

South Kentucky Rural Electric Cooperative Corporation
Financial Statements
Years Ended December 31, 2022 and 2021

South Kentucky Rural Electric Cooperative Corporation
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Years Ended December 31, 2022 and 2021

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Independent Auditor's Report on Financial Statements

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, 2022 and 2021, 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, 2022 and 2021, 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 on Financial Statements (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 and the standards applicable to financial audits contained in *Government Auditing Standards*, 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.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated April 26, 2023, 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.



Louisville, Kentucky
April 26, 2023

South Kentucky Rural Electric Cooperative Corporation
Balance Sheets
December 31, 2022 and 2021

	<u>2022</u>	<u>2021</u>
Assets		
Electric plant in service, net	\$ 210,277,534	\$ 204,261,958
Investments		
Investments in associated organizations	8,489,529	8,213,797
Investment in East Kentucky Power Cooperative	84,745,272	81,537,084
Total investments	<u>93,234,801</u>	<u>89,750,881</u>
Current assets		
Cash and equivalents	15,616,385	7,636,716
Accounts receivable - customers (net of allowance for doubtful accounts of \$852,618 and \$851,883 in 2022 and 2021, respectively)	9,796,316	8,246,522
Accounts receivable - unbilled	9,864,663	7,411,005
Other receivables	1,851,252	2,623,292
Materials and supplies	2,042,774	1,798,502
Prepayments and other	509,000	491,233
Total current assets	<u>39,680,390</u>	<u>28,207,270</u>
Regulatory assets, net	1,247,874	1,123,374
Deferred debits		
Prepayment	490,951	911,767
General plant clearing	96,000	-
Total deferred debits	<u>586,951</u>	<u>911,767</u>
Total assets	<u>\$ 345,027,550</u>	<u>\$ 324,255,250</u>
Members' and patrons' equities and liabilities		
Members' and patrons' equities		
Memberships	\$ 1,213,436	\$ 1,196,930
Patronage capital	158,321,985	147,813,512
Equities	10,208,991	12,315,367
Accumulated other comprehensive loss	(2,971,435)	(4,845,476)
Total members' and patrons' equities	<u>166,772,977</u>	<u>156,480,333</u>
Long-term debt and other liabilities		
Long-term debt, less current maturities	139,773,946	129,727,820
Accrued compensated absences	1,581,311	1,248,410
Postretirement benefits obligation	8,565,834	10,663,877
Total long-term debt and other liabilities	<u>149,921,091</u>	<u>141,640,107</u>
Current liabilities		
Current portion of long-term debt	8,117,947	9,329,947
Accounts payable	15,822,498	13,444,791
Accrued interest	148,125	160,806
Customer guaranty deposits	2,681,345	1,761,127
Other current liabilities	1,164,306	973,678
Total current liabilities	<u>27,934,221</u>	<u>25,670,349</u>
Deferred credits		
Consumer advances for construction	398,947	464,128
Other	314	333
Total deferred credits	<u>399,261</u>	<u>464,461</u>
Total members' and patrons' equities and liabilities	<u>\$ 345,027,550</u>	<u>\$ 324,255,250</u>

See accompanying notes.

South Kentucky Rural Electric Cooperative Corporation
Statements of Income and Comprehensive Income
Years Ended December 31, 2022 and 2021

	<u>2022</u>	<u>%</u>	<u>2021</u>	<u>%</u>
Operating revenue				
Sale of electric energy				
Residential	\$ 106,401,541	66.15 %	\$ 88,027,419	65.81 %
Commercial	49,279,025	30.64	41,101,873	30.73
Public authorities and outdoor lighting	2,069,503	1.29	1,781,510	1.33
Total sale of electric energy	157,750,069	98.08	130,910,802	97.87
Other revenue	3,093,324	1.92	2,841,209	2.13
Total operating revenue	160,843,393	100.00	133,752,011	100.00
Operating expenses				
Cost of power	120,218,607	74.74	96,010,219	71.78
Distribution expense	13,004,218	8.09	12,133,756	9.07
Customer accounts expense	4,264,156	2.65	3,993,783	2.99
Customer services and information expense	448,225	0.28	617,042	0.46
Administrative and general expense	4,312,848	2.68	4,046,421	3.03
Depreciation and amortization	9,929,186	6.17	9,627,826	7.20
Taxes	127,723	0.08	155,255	0.12
Total operating expenses	152,304,963	94.69	126,584,302	94.65
Net operating income	8,538,430	5.31	7,167,709	5.35
Non-operating (expense) income				
Interest expense	(5,254,159)	(3.27)	(5,239,774)	(3.92)
Other margins	588,273	0.37	3,943,727	2.95
Patronage capital	5,713,797	3.55	3,559,110	2.66
Total non-operating	1,047,911	0.65	2,263,063	1.69
Net margins	9,586,341	5.96	9,430,772	7.04
Other comprehensive income (loss)				
Change in post-retirement benefit obligation	1,874,041	1.17	(847,428)	(0.63)
Comprehensive income	<u>\$ 11,460,382</u>	<u>7.13 %</u>	<u>\$ 8,583,344</u>	<u>6.41 %</u>

