

































## (2) Utility Plant

Listed below are the major classes of the electric utility plant as of December 31:

	<u>2019</u>	<u>2018</u>
Distribution Plant	\$ 597,677,481	\$ 570,393,818
General Plant	<u>54,283,694</u>	<u>49,923,708</u>
<b>Electric Plant in Service</b>	<b>651,961,175</b>	<b>620,317,526</b>
Construction Work in Progress	<u>7,700,509</u>	<u>9,565,226</u>
	<u><u>\$ 659,661,684</u></u>	<u><u>\$ 629,882,752</u></u>

## (3) Investments in Associated Organizations

	<u>2019</u>	<u>2018</u>
National Rural Utilities Cooperative Finance Corporation		
Capital Term Certificates	\$ 1,286,469	\$ 1,286,469
Capital Credits	1,490,928	1,569,607
GRESKO Utility Supply, Inc.	4,534,417	4,243,955
Southeastern Data Cooperative, Inc.	40,846	40,846
Georgia Transmission Corporation	23,226,045	22,020,579
Smarr EMC	10,665,084	10,665,084
Federated Rural Electric Insurance Exchange	802,937	749,056
Green Power EMC	63,351	56,485
National Information Solutions Cooperative	562,026	525,985
Other	<u>1,040</u>	<u>1,040</u>
	<u><u>\$ 42,673,143</u></u>	<u><u>\$ 41,159,106</u></u>

## (4) Deferred Debits

Deferred debits are comprised of the following as of December 31:

	<u>2019</u>	<u>2018</u>
Hurricane Irma Restoration	\$ 435,534	\$ 294,268
Clearing Accounts and Other	<u>200</u>	<u>200</u>
	<u><u>\$ 435,734</u></u>	<u><u>\$ 294,468</u></u>

The Federal Emergency Management Agency (FEMA) declared a portion of the Corporation's service territory a disaster area (FEMA-4338-DR) on September 7, 2017. The Corporation expects the amount remaining to be reimbursed to be settled in 2020.

## (5) Other Equities

	<u>2019</u>	<u>2018</u>
Capital Gains and Losses	\$ 37,520	\$ 37,520
Retired Capital Credits - Gain	9,388,029	8,441,008
Unbilled Revenue Prior to 2017	13,093,000	13,093,000
Donated Capital	1,643,958	1,547,316
	<u>\$ 24,162,507</u>	<u>\$ 23,118,844</u>

## (6) Debt

Long-term debt consists primarily of mortgage notes payable to the United States of America acting through RUS and the Federal Financing Bank (FFB). The notes are secured by a mortgage agreement among the Corporation, RUS and FFB. Substantially all the assets of the Corporation are pledged as security for the long-term debt. The notes generally have 35-year maturity periods and are payable in quarterly and monthly installments. The notes contain certain affirmative and negative covenants, including maintenance of certain financial ratios as defined in the agreement. At December 31, 2019 and 2018, the Corporation was in compliance with the covenants.

<u>Holder of Note</u>	<u>Interest Rate at December 31, 2019</u>	<u>2019</u>	<u>2018</u>
RUS Mortgage Notes	1.875% to 4.82%	\$ 86,823,339	\$ 123,748,759
FFB Mortgage Notes	1.785% to 4.969%	259,777,869	191,629,804
		<u>346,601,208</u>	315,378,563
RUS Advanced Payments Unapplied		(33,604,598)	(77,046,078)
Maturities Due Within One Year		(11,301,000)	(10,414,000)
		<u>\$ 301,695,610</u>	<u>\$ 227,918,485</u>

Approximate principal maturities of long-term debt for each of the next five years are as follows:

<u>Year</u>	<u>Amount</u>
2020	\$ 11,301,000
2021	12,305,000
2022	13,399,000
2023	14,590,000
2024	15,887,000

The Corporation has a loan commitment from FFB in the amount of \$229,277,000. The availability of funds is contingent on the Corporation's compliance with one or more preconditions set forth in the mortgage agreements. The Corporation submitted the documents to execute the loan contract subsequent to December 31, 2019.

