

Kentucky 23
Taylor County Rural Electric
Cooperative Corporation
Campbellsville, Kentucky
Audited Financial Statements
May 31, 2017 and 2016

Alan M. Zumstein
Certified Public Accountant
1032 Chetford Drive
Lexington, Kentucky 40509

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ALAN M. ZUMSTEIN
CERTIFIED PUBLIC ACCOUNTANT

1032 CHETFORD DRIVE
LEXINGTON, KENTUCKY 40509
(859) 264-7147
zumstein@windstream.net

MEMBER
• AMERICAN INSTITUTE OF CPA'S
• KENTUCKY SOCIETY OF CPA'S
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Independent Auditor's Report

To the Board of Directors
Taylor County Rural Electric Cooperative
Campbellsville, Kentucky

Report on the Financial Statements

I have audited the accompanying financial statements of Taylor County Rural Electric Cooperative, which comprise the balance sheets as of May 31, 2017 and 2016, and the related statements of revenue and comprehensive income, changes in equities, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, I express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

I believe the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

To the Board of Directors
Taylor County Rural Electric Cooperative

Opinion

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Taylor County Rural Electric Cooperative as of May 31, 2017 and 2016, and the results of their operations and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, I have also issued a report dated July 21, 2017, on my consideration of Taylor County Rural Electric Cooperative's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering internal control over financial reporting and compliance.

Alan M. Zumstein

Alan M. Zumstein, CPA
July 21, 2017

Taylor County Rural Electric Cooperative Corporation
Balance Sheets, May 31, 2017 and 2016

<u>Assets</u>	<u>2017</u>	<u>2016</u>
Electric Plant, at original cost:		
In service	\$ 86,441,425	\$ 83,241,261
Under construction	266,841	145,955
	<u>86,708,266</u>	<u>83,387,216</u>
Less accumulated depreciation	29,140,948	27,046,763
	<u>57,567,318</u>	<u>56,340,453</u>
Investments in Associated Organizations	<u>27,304,678</u>	<u>24,919,776</u>
Current Assets:		
Cash and cash equivalents	2,906,346	3,105,052
Accounts receivable, less allowance for 2017 of \$108,194 and 2016 of \$127,571	477,653	305,585
Other receivables	357,792	361,315
Material and supplies, at average cost	631,108	721,849
Other current assets	189,913	181,845
	<u>4,562,812</u>	<u>4,675,646</u>
Total	<u>\$ 89,434,808</u>	<u>\$ 85,935,875</u>
<u>Members' Equities and Liabilities</u>		
Members' Equities:		
Memberships	\$ -	\$ 278,460
Patronage capital	62,560,244	59,827,974
Other equities	401,364	120,578
Comprehensive income	(2,816,645)	(3,026,189)
	<u>60,144,963</u>	<u>57,200,823</u>
Long Term Debt	<u>18,428,699</u>	<u>19,808,373</u>
Accumulated Postretirement Benefits	<u>4,746,808</u>	<u>4,725,861</u>
Current Liabilities:		
Notes payable	1,750,000	-
Accounts payable	481,022	341,492
Consumer deposits	1,488,843	1,470,870
Current portion of long term debt	1,267,000	1,150,000
Accrued expenses	472,818	458,298
	<u>5,459,683</u>	<u>3,420,660</u>
Consumer Advances	<u>654,655</u>	<u>780,158</u>
Total	<u>\$ 89,434,808</u>	<u>\$ 85,935,875</u>

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

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

	<u>2017</u>	<u>2016</u>
Operating Revenues		
Sales of electric energy	\$ 45,341,830	\$ 43,143,892
Other revenues	<u>715,952</u>	<u>704,710</u>
	<u>46,057,782</u>	<u>43,848,602</u>
Operating Expenses:		
Cost of power	35,757,796	33,822,109
Distribution - operations	1,912,874	1,875,718
Distribution - maintenance	1,981,602	1,956,231
Consumer accounts	1,110,055	1,279,779
Customer services	7,313	(108,782)
Administrative and general	1,533,995	1,488,359
Depreciation, excluding \$163,406 in 2017 and \$144,368 in 2016 charged to clearing accounts	2,809,702	2,788,501
Taxes	54,062	48,745
Interest on long-term debt	619,669	676,254
Other interest	<u>48,575</u>	<u>15,979</u>
Total cost of electric service	<u>45,835,643</u>	<u>43,150,660</u>
Operating margins	<u>222,139</u>	<u>5,709</u>
Nonoperating Margins		
Interest income	237,171	66,358
Others	<u>6,547</u>	<u>178,032</u>
	<u>243,718</u>	<u>244,390</u>
Patronage Capital Credits		
G&T capital credits	2,328,012	2,164,746
Others	<u>139,101</u>	<u>138,719</u>
	<u>2,467,113</u>	<u>2,303,465</u>
Net Margins	2,932,970	2,553,564
Comprehensive Income:		
Accumulated postretirement benefits	<u>209,544</u>	<u>227,006</u>
Net Comprehensive Income	<u>\$ 3,142,514</u>	<u>\$ 2,780,570</u>