See accompanying notes.

South Kentucky Rural Electric Cooperative Corporation
Statements of Changes in Members' and Patrons' Equities
Years Ended December 31, 2022 and 2021

	<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, 2021	\$ 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	1,196,930	147,813,512	12,315,367	(4,845,476)	156,480,333
Comprehensive income	-	8,998,068	588,273	1,874,041	11,460,382
Net change in memberships	16,506	-	-	-	16,506
Refunds to estates	-	(408,989)	(213,392)	-	(622,381)
General retirement refund	-	(1,961,290)	1,448,038	-	(513,252)
Recapture of bad debt	-	(63,043)	14,432	-	(48,611)
Transfers to other equity and prior year's income	-	3,943,727	(3,943,727)	-	-
Balance, December 31, 2022	<u>\$ 1,213,436</u>	<u>\$ 158,321,985</u>	<u>\$ 10,208,991</u>	<u>\$ (2,971,435)</u>	<u>\$ 166,772,977</u>

See accompanying notes.

South Kentucky Rural Electric Cooperative Corporation
Statements of Cash Flows
Years Ended December 31, 2022 and 2021

	<u>2022</u>	<u>2021</u>
Cash flows from operating activities		
Net margins	\$ 9,586,341	\$ 9,430,772
Non-cash (income) expenses included in net margins		
Patronage capital assigned but not paid		
by associated organizations	(5,713,797)	(3,559,110)
Depreciation and amortization	9,929,186	9,627,826
Bad debt expense	73,318	111,392
Bad debt recapture - patronage capital	(48,611)	(64,273)
(Gain) loss on disposition of electric plant in service	(31,848)	177,821
PPP loan forgiveness income	-	(3,087,600)
Changes in current and non-current assets and liabilities		
Accounts receivable	(4,091,202)	(1,909,287)
Other receivables	772,040	(495,809)
Materials and supplies	(244,272)	(358,147)
Prepayments and other	(17,767)	130,195
Accounts payable	2,377,707	1,410,484
Customer guaranty deposits	920,218	33,101
Accrued interest and other current liabilities	177,947	108,899
Accrued compensated absences	332,901	(34,013)
Postretirement benefits obligation	(224,002)	(17,242)
Net cash provided by operating activities	<u>13,798,159</u>	<u>11,505,009</u>
Cash flows from investing activities		
Decrease in deferred debits	48,000	426,951
(Decrease) increase in deferred credits	(65,200)	50,022
Interest income - other margins	(273,877)	(918,739)
Decrease in advance loan payments unapplied	8,544,241	24,415
(Increase) decrease in economic development loan funds	(101,722)	891,663
Proceeds from sale of electric plant in service	46,496	143,049
Additions to electric plant in service	(14,453,503)	(12,337,579)
Removal cost, net	(1,353,591)	(1,202,373)
Patronage capital received from associated organizations	2,331,599	82,114
Net cash used in investing activities	<u>(5,277,557)</u>	<u>(12,840,477)</u>
Cash flows from financing activities		
Proceeds from long-term notes payable	10,000,000	-
Payment of principal on long-term notes payable	(9,436,238)	(6,158,614)
Membership fees, net	16,506	12,490
Refund of patronage capital to members	(2,370,279)	(3,341,679)
Changes in other patronage capital and equities	1,249,078	1,618,953
Proceeds from PPP loan	-	3,087,600
Net cash used in financing activities	<u>(540,933)</u>	<u>(4,781,250)</u>
Increase (decrease) in cash and equivalents during the year	7,979,669	(6,116,718)
Cash and equivalents, beginning of year	<u>7,636,716</u>	<u>13,753,434</u>
Cash and equivalents, end of year	<u>\$ 15,616,385</u>	<u>\$ 7,636,716</u>
Supplemental disclosures of cash flow information		
Interest paid	\$ 5,266,840	\$ 5,275,829

See accompanying notes.

