



REPORT OF INDEPENDENT AUDITORS AND  
CONSOLIDATED FINANCIAL STATEMENTS  
WITH SUPPLEMENTARY INFORMATION

**MIDWEST ENERGY COOPERATIVE**

December 31, 2017 and 2016

## Table of Contents

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	PAGE
<b>Board of Directors</b>	1
<b>Report of Independent Auditors</b>	2–3
<b>Financial Statements</b>	
Consolidated balance sheets	4–5
Consolidated statements of operations	6
Consolidated statements of equities and margins	7
Consolidated statements of cash flows	8–9
Notes to consolidated financial statements	10–24
<b>Supplementary Information</b>	
Consolidating balance sheets	25–26
Consolidating statements of operations	27
<b>Report Required by <i>Government Auditing Standards</i></b>	
Report of independent auditors on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with <i>Government Auditing Standards</i>	28–29

Midwest Energy Cooperative  
Board of Directors  
December 31, 2017

Clarence A. Barth	Chairman
Ben Russell	Vice Chairman
Ronald Armstrong	Secretary
John Green	Treasurer
Fred Turk	Director
James W. Dickerson	Director
Harry Gentz	Director
Arell Chapman	Director
Gerry Bundle	Director

President and CEO

Robert Hance

## **Report of Independent Auditors**

The Board of Directors  
Midwest Energy Cooperative  
Cassopolis, Michigan

### **Report on the Financial Statements**

We have audited the accompanying consolidated financial statements of Midwest Energy Cooperative (the Cooperative), which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of operations, equities and margins, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

Our responsibility is to express opinions on these consolidated 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 audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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, 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 consolidated financial statements.

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

***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Cooperative 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 Supplementary Information***

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Company's consolidated financial statements. The consolidating balance sheets and consolidating statements of operations (collectively, "supplementary information") are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The supplementary information has been subjected to the auditing procedures applied in the audit of the financial statements and certain other procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated in all material respects in relation to the financial statements as a whole.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated March 30, 2018, on our consideration of Midwest Energy Cooperative's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is 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 Midwest Energy Cooperative's internal control over financial reporting and compliance.

**Moss Adams LLP**

Portland, Oregon  
March 30, 2018

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# Midwest Energy Cooperative

## Consolidated Balance Sheets

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### ASSETS

	December 31,	
	2017	2016
<b>ELECTRIC PLANT AND EQUIPMENT</b>		
In service – at cost	\$ 255,557,752	\$ 205,935,001
Construction work in progress	9,314,532	22,443,390
	264,872,284	228,378,391
Less accumulated depreciation	71,393,337	68,199,618
Net electric plant and equipment	193,478,947	160,178,773
<b>OTHER ASSETS AND INVESTMENTS</b>		
Investments in associated organizations	25,348,065	23,794,584
Notes receivable	161,702	138,053
Income taxes receivable	16,719	9,565
Grant receivable	119,692	134,499
Total other assets and investments	25,646,178	24,076,701
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	7,031,862	2,374,804
Accounts receivable, less allowance for doubtful accounts of \$462,000 and \$441,000 in 2017 and 2016, respectively	4,921,880	4,562,610
Unbilled revenue	5,206,029	4,476,669
Current portion of notes receivable	60,000	84,000
Power supply cost recovery	-	71,256
Materials and supplies	2,256,124	2,128,928
Inventory of subsidiary	321,999	576,034
Other current assets	453,485	626,611
Total current assets	20,251,379	14,900,912
<b>DEFERRED CHARGES</b>	142,300	142,300
Total assets	<u>\$ 239,518,804</u>	<u>\$ 199,298,686</u>

## Midwest Energy Cooperative Consolidated Balance Sheets

### LIABILITIES, EQUITIES, AND MARGINS

	December 31,	
	2017	2016
<b>EQUITIES AND MARGINS</b>		
Patronage capital and other equities	\$ 56,199,354	\$ 52,968,643
<b>LONG-TERM DEBT, less current maturities</b>	158,140,643	105,747,430
<b>OTHER LIABILITIES</b>		
Post retirement benefits other than pensions	3,450,816	3,181,875
Accrued pension liability	1,379,815	2,183,614
Total other liabilities	4,830,631	5,365,489
<b>COMMITMENTS AND CONTINGENCIES (NOTE 7)</b>		
<b>CURRENT LIABILITIES</b>		
Current maturities of long-term debt	4,772,112	3,960,629
Accounts payable		
Purchased power and cooperative payables	7,010,741	9,117,070
Regulatory liabilities – energy optimization	642,789	830,546
Other	255,809	274,280
Power supply cost recovery	455,425	-
Customer deposits	2,053,020	2,281,108
Accrued liabilities	4,615,375	3,680,380
Line of credit borrowings	-	14,500,000
Total current liabilities	19,805,271	34,644,013
<b>DEFERRED TAX LIABILITY</b>	527,978	562,531
<b>DEFERRED CREDITS</b>	14,927	10,580
Total liabilities, equities and margins	\$ 239,518,804	\$ 199,298,686