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

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

	Memberships	Patronage Capital				Other Equities	Comprehensive Income	Total Members' Equity	
		Assigned	Unassigned	Retirements	Assignable				Total
Balance - May 31, 2015	\$ 279,535	\$ 56,774,064	\$ 3,949,100	\$ (4,378,183)	\$ 1,082,205	\$ 57,427,186	\$ 115,342	\$ (3,253,195)	\$ 54,568,868
Allocate margins		2,222,434	325,367		(2,547,801)	-			
Comprehensive income:									
Net margins					2,553,564	2,553,564			2,553,564
Postretirement benefit obligation Amortization							227,006		227,006
Adjustments									2,780,570
Total comprehensive income									
Net change in memberships	(1,075)					(152,776)			(1,075)
Refunds to estates									(152,776)
Other equities							5,236		5,236
Balance - May 31, 2016	278,460	58,996,498	4,274,467	(4,530,959)	1,087,968	59,827,974	120,578	(3,026,189)	57,200,823
Allocate margins		2,222,434	325,367		(2,547,801)	-			
Comprehensive income:									
Net margins					2,932,970	2,932,970			2,932,970
Postretirement benefit obligation Amortization							209,544		209,544
Adjustments									3,142,514
Total comprehensive income									
Net change in memberships	(278,460)					(200,700)			(278,460)
Refunds to estates									(200,700)
Other equities							280,786		280,786
Balance - May 31, 2017	\$ -	\$ 61,218,932	\$ 4,599,834	\$ (4,731,659)	\$ 1,473,137	\$ 62,560,244	\$ 401,364	\$ (2,816,645)	\$ 60,144,963

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

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

	<u>2017</u>	<u>2016</u>
Cash Flows from Operating Activities:		
Net margins	\$ 2,932,970	\$ 2,553,564
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation:		
Charged to expense	2,809,702	2,788,501
Charged to clearing accounts	163,406	144,368
Patronage capital credits assigned	(2,467,113)	(2,303,465)
Accumulated postretirement benefits	230,491	84,413
Deferred property retirements	-	51,945
Change in assets and liabilities:		
Receivables	(168,545)	191,884
Material and supplies	90,741	(39,965)
Other assets	(8,068)	(79,726)
Payables	139,530	96,778
Consumer deposits and advances	(107,530)	(89,724)
Accrued expenses	14,520	44,746
	<u>3,630,104</u>	<u>3,443,319</u>
Cash Flows from Investing Activities:		
Plant additions	(3,879,056)	(3,253,768)
Plant removal costs	(334,706)	(228,438)
Salvage recovered from retired plant	13,789	12,823
Receipts from other investments, net	82,211	88,225
	<u>(4,117,762)</u>	<u>(3,381,158)</u>
Cash Flows from Financing Activities:		
Net increase in memberships	(278,460)	(1,075)
Increase in other equities	280,786	5,236
Retirements of capital credits	(200,700)	(152,776)
Short term borrowings, net	1,750,000	-
Advances of long term debt	-	6,000,000
Payments on long term debt	(1,267,166)	(1,106,954)
Advance payments on long term debt	4,492	(3,889,449)
	<u>288,952</u>	<u>854,982</u>
Net increase in cash	(198,706)	917,143
Cash and cash equivalents, beginning of year	<u>3,105,052</u>	<u>2,187,909</u>
Cash and cash equivalents, end of year	<u>\$ 2,906,346</u>	<u>\$ 3,105,052</u>
Supplemental cash flows information:		
Interest paid on long-term debt	\$ 619,669	\$ 660,254

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

Taylor County Rural Electric Cooperative
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies

Taylor County Rural Electric Cooperative Corporation (“Taylor County”) maintains its records in accordance with the policies prescribed or permitted by the Kentucky Public Service Commission (“PSC”) and the United States Department of Agriculture, Rural Utilities Service (“RUS”), which conform in all material respects with generally accepted accounting principles. The more significant of these policies are as follows:

Electric Plant Electric plant is stated at original cost, which is the cost when first dedicated to public service. Such amount includes applicable supervisory and overhead cost including any construction period interest and taxes. There was no interest required to be capitalized during the year.