## **(6) Debt (Continued)**

Cash payments of interest totaled \$11,970,575 and \$9,226,067 for 2019 and 2018, respectively.

The Corporation has two separate and distinct line-of-credit instruments with NRUCFC that total \$80,000,000. The first line-of-credit is for \$50,000,000 and is for general use to meet the ongoing short-term cash needs of the Corporation. The second line-of-credit is for \$30,000,000 and is limited to serving the short-term cash needs of the Corporation. The line-of-credit instruments had an outstanding obligation of \$-0- and \$22,820,183 as of December 31, 2019 and 2018, respectively. The rate of interest as of December 31, 2019 was 3.2 percent.

The Corporation has made unapplied advance payments to the RUS Cushion-of-Credit program. Under this program, the Corporation may make voluntary deposits into a special cushion-of-credit account. The cushion-of-credit account balance accrues interest to the Corporation at a rate of 5 percent per annum. The use of the cushion-of-credit account is restricted to funding the future debt service payments that the Corporation is obligated to pay against its outstanding indebtedness to RUS or FFB. Interest payments totaling \$32,724 and \$2,441,516 were made through the cushion-of-credit program for the years ended December 31, 2019 and 2018, respectively. Interest earned on unapplied advanced payments is recorded as a component of nonoperating margins.

On December 20, 2018, the President of the United States signed the Agriculture Improvement Act which makes the following changes to the RUS Cushion-of-Credit program:

- No new cushion-of-credit deposits will be allowed after December 20, 2018,
- Cooperatives in the program may transfer their cushion-of-credit money to prepay RUS loans without penalty through September 30, 2020,
- Remaining cushion-of-credit funds after September 30, 2020, may be applied only to regular RUS and FFB debt service payments,
- Existing cushion-of-credit balances will earn 5 percent interest until October 1, 2020, when that rate will drop to 4 percent. Beginning October 1, 2021, interest on remaining balances will be paid at a floating one-year Treasury rate.

## **(7) Retiree Benefits**

### ***Pension Plan (Defined Benefit)***

Pension benefits for qualified employees of the Corporation are provided through participation in the National Rural Electric Cooperative Association (NRECA) Retirement Security (RS) Plan, a defined benefit plan qualified under Section 401 and tax-exempt under 501(a) of the Internal Revenue Code. 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.

## **(7) Retiree Benefits (Continued)**

### ***Pension Plan (Defined Benefit) (Continued)***

The Corporation's annual contributions to the NRECA RS Plan represented less than 5 percent of total contributions made to the plan by all participating employers and are equal to the amounts recorded for pension cost. Contributions were \$3,273,527 and \$3,549,829 for the years ended December 31, 2019 and 2018, respectively.

In the RS Plan, a "zone status" determination is not required, and therefore not determined, under the Pension Protection Act (PPA) of 2006. In addition, the accumulated benefit obligations and plan assets are not determined or allocated separately by individual employer. In total, the RS Plan was greater than 80 percent funded at January 1, 2020 and 2019 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.

### ***Pension Plan (Defined Contribution Plan)***

The Corporation also provides employee benefits to qualified employees through the NRECA sponsored defined contribution Savings Plan (401-k). In this defined contribution plan, the Corporation's contributory portion of costs of this plan totaled \$882,249 and \$745,510 for the years ended December 31, 2019 and 2018, respectively.

### ***Postretirement Healthcare Benefits***

The Corporation provides healthcare benefits to qualified retirees and directors. U.S. GAAP requires cooperatives to recognize the estimated future cost of providing healthcare and any other postretirement benefits on an accrual basis.