# Midwest Energy Cooperative

## Consolidated Statements of Operations

	Years Ended December 31,	
	2017	2016
OPERATING REVENUES	\$ 88,517,038	\$ 87,748,170
OPERATING EXPENSES		
Cost of power	47,356,174	50,960,882
Cost of goods sold	2,811,222	3,057,160
Distribution – operations	2,764,651	2,440,108
Distribution – maintenance	9,373,263	6,786,498
Customer accounts	2,363,844	2,157,063
Customer service and information expense	2,503,384	2,281,374
Administrative and general	8,413,160	6,894,145
Depreciation and amortization	7,490,002	6,338,419
Taxes – property	2,635,530	2,242,701
Total operating expenses	85,711,230	83,158,350
OPERATING MARGINS BEFORE FIXED CHARGES	2,805,808	4,589,820
FIXED CHARGES		
Interest on long-term debt	4,180,829	3,416,920
Other interest	-	119,090
Total fixed charges	4,180,829	3,536,010
OPERATING MARGINS (DEFICITS) AFTER FIXED CHARGES	(1,375,021)	1,053,810
G&T AND OTHER CAPITAL CREDITS	3,594,185	4,548,655
NET OPERATING MARGINS	2,219,164	5,602,465
NON-OPERATING MARGINS		
Interest and dividend income	143,257	240,864
Gain (loss) on sale of assets	(38,951)	64,659
Other income (expense)	705,205	(306,663)
Income tax benefit (expense)	16,603	(335,384)
Total non-operating margins (deficits)	826,114	(336,524)
NET MARGINS	3,045,278	5,265,941
COMPREHENSIVE LOSS		
Unrealized gain (loss) on pension and post-retirement benefits other than pensions	354,470	(1,109,469)
COMPREHENSIVE INCOME	\$ 3,399,748	\$ 4,156,472

## Midwest Energy Cooperative Consolidated Statements of Equities and Margins

	Years Ended December 31,	
	2017	2016
Patronage capital		
Balance at January 1,	\$ 58,554,284	\$ 53,994,103
Transfer of current year Cooperative net operating margins	1,664,221	4,743,410
Retirement of capital credits, net	<u>(191,638)</u>	<u>(183,229)</u>
Balance at December 31,	<u>60,026,867</u>	<u>58,554,284</u>
Non-operating margins		
Balance at January 1,	2,900,665	2,965,067
Current year Cooperative non-operating margins (deficits)	<u>783,645</u>	<u>(64,402)</u>
Balance at December 31,	3,684,310	2,900,665
Undistributed subsidiary earnings		
Balance at January 1,	468,999	(117,936)
Income from subsidiary, excluded from net operating and non-operating margins	<u>597,412</u>	<u>586,935</u>
Balance at December 31,	1,066,411	468,999
Other equity		
Balance at January 1,	1,914,138	1,896,975
Additions	<u>22,601</u>	<u>17,163</u>
Balance at December 31,	<u>1,936,739</u>	<u>1,914,138</u>
Accumulated other comprehensive loss		
Balance at January 1,	(10,869,443)	(9,759,974)
Unrealized gain (loss) on pension and post-retirement benefits other than pensions	<u>354,470</u>	<u>(1,109,469)</u>
Balance at December 31,	<u>(10,514,973)</u>	<u>(10,869,443)</u>
Total equities and margins	<u>\$ 56,199,354</u>	<u>\$ 52,968,643</u>

## Midwest Energy Cooperative

### Consolidated Statements of Cash Flows

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	December 31,	
	2017	2016
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net margins	\$ 3,045,278	\$ 5,265,941
Adjustments to reconcile net margins to net cash provided by operating activities		
Depreciation and amortization	7,490,002	6,338,419
Capital credits allocated	(3,594,185)	(4,548,655)
Gain (loss) on disposal of assets	38,951	(64,659)
Deferred taxes	(34,553)	292,976
Changes in assets and liabilities		
Customer and other accounts receivable	(359,270)	(1,386,503)
Unbilled revenue	(729,360)	(311,459)
Inventory of subsidiary	254,035	(84,914)
Power supply cost recovery	526,681	451,967
Other current assets and income tax receivable	165,972	184,403
Deferred charges	-	103
Accrued pension liability	(405,650)	(609,344)
Post-retirement benefits other than pensions	225,262	218,783
Accounts payable	(2,124,800)	2,798,020
Regulatory liabilities	(187,757)	(230,302)
Customer deposits	(228,088)	(134,563)
Deferred credits	4,347	10,580
Current and accrued liabilities – other	934,995	838,761
	<u>5,021,860</u>	<u>9,029,554</u>
Net cash provided by operating activities		
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Construction and acquisition of plant, net of retirements	(40,902,589)	(41,131,761)
Net proceeds from sale of plant	73,462	134,321
(Increase) decrease in		
Materials inventory	(127,196)	159,373
Notes receivable	351	21,817
Investments – associated organizations	2,040,704	1,783,129
	<u>(38,915,268)</u>	<u>(39,033,121)</u>
Net cash used in investing activities		

## Midwest Energy Cooperative Consolidated Statements of Cash Flows

	December 31,	
	2017	2016
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Advances on long-term debt	\$ 56,373,582	\$ 20,334,410
Proceeds from line of credit	23,000,000	11,000,000
Payments on line of credit	(37,500,000)	-
Cushion of credit payment to RUS	390,520	2,260,852
Grant receivable	14,807	77,033
Retirement of patronage capital credits, net	(191,638)	(183,229)
Other equity	22,601	17,163
Payments on long-term debt	(3,559,406)	(3,569,714)
	<u>38,550,466</u>	<u>29,936,515</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	4,657,058	(67,052)
<b>CASH AND CASH EQUIVALENTS – beginning</b>	<u>2,374,804</u>	<u>2,441,856</u>
<b>CASH AND CASH EQUIVALENTS – ending</b>	<u>\$ 7,031,862</u>	<u>\$ 2,374,804</u>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Cash paid for interest	<u>\$ 3,677,413</u>	<u>\$ 3,599,958</u>
Cash paid for property taxes	<u>\$ 2,370,833</u>	<u>\$ 2,447,174</u>
Cash paid for income taxes	<u>\$ 29,000</u>	<u>\$ 113,000</u>

# Midwest Energy Cooperative

## Notes to Consolidated Financial Statements

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### Note 1 – Nature of Organization and Operations

Midwest Energy Cooperative (Midwest or Cooperative) is a non-profit organization generally exempt from income tax under Section 501(c)(12) of the United States Internal Revenue Code. The Cooperative is engaged principally in the distribution and sale of electricity in Southwest and Southeast Michigan, Northern Indiana and Northern Ohio.

