other Than Pensions," requires the accrual of the cost of providing certain postretirement benefits over the employees' years of service, rather than on a pay-as-you-go (cash) basis.

In accordance with the provision of "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans," the Cooperative has recorded an accrued benefit cost for the full benefit obligation as of December 31, 2021 and 2020.

South Kentucky Rural Electric Cooperative Corporation
Notes to Financial Statements (Continued)
Years Ended December 31, 2021 and 2020

Note J - Postretirement Benefits (Continued)

The following table sets forth the plan's benefit obligation and accrued liability:

	December 31,	
	2021	2020
Benefit obligation	\$ (10,663,877)	\$ (9,833,691)
Fair value of plan assets	-	-
Funded status	<u>\$ (10,663,877)</u>	<u>\$ (9,833,691)</u>
Accrued benefit cost recognized in the balance sheet	\$ (10,663,877)	\$ (9,833,691)
Weighted-average assumptions		
Discounted rate	2.80%	2.50%

For measurement purposes, the health care cost trend rate is assumed to be 4.25% and 4.50% in 2021 and 2020 for Pre-65. For Post-65, the healthcare cost trend rate is 0.5% for all years.

Other information, per the actuarial report, as of December 31, 2021 regarding the Cooperative's benefit plans is as follows:

	December 31,	
	2021	2020
Benefit cost	\$ 631,535	\$ 641,471
Benefits paid	833,014	885,563

Note K - Concentrations

All of the Cooperative's sales are made in portions of eleven counties in south central Kentucky and two counties in north central Tennessee, which is primarily an agricultural and rural region. Accounts receivable and customer deposits at December 31, 2021 and 2020, were derived from the various classes of customers in approximately the same proportion as the revenues shown in the accompanying statements of income and other comprehensive income.

The Cooperative maintains its cash balances with banks throughout Kentucky. Effective July 21, 2010, the federal deposit insurance coverage provided by the Federal Deposit Insurance Corporation ("FDIC") is \$250,000 per depositor. The Cooperative has implemented a policy whereby it sweeps non-interest-bearing funds from its district accounts to its general funds to maintain balances below the FDIC insured limit of \$250,000. The local bank provides additional FDIC insurance on deposits and repurchase agreements in excess of the FDIC limits in the general fund up to an amount of \$4,000,000. An additional \$1,250,000 of coverage is provided for funds held in the economic development grant fund. As of December 31, 2021, there were no uninsured balances.

Note L - Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date and establishes a framework for measuring fair value. The ASC establishes a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date.

South Kentucky Rural Electric Cooperative Corporation
Notes to Financial Statements (Continued)
Years Ended December 31, 2021 and 2020

Note L - Fair Value Measurements (Continued)

The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1: inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2: inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3: inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

At December 31, 2021 and 2020, financial instruments consisted of patronage capital whose carrying value is determined based on an allocation by a third party. These investments are valued using Level 2.

Note M - Contingencies

During the course of normal operations, the Cooperative may be subject to possible litigation. However, there are currently no amounts which are deemed as contingent liabilities which should be disclosed or accrued in the financial statements.

Note N - Paycheck Protection Program Loan

During 2020, the World Health Organization declared the global novel COVID-19 outbreak a pandemic. Further, the United States Centers for Disease Control and Prevention confirmed the spread of the disease throughout the United States. In response, the Governor of Kentucky implemented a State of Emergency limiting business operations and citizen movement. Since that time, Governor imposed restrictions have been relaxed, but still remain in effect. Any future financial impact of any residual restrictions is unknown. However, in response to these restrictions, several utility payment assistance programs have been put into place. Beginning in February 2021, a new program through the Kentucky Housing Department has been added that will provide for utility payment relief for qualified renters in the amount of past due balances dating back to April 2020 and forward for three months of future bills.

The Cooperative applied and was approved for a Paycheck Protection Program ("PPP") Loan under the Coronavirus Aid, Relief, and Economic Security ("CARES") Act in the amount of \$3,087,600 in March 2021. In accordance with the related PPP loan guidelines, the SBA reserves the right to audit any PPP loan at any time during the loan process, including after the loan is partially or fully forgiven and the Company has been legally released. The Cooperative received notification on October 5, 2021 that the loan has been fully forgiven. The PPP loan amount was recognized as gain on forgiveness of PPP loan in other margins on the statement of income and comprehensive income for the year ended December 31, 2021.