The cost of maintenance and repairs, including renewals of minor items of property, is charged to operating expense. The cost of replacement of depreciable property units, as distinguished from minor items, is charged to electric plant. The units of property replaced or retired, including cost of removal, net of any salvage value, is charged to accumulated depreciation for distribution plant. Gain or loss is recognized on disposition of general plant items. Electric plant consists of:

	<u>2017</u>	<u>2016</u>
Distribution plant	\$81,727,313	\$78,969,559
General plant	<u>4,714,112</u>	<u>4,271,702</u>
Total	<u>\$86,441,425</u>	<u>\$83,241,261</u>

Depreciation Provision has been made for depreciation on the basis of the estimated lives of assets, using the straight-line method. Depreciation rates are as follows:

Distribution plant	3%
Structures and improvements	2%
Transportation equipment	16%
Other general plant items	6% - 16%

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

Off Balance Sheet Risk Taylor County maintains its cash balances, which may exceed the federally insured limit, with several financial institutions. These financial institutions have strong credit ratings and management believes that the credit risk related to the accounts is minimal.

Revenue Taylor County utilizes an Automated Meter Reading (“AMR”) process where meters are remotely read on the 1st day of each month. All consumers are required to pay a refundable deposit, which may be waived under certain circumstances. Taylor County’s sales are concentrated in a six county area of southeastern Kentucky. Consumers must pay their bill within 20 days of billing, then are subject to disconnect after another 10 days. Accounts are written off when they are deemed to be uncollectible. The allowance for uncollectible accounts is based on the aging of receivables. There were no customers whose individual account balance exceeded 10% of outstanding accounts receivable at May 31, 2017 or 2016.

Sales Taxes Taylor County is required to collect, on behalf of the Commonwealth 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. Taylor County’s policy is to exclude taxes from revenue when collected and expenses when paid and instead, record collection and payment of taxes through a liability account.

Taylor County Rural Electric Cooperative
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies, continued

Cost of Power Taylor County is one of sixteen (16) members of East Kentucky Power Cooperative (“East Kentucky”). Under a wholesale power agreement, Taylor County 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 power bill is received, rather than the period of actual usage, based upon billings from East Kentucky. The cost of power purchased but not recorded was \$2,234,146 for 2017 and \$2,032,896 for 2016.

Fair Value Measurements The Fair Value Measurements and Disclosures Topic of the FASB ASC 820, *Fair Value Measurements and Disclosures*, defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal, or most advantageous, market for the asset or liability in an orderly transaction between market participants at the measurement date. The Fair Value Measurements Topic establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of observable inputs when possible. The three levels of inputs used to measure fair value are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities

Level 2: Quoted prices in markets that are not considered to be active or financial instruments for which all significant inputs are observable, either directly or indirectly.

Level 3: Prices or valuations that require inputs that are both significant to the fair value measure and unobservable.

A financial instrument’s level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

The carrying amounts of Taylor County’s cash and cash equivalents, other receivables, inventories, accounts payable, accrued expenses, and liabilities approximate fair value due to their short maturity. Investments in associated organizations are not considered a financial instrument because they represent nontransferable interests in associated organizations. Other assets and liabilities are not considered financial instruments because they represent activities specifically related to Taylor County. Long term debt cannot be traded in the market, and is specifically for electric cooperatives and, therefore, a value other than its outstanding principal cannot be determined.

Taylor County may, and also does, invest idle funds in local banks. These investments are classified as held-to-maturity in accordance with provisions of the *Financial Instruments Topic* of FASB ASC 320. Held-to-maturity securities are presented at amortized cost. The fair value of held-to-maturity securities approximates cost at 2017 and 2016.

Risk Management Taylor County is exposed to various forms of losses of assets associated with, but not limited to, fire, personal liability, theft, vehicular accidents, errors and omissions, fiduciary responsibility, workers compensation, etc. Each of these areas is covered through the purchase of commercial insurance.

Estimates The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates used in the preparation of the financial statements.

Taylor County Rural Electric Cooperative
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies, continued

Advertising Taylor County expenses advertising costs as incurred.

Income Tax Status Taylor County is exempt from federal and state income taxes under provisions of Section 501(c)(12). Accordingly, the financial statements for Taylor County include no provision for income taxes. Taylor County's accounting policy provides that a tax expense/benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits. Management believes Taylor County has no uncertain tax positions resulting in an accrual of tax expense or benefit. Taylor County recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. Taylor County did not recognize any interest or penalties during the years ended May 31, 2017 and 2016. Taylor County's income tax return is subject to possible examination by taxing authorities until the expiration of related statutes of limitations on the return, which is generally three years.