Midwest Energy, Inc. and Subsidiary, a wholly-owned subsidiary of the Cooperative, is a Michigan corporation, which was incorporated and commenced doing business January 30, 1998. Midwest Energy, Inc. and Subsidiary's principal business activity is providing propane services. The main office is located in Cassopolis, Michigan.

The Cooperative began a project for communication and fiber to the home in 2013. This includes providing phone and high-speed broadband to 5,879 members in their service territory. It was under construction in 2016 and 2017.

### Note 2 – Summary of Significant Accounting Policies

#### Use of estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Specific estimates include allowance for doubtful accounts, unbilled revenue, depreciation and postretirement benefit obligation. Actual results could differ from those estimates.

#### Principles of consolidation

The consolidated financial statements for 2017 and 2016 combine the financial results of the Cooperative and its wholly owned subsidiary Midwest Energy, Inc. and subsidiary. The Cooperative has accounted for the investment using the equity method. All significant intercompany transactions and accounts have been eliminated.

#### Accounting records

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as applied to regulated enterprises, which conform to policies prescribed or permitted by the Michigan Public Service Commission (MPSC) and United States Department of Agriculture Rural Utilities Service (RUS). The applicable uniform system of accounts prescribed by these regulatory commissions conform in all material respects with generally accepted accounting principles as applied to rate regulated utilities.

The accounting records 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.

# Midwest Energy Cooperative

## Notes to Consolidated Financial Statements

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### **Note 2 – Summary of Significant Accounting Policies (continued)**

#### **Electric plant and equipment**

Additions with a life expectancy of more than one year are recorded at the cost of construction, which includes the cost of contracted services, direct labor and materials, and overhead items, less contributions in aid of construction received from customers. As items are retired or otherwise disposed of, the asset account is credited for the cost and the accumulated depreciation account is charged. The cost of removal, less salvage, is also charged to the accumulated depreciation account.

#### **Cash and cash equivalents**

Cash and cash equivalents include cash in bank and all short-term debt securities purchased with a maturity of three months or less to be cash equivalents. The Cooperative places its cash and investments with high credit quality financial institutions. At times, such cash and investments may be in excess of the FDIC insurance limit.

#### **Fair value of financial instruments**

Financial instruments include cash, investments and long-term debt. Investments in associated organizations are not considered financial instruments because they represent nontransferable interests in associated organizations.

#### **Investments in associated organizations**

The carrying values of investments in associated organizations are stated at cost, adjusted for capital credits earned or retired.

#### **Accounts receivable**

Accounts receivable consist primarily of amounts due from members for electric service. An allowance for doubtful accounts has been estimated based on collection history. When a member's account becomes past due and uncollectible, the member's service is terminated. The Board of Directors approve all accounts charged off.

#### **Purchased power billing**

Refundable or recoverable power supply cost recovery (PSCR) credit-over collections, as well as under collections of the cost of electricity purchased not recovered or refunded through rates, are deferred and are being refunded or recovered in accordance with procedures approved by the Board.

#### **Materials and supplies**

Electrical materials and supplies are valued at lower of average cost or net realizable value.

#### **Inventory of subsidiary**

Propane inventory is recorded at the lower of cost or net realizable value using average cost.

# Midwest Energy Cooperative

## Notes to Consolidated Financial Statements

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### Note 2 – Summary of Significant Accounting Policies (continued)

#### Revenue recognition

The Cooperative utilizes cycle billing and records revenue billed to its electric and propane customers primarily when the meters are read (electric) or when propane is delivered (propane).

In addition, the Cooperative records unbilled revenue for electric power and propane delivered but not yet billed at the end of the fiscal year.

The Cooperative bills its fiber customers in advance of services and records unearned revenue for services billed but not yet performed at the end of the fiscal year.

#### Recognition of patronage revenue

Patronage revenue of associated organizations is recognized in the year in which the associated organization allocates its earnings to their respective members.

#### Advertising

The cost of advertising is expensed as incurred.

#### Regulation and regulatory accounting

The MPSC has jurisdiction over regulated Rural Electric Cooperatives in Michigan. On May 24, 2015, the Board of Directors voted to become member-regulated as of August 24, 2015. On that date, the Cooperative became self-regulated for rates, billing practices, and accounting standards. MPSC regulated the Cooperative's electric utility business operations and rates prior to August 24, 2015. All other aspects of electric service continue to be regulated by MPSC. Due to regulation of its rates by the Board, the Cooperative follows regulatory accounting requirements. Regulatory accounting requirements recognize that the ratemaking process can result in differences in the application of generally accepted accounting principles between regulated and non-regulated businesses. Such differences generally involve the accounting period in which various transactions enter into the determination of net margins. Accordingly, certain costs and income may be capitalized as a regulatory asset or liability that would otherwise be charged to expense or revenues. Regulatory assets and liabilities are recorded when it is probable that future rates will permit recovery and are approved by the Board.

#### Unclaimed property

Unclaimed property represents refunds to members of deposits, membership fees received and patronage refunds received which have not been claimed. After five years and appropriate notification, such amounts may be credited back to the cooperative as donated capital.

## Midwest Energy Cooperative

### Notes to Consolidated Financial Statements

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#### **Note 2 – Summary of Significant Accounting Policies (continued)**

##### **Compensated absences**

The Cooperative provides a flexible leave program to meet the needs of their unique employee base. Each regular employee will earn Paid Time Off (PTO) in increments that are based on their length of service on a bi-weekly basis. PTO is added to the employee's PTO bank when the bi-weekly paycheck is issued and subtracted from the employee's bank as used. Each employee may carry over unused hours of PTO, provided they do not exceed the maximum level based on years of service detailed in their accrual schedule. The Cooperative's policy on accumulated extended sick leave is to grant 48 hours annually with any unused hours available to be carried forward to future years up to a maximum of 800 hours. Employees may use extended sick leave hours on their 4th consecutive day of absence due to their own personal illness or injury. It is the Cooperative's policy to pay one-half of the employee's accumulated unused sick leave upon normal retirement, provided that their extended sick leave bank is equal to or greater than 520 hours.

