

**MONTANA 19 STILLWATER
BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA**

**FINANCIAL STATEMENTS
AS OF
June 30, 2017 and 2016
AND
INDEPENDENT AUDITORS' REPORT**

**MONTANA 19 STILLWATER
BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA**

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**MONTANA 19 STILLWATER
BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA**

DIRECTORS

<u>Name</u>	<u>Address</u>	<u>Business</u>
Roxie Melton	Boyd, Montana	Business Owner
Julie Lindgren	Red Lodge, Montana	Business Owner
William Pascoe	Absarokee, Montana	Business Owner
Arleen Boyd	Fishtail, Montana	Retired
Dick Nolan	Luther, Montana	Retired
Daniel Dutton	Belfry, Montana	Retired
David Peterson	Reed Point, Montana	Rancher

OFFICERS AND MANAGER

David Peterson	President
Arleen Boyd	Vice President
Julie Lindgreen	Secretary-