## (7) Retiree Benefits (Continued)

### Postretirement Healthcare Benefits (Continued)

The status of the Corporation's postretirement healthcare plan as of December 31 is detailed as follows:

	<u>2019</u>	<u>2018</u>
<b>Changes in the Accumulated Postretirement Benefit Obligation (APBO)</b>		
APBO Beginning of Year	\$ 26,182,968	\$ 29,205,667
Service Cost	651,847	843,123
Interest Cost	1,172,241	1,215,102
Actuarial (Gain) Loss	6,797,075	(4,122,321)
Direct Benefit Payments	(982,117)	(958,603)
	<u>33,822,014</u>	<u>26,182,968</u>
<b>Changes in Plan Assets</b>		
Fair Value of Plan Assets Beginning of Year	-	-
Employer Contributions	982,117	958,603
Plan Participant Contributions	-	-
Actual Distributions	(982,117)	(958,603)
	<u>-</u>	<u>-</u>
Fair Value of Plan Assets at End of Year	-	-
<b>Under Funded Status at End of Year</b>	<u>\$ 33,822,014</u>	<u>\$ 26,182,968</u>

Amounts recognized on the balance sheets consist of the following:

	<u>2019</u>	<u>2018</u>
Current Liabilities	\$ 958,104	\$ 1,011,230
Noncurrent Liabilities	32,863,910	25,171,738
	<u>\$ 33,822,014</u>	<u>\$ 26,182,968</u>

Changes in benefit obligations recognized in patronage capital are as follows:

	<u>2019</u>	<u>2018</u>
Service Cost	\$ 651,847	\$ 843,123
Interest Cost	1,172,241	1,215,102
Actuarial (Gain) Loss	6,797,075	(4,122,321)
	<u>\$ 8,621,163</u>	<u>\$ (2,064,096)</u>

## (7) Retiree Benefits (Continued)

### *Postretirement Healthcare Benefits (Continued)*

The Corporation's net postretirement benefit cost is calculated using various actuarial assumptions and methodologies. These assumptions include discount rates, expected return on plan assets, mortality rates and other factors. Actuarial assumptions are reviewed on an annual basis. The following table shows key assumptions used for the measurement of obligations for the plan:

Description	December 31		
	2019	2018	2017
Discount Rate			
Benefit Obligations	<b>3.43%</b>	4.70%	3.98%
Net Periodic Benefit Cost	<b>4.70%</b>	3.98%	4.62%
Medical Trend Rate			
Initial (Pre-65/Post 65)	<b>6.00/6.30%</b>	6.30/7.10%	6.60/7.10%
Ultimate	<b>4.50%</b>	4.50%	4.50%
Year Reached	<b>2037</b>	2037	2037

The Corporation has elected to amortize gains and losses from changes in actuarial assumptions in the year they occur. This practice is accepted under U.S. GAAP.

The components of net periodic benefit cost, other than the service cost component, are included in the line item nonoperating margins for the year ended December 31, 2019. All components of net periodic benefit cost, other than service costs, included in the statement of operations for the year ended December 31, 2018 have been reclassified to the line item nonoperating margins.

The following benefits are expected to be paid:

Year	Amount
2020	\$ 958,104
2021	1,008,582
2022	1,036,310
2023	1,181,623
2024	1,208,123
2025-2028	6,351,341

### *Deferred Compensation Plans*

The Corporation has also established an Executive Benefit Restoration Plan (EBR Plan) for key management and highly compensated employees whose benefits under the RS Plan are restricted because of maximum limits on benefits or compensation that may be provided by the RS Plan. The net periodic benefit cost is calculated using various actuarial assumptions and methodologies. These assumptions include discount rates, expected return on plan assets, mortality rates and other factors. Actuarial assumptions are reviewed on an annual basis.

The EBR Plan accumulated benefit obligation was \$213,530 and \$431,818 as of December 31, 2019 and 2018, respectively. The amounts are included in other long-term liabilities on the balance sheets.

## (8) Deferred Credits

Deferred credits are comprised of the following as of December 31:

	<u>2019</u>	<u>2018</u>
Power Cost Revenue Deferral	\$ 137,071,270	\$ 122,071,270
Holcombe Bridge Substation	105,424	122,992
Clearing Accounts and Other	10,343	1,785
	<u>\$ 137,187,037</u>	<u>\$ 122,196,047</u>

### *Power Cost Revenue Deferrals*

The power cost revenue deferrals represent revenue deferral plans to reduce the impact of the future power cost increases by various power suppliers on the Corporation's rate structure.