South Kentucky Rural Electric Cooperative Corporation
Notes to Financial Statements
Years Ended December 31, 2022 and 2021

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 June 30, 2022. The composite depreciation rate for distribution plant was approximately 3.35% and 3.33% for 2022 and 2021, respectively. Plant is being depreciated using specific identification straight-line method as follows:

Distribution plant	2.08% - 5.79%
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:

	<u>2022</u>	<u>2021</u>
Distribution plant	\$ 263,224,496	\$ 253,377,220
General plant	42,017,563	40,597,673
Construction in progress	3,378,565	1,278,038
	<u>308,620,624</u>	<u>295,252,931</u>
Accumulated depreciation	<u>98,343,090</u>	<u>90,990,973</u>
Electric plant in service, net	<u><u>\$ 210,277,534</u></u>	<u><u>\$ 204,261,958</u></u>

South Kentucky Rural Electric Cooperative Corporation
Notes to Financial Statements (Continued)
Years Ended December 31, 2022 and 2021

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.

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, 2022 and 2021 was \$936,145 and \$1,123,374, respectively. Amortization expense for the years ended December 31, 2022 and 2021 was \$187,229; deferred meter retirement is displayed on the balance sheets as a regulatory asset, net of the accumulated amortization.

The Cooperative also incurred expenses pertaining to a regulatory rate increase in 2022 in the amount of \$345,365. This expense is to be amortized over a five-year period which commenced in July 2022. The net amount of this deferred expense as of December 31, 2022 was \$311,729. Amortization expense for the years ended December 31, 2022 and 2021 was \$34,537. Deferred regulatory rate increase expenses are 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, 2022 and 2021

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 \$34,752 and \$35,817 for the years ended December 31, 2022 and 2021, 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, 2022 and 2021. 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).

South Kentucky Rural Electric Cooperative Corporation
Notes to Financial Statements (Continued)
Years Ended December 31, 2022 and 2021

Note B - Summary of Significant Accounting Policies (Continued)

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.
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 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 has evaluated the impact of ASU 2016-13 on its future financial statements and has determined the impact will be immaterial to the Cooperative's financial statements.
15. 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 C - Investments in Associated Organizations

East Kentucky Power Cooperative ("East Kentucky"):

The Cooperative's investment of \$84,745,272 and \$81,537,084 as of December 31, 2022 and 2021, 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 \$14,103,367 and \$10,938,849 at December 31, 2022 and 2021, 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, 2022 and 2021

Note C - Investments in Associated Organizations (Continued)

Associated Organizations:

Investments in other associated organizations consisted of:

	December 31,	
	2022	2021
Cooperative Finance Corporation, capital term certificates	\$ 1,516,205	\$ 1,521,848
Cooperative Finance Corporation, patronage capital	677,860	693,319
United Utility Supply	978,980	915,633
Meridian Cooperative, Inc.	424,671	388,569
Other associated organizations	951,434	855,772
Rural economic development loans and grants	3,915,584	3,813,862
Non utility property	24,795	24,794
	<u>\$ 8,489,529</u>	<u>\$ 8,213,797</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 \$2,578,898 and \$2,588,333 for the years ended December 31, 2022 and 2021, respectively. The Cooperative owed United \$135,799 and \$291,054 at December 31, 2022 and 2021, respectively. These amounts are included in accounts payable on the balance sheets.

Meridian Cooperative, Inc., ("Meridian"), formally Southeastern Data Cooperative, Inc., is a primary supplier of data processing services and computer hardware and software. The Cooperative's purchases from Meridian were \$1,398,295 and \$656,179 for the years ended December 31, 2022 and 2021, respectively. The Cooperative owed Meridian \$115,680 and \$0 at December 31, 2022 and 2021, respectively. These amounts are 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 H. The Cooperative currently sponsors three local organizations with loans with a principal amount due of \$1,517,362 as of December 31, 2022. The Cooperative sponsored three local organizations with loans with a principal amount due of \$1,825,695 as of December 31, 2021.

