# Southside Electric Cooperative, Inc.
## Financial Statements
## December 31, 2017 and 2016

# Contents

## Financial Statements



## Supplemental Matters Required by the Rural Utilities Service

ADAMS, JENKINS AND CHEATHAM
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS CONSULTANTS

# Independent Auditor's Report

The Board of Directors
Southside Electric Cooperative, Inc.
Crewe, Virginia

## Report on the Financial Statements

We have audited the accompanying financial statements of Southside Electric Cooperative, Inc. (the "Cooperative") which comprise the balance sheets as of December 31, 2017 and 2016 and the related statements of operations, 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

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our 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 we 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 Cooperative'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 Cooperative's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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



231 Wylderose Drive | Midlothian, VA 23113 | 804.323.1313

**Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Southside Electric Cooperative, Inc. as of December 31, 2017 and 2016, 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.

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated February 26, 2018 on our consideration of Southside Electric Cooperative, Inc's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Cooperative's internal control over financial reporting and compliance.

Adams, Jenkins & Cheatham

Richmond, Virginia
February 26, 2018

## Balance Sheets

## Southside Electric Cooperative, Inc.

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| **Assets** | | |
| Electric plant | | |
| Electric plant | $ 364,417,536 | $ 358,784,822 |
| Less accumulated provision for depreciation | 107,636,079 | 101,522,808 |
| | 256,781,457 | 257,262,014 |
| Other property and investments | | |
| Investments in associated organizations | 50,000,146 | 49,044,394 |
| Other investments | 697,188 | 841,308 |
| | 50,697,334 | 49,885,702 |
| Current assets | | |
| Cash and cash equivalents | 4,360,479 | 2,216,594 |
| Accounts receivable, net | 23,929,343 | 20,157,570 |
| Materials and supplies | 2,169,365 | 1,084,524 |
| Other current assets | 204,974 | 202,276 |
| | 30,664,161 | 23,660,964 |
| Deferred charges and regulatory assets | 4,380,010 | 5,269,228 |
| | $ 342,522,962 | $ 336,077,908 |

See Independent Auditor's Report and Notes to Financial Statements

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| **Equities and Liabilities** | | |
| Equities | | |
| Patronage capital | $ 103,363,175 | $ 99,998,786 |
| Memberships | 232,490 | 231,060 |
| Other equities | 1,242,768 | 980,852 |
| | 104,838,433 | 101,210,698 |
| Noncurrent liabilities | | |
| Long-term debt | 189,204,922 | 192,365,377 |
| Other | 115,058 | 115,058 |
| | 189,319,980 | 192,480,435 |
| Current liabilities | | |
| Accounts payable | 9,679,487 | 10,095,305 |
| Lines of credit | 21,500,000 | 15,000,000 |
| Current maturities of long-term debt | 8,251,180 | 7,813,673 |
| Consumer deposits | 2,192,691 | 2,312,940 |
| Other current and accrued liabilities | 1,413,988 | 1,381,415 |
| | 43,037,346 | 36,603,333 |
| Deferred credits and regulatory liabilities | 5,327,203 | 5,783,442 |
| | $ 342,522,962 | $ 336,077,908 |

# Statements of Operations

# Southside Electric Cooperative, Inc.

| | Year Ended December 31, 2017 | Year Ended December 31, 2016 |
|---|---|---|
| Operating revenues | $ 108,770,569 | $ 116,039,703 |
| Operating expenses | | |
| Cost of power | 61,138,533 | 68,659,413 |
| Transmission | 58,545 | 78,108 |
| Distribution - operation | 5,626,491 | 5,682,868 |
| Distribution - maintenance | 10,823,864 | 10,682,832 |
| Consumer accounts | 1,993,434 | 2,005,430 |
| Customer service and informational | 2,702,377 | 2,564,499 |
| Administrative and general | 6,195,781 | 7,266,462 |
| Depreciation and amortization | 10,488,513 | 10,509,743 |
| Taxes | 39,632 | 31,049 |
| Interest on long-term debt | 6,211,842 | 5,778,079 |
| Other | 124,383 | 65,139 |
| | 105,403,395 | 113,323,622 |
| Operating Margins Before Patronage Allocations | 3,367,174 | 2,716,081 |
| Patronage allocations | | |
| Generation and transmission | 2,221,015 | 1,526,784 |
| Other | 715,226 | 497,013 |
| | 2,936,241 | 2,023,797 |
| Net Operating Margins | 6,303,415 | 4,739,878 |
| Nonoperating income (expense) | | |
| Investment income, net | 111,052 | 112,282 |
| Other | 86,779 | 4,396 |
| Loss on disposition of property | (20,286) | (800,762) |
| | 177,545 | (684,084) |
| Net Margins | $ 6,480,960 | $ 4,055,794 |