The payout is capped at 260 hours and will be reduced by any PTO payouts taken during the employee's tenure. For the years ended December 31, 2017 and 2016, an accrual has been made for individuals who meet the required qualifications and have attained the age of 60, which has been included in accrued liabilities on the balance sheet.

##### **Cushion of credit**

RUS established a Cushion of Credit Payment Program, whereby borrowers may make advance payments on their RUS and Federal Financing Bank (FFB) notes. These advance payments earn interest at the rate of 5.0% per annum. The advance payments, plus any accrued interest, can only be used for the payment of principal and interest on the notes. The Cooperative's participation in the Cushion of Credit Payment Program totaled approximately \$390,520 and \$2,260,852 at December 31, 2017 and 2016, respectively, and is recorded as a reduction of RUS long-term debt on the balance sheets.

##### **Concentration of credit risk**

Financial instruments that are exposed to concentrations of credit risk consist primarily of cash, including temporary investments and receivables. Credit is extended to customers generally without collateral requirements; however, deposits are obtained from certain customers and formal shut-off procedures are in place.

##### **Income taxes**

The Cooperative is exempt from federal and state income taxes under Section 501(c)(12) of the Internal Revenue Code. The Cooperative adopted Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 740-10, relating to accounting for uncertain tax positions. As of December 31, 2017 and 2016, the Cooperative does not have any uncertain tax positions. The Cooperative files an exempt organization tax return in the U.S. federal jurisdiction and the state of Michigan.

# Midwest Energy Cooperative

## Notes to Consolidated Financial Statements

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### **Note 2 – Summary of Significant Accounting Policies (continued)**

Midwest Energy, Inc. and Subsidiary is a taxable for-profit corporation for both federal and state tax purposes. Income taxes are provided for in the consolidated financial statements and consist of taxes currently due plus deferred taxes. Deferred taxes are provided on an asset and liability approach whereby deferred tax assets are recognized for deductible temporary differences and operating loss carryforwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion of or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

#### **Patronage capital**

Cooperative operating margins are assigned to individual Cooperative members' capital credit accounts based upon their revenue. Amounts are assigned to members within eight months after year end. Non-operating margins are allocated to members at the discretion of the Board of Directors. Capital credits are returned to members in accordance with the Cooperative's bylaws.

#### **Assets pledged**

Substantially all assets are pledged as collateral on long-term debt payable to the Rural Utilities Service (RUS) of the United States of America, the National Rural Utilities Cooperative Finance Corporation (CFC), and CoBank Cooperative.

#### **Subsequent events**

Accounting standards require disclosure of the date through which subsequent events have been evaluated, as well as whether the date is the date the financial statements were issued or the date the financial statements were available to be issued. The Cooperative has evaluated subsequent events through March 30, 2018, the date the financial statements were available to be issued.

## Midwest Energy Cooperative Notes to Consolidated Financial Statements

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### Note 3 – Electric Plant and Equipment and Depreciation Rates

Major classes of electric plant and equipment as of December 31, 2017 and 2016, consisted of:

	2017	2016
Cost		
General plant	\$ 64,908,055	\$ 29,872,828
Transmission plant	6,451,461	6,451,461
Distribution plant	149,764,439	147,015,113
Fiber plant	34,433,797	22,595,599
Construction in progress	9,314,532	22,443,390
Total cost	264,872,284	228,378,391
Accumulated depreciation and amortization	71,393,337	68,199,618
Net electric plant and equipment	\$ 193,478,947	\$ 160,178,773

Provision has been made for depreciation of the distribution plant at a straight-line composite rate of 3.0 percent per annum, except for ONTs and meters which are being depreciated at the rate of 20.0 percent and 4.6 percent per annum. Depreciation of the subsidiary's assets is computed over the estimated useful life of the assets on a straight-line method for financial reporting and an accelerated method for income tax purposes.

General plant depreciation rates have been applied on a straight-line basis as follows:

Structures and improvements	2.00%
Office furniture, fixtures, data processing, and laboratory equipment	4.80–20.00%
Transportation equipment	10.0–33.3%
Stores, tools, and power operated equipment	6.00%
Communications	8.40%
Miscellaneous	9.60%
Propane tanks	3.33%

## Midwest Energy Cooperative

### Notes to Consolidated Financial Statements

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#### Note 4 – Investments in Associated Organizations

Investments in associated organizations consisted of the following at December 31, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
National Rural Utilities Cooperative Finance Corp. (CFC)		
Capital term certificates, 5.00% maturing through 2080	\$ 1,049,571	\$ 1,049,571
Loan term certificates, 3.00% maturing through 2035	206,000	206,000
Patronage capital		
CFC	412,807	402,250
National Information Solutions Cooperative	282,336	256,691
Wabash Valley Power Association	7,525,455	8,124,525
Buckeye Power, Inc.	987,883	944,715
Wolverine Power Supply Cooperative, Inc.	13,395,117	11,444,639
Federated Rural Electric Insurance Cooperative, at cost	249,101	261,468
Buckeye Power, Inc. – membership	98,889	98,889
Resco (WISC)	567,959	599,499
NRTC	213,486	199,568
Other	359,461	206,769
	<u>\$ 25,348,065</u>	<u>\$ 23,794,584</u>

The accounting policies for recognition of patronage revenue are described in Note 2. Investments are pledged to secure long-term debt as described in Note 5.

#### Note 5 – Long-Term Debt

Long-term debt is composed of mortgage notes payable to the Rural Utilities Service (RUS) of the United States of America, the National Rural Utilities Cooperative Finance Corporation (CFC), the Federal Financing Bank (FFB), and CoBank Cooperative. Several mortgage notes to CFC and RUS will be repriced and the interest rate adjusted accordingly during the next 10 years in accordance with the policy and procedure governing such repricing. The notes are scheduled to be fully repaid at various times from 2018 through 2052. Unadvanced loan funds were available from RUS at December 31, 2017 and 2016, in the amount of \$32,858,229 and \$48,224,371, respectively.