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

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

Subsequent Events Management has evaluated subsequent events through July 21, 2017, the date the financial statements were available to be issued. There were no significant subsequent events to report.

Note 2. Investments in Associated Organizations

Investments in associated organizations consist of:

	<u>2017</u>	<u>2016</u>
East Kentucky, patronage capital	\$26,094,501	\$23,766,489
CoBank	628,838	607,161
Others	<u>581,339</u>	<u>546,126</u>
Total	<u>\$27,304,678</u>	<u>\$24,919,776</u>

Taylor County records patronage capital assigned by associated organizations in the year in which such assignments are received. Investments and purchases from National Bank for Cooperatives ("CoBank") are a condition of borrowing loan funds.

Note 3. Patronage Capital

Under provisions of the long-term debt agreement, return to patrons of capital contributed by them is limited to amounts which would not allow the total equities and margins to be less than 30% of total assets, except that distributions may be made to estates of deceased patrons. The debt agreement provides, however, that should such distributions to estates not exceed 25% of the net margins for the next preceding year, Taylor County may distribute the difference between 25% and the payments made to such estates. At May 31, 2017, the equities and margins were 67% of total assets.

Taylor County Rural Electric Cooperative
Notes to Financial Statements

Note 4. Long Term Debt

All assets, except vehicles, are pledged as collateral on the long term debt to RUS, Federal Financing Bank (FFB), and CoBank under a joint mortgage agreement. First mortgage notes consist of:

	<u>2017</u>	<u>2016</u>
RUS, 0.875% to 5.375%	\$5,713,064	\$6,041,674
Advance payments, earns 5.0%	(4,077,658)	(4,082,149)
	1,635,406	1,959,525
FFB, 0.783% and 3.306%	10,933,705	11,266,768
CoBank, 2.91% to 6.95%	4,571,729	4,804,476
Refinance RUS loans, 4.52%	2,554,859	2,927,604
	7,126,588	7,732,080
	19,695,699	20,958,373
Less current portion	1,267,000	1,150,000
Long term portion	<u>\$18,428,699</u>	<u>\$19,808,373</u>

The long term debt payable to RUS and CoBank are due in quarterly and monthly installments of varying amounts through 2039. RUS assess 125 basis points to administer the FFB loans. During August 2010, Taylor County refinanced \$5.42 million of RUS loans with lower interest rate loans from CoBank.

As of May 31, 2017, annual current principal due for the next five years are as follows: 2018 - \$1,267,000; 2019 - \$1,307,000; 2020 - \$1,348,000; 2021 - \$1,339,000; 2022 - \$1,435,000.

Note 5. Short Term Borrowings

Taylor County has executed short term line of credit agreements in the amount of \$3,000,000 each with CoBank and with National Rural Utilities, Cooperative Finance Corporation ("CFC"). At May 31, 2017 Taylor County had advances against the CoBank line of credit in the amount of \$1,750,000 at an interest rate of 3.16%.

Note 6. Pension Plan

Effective January 1, 1995, Taylor County implemented a Retirement Savings Plan for all employees who are eligible to participate in Taylor County's benefit programs. The plan allows participants to make contributions by salary reduction, pursuant to Section 401(k) of the Internal Revenue Code. Taylor County makes contributions for each participant equal to 10% of participants' base compensation with employees required to make a minimum contribution of 3% of base wages. Taylor County contributed \$291,747 in 2017 and \$288,466 in 2016. Participants vest immediately in their contributions and the contributions of Taylor County. There were no changes in the plan that would affect the comparability of the prior year.

Note 7. Postretirement Benefits

Taylor County sponsors a defined benefit plan that provides medical insurance coverage for qualified retired employees and their spouses. Qualified employees are those hired prior to December 1, 2005. Taylor County pays all the premiums for qualified retirees and their dependents. For measurement purposes, an annual rate of increase of 5% in 2017, then decreasing by 0.5% per year until 5% per year, in the per capita cost of covered health care benefit was assumed. The discount rate used in determining the accumulated postretirement benefit obligation was 4.5% in 2017 and 2016. There were no changes in the plan that would affect the comparability of the prior year.