See Independent Auditor's Report and Notes to Financial Statements

## Statements of Equities

## Southside Electric Cooperative, Inc.

## Years Ended December 31, 2017 and 2016

| | Patronage Capital | Other Equities | Memberships | Total |
|---|---|---|---|---|
| Balance, December 31, 2015 | $ 99,177,422 | $ 92,923 | $ 229,400 | $ 99,499,745 |
| Net margins | 4,055,794 | | | 4,055,794 |
| Retirement of capital credits | (3,327,353) | 980,852 | | (2,346,501) |
| Reallocated gains | 92,923 | (92,923) | | |
| Net change in memberships | | | 1,660 | 1,660 |
| Balance, December 31, 2016 | 99,998,786 | 980,852 | 231,060 | 101,210,698 |
| Net margins | 6,480,960 | | | 6,480,960 |
| Retirement of capital credits | (3,213,190) | 358,535 | | (2,854,655) |
| Reallocated gains | 96,619 | (96,619) | | |
| Net change in memberships | | | 1,430 | 1,430 |
| Balance, December 31, 2017 | $ 103,363,175 | $ 1,242,768 | $ 232,490 | $ 104,838,433 |

See Independent Auditor's Report and Notes to Financial Statements

## Statements of Cash Flows

## Southside Electric Cooperative, Inc.

| | Year Ended December 31, 2017 | 2016 |
|---|---|---|
| **Cash Flows from Operating Activities** | | |
| Cash received from members | $ 109,500,281 | $ 116,551,825 |
| Cash paid to suppliers and employees | (85,847,091) | (96,292,771) |
| Interest received | 111,052 | 112,282 |
| Interest paid | (6,223,069) | (5,785,378) |
| Net Cash Provided by Operating Activities | 17,541,173 | 14,585,958 |
| **Cash Flows from Investing Activities** | | |
| Extension and replacement of plant | (17,870,097) | (28,180,325) |
| Plant removal costs | (1,625,656) | (2,423,447) |
| Contributions in aid of construction | 1,946,101 | 308,360 |
| Proceeds from retirement of investments in CTC's | 17,207 | 45,275 |
| Proceeds from the sale of plant | 88,239 | 198,980 |
| Net Cash Used by Investing Activities | (17,444,206) | (30,051,157) |
| **Cash Flows from Financing Activities** | | |
| Proceeds from line of credit | 6,500,000 | 25,000,000 |
| Payments on line of credit | | (18,000,000) |
| Proceeds from long-term debt | 6,000,000 | 17,281,000 |
| Principal payments of long-term debt | (8,722,948) | (7,953,078) |
| Capital credits paid to members, net | (2,615,146) | (2,346,501) |
| Proceeds from capital credits and other investments | 1,003,831 | 181,102 |
| Net change in member deposits | (120,249) | (163,967) |
| Net change in memberships | 1,430 | 1,660 |
| Net Cash Provided by Financing Activities | 2,046,918 | 14,000,216 |
| Net Increase (Decrease) in Cash and Cash Equivalents | 2,143,885 | (1,464,983) |
| Cash and cash equivalents - beginning of year | 2,216,594 | 3,681,577 |
| Cash and Cash Equivalents - End of Year | $ 4,360,479 | $ 2,216,594 |

See Independent Auditor's Report and Notes to Financial Statements

| | Year Ended December 31, 2017 | Year Ended December 31, 2016 |
|---|---|---|
| Net margins | $ 6,480,960 | $ 4,055,794 |
| Adjustments to reconcile net margins to net cash provided by operating activities: | | |
| Depreciation and amortization | 10,488,513 | 10,509,743 |
| Net change in life insurance benefit | 144,119 | |
| Loss on disposition of plant | 20,746 | 1,107,162 |
| Special equipment installation costs | (54,187) | (154,200) |
| Noncash capital credits received | (2,936,241) | (2,023,797) |
| (Increase) decrease in: | | |
| Accounts receivable | 1,260,374 | 827,990 |
| Other current assets | (622,557) | (8,034) |
| Deferred charges | 889,218 | 1,021,691 |
| Increase (decrease) in: | | |
| Accounts payable | 984,184 | 358,868 |
| Other current and accrued liabilities | 12,679 | 86,965 |
| Deferred credits | 873,365 | (1,196,224) |
| Net Cash Provided by Operating Activities | $ 17,541,173 | $ 14,585,958 |