Midwest Energy, Inc. and Subsidiary long-term debt is composed of mortgage notes payable to National Cooperative Services Corporation (NCSC). These notes are secured by substantially all assets of the organization and guaranteed by the Cooperative.

## Midwest Energy Cooperative

### Notes to Consolidated Financial Statements

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#### Note 5 – Long-Term Debt (continued)

Detail of the long-term debt is as follows:

	2017	2016
Cooperative		
Notes payable to CFC in quarterly installments of \$259,679, including interest at 5.25%–7.35%, with final maturity ranging from 2018 to 2032. Secured by substantially all assets.	\$ 3,376,043	\$ 3,625,378
Notes payable to Cobank in monthly installments of \$375,861, including interest at 3.49%–3.83%, with final maturity ranging from 2032 to 2037. Secured by substantially all assets.	53,445,737	55,818,232
Notes payable to FFB in quarterly installments of \$279,182, including interest at 2.20%–3.94%, with final maturity ranging from 2042 to 2052. Secured by substantially all assets.	105,980,066	51,842,542
RUS advance payments (cushion of credit)	(390,520)	(2,260,852)
Midwest Energy, Inc. and Subsidiary		
Notes payable to NCSC in quarterly installments including interest at 3.70%, per annum, with final maturity ranging from 2018 to 2023.	501,429	682,759
	162,912,755	109,708,059
Less current maturities	4,772,112	3,960,629
TOTAL LONG-TERM DEBT, less current maturities	\$ 158,140,643	\$ 105,747,430

Maturities of long-term debt for each of the next five years are as follows:

2018	\$ 4,772,112
2019	5,592,700
2020	5,828,944
2021	6,042,070
2022	6,016,518
Thereafter	134,660,411
	\$ 162,912,755

# Midwest Energy Cooperative

## Notes to Consolidated Financial Statements

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### Note 6 – Line of Credit

The Cooperative has available a line of credit with CFC in the amount of \$10,000,000 for both 2017 and 2016. The Cooperative had no balance outstanding as of December 31, 2017 and 2016. The interest rate at December 31, 2017 was 2.75%.

The Cooperative has available a line of credit with CoBank in the amount of \$50,000,000 for 2017 and 2016. The Cooperative had an outstanding balance of \$0 for 2017 and \$14,500,000 for 2016. Interest at December 31, 2017 and 2016, was 3.97% and 3.02%, respectively.

The Cooperative also had a \$5,000,000 unsecured promissory note from Wolverine Power Supply Cooperative. Interest on advances was charged at 1.25%. The note expired December 31, 2016. In January 2016, the Cooperative renewed and increased the unsecured promissory note to \$8,000,000. The note expired December 31, 2016. Interest charges during the year ended December 31, 2016, have been included in other interest on the consolidated statement of operations.

Midwest Energy, Inc. and Subsidiary had available a \$3,750,000, 60 month revolving line of credit with NCSC for 2017 with a variable interest rate. The line of credit matures in 2018. Midwest Energy, Inc. and Subsidiary has an outstanding balance of \$0 as of December 31, 2017 and 2016. Interest at December 31, 2017, is 3.70%. The agreement provides that Midwest Energy Cooperative unconditionally guarantee all amounts due on the loan.

### Note 7 – Commitments and Contingencies

#### Wholesale power commitment

Under its wholesale power agreement, the Cooperative is committed to purchase most of its electric power and energy requirements from Wolverine Power Supply Cooperative, Inc., until December 31, 2050. The rates paid for such purchases are subject to approval of the Federal Energy Regulatory Commission (FERC).

#### Propane purchase commitment

Midwest Energy, Inc. and Subsidiary have entered into contracts with Plains Marketing Canada, L.P. to buy propane gas for a specific period, in agreed upon quantities and at agreed upon prices. These transactions lock in the price Midwest Energy, Inc. and Subsidiary will be paying for such gas in the upcoming heating season. Upon entering these contracts, Midwest Energy, Inc. and Subsidiary pays a security deposit for such commitments. This deposit is deducted from each invoice for propane gas upon delivery. As of December 31, 2017, Midwest Energy's related commitment to buy such propane gas from January 1, 2018 through December 31, 2018, totaled 2,239,700 gallons at an average price per gallon of \$0.66. As of December 31, 2017, Midwest Energy also had another commitment to buy propane gas from January 1, 2018 through July 31, 2019 that totaled 342,000 gallons at a price per gallon of \$0.68. In the event that all gallons are not purchased during the agreed upon period, Midwest Energy is obligated to buy such unpurchased propane gas in subsequent months, at escalating prices.

## **Midwest Energy Cooperative**

### **Notes to Consolidated Financial Statements**

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#### **Note 7 – Commitments and Contingencies**

##### **Legal**

In the normal course of business, Midwest is a party to claims and matters of litigation. The ultimate outcome of these matters cannot presently be determined; however, in the opinion of management of the Cooperative, the resolution of these matters will not have a material adverse effect on Midwest's financial position, results of operations or liquidity.

##### **Union contracts**

The Cooperative has an agreement with two separate unions. One union represents 16 inside staff including the customer service and billing employees. The other union represents 33 outside staff. As of December 31, 2017, 40% of the employees were covered by the two union contracts. The agreement for inside employees expires on July 14, 2019. The agreement with outside employees expires August 31, 2019.

#### **Note 8 – Retirement Plans**

The Cooperative has a defined benefit pension plan covering 49 employees. As of January 1, 2007, the plan was closed to all new non-union staff and inside union staff. As of January 1, 2009, the plan was closed to all new outside union staff. Retirement benefits are based on a percentage of compensation, as defined in the plan, and benefits vested after completion of five years of service or age 55. The normal retirement age is 62. The assets of the plan consist primarily of mutual funds. The Cooperative's funding policy is to contribute so as to amortize the unfunded actuarial accrued liabilities over a 30-year period from January 1, 1987.