South Kentucky Rural Electric Cooperative Corporation
Notes to Financial Statements (Continued)
Years Ended December 31, 2022 and 2021

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 was \$0, as of December 31, 2022 and 2021. The Cooperative also has a revolving loan fund in which loans are made from the repaid grant funds. There are nine organizations that have received loans with a principal amount due of \$2,398,222 as of December 31, 2022. There were seven organizations that had received loans with a principal amount due of \$1,988,167 as of December 31, 2021. The available cash balance of the rural economic development revolving loan fund was \$722,799 and \$1,131,223 as of December 31, 2022 and 2021, 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, 2022 and 2021, 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, 2022 and 2021, 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,	
	2022	2021
RUS, 0.875% to 2.125%	\$ 2,794,653	\$ 3,080,169
Less advance payment	<u>(22,795,174)</u>	<u>(31,065,538)</u>
	(20,000,521)	(27,985,369)
FFB, 1.118% to 4.422%	150,848,203	155,747,372
Less advance payment	<u>(34,000,000)</u>	<u>(44,000,000)</u>
	116,848,203	111,747,372
CoBank, 3.55%	40,959,707	43,887,983
Economic development loans, 0%	4,090,306	4,398,639
CFC, 4.50% to 6.65%	3,794,198	4,662,475
City of Monticello, 4.75%	<u>2,200,000</u>	<u>2,346,667</u>
	147,891,893	139,057,767
Less current maturities	<u>8,117,947</u>	<u>9,329,947</u>
	<u>\$ 139,773,946</u>	<u>\$ 129,727,820</u>

South Kentucky Rural Electric Cooperative Corporation
Notes to Financial Statements (Continued)
Years Ended December 31, 2022 and 2021

Note F - Long-term Debt (Continued)

The aggregate principal maturities of long-term debt as of December 31, 2022 are as follows:

2023	\$ 8,117,947
2024	8,322,557
2025	8,063,493
2026	8,283,266
2027	8,260,717
Thereafter	<u>106,843,913</u>
	<u>\$ 147,891,893</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, 2022.

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, 2022 and 2021.

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 2022, this capital credit recapture of bad debt was accomplished for member bad debt written off during 2017. The amount of the recapture recorded as a reduction to bad debt expense in 2021 was \$152,405. During 2021, the recapture of bad debt was accomplished for member bad 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, 2022 and 2021

Note H - Retirement Benefits (Continued)

The Cooperative contributions to the RS Plan in 2022 and in 2021 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 \$2,385,535 in 2022 and \$2,356,552 in 2021.

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, 2022 and over 80 percent funded on January 1, 2021, 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 \$191,765 and \$188,665 for 2022 and 2021, 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, 2022 and 2021, the Cooperative's prepayment as reflected on the balance sheets is \$490,951 and \$911,767, 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, 2022 and 2021.

South Kentucky Rural Electric Cooperative Corporation
Notes to Financial Statements (Continued)
Years Ended December 31, 2022 and 2021

Note J - Postretirement Benefits (Continued)

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

	December 31,	
	2022	2021
Benefit obligation	\$ (8,565,834)	\$ (10,663,877)
Fair value of plan assets	-	-
Funded status	<u>\$ (8,565,834)</u>	<u>\$ (10,663,877)</u>
Accrued benefit cost recognized in the balance sheet	\$ (8,565,834)	\$ (10,663,877)
Weighted-average assumptions		
Discounted rate	5.00%	2.80%

For measurement purposes, the health care cost trend rate is assumed to be 4.25% in 2022 and 2021 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, 2022 regarding the Cooperative's benefit plans is as follows:

	December 31,	
	2022	2021
Benefit cost	\$ 728,026	\$ 631,535
Benefits paid	980,883	833,014

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, 2022 and 2021, 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, 2022, 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, 2022 and 2021

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, 2022 and 2021, 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.

Other Required Reports



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, 2022 and 2021, 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 26, 2023.

Report on 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 procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Cooperative's internal control. Accordingly, we do not express an opinion on the effectiveness of the Cooperative's internal control.

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

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 or significant deficiencies may exist that were not 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)**

Report on 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 26, 2023

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, 2022, 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 26, 2023. In accordance with *Government Auditing Standards*, we have also issued our report dated April 26, 2023, 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, 2022

Description	Amount
Deferred pension prepayment	\$ 490,951
General plant clearing account	96,000
	\$ 586,951

South Kentucky Rural Electric Cooperative Corporation
Detailed Schedule of Deferred Credits
December 31, 2022

Description	Amount
Customer advances for construction	\$ 398,947
Other	314
	\$ 399,261

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.

MUM CPAs & Advisors LLP

Louisville, Kentucky
April 26, 2023