Note O - Subsequent Events

In January 2022, the Cooperative drew \$10,000,000 of the funds advanced by RUS for purpose of funding its capital projects work plan.

Supplementary Information

South Kentucky Rural Electric Cooperative Corporation
Schedule of Expenditures of Federal Awards
Year Ended December 31, 2021

Federal grantor Program title Grant name (Assistance Listing)	Federal assistance listing number	Pass-through grantor's number	Pass-through to subrecipients	Federal expenditures	Total federal expenditures
<u>U.S. Department of Homeland Security</u>					
<i>Passed-through Kentucky Emergency Management</i>					
Disaster Grants - Public Assistance (Presidentially Declared Disasters)	97.036*	FEMA-4592-DR-KY	\$ -	\$ 1,243,419	\$ -
Total expenditures of federal awards			<u>\$ -</u>		<u>\$ 1,243,419</u>

* Major program tested

South Kentucky Rural Electric Cooperative Corporation
Notes to the Schedule of Expenditures of Federal Awards
Year Ended December 31, 2021

Note A - Basis of Presentation and Relationship to Basic Financial Statements

The schedule of expenditures of federal awards includes the federal grant activity of the Cooperative and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* ("Uniform Guidance"). Therefore, some amounts presented in this schedule may differ from amounts presented in or used in the preparation of the financial statements. The amounts presented in this schedule only reflect the federal expenditures.

Note B - Indirect Cost Rate

The Cooperative does not use the 10% de minimis indirect rate allowed in the Uniform Guidance, section 414, to allocate costs to federal grants.



Independent Auditor's 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
South Kentucky Rural Electric Cooperative Corporation

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 the *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of South Kentucky Rural Electric Cooperative Corporation (the "Cooperative") as of and for the years ended December 31, 2021 and 2020, and the related notes to the financial statements, which collectively comprise the Cooperative's basic financial statements and have issued our report thereon dated April 14, 2022.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Cooperative's internal control over financial reporting ("internal control") as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Cooperative's internal control. Accordingly, we do not express an opinion on the effectiveness of the Cooperative's internal control.

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

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

**Independent Auditor's 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* (Continued)**

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Cooperative's 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 financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

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



Louisville, Kentucky

April 14, 2022



Independent Auditor's Report on Compliance for Each Major Federal Program and Report on Internal Control Over Compliance in Accordance with the *Uniform Guidance*

To the Board of Directors
South Kentucky Rural Electric Cooperative Corporation

Report on Compliance for Each Major Federal Program

Opinion on Each Major Federal Program

We have audited South Kentucky Rural Electric Cooperative Corporation's (the "Cooperative") compliance with the types of compliance requirements identified as subject to audit in the OMB *Compliance Supplement* that could have a direct and material effect on each of the Cooperative's major federal programs for the year ended December 31, 2021. The Cooperative's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

In our opinion, the Cooperative complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2021.

Basis for Opinion on Each Major Federal Program

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America ("GAAS"); the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States (*Government Auditing Standards*); and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* ("Uniform Guidance"). Our responsibilities under those standards and the Uniform Guidance are further described in the Auditor's Responsibilities for the Audit of Compliance section of our report.

We are required to be independent of the Cooperative and to meet our other ethical responsibilities, in accordance with relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion on compliance for each major federal program. Our audit does not provide a legal determination of the Cooperative's compliance with the compliance requirements referred to above.

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Independent Auditor's Report on Compliance for Each Major Federal Program and Report on Internal Control Over Compliance in Accordance with the *Uniform Guidance* (Continued)

Responsibilities of Management for Compliance

Management is responsible for compliance with the requirements referred to above and for the design, implementation, and maintenance of effective internal control over compliance with the requirements of laws, statutes, regulations, rules and provisions of contracts or grant agreements applicable to the Cooperative's federal programs.