## Midwest Energy Cooperative

### Notes to Consolidated Financial Statements

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#### Note 8 – Retirement Plans (continued)

The following table sets forth the plan's funded status and amounts recognized in the Cooperative's financial statements at December 31, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Actuarial present value of benefit obligations		
Accumulated benefit obligation, including vested benefits	<u>\$ 29,497,900</u>	<u>\$ 25,631,176</u>
Change in benefit obligation		
Benefit obligation at beginning of year	\$ 28,956,942	\$ 26,191,058
Service cost	919,752	860,109
Interest cost	1,209,208	1,187,539
Actuarial loss	3,118,007	1,353,552
Benefits paid	(781,491)	(635,316)
Other - freeze highly compensation employees	<u>(394,750)</u>	<u>-</u>
Benefit obligation at end of year	<u>\$ 33,027,668</u>	<u>\$ 28,956,942</u>
Change in plan assets		
Fair value of plan assets at beginning of year	\$ 26,826,638	\$ 24,427,443
Actual return on plan assets	4,202,706	1,434,511
Employer contributions	1,400,000	1,600,000
Benefits paid	<u>(781,491)</u>	<u>(635,316)</u>
Fair value of plan assets at end of year	<u>\$ 31,647,853</u>	<u>\$ 26,826,638</u>
Reconciliation of funded status		
Funded status underfunded	<u>\$ (1,379,815)</u>	<u>\$ (2,130,304)</u>
Service cost – benefits earned during the period	\$ 919,752	\$ 860,109
Interest cost on projected benefit obligation	1,209,208	1,187,539
Return on plan assets	(1,768,891)	(1,677,870)
Net amortization and deferral	683,185	594,864
Amortization of prior service cost	<u>-</u>	<u>10,487</u>
Net periodic pension cost	<u>\$ 1,043,254</u>	<u>\$ 975,129</u>
Amounts recognized in accumulated other comprehensive loss – ending	<u>\$ (10,092,257)</u>	<u>\$ (10,486,000)</u>

## Midwest Energy Cooperative

### Notes to Consolidated Financial Statements

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#### Note 8 – Retirement Plans (continued)

The Cooperative expects to contribute \$1,000,000 to its pension plan in 2018. Future expected benefit payments are as follows:

2018	\$ 1,030,000
2019	1,080,000
2020	1,140,000
2021	1,190,000
2022	1,230,000
2023-2027	6,950,000

The investment strategy is to build an efficient, well-diversified portfolio based on long-term, strategic outlook of the investment markets. The investment market outlook utilizes both historical-based and forward looking return forecasts to establish future return expectations for various asset classes. These return expectations are used to develop a core asset allocation based on the needs of the plan. The core asset allocation utilizes investment portfolios of various asset classes and multiple investment managers in order to help maximize the plans return while providing multiple layers of diversification to help minimize risk.

The plan investments are stated at fair market value. There were no restricted investments as of December 31, 2017 and 2016. The Cooperative has determined that its investments in the pension plan fall into the Level 1 category. Level 1 asset valuations are based on assets at the quoted prices in active markets for identical assets, level 2 asset valuations are based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly and level 3 asset valuations based on inputs that are unobservable and significant to the overall fair value measurement.

Asset allocation for Midwest Energy Cooperative as of December 31 as follows:

	2017	2016
U.S. Large cap equity	\$ 10,276,601	\$ 8,784,955
U.S. small/mid cap equity	1,831,765	1,599,475
International equity	5,111,421	3,501,889
Balanced	629,157	542,551
Fixed income	11,939,056	10,788,581
Other	1,859,853	1,609,187
Total	\$ 31,647,853	\$ 26,826,638

Weighted-average assumptions used to determine net periodic benefit costs as of December 31 were:

	2017	2016
Discount rate	4.25%	4.60%
Expected long-term return on plan assets	6.50%	6.75%
Rate of compensation increase	3.25%	3.50%

## Midwest Energy Cooperative

### Notes to Consolidated Financial Statements

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#### Note 8 – Retirement Plans (continued)

The Cooperative established an unfunded 457(f) deferred compensation plan in 2014 for the purposes of providing benefits for a select group of management or highly compensated employees within the regulations of the Employee Retirement Income Security Act (ERISA). New participants may be added to the plan at the discretion of the Board of Directors.

The plan provides for a deferred compensation benefit equal to the difference between the single lump sum actuarial equivalents of the benefit that the Participant would have accrued under the Cooperative Pension Plan as calculated by the Cooperative without application of the limitations provided in Sections 415 and 401(a)(17) of the Code, and the Participant's accrued benefit under the Cooperative Pension Plan as calculated by the Cooperative after application of those limitations under Code Sections 415 and 401(a)(17). The missed benefit is calculated each year and is recorded to accrued pension liability on the consolidated balance sheet. As of December 31, 2017 and 2016, the related liability for this plan was approximately \$0 and \$53,000, respectively.

The participant becomes fully vested in the 457(f) plan if the participant remains employed by the Cooperative until the earliest of the following occur: the participant's date of death; the date of the Participant's disability; the Participant's involuntary termination of employment by the Cooperative without just cause; or the vesting date established by the Participant. If the Participant has a separation from service prior to the earliest of the dates set forth above, all of the Participant's rights to any such benefits under this plan will be forfeited.

#### Note 9 – Post-Retirement Benefits Other Than Pensions

The Cooperative sponsors a defined benefit post-retirement plan that covers both salaried and non-salaried employees, but none of its subsidiary employees. The plan provides for medical benefits for retirees between the ages of 60 and 65. The Cooperative's funding policy is pay-as-you-go.

