Electric Co-Operatives in Transition

Electric co-operatives are unique entities that are part government agency, part agricultural co-operative, and part not-for-profit company that provide electricity to rural areas of the United States. Most co-operatives are solely distributors of energy to the end-user and do not actually generate the electricity themselves. Due to their unique nature, co-operatives face a specific set of risks. Here are the key risks for 2017.

1. **Cybersecurity.** Co-operatives need to address cybersecurity threats proactively by implementing controls to prevent and detect cybercrime. Education of employees of potential phishing schemes is paramount to a successful cybersecurity campaign. Potential effects of a co-op network infiltration can include shut down of an energy grid, re-direction of energy to a particular location, or theft of customer payment information.

2. **Power Supply Costs.** The EPA's Clean Power Plan provides for carbon dioxide limit regulations which will increase compliance costs. Management needs to investigate alternative sources of energy, such as wind, solar, biomass, etc., to further diversify power sources as well as work with communities to deploy energy storage and efficiency technologies.

3. **Safety, Including Overtime Management.** Safety is a major concern for co-operatives as their employees routinely work in dangerous conditions (i.e. downed power line in a thunderstorm) that, if not taken seriously, can expose the co-operative. Excessive overtime hours can push employees beyond their capacity, thus increasing safety risks. The monitoring of overtime hours to help protect the safety of employees represents an important oversight role and a vital way to control costs.

4. **Community and Environmental Responsibility.** Electric co-operatives have to balance providing affordable electricity to the communities they serve while protecting those same communities from environmental degradation. Through effective use of social media and other forms of technology, co-operatives can launch conservation programs in their communities by providing information and resources to members about how they can individually reduce their energy costs. This not only saves the members money but also keeps the co-operatives from wasting energy resources and protecting the environment.

5. **Succession Planning.** As co-operative executives continue to grow older and retire in larger numbers than in the past, there must be a greater emphasis on succession planning and staff development. This risk flows all the way down to recruitment of top talent as urbanization continues to increase in the U.S. and competition from other industry sectors for talent intensifies. Whether a co-op decides to use an internal or external hire to replace key top management, steps need to be taken to ensure a smooth transition.

6. **Billing Adjustments (Fraud Risk).** Proper segregation of duties needs to be in place to prevent those who initiate billing adjustments from those approving the adjustment. Otherwise, an employee could raise a customer's rate, remit the proper agreed upon amount and then pocket the extra amount. Additionally, adjustments involving employee accounts need senior level review.

7. **Cash Handling (Fraud Risk).** Proper controls should be implemented to protect against fraud regarding the handling of cash. This would include proper segregation of duties around cash collection, accounting module access, reconciliation of the cash balance, and recording the collection in the accounting system.

8. **Pensions.** Unfunded pension benefit obligations pose a serious threat to co-operatives who do not have the resources available to pay benefits as they become due. Additionally, co-operatives that participate in multi-employer pension plans may be contributing funds which ultimately benefits employees of companies who do not contribute their proportionate share of the liability. Finally, management should have its pension obligations updated at least every other year through a credible actuary and have active discussions with its actuary regarding key assumptions.

Sources: electric.coop, ey.com, thenews.coop, myelectriccooperative.com, owen.vanderbilt.edu

DEANDORTON
DEAN DORTON ALLEN FORD, PLLC
BUSINESS ADVISORS CPAs CONSULTANTS

For more information, contact Bill Kohm at 859.425.7625 or bkohm@deandorton.com

Louisville 502.589.6050

Lexington 859.255.2341

Electric Co-Operative Statistics

As you close out 2016, take a look at the following key electric co-op performance indicators in Kentucky. Dean Dorton analyzed a group of the larger electric co-op financial statements as provided to the Public Service Commission.

The industry looks stable with equity as a percentage of total assets climbing from 41% to 43% and current ratio of 1.32. Accounts receivable and accounts payable continue to turnover about every 15th day. Operating margin dipped from 6% to 5% and the group continues to reinvest in itself at the rate of 8% of revenue.

The industry is highly leveraged to fund its capital with debt exceeding its equity. The purchase of energy sits at 73% of revenue and represents one of the main risks going forward as highlighted in Dean Dorton's top 10 electric co-op list for 2016 (deandorton.com/challenging-times-for-electric-co-operatives).

	2015	2014	2013
Debt to equity	1.19	1.28	1.38
Equity to total assets	43%	41%	39%
Current ratio	1.32	1.31	1.19
Accounts payable turnover	15.74	14.83	14.16
Accounts receivable turnover	14.74	13.31	14.32
Operating margin	5%	6%	5%
Cost of purchase %	73%	74%	74%
Plant additions %	8%	7%	7%

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