Plan transactions were as follows:

	<u>2019</u>	<u>2018</u>
Beginning Balance	\$ 122,071,270	\$ 107,071,270
Current Year Recognition	(22,420,846)	(19,727,407)
Current Year Deferral	37,420,846	34,727,407
	<u>\$ 137,071,270</u>	<u>\$ 122,071,270</u>

The revenue deferrals are in compliance with U.S. GAAP related to the effects of certain types of regulation and have been approved by RUS.

The board of directors of the Corporation specified the deferred funds be deposited in special accounts until such time as a like amount is subsequently amortized into revenue. Accordingly, the funds have been set aside as restricted funds.

## (9) Commitments

The Corporation entered into a Wholesale Power Contract with Oglethorpe Power Corporation (An Electric Membership Corporation) (OPC) in 1997. The Wholesale Power Contract was amended in 2003 and its term has been extended through December 31, 2050. Under the Wholesale Power Contract, the Corporation is obligated, on a "take or pay" basis, for a fixed percentage of capacity costs (referred to as a "percentage capacity responsibility") of certain of OPC's generation and purchased power resources. The Corporation will be assigned only a percentage capacity responsibility for any future OPC resource if the Corporation elects to participate in the resource. The Corporation's percentage capacity responsibility in each of OPC's existing generation and purchased power resources ranges from 3.5246 percent to 34.3401 percent with an aggregate capacity cost responsibility totaling approximately \$83,994,000 for the year ended December 31, 2019.

## **(9) Commitments (Continued)**

The Corporation is a member of a transmission cooperative known as Georgia Transmission Corporation (GTC) and as such, has a Member Transmission Service Agreement (MTSA) executed in 1996 and amended in 2005 and 2012. The MTSA revision of 2012 requires the Corporation to take transmission-related services through 2060 and allows for a reduction in service at prescribed periods. Transmission service under the MTSA was \$24,038,502 in 2019 and is expected to remain relatively constant in the immediate future. Transmission service is recorded as a component of cost of power.

GSOC is an independent, not-for-profit system operations company. The Corporation has a service agreement with GSOC that can be terminated with a one-year notice. For 2019, the Corporation paid GSOC \$286,753.

Southeastern Power Administration (SEPA) is responsible for marketing electric power and energy to preferred power customers of which the Corporation is considered to be. The Corporation has a perpetual agreement with SEPA that can be terminated with a two-year notice. For 2019, the Corporation paid SEPA \$1,431,962.

The Corporation entered into a Requirements Service Agreement (RSA) dated February 28, 2002 through December 31, 2017 with Southern Power Company. Under the original terms of the RSA, the Corporation received all energy and capacity above its existing and approved resources and agreements. On September 28, 2010, the Corporation extended the RSA until December 31, 2027. Beginning on January 1, 2028, by mutual consent, a portion of the RSA can be converted to a Block Power Purchase Agreement (BPPA) for the balance of the term which ends December 31, 2032. The Corporation has to meet certain financial covenants under the RSA or provide a predefined level of credit support as specified by the agreement.

In addition, the Corporation has committed to participate in a utility scale solar project under a power purchase agreement with Southern Power Company. This agreement is to expire 25 years from the date of commercial operations or on approximately December 31, 2042. The Corporation currently meets these required financial covenants and currently provides no credit support.

The Corporation has entered into various assignment and assumption agreements through Green Power EMC and its participating EMCs. These agreements are in support of the Corporation's receiving capacity and energy from the various renewable generation projects that the Corporation has chosen to participate in through Green Power EMC. The Corporation participates in twelve Green Power EMC projects (Taylor County Biomass, Rabun Gap Biomass, Wolf Creek Biomass, Hazlehurst Solar Project, SR South Living Solar, SR Baxley, SR Hazlehurst, SR Clay, SR Houston, SR Arlington, SR Bluffton and SR Lumpkin). In 2019, the Corporation made \$5,277,429 in capacity and energy payments for these assets.

Under current Georgia law, the Corporation has the ability to recover these purchase power costs as well as other operating costs from its members; however, any change to existing laws could adversely affect the ability to recover such costs.