The following table sets forth the plan's combined funded status reconciled with the amount shown in the Cooperative's consolidated financial statements at December 31, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Accrued post-retirement benefit costs, beginning	\$ (3,181,875)	\$ (2,845,185)
Net periodic post-retirement costs	(325,565)	(292,675)
Contributions made	100,303	73,775
Actuarial adjustment	<u>(43,679)</u>	<u>(117,790)</u>
Accrued post-retirement benefit cost, end of year	<u>\$ (3,450,816)</u>	<u>\$ (3,181,875)</u>

## Midwest Energy Cooperative Notes to Consolidated Financial Statements

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### Note 9 – Post-Retirement Benefits Other Than Pensions (continued)

Net periodic post-retirement benefit cost includes the following components:

	<u>2017</u>	<u>2016</u>
Service cost-benefits attributed to service during the period	\$ 192,885	\$ 163,889
Interest cost	132,680	128,786
Net amortization and deferral	<u>-</u>	<u>-</u>
Net periodic post-retirement benefit cost	<u>\$ 325,565</u>	<u>\$ 292,675</u>

Amounts recognized in accumulated other comprehensive loss:

Net actuarial gains	\$ (422,716)	\$ (383,443)
Net prior service cost	<u>-</u>	<u>-</u>
Total recognized in other comprehensive income	<u>\$ (422,716)</u>	<u>\$ (383,443)</u>

In 2019, medical costs are expected to increase 7.0% for pre-65 medicals, 6.0% for post-65 medical, and then drop to 4.5% per year in 2026 and after for both categories.

The weighted average discount rate used in determining the accumulated post-retirement benefit obligation is 3.69% and 4.25% for 2017 and 2016, respectively.

Benefit payments of \$180,000 are expected for 2018, \$230,000 for 2019, \$210,000 for 2020, \$230,000 for 2021, \$230,000 for 2022, and \$1,240,000 for 2023-2027.

### Note 10 – Income Taxes

The provision for income taxes consists of the following as of and for the year ended December 31:

	<u>2017</u>	<u>2016</u>
Current	\$ 17,950	\$ 42,408
Deferred	207,598	292,976
Deferred – Change in federal rate	<u>(242,151)</u>	<u>-</u>
Income tax (benefit) expense	<u>\$ (16,603)</u>	<u>\$ 335,384</u>

## Midwest Energy Cooperative

### Notes to Consolidated Financial Statements

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#### Note 10 – Income Taxes (continued)

The “Tax Reform Act” was enacted December 22, 2017. The law includes significant changes to the U.S. corporate system, including a Federal corporate rate reduction from 34% to 21%. As a result of when the Act was signed into law, the Company’s deferred tax assets and liabilities were required to be remeasured using the lower 21% federal rate as of December 31, 2017. This resulted in a one-time favorable charge to tax expense of \$242,151.

The net deferred tax liability as of December 31 consists of the following:

	<u>2017</u>	<u>2016</u>
Deferred tax assets (liabilities)		
Allowance for bad debt	\$ 11,020	\$ 22,715
Tax depreciation greater than book	(771,087)	(1,022,216)
Net operating losses	199,430	399,640
AMT credits	37,772	41,587
Other	<u>(5,113)</u>	<u>(4,257)</u>
Net deferred tax liability	<u>\$ (527,978)</u>	<u>\$ (562,531)</u>

As of December 31, 2017, Midwest Energy, Inc. had \$37,772 in AMT credits available which do not have an expiration date. At December 31, 2017, Midwest Energy, Inc. had an unused federal net operating loss carryforward of \$950,000, which will begin expiring in 2025.

#### Note 11 – Related Party Transactions

Midwest Energy, Inc. and Subsidiary is a wholly-owned subsidiary of Midwest Energy Cooperative. In addition, Midwest Energy Cooperative has furnished some personnel, office space, and other necessary operating facilities such as computer time for Midwest Energy, Inc. and Subsidiary’s operations. During the year, Midwest Energy Cooperative charged Midwest Energy, Inc. and Subsidiary’s operations for such services. The 2017 and 2016 inter-company balance includes a \$552,894 and \$1,700,016, respectively, non-interest bearing fund advancement, which are expected to be repaid in 2018. During the year ended December 31, 2017, Midwest Energy, Inc. advanced a note payable to the Cooperative for the fiber activity in the amount of \$4,539,272 and \$3,240,272 for 2017 and 2016, respectively, bearing an interest rate of 3.50%. There is currently no firm payment plan established on the note payable due to Midwest Energy, Inc. and Subsidiary. These transactions have been eliminated in the consolidated financial statements.

## **Supplementary Information**

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**Midwest Energy Cooperative**  
**Consolidating Balance Sheets**  
**December 31, 2017**

	Midwest Energy Cooperative	Midwest Energy Inc. and Subsidiary	Eliminations	Consolidated Total
<b>ASSETS</b>				
<b>ELECTRIC PLANT</b>				
In service – at cost	\$ 247,929,278	\$ 7,628,474	\$ -	\$ 255,557,752
Construction work in progress	9,314,532	-	-	9,314,532
	257,243,810	7,628,474	-	264,872,284
Less accumulated depreciation	67,104,760	4,288,577	-	71,393,337
Net electric plant	190,139,050	3,339,897	-	193,478,947
<b>OTHER ASSETS AND INVESTMENTS</b>				
Investments in associated organizations	32,913,576	1,000	(7,566,511)	25,348,065
Notes receivable	161,702	4,539,272	(4,539,272)	161,702
Receivables from subsidiary	357,973	-	(357,973)	-
Income taxes receivable	-	16,719	-	16,719
Grant receivable	119,692	-	-	119,692
Total other assets and investments	33,552,943	4,556,991	(12,463,756)	25,646,178
<b>CURRENT ASSETS</b>				
Cash and cash equivalents	6,661,801	370,061	-	7,031,862
Accounts receivable, less allowance for doubtful accounts of approximately \$462,000	4,110,065	811,815	-	4,921,880
Accounts receivable, associated organizations	-	910,868	(910,868)	-
Unbilled revenue	5,206,029	-	-	5,206,029
Current portion of notes receivable	60,000	-	-	60,000
Materials and supplies	2,256,124	-	-	2,256,124
Inventory of subsidiary	-	321,999	-	321,999
Other current assets and accrued assets	193,367	333,238	(73,120)	453,485
Total current assets	18,487,386	2,747,981	(983,988)	20,251,379
<b>DEFERRED CHARGES</b>	142,300	-	-	142,300
Total assets	\$ 242,321,679	\$ 10,644,869	\$ (13,447,744)	\$ 239,518,804