# Notes to Financial Statements

# Southside Electric Cooperative, Inc.

# December 31, 2017 and 2016

**Note A - Significant Accounting Policies**

Nature of Operations

Southside Electric Cooperative, Inc. (the "Cooperative") is a member owned, nonprofit Cooperative organized to provide electric service to its members residing in eighteen counties, five towns and one city in the Commonwealth of Virginia. The Cooperative's main office is located in Crewe, Virginia.

Basis of Presentation

These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP), including GAAP for regulated operations. The system of accounts of the Cooperative are maintained in accordance with the Uniform System of Accounts as prescribed by the Federal Energy Regulatory Commission (FERC) for Class A and B electric utilities modified for electric borrowers of the Rural Utilities Service (RUS).

Accounting Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Cash and Cash Equivalents

The Cooperative considers all highly liquid investments with a maturity of three months or less to be cash equivalents.

Income Taxes

The Cooperative has been granted exemption from income tax under Internal Revenue Service Code Section 501(c)(12) of the Internal Revenue Code. The Cooperative evaluates the components of the annual test for compliance to maintain its filing status as a tax exempt entity. In accordance with Accounting Standards Codification ("ASC") Topic 740 for "uncertain tax positions", the Cooperative had determined that it is more likely than not that their tax positions will be sustained upon examination by the Internal Revenue Service. Tax years ending on or after December 31, 2014 remain subject to examination by federal and state taxing authorities.

# Notes to Financial Statements

# Southside Electric Cooperative, Inc.

# December 31, 2017 and 2016

**Note A - Significant Accounting Policies - Continued**

Electric Plant

Electric plant is stated at the original cost of construction, which includes the cost of contracted services, direct labor, materials and overhead items. Contributions from others toward the construction of electric plant are credited to the applicable plant accounts. When property, which represents a retirement unit, is replaced or removed, the average cost of such property as determined from the continuing property records is credited to electric plant and such cost, together with cost of removal less salvage is charged to the accumulated provision for depreciation. Maintenance and repairs, including the renewal of minor items of plant not comprising a retirement unit, are charged to the appropriate maintenance accounts, except that repairs of transportation and service equipment are charged to clearing accounts and redistributed to operating expenses and other accounts.

Depreciation

Provision for depreciation has been made by application of the straight-line method to the original cost, by groups of depreciable properties in service. Current depreciation rates, which are estimated to amortize the cost of plant over the service lives, were as follows at December 31, 2017 and 2016:

| | |
|---|---|
| Transmission plant | 2.75% |
| Distribution plant | 2.70 - 5.30% |
| Load management equipment | 11.00% |
| General plant | 3.00 - 25.00% |

Materials and supplies

Inventories are generally used for construction, operation and maintenance work, and are not for resale. They are valued at the lower of moving average unit cost or market.

Accounts Receivable

The Cooperative provides for the uncollectible accounts monthly, based on a percentage of sales which past experience has indicated will be uncollectible. When accounts are deemed to be uncollectible, they are charged against the provision for uncollectible accounts.

Revenues

The Cooperative records electric revenues as energy is delivered to consumers on a monthly basis. The billing rate schedules of the Cooperative contain provisions to either increase or decrease the consumers' billing from the base level billing schedules dependent upon the cost of the wholesale power for electrical energy purchased for resale. Any amounts collected over or under the Cooperative's monthly power costs are recorded as a deferred credit or deferred charge as applicable.

# Notes to Financial Statements

## Southside Electric Cooperative, Inc.

## December 31, 2017 and 2016

**Note A - Significant Accounting Policies - Continued**

Regulatory Assets and Liabilities

The Cooperative currently complies with accounting guidance set forth by the ASC Topic 980 regarding accounting for the effect of certain types of regulation. This guidance allows a regulated cooperative to record certain costs or credits that have been or are expected to be allowed in the ratemaking process in a period different from the period in which the costs would be charged to expense or income by a non-regulated enterprise. Accordingly, the Cooperative records certain assets and liabilities that result from the regulated ratemaking process that would not be recorded under GAAP for non-regulated entities.