## **(10) Concentrations of Credit Risk**

Financial instruments that potentially subject the Corporation to concentrations of credit risk consist principally of cash and cash equivalents and consumer accounts receivable. The Corporation maintains its cash balances in financial institutions; cash balances throughout the year periodically exceed federally insured deposit limits of \$250,000. At December 31, 2019, the amount exceeding insured limits totaled \$10,841,572.

At December 31, 2019, the Corporation held medium-term notes and commercial paper of the NRUCFC in the amount of \$137,550,000 and \$37,307,892, respectively. The amount is not secured or otherwise subject to federally insured deposit liability coverage.

The Corporation serves consumers in the state of Georgia. The geographic concentration of the Corporation's consumers results in a concentration of credit risk with respect to the collection of accounts receivable. Credit evaluations are performed on potential customers based on a board-approved methodology as defined in board policy prior to accepting them for service. Depending upon the results of the credit evaluation, a service security deposit may be required.

## **(11) Fair Value Measurements**

The Corporation measures and reflects fair value in the balance sheets for OPC and GSOC Capital Credits. Since the Corporation reflects these assets at fair value, accounting standards require the following three-tier value information.

- Level 1. Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Corporation has the ability to access.
- Level 2. Valuations based on quoted market prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable data for substantially the full term of the assets or liabilities.
- Level 3. Valuations based on inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following valuation techniques are used to estimate the fair value of each class of financial instruments:

- (1) *Market approach*. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities (including a business) and deriving fair value based on these inputs.
- (2) *Income approach*. The income approach uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present amount (discounted). The measurement is based on the value indicated by current market expectations about those future amounts.
- (3) *Cost approach*. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (often referred to as current replacement cost). This approach assumes that the fair value would not exceed what it would cost a market participant to acquire or construct a substitute asset or comparable utility, adjusted for obsolescence.

**(11) Fair Value Measurements (Continued)**

The Corporation has capital credit notifications from OPC and GSOC totaling \$72,651,595 and \$68,681,699 as of December 31, 2019 and 2018, respectively. The Corporation has elected to account for OPC and GSOC capital credits as financial instruments under U.S. GAAP, based on an expectation of a return of capital, and measures these capital credits at fair value on an annual basis (recurring fair value measurement) using significant unobservable inputs (Level 3). No market data exists for these instruments.

The Corporation had no nonrecurring fair value measurements for the years ended December 31, 2019 and 2018.

***Fair Value Measurements Carried at Fair Value***

	Fair Value Measurements Using				Total Gains (Losses)
	Carrying Value as of December 31	Quoted Market Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<b><u>2019</u></b>					
<b><u>Recurring Fair Value Measurements</u></b>					
<b>Investments in Associated Organizations</b>					
<b>OPC and GSOC Capital Credits</b>	\$ -			\$ -	\$ -
<b><u>2018</u></b>					
<b><u>Recurring Fair Value Measurements</u></b>					
<b>Investments in Associated Organizations</b>					
<b>OPC and GSOC Capital Credits</b>	\$ -			\$ -	\$ -

Gains and losses included in earnings for each period are presented as a component of generation and transmission cooperative capital credits on the statements of operations.

## (11) Fair Value Measurements (Continued)

### Fair Value Measurements Carried at Fair Value (Continued)

Unobservable inputs are inputs that reflect management's own assumptions about the assumptions market participants would use in pricing an asset or liability developed based on the best information available in the circumstances. Level 3 fair value measurements for the years ended December 31 are as follows:

	2019	2018
<b>Beginning Balance</b>	\$ -	\$ -
Transfers into Level 3	-	-
Total Gains or Losses for the Period		
Included in Margins		
Patronage Notifications	3,969,896	3,747,820
Fair Value Adjustment(s)	(3,969,896)	(3,747,820)
Purchases, Issues, Sales and Settlements	-	-
<b>Ending Balance</b>	<b>\$ -</b>	<b>\$ -</b>

For Level 3 fair value measurements, the Corporation's management determines the fair value measurement valuation policies and procedures. In accordance with board policy, the board of directors assess and approve the fair value measurement policies and procedures. On an annual basis, management determines if the current valuation techniques used in the fair value measurements are still appropriate and evaluates and adjusts the unobservable inputs used in the fair value measurements based on current market conditions and any available third-party information. There were no changes in the valuation techniques during the current year.