Auditor's Responsibilities for the Audit of Compliance

Our objectives are to obtain reasonable assurance about whether material noncompliance with the compliance requirements referred to above occurred, whether due to fraud or error, and express an opinion on the Cooperative's compliance based on our audit. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS, *Government Auditing Standards*, and the Uniform Guidance will always detect material noncompliance when it exists. The risk of not detecting material noncompliance resulting from fraud is higher than for that resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Noncompliance with the compliance requirements referred to above is considered material, if there is a substantial likelihood that, individually or in the aggregate, it would influence the judgment made by a reasonable user of the report on compliance about the Cooperative's compliance with the requirements of each major federal program as a whole.

In performing an audit in accordance with GAAS, *Government Auditing Standards*, and the Uniform Guidance, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material noncompliance, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the Cooperative's compliance with the compliance requirements referred to above and performing such other procedures as we considered necessary in the circumstances.
- Obtain an understanding of the Cooperative's internal control over compliance relevant to the audit in order to design audit procedures that are appropriate in the circumstances and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of the Cooperative's internal control over compliance. Accordingly, no such opinion is expressed.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and any significant deficiencies and material weaknesses in internal control over compliance that we identified during the audit.

Report on Internal Control Over Compliance

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

**Independent Auditor's Report on Compliance for Each Major Federal Program and
Report on Internal Control Over Compliance in Accordance with the *Uniform Guidance* (Continued)**

Our consideration of internal control over compliance was for the limited purpose described in the Auditor's Responsibilities for the Audit of Compliance section above and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies in internal control over compliance. Given these limitations, during our audit we did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, material weaknesses or significant deficiencies in internal control over compliance may exist that were not identified.

Our audit was not designed for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, no such opinion is expressed.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.



Louisville, Kentucky
April 14, 2022

South Kentucky Rural Electric Cooperative Corporation
Schedule of Findings and Questioned Costs
Year Ended December 31, 2021

Section I - Summary of Auditor's Results

Financial Statements

Type of auditor's report issued: Unmodified

Internal control over financial reporting:

- Material weakness identified? yes X no
- Significant deficiencies identified that are not considered to be material weaknesses? yes X none reported

Noncompliance material to financial statements noted? yes X no

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? yes X no
- Significant deficiencies identified that are not considered to be material weaknesses? yes X none reported

Type of auditor's report issued on compliance for major programs: Unmodified

Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)? yes X no

Identification of major programs:

<u>Assistance list number(s)</u>	<u>Name of federal program or cluster</u>
97.036	Disaster Grants – Public Assistance (Presidentially Declared Disasters)

Dollar threshold used to distinguish between type A and type B programs: \$ 750,000

Auditee qualified as low-risk auditee? yes X no

**South Kentucky Rural Electric Cooperative Corporation
Schedule of Findings and Questioned Costs (Continued)
Year Ended December 31, 2021**

Section II - Financial Statement Findings

None noted

Section III - Federal Award Findings and Questioned Costs

None noted

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

To the Board of Directors
South Kentucky Rural Electric Cooperative Corporation

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of South Kentucky Rural Electric Cooperative Corporation ("the Cooperative"), which comprise the balance sheet as of December 31, 2021, and the related statements of income and comprehensive income, changes in members' and patrons' equities, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated April 14, 2022. In accordance with *Government Auditing Standards*, we have also issued our report dated April 14, 2022, on our consideration of 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 have been furnished to management.

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

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

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

- 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.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The detail schedule of deferred debits and deferred credits required by 7 CFR 1773.33 (h), provided below, is presented for purposes of additional analysis and is not a required part of the basic financial statements. This information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

South Kentucky Rural Electric Cooperative Corporation
 Detailed Schedule of Deferred Debits
 December 31, 2021

<u>Description</u>	<u>Amount</u>
Deferred pension prepayment	<u>\$ 911,767</u>

South Kentucky Rural Electric Cooperative Corporation
 Detailed Schedule of Deferred Credits
 December 31, 2021

<u>Description</u>	<u>Amount</u>
Customer advances for construction	\$ 464,128
Other	<u>333</u>
	<u>\$ 464,461</u>

The purpose of this report is solely to communicate, in connection with the audit of the financial statements, on compliance with aspects of contractual agreements and the regulatory requirements for electric borrowers based on the requirements of 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers and Grantees*. Accordingly, this report is not suitable for any other purpose.

MCM CPAs & Advisors LLP

Louisville, Kentucky
 April 14, 2022