Advertising Costs

Advertising costs were expensed as incurred.

Subsequent Events

Subsequent events have been evaluated through February 26, 2018, which is the date the financial statements were available to be issued.

**Note B - Assets Pledged**

All assets are pledged as security for the long-term debt to National Rural Utilities Cooperative Finance Corporation (CFC), Federal Financing Bank (FFB) and CoBank.

# Notes to Financial Statements

# Southside Electric Cooperative, Inc.

# December 31, 2017 and 2016

### Note C - Electric Plant

Listed below are the major classes of electric plant:

| | December 31, | |
|---|---|---|
| | 2017 | 2016 |
| Distribution plant | $ 297,208,463 | $ 294,665,878 |
| General plant | 43,773,262 | 29,581,500 |
| Transmission plant | 18,471,197 | 14,035,617 |
| Electric plant in service | 359,452,922 | 338,282,995 |
| Construction work in progress | 4,964,614 | 20,501,827 |
| | $ 364,417,536 | $ 358,784,822 |

In accordance with the guidance for asset retirement obligations, as set forth in the ASC Topic 410 – Asset Retirement and Environmental Obligations, and FERC Order 631 as adopted by the RUS, the Cooperative has determined that it had no legal asset retirement obligations as of December 31, 2017 and 2016. Regarding non-legal retirement costs, the Cooperative follows the regulatory principle of inter-generational cost allocation by including net salvage (gross salvage less cost of removal) as a component of depreciation rates. For the years ended December 31, 2017 and 2016, the Cooperative followed the RUS prescribed rates for depreciation and therefore, collections for net salvage and differences in timing of recognition of period costs associated with non-legal retirement obligations had not been specifically identified.

### Note D - Concentrations of Credit Risk

The Cooperative places its cash on deposit with financial institutions located in the United States of America, which are insured by the Federal Deposit Insurance Corporation (FDIC). The FDIC provides insurance coverage for up to $250,000 of cash held by the Cooperative in each separate FDIC insured bank and savings institution. From time to time, the Cooperative may have amounts on deposit in excess of the insured limits. As of December 31, 2017, the Cooperative had approximately $901,000 of deposits that exceed the insured limits.

### Note E - Investments in Associated Organizations

Investments in associated organizations consisted of the following:

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Patronage capital: | | |
| Old Dominion Electric Cooperative (ODEC) | $ 44,166,170 | $ 43,537,556 |
| CFC | 1,825,020 | 1,694,325 |
| Tarheel Electric Membership Corp. (TEMA) | 614,399 | 512,060 |
| Federated Rural Electric Insurance Corp. | 381,882 | 348,336 |
| Other | 136,701 | 112,161 |
| | 47,124,172 | 46,204,438 |
| Capital Term Certificates (CTC): | | |
| Subscriptions (SCTC's) | 1,552,277 | 1,552,277 |
| Loan (LCTC's) | 367,050 | 367,050 |
| Loan (ZCTC's) | 233,830 | 251,034 |
| | 2,153,157 | 2,170,361 |
| Other: | | |
| TEC Trading, Inc. | 622,500 | 622,500 |
| Membership fees | 49,251 | 2,000 |
| Other | 51,066 | 45,095 |
| | 722,817 | 669,595 |
| | $ 50,000,146 | $ 49,044,394 |

The capital term certificates invested in CFC are unsecured and subordinated. The SCTC’s bear interest at an annual rate of 5% payable semiannually and the LCTC’s bear interest at an annual rate of 3% payable semiannually. The ZCTC’s are non-interest bearing.

The investment in TEC Trading, Inc. represents an unconsolidated joint venture with other members of ODEC. The Cooperative has a non-controlling ownership interest that has been accounted for under the cost method.