Quantitative information about Level 3 fair value measurements for the years ended December 31, 2019 and 2018 is as follows:

Financial Instrument	Fair Value	Valuation Technique	Unobservable Input	Percentage
OPC and GSOC Capital Credits	\$ -	Discounted Cash Flow	Expected Return of Capital	0.0%

The significant unobservable input used in the fair value measurement of the Corporation's OPC capital credits is an expected return of capital. Management has assessed that no expected return of capital exists based on the following factors:

- Uncertainty as to return of capital since no capital has been returned in recent years.
- Capital returns limited by debt agreements.
- Review of major construction and related debt requirements.
- Regulatory environment.
- No known market.

An increase in the percentage of expected capital returns would result in a significantly higher fair value measurement.

March 19, 2020

**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  
Sawnee Electric Membership 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 *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of **Sawnee Electric Membership Corporation** (the Corporation), which comprise the balance sheet as of December 31, 2019 and the related statements of operations, changes in members' equity, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated March 19, 2020.

***Internal Control Over Financial Reporting***

In planning and performing our audit of the financial statements, we considered the Corporation'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 Corporation's internal control. Accordingly, we do not express an opinion on the effectiveness of the Corporation'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 Corporation'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 the board of directors.

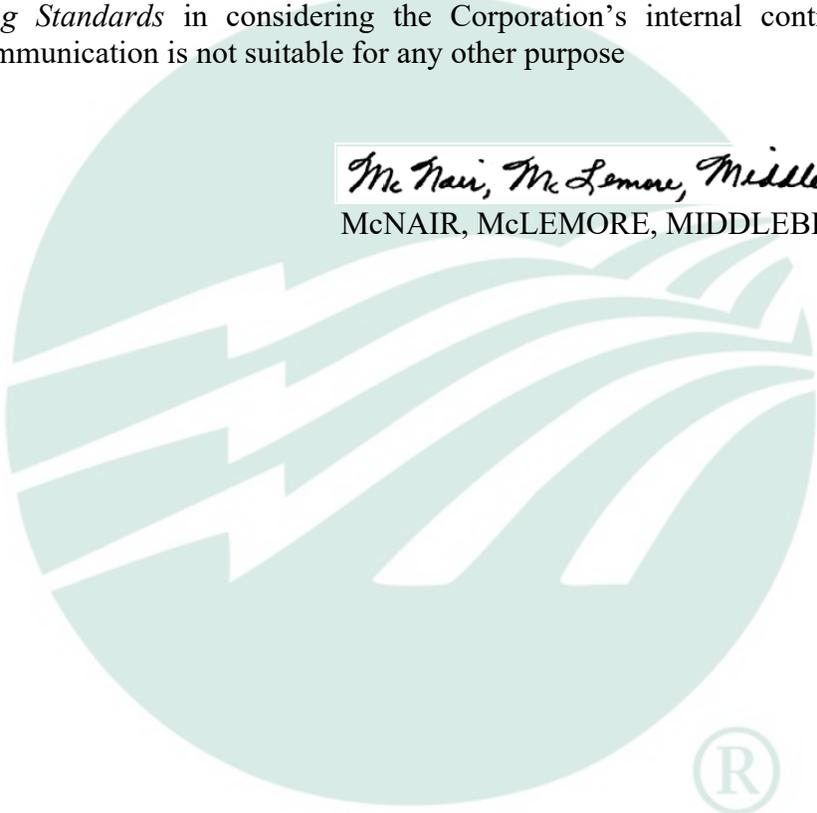
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not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

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

As part of obtaining reasonable assurance about whether the Corporation'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 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 Corporation's internal control or on compliance. The report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Corporation's internal control and compliance. Accordingly, this communication is not suitable for any other purpose



*McNaair, McLemore, Middlebrooks & Co., LLC*  
McNAIR, McLEMORE, MIDDLEBROOKS & CO., LLC

March 19, 2020

**INDEPENDENT AUDITOR'S REPORT  
ON COMPLIANCE WITH ASPECTS OF CONTRACTUAL AGREEMENTS  
AND REGULATORY REQUIREMENTS FOR ELECTRIC BORROWERS**