**Midwest Energy Cooperative**  
**Consolidating Balance Sheets**  
**December 31, 2017**

	<u>Midwest Energy Cooperative</u>	<u>Midwest Energy Inc. and Subsidiary</u>	<u>Eliminations</u>	<u>Consolidated Total</u>
<b>LIABILITIES, EQUITIES, AND MARGINS</b>				
<b>EQUITIES</b>				
Patronage capital and other equities	\$ 56,199,354	\$ 7,566,511	\$ (7,566,511)	\$ 56,199,354
<b>LONG-TERM DEBT, NET OF CURRENT MATURITIES</b>	<u>157,745,345</u>	<u>395,298</u>	<u>-</u>	<u>158,140,643</u>
<b>OTHER LIABILITIES</b>				
Post-retirement benefits other than pensions	3,450,816	-	-	3,450,816
Accrued pension liability	<u>1,379,815</u>	<u>-</u>	<u>-</u>	<u>1,379,815</u>
Total other liabilities	<u>4,830,631</u>	<u>-</u>	<u>-</u>	<u>4,830,631</u>
<b>COMMITMENTS AND CONTINGENCIES (NOTE 7)</b>				
<b>CURRENT LIABILITIES</b>				
Current maturities of long-term debt	4,665,981	106,131	-	4,772,112
Accounts payable				
Purchased power and cooperative payables	7,010,741	-	-	7,010,741
Regulatory Liabilities – energy optimization	642,789	-	-	642,789
Associated organizations	910,868	357,973	(1,268,841)	-
Other	78,346	194,183	(16,720)	255,809
Power supply cost recovery	455,425	-	-	455,425
Customer deposits	661,795	1,391,225	-	2,053,020
Accrued liabilities	4,512,001	103,374	-	4,615,375
Note payable to subsidiary	<u>4,539,272</u>	<u>-</u>	<u>(4,539,272)</u>	<u>-</u>
Total current liabilities	<u>23,477,218</u>	<u>2,152,886</u>	<u>(5,824,833)</u>	<u>19,805,271</u>
<b>DEFERRED TAX LIABILITY</b>	<u>-</u>	<u>527,978</u>	<u>-</u>	<u>527,978</u>
<b>DEFERRED CREDITS</b>	<u>69,131</u>	<u>2,196</u>	<u>(56,400)</u>	<u>14,927</u>
Total liabilities, equities, and margins	<u>\$ 242,321,679</u>	<u>\$ 10,644,869</u>	<u>\$ (13,447,744)</u>	<u>\$ 239,518,804</u>

**Midwest Energy Cooperative**  
**Consolidating Statements of Operations**  
**December 31, 2017**

	Midwest Energy Cooperative	Midwest Energy Inc. and Subsidiary	Eliminations	Consolidated Total
OPERATING REVENUES	\$ 82,762,864	\$ 5,772,299	\$ (18,125)	\$ 88,517,038
OPERATING EXPENSES				
Cost of power	47,356,174	-	-	47,356,174
Cost of goods sold	-	2,811,222	-	2,811,222
Distribution – operations	2,764,651	-	-	2,764,651
Distribution – maintenance	9,373,263	-	-	9,373,263
Customer accounts	2,363,844	-	-	2,363,844
Customer service and information expense	2,503,384	-	-	2,503,384
Administrative and general	6,297,738	2,133,547	(18,125)	8,413,160
Depreciation and amortization	7,109,038	380,964	-	7,490,002
Taxes – property	2,624,275	11,255	-	2,635,530
Total operating expenses	80,392,367	5,336,988	(18,125)	85,711,230
OPERATING MARGINS BEFORE FIXED CHARGES	2,370,497	435,311	-	2,805,808
FIXED CHARGES				
Interest on long-term debt	4,300,461	22,765	(142,397)	4,180,829
Total fixed charges	4,300,461	22,765	(142,397)	4,180,829
OPERATING MARGINS (DEFICITS) AFTER FIXED CHARGES	(1,929,964)	412,546	142,397	(1,375,021)
G&T AND OTHER CAPITAL CREDITS	3,594,185	-	-	3,594,185
NET OPERATING MARGINS	1,664,221	412,546	142,397	2,219,164
NON-OPERATING MARGINS				
Interest and dividend income	143,257	142,397	(142,397)	143,257
Income from subsidiary	597,412	-	(597,412)	-
Gain (loss) on sale of assets	(58,094)	19,143	-	(38,951)
Other income	705,205	-	-	705,205
Income tax benefit (expense)	(6,723)	23,326	-	16,603
TOTAL NON-OPERATING MARGINS (DEFICITS)	1,381,057	184,866	(739,809)	826,114
NET MARGINS	3,045,278	597,412	(597,412)	3,045,278
COMPREHENSIVE LOSS				
Unrealized gain on pension and post-retirement benefits other than pensions	354,470	-	-	354,470
COMPREHENSIVE INCOME	\$ 3,399,748	\$ 597,412	\$ (597,412)	\$ 3,399,748

**Report of Independent Auditors 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  
Midwest Energy Cooperative

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 consolidated financial statements of Midwest Energy Cooperative (the "Cooperative") as of and for the year ended December 31, 2017, and the related notes to the financial statements, which collectively comprise Midwest Energy Cooperative's consolidated financial statements, and have issued our report thereon dated March 30, 2018.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered Midwest Energy 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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Cooperative's internal control. Accordingly, we do not express an opinion on the effectiveness of the Cooperative's internal control.

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

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

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Cooperative's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the 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 entity'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 entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose

*Moss Adams LLP*

Portland, Oregon  
March 30, 2018