# Notes to Financial Statements

## Southside Electric Cooperative, Inc.

## December 31, 2017 and 2016

### Note F - Accounts Receivable

Accounts receivable consisted of the following:

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Unbilled revenue | $ 8,777,582 | $ 8,157,723 |
| Other accounts receivable | 7,979,948 | 4,885,130 |
| Consumer accounts receivable | 7,251,693 | 7,199,658 |
| | 24,009,223 | 20,242,511 |
| Less provision for uncollectible accounts | 79,880 | 84,941 |
| | $ 23,929,343 | $ 20,157,570 |

### Note G - Deferred Charges and Regulatory Assets

Deferred charges and regulatory assets consisted of the following:

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Regulatory assets: | | |
| NRECA prepayment (Note K) | $ 4,334,775 | $ 5,201,730 |
| Deferred SERP cost | | 67,498 |
| Survey and Investigation - preliminary | 45,235 | |
| | $ 4,380,010 | $ 5,269,228 |

### Note H - Patronage Capital

Patronage capital consisted of the following:

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Assigned | $ 96,882,215 | $ 95,942,992 |
| Assignable | 6,480,960 | 4,055,794 |
| | $ 103,363,175 | $ 99,998,786 |

**Note H - Patronage Capital - Continued**

Under provisions of the long-term debt agreements and Title 7 of the Code of Federal Regulations (Part 1717.617), the Cooperative may refund capital to patrons without limitation if total equity is equal to or greater than 30% of total assets and there are no instances of default. If equities are between 20% and 30% of total assets, general refunds are limited to 25% (adjusted for returns to estates, which are not limited) of patronage capital or margins received in the next preceding year. Total equities and margins amounted to approximately 31% and 30% of total assets for 2017 and 2016, respectively.

**Note I - Long-Term Debt**

Long-term debt consisted of the following:

| | December 31, | |
|---|---|---|
| | 2017 | 2016 |
| FFB | | |
| Mortgage notes, fixed | $ 126,501,172 | $ 130,283,700 |
| CFC | | |
| Mortgage notes, fixed | 55,271,439 | 53,357,929 |
| CoBank | | |
| Mortgage note, fixed | 15,683,491 | 16,537,421 |
| | 197,456,102 | 200,179,050 |
| Less current maturities | 8,251,180 | 7,813,673 |
| | $ 189,204,922 | $ 192,365,377 |

The long-term debt payable to CoBank is represented by a mortgage note with an interest rate of 3.79%. The note matures in December 2031. Principal and interest installments were due monthly in the amount of approximately $137,000.

Long-term debt payable to CFC is represented by mortgage notes with rates ranging from 2.85% to 7.15%. The notes generally have 35-year maturity periods and are payable on an installment basis. The notes mature at various dates between March 2018 and September 2047. Principal and interest installments were due quarterly in the amount of approximately $1,765,000. The Cooperative had unadvanced loan funds from CFC of approximately $8,830,000 at December 31, 2017.

# Notes to Financial Statements

## Southside Electric Cooperative, Inc.

## December 31, 2017 and 2016

**Note I - Long-Term Debt - Continued**

The long-term debt payable to FFB is represented by mortgage notes with interest rates ranging from 1.07% to 5.86%. The notes mature at various dates between January 2018 and December 2048. Principal and interest installments were due quarterly in the amount of approximately $1,596,000. The Cooperative had unadvanced loan funds from FFB of $6,400,000 at December 31, 2017.

Approximate future maturities of long-term debt were estimated as follows:

| | CoBANK | CFC | FFB | Total |
|---|---|---|---|---|
| 2018 | $ 941,695 | $ 3,526,957 | $ 3,782,528 | $ 8,251,180 |
| 2019 | 971,392 | 4,009,596 | 3,881,040 | 8,862,028 |
| 2020 | 1,000,628 | 4,196,065 | 3,950,192 | 9,146,885 |
| 2021 | 1,033,587 | 4,391,870 | 4,019,337 | 9,444,794 |
| 2022 | 1,066,174 | 4,461,439 | 4,095,480 | 9,623,093 |
| 2023 and thereafter | 10,670,015 | 34,685,512 | 106,772,595 | 152,128,122 |
| | $ 15,683,491 | $ 55,271,439 | $ 126,501,172 | $ 197,456,102 |

Under the terms of the loan agreements with RUS and CFC, there are certain restrictions, which include requirements to maintain a TIER (times interest earned ratio) of 1.25 and DSC (debt service coverage) of 1.25. There were also restrictions on the return of capital to patrons as discussed in (Note H). As of December 31, 2017 and 2016, the Cooperative was in compliance with all restrictions.

The Cooperative had a $15,000,000 line of credit with CFC at a variable interest rate (2.35% at December 31, 2017), of which $14,500,000 and $10,000,000 was outstanding at December 31, 2017 and 2016, respectively. The line of credit is secured by substantially all of the Cooperative's assets and renews annually.