Taylor County Rural Electric Cooperative
Notes to Financial Statements

Note 7. Postretirement Benefits, continued

The funded status of the plan is as follows:

	<u>2017</u>	<u>2016</u>
Projected benefit obligation	(4,746,808)	(\$4,725,861)
Plan assets at fair value	-	-
Total	(\$4,746,808)	(\$4,725,861)

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

	<u>2017</u>	<u>2016</u>
Benefit obligation at beginning of year	\$4,725,861	\$4,868,454
Components of net periodic benefit cost:		
Service cost	142,845	140,108
Interest cost	213,135	215,872
Net periodic benefit cost	355,980	355,980
Benefits paid	(335,033)	(498,573)
Actuarial adjustments	-	-
Benefit obligation at end of year	\$4,746,808	\$4,725,861
Amounts included in accumulated comprehensive income:		
Unrecognized actuarial gain (loss)	(\$2,816,645)	(\$3,026,189)
Effect of 1% increase in the health care trend:		
Postemployment benefit obligation	\$4,880,000	
Net periodic benefit cost	\$379,000	

Projected retiree benefit payments for the next five years are expected to be as follows: 2017 - \$405,000; 2018 - \$395,000; 2019 - \$380,000; 2020 - \$370,000; 2021 - \$360,000.

Note 8. Related Party Transactions

Several of the Directors of Taylor County and its General Manager & CEO are on the Boards of Directors of various associated organizations.

Note 9. Environmental Contingency

Taylor County from time to time is required to work with and handle PCBs, herbicides, automotive fluids, lubricants, and other hazardous materials in the normal course of business. As a result, there is the possibility that environmental conditions may arise which would require Taylor County to incur cleanup costs. The likelihood of such an event, or the amount of such costs, if any, cannot be determined at this time. However, management does not believe such costs, if any, would materially affect Taylor County's financial position or its future cash flows.

Note 10. Contingencies

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

ALAN M. ZUMSTEIN
CERTIFIED PUBLIC ACCOUNTANT

1032 CHETFORD DRIVE
LEXINGTON, KENTUCKY 40509
(859) 264-7147
zumstein@windstream.net

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

To the Board of Directors
Taylor County Rural Electric Cooperative

I have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Taylor County Rural Electric Cooperative, which comprise the balance sheets as of May 31, 2017 and 2016, and the related statements of revenue and comprehensive income, members' equities and cash flows for the years then ended, and related notes to the financial statements, and have issued my report thereon dated July 21, 2017.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Taylor County's financial statements are free of material misstatement, I performed test of its compliance with certain provisions of laws, regulations,

To the Board of Directors
Taylor County Rural Electric Cooperative

contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

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

Alan M. Zumstein
Alan M. Zumstein, CPA
July 21, 2017

ALAN M. ZUMSTEIN
CERTIFIED PUBLIC ACCOUNTANT

1032 CHETFORD DRIVE
LEXINGTON, KENTUCKY 40509
(859) 264-7147
zumstein@windstream.net

MEMBER
• AMERICAN INSTITUTE OF CPA'S
• KENTUCKY SOCIETY OF CPA'S
• INDIANA SOCIETY OF CPA'S
• AICPA DIVISION FOR FIRMS

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

Board of Directors
Taylor County Rural Electric Cooperative

Independent Auditor's Report

I have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Taylor County Rural Electric Cooperative ("the Cooperative"), which comprise the balance sheet as of May 31, 2017, and the related statements of revenue and comprehensive income, patronage capital, and changes in cash flows for the year then ended, and the related notes to the financial statements, and have issued my report thereon dated July 21, 2017. In accordance with *Government Auditing Standards*, we have also issued my report dated July 21, 2017, on my consideration of the Cooperative's internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. No reports other than the reports referred to above and my schedule of findings and recommendations related to my audit have been furnished to management.

In connection with my audit, nothing came to my attention that caused me to believe that the Cooperative failed to comply with the terms, covenants, provisions, or conditions of their loan, grant, and security instruments as set forth in 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers*, §1773.33 and clarified in the RUS policy memorandum dated February 7, 2017, insofar as they relate to accounting matters as enumerated below. However, my audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had I performed additional procedures, other matters may have come to my attention regarding the Cooperative's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters. In connection with my audit, I noted no matters regarding the Cooperative's accounting and records to indicate that the Cooperative did not:

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

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- Seek approval of the sale, lease, or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap;
- Maintain adequate control over material and supplies;
- Prepare accurate and timely Financial and Operating Reports;
- Obtain written RUS approval to enter into any contract for the management, operation, or maintenance of the borrower's system if the contract covers all or substantially all of the electric system;
- Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles;
- Record depreciation in accordance with RUS requirements ("See RUS Bulletin 183-1, Depreciation Rates and Procedures");
- Comply with the requirements for the detailed schedule of deferred debits and deferred credits, which are listed below; and
- Comply with the requirements for the detailed schedule of investments, of which there were none.

The deferred credits are as follows:

Consumer advances for construction	<u>\$654,655</u>
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This report is intended solely for the information and use of the board of directors, management, RUS, and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distributions is not limited.

Alan Zumstein

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