The Board of Directors  
Sawnee Electric Membership 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 **Sawnee Electric Membership Corporation** (the Corporation), which comprise the balance sheet as of December 31, 2019 and the related statements of operations, changes in members' equity, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated March 19, 2020. In accordance with *Government Auditing Standards*, we have also issued our report dated March 19, 2020, on our consideration of the Corporation'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 Corporation 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 Corporation'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 Corporation's accounting and records to indicate that the Corporation 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, 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), except for automated metering equipment which is being depreciated in compliance with guidance provided in 7 CFR Part 1767;
- Comply with the requirements for the detailed schedule of deferred debits and deferred credits which is included in the notes to the financial statements; and
- Comply with the requirements for the detailed schedule of investments which consists of investments in associated organizations and is disclosed in the notes to the financial statements.

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 distribution is not limited.

*McNair, McLemore, Middlebrooks & Co., LLC*  
McNAIR, McLEMORE, MIDDLEBROOKS & CO., LLC



**SAWNEE ELECTRIC MEMBERSHIP CORPORATION**  
**MATTERS TO BE COMMUNICATED WITH THE BOARD OF DIRECTORS**  
**DECEMBER 31, 2019**

**Auditor's Responsibility Under Generally Accepted Auditing Standards and *Government Auditing Standards***

As stated in our engagement letter, the auditor is responsible for forming and expressing an opinion about whether the financial statements are presented fairly, in all material respects, in accordance with generally accepted accounting principles in the United States of America. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

**Planned Scope and Timing of the Audit**

The audit was performed according to the planned scope and timing previously communicated to you in our engagement letter.

**Significant Accounting Policies**

Management is responsible for the selection of appropriate accounting policies. The significant accounting policies used by Sawnee Electric Membership Corporation (the Corporation) are outlined in Note 1 to the financial statements. The Corporation implemented the following provisions during the year:

- Accounting Standards Update (ASU) 2017-07, *Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, to report the service cost component of net periodic pension and postretirement benefit cost in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The remaining components of net benefit costs are presented in the statements of operations separately from the service cost component and outside a subtotal of income from operations. The amendment further allows only the service cost component of net periodic pension and postretirement costs to be eligible for capitalization.
- ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*, which requires cash and cash equivalents with restrictions to be included in total cash and cash equivalents on the statement of cash flows. If restricted cash is presented separately from cash and cash equivalents on the balance sheet, a reconciliation between the balance sheet and the statement of cash flows must be disclosed.
- ASU 2014-09, *Revenue from Contracts with Customers*, is designed to create greater comparability for financial statement users across industries and jurisdictions through a more principles-based approach than companies in the United States are used to following. The standard would require companies to recognize revenue through a five-step process: (1) identify the contract with the customer, (2) identify the separate performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the separate performance obligations in the contract, and (5) recognize revenue when (or as) the entity satisfies a performance obligation.

## **Management Judgments and Accounting Estimates**

Accounting estimates are an integral part of the financial statements and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting the estimates may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

- Allocations for construction work in progress
- Useful lives of utility plant
- Reserve for uncollectible accounts
- Expense accruals
- Actuarial assumptions of postretirement benefit plans
- Accrued utility revenue
- Fair value measurements

We evaluated the key factors and assumptions used to develop management's estimates in determining that they are reasonable in relation to the financial statements as a whole.

## **Significant Audit Adjustments and Uncorrected Misstatements**

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. There were no audit adjustments for the year ended December 31, 2019. There were no material uncorrected misstatements.

## **Disagreements with Management**

Professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

## **Management Representations**

We have requested certain representations from management that are included in the management representation letter dated March 19, 2020.

## **Consultation with Other Accountants**

To our knowledge, management did not consult with other accountants relating to auditing or accounting matters.

## **Major Issues Discussed with Management Prior to Retention**

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Corporation's auditor. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

### **Difficulties Encountered in Performing the Audit**

There were no difficulties encountered in dealing with management related to the performance of the audit.

### **Restriction of Use**

This report is intended solely for the information and use of the board of directors and management 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.