The Cooperative had a $8,000,000 line of credit with First Citizens Bank at a variable interest rate (3.82% at December 31, 2017), of which there was no balance outstanding at December 31, 2017 or 2016, respectively. The line of credit is unsecured and will expire in June 2018.

The Cooperative has a $10,000,000 line of credit with CoBank at variable rates (3.67% at December 31, 2017), of which $7,000,000 and $5,000,000 was outstanding at December 31, 2017 and 2016 respectively. The line of credit is unsecured and will expire in September 2018.

### Note J - Deferred Credits and Regulatory Liabilities

Deferred credits and regulatory liabilities consisted of the following:

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Regulatory liabilities: | | |
| Deferred power costs | $ 5,195,126 | $ 2,414,847 |
| Deferred special equipment labor | 113,092 | 244,073 |
| Other | 18,985 | 29,132 |
| Consumer advances | | 3,095,390 |
| | $ 5,327,203 | $ 5,783,442 |

### Note K - Retirement Plans

<u>Pension Plan</u>

The retirement Security Plan (RS Plan), sponsored by the National Rural Electric Cooperative Association (NRECA) 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 multiemployer 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 multiemployer plan compared to a single employer plan is that all plan assets are available to pay benefits of any plan participant. Separate asset accounts are not maintained for participating employers. This means that assets contributed by one employer may be used to provide benefits to employees of other participating employers.

The Cooperative's contributions to the RS Plan in 2017 and in 2016 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 approximately $3,093,000 and $2,976,000 in 2017 and 2016, respectively. There have been no significant changes that affect the comparability of 2017 and 2016 contributions.

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 at January 1, 2017 and over 80 percent funded on January 1, 2016 based on the PPA funding target and PPA actuarial value of assets on those dates.

Because the provisions of the PPA do not apply to the RS Plan, funding improvement plans and surcharges are not applicable. Future contribution requirements are determined each year as part of the actuarial valuation of the plan and may change as a result of plan experience.

# Notes to Financial Statements

# Southside Electric Cooperative, Inc.

# December 31, 2017 and 2016

**Note K - Retirement Plans – Continued**

At its December 2012 meeting, the I&FS Committee of the NRECA Board of Directors 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, the billing rate for most co-ops is reduced by approximately 25%, retroactive to the January 1 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 from January 1, 2013. 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.

On April 29, 2013 the Cooperative made a prepayment of $8,669,550 to the NRECA RS Plan. The Cooperative elected to finance the prepayment through a 10 year term loan with a fixed interest rate of 2.85%. The Cooperative is amortizing the prepayment to expense over 10 years with the balance represented as a part of deferred charges.

<u>Deferred Income Plan</u>

In addition to the NRECA RS Plan, substantially all employees of the Cooperative are eligible to participate in the NRECA SelectRE pension plan (the "Plan"), a defined contribution multi-employer deferred income plan qualified under Section 401(k) of the Internal Revenue Code. The Cooperative's required contribution to the Plan and its net pension cost was approximately $424,000 and $420,000 for the years ended December 31, 2017 and 2016, respectively.

**Note L - Financial Instruments Carried at Cost**

The Cooperative has recorded all financial instruments based on the carrying amount (book value) in the financial statements in accordance with ASC Topic 825. According to this guidance, the Cooperative is required to disclose the fair value of those financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using discounted cash flow analysis. This technique involves subjective judgment and is significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. As a result, the derived fair value estimates cannot be substantiated by comparison to independent markets, and in many cases, could not be realized in immediate settlement of the instrument. Accordingly, the following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it was practicable to estimate that value.

<u>Cash and Cash Equivalents</u>

The carrying amount of cash and cash equivalents approximates fair value due to the short maturity of these instruments.

# Notes to Financial Statements

## Southside Electric Cooperative, Inc.

## December 31, 2017 and 2016

### Note L - Financial Instruments Carried at Cost - Continued

Accounts Receivable

The carrying amount of accounts receivable approximates fair value due to the short period of time amounts are outstanding.

Investments in Associated Organizations

Investments in associated organizations are primarily composed of patronage capital assigned from associated organizations. These investments are recorded at costs plus allocated equities.

Fair value of capital term certificates was determined by computing the present value of estimated future cash flows, discounted at the long-term treasury rate of 2.74% and 3.06% for the years ended December 31, 2017 and 2016, respectively. The fair value of patronage capital is not determinable since no legal obligation exists to retire capital credits. The fair value of the cost method investment is not estimated since there are no identified events or changes in circumstances that may have a significant adverse effect on the fair value and it is not practicable to estimate fair value. The carrying value of memberships approximates fair value.

Accounts Payable

The carrying amount of accounts payable approximates fair value due to the short period of time amounts are outstanding.

Long-Term Debt

The carrying amount of the Cooperative's fixed long-term debt includes certain interest rates that are below quoted market prices for the same or similar issues. Therefore, the fair value of fixed long-term debt is estimated based on current market prices for the same or similar issues offered for debt of the same and remaining maturities which was 5.50% and 5.85% for the years ended December 31, 2017 and 2016, respectively.

The carrying amount of lines of credit approximates fair value due to the short maturity of the instruments.

Consumer Deposits

The carrying amount approximates fair value due to the relatively short maturity of the deposits.

# Notes to Financial Statements

## Southside Electric Cooperative, Inc.

## December 31, 2017 and 2016

**Note L - Financial Instruments Carried at Cost - Continued**

The estimated fair value of the Cooperative's financial instruments were as follows:

| | December 31, | | | |
|---|---|---|---|---|
| | 2017 | | 2016 | |
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Assets: | | | | |
| Capital term certificates | $ 2,153,157 | $ 3,200,000 | $ 2,170,361 | $ 3,030,000 |
| Liabilities: | | | | |
| Long-term debt, including mortgage notes and capital lease obligation | $ 197,456,102 | $ 164,670,000 | $ 200,179,050 | $ 164,790,000 |

**Note M - Commitments and Contingencies**

Purchased Power

The Cooperative, as a member of ODEC, an organization composed of electric cooperatives in Virginia, Maryland and Delaware, has entered into a long-term contract with ODEC for the acquisition of wholesale power through ODEC as have other members of the organization. The cost of wholesale power purchases through ODEC may increase or decrease based upon rates established by the Board of Directors of ODEC.

Other

From time to time, the Cooperative becomes involved in litigation in the ordinary course of business. In management's opinion, the ultimate resolution of these matters will not have a material adverse effect on the Cooperative's financial position, results of operations or cash flows.

**Note N - Related Party Transactions**

The Cooperative is a member of the following organizations and conducted business transactions during the current and prior years as set forth below:

The Cooperative is a member of CFC (Notes E and I), a national financing organization, and had investment assets and mortgage notes payable at various interest rates and maturities.

The Cooperative, as a member of the ODEC, has entered into a contract for the acquisition of wholesale power.

The Cooperative is a shareholder of Federated Rural Electric Insurance Corporation (Note E), and purchases its general property and liability coverage from this organization.

The Cooperative, as a member of TEMA (Note E), purchased materials and supplies for construction and maintenance of the utility assets.

**Supplemental Matters Required by the**

**Rural Utilities Service**

ADAMS, JENKINS AND CHEATHAM
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS CONSULTANTS

**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***

The Board of Directors
Southside Electric Cooperative, Inc.
Crewe, Virginia

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Southside Electric Cooperative, Inc. (the "Cooperative"), which comprise the balance sheets as of December 31, 2017 and 2016, and the related statements of operations, equities and cash flows for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated February 26, 2018.

**Internal Control Over Financial Reporting**

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



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**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Cooperative's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audits, 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*.

We noted certain matters that we reported to management of Southside Electric Cooperative, Inc. in a separate letter dated February 26, 2018.

**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 Cooperative's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Governmental Auditing Standards* in considering the Cooperative's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Adams, Jenkins & Cheatham

Richmond, Virginia
February 26, 2018

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

The Board of Directors
Southside Electric Cooperative, Inc.
Crewe, Virginia

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 Southside Electric Cooperative, Inc. (the "Cooperative"), which comprise the balance sheet as of December 31, 2017, and the related statements of operations, equities, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated February 26, 2018. In accordance with *Government Auditing Standards*, we have also issued a report dated February 26, 2018 on our consideration of the Cooperative's internal control over financial reporting and 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*, §1773.33 and clarified in the RUS policy memorandum dated February 7, 2014, 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 related 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;
- Obtain written RUS approval to enter into any contract for the management, operations, 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.

This report is intended solely for the information and use of the board of directors, management, and the RUS and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Adams, Jenkins & Cheatham

Richmond, Virginia
February 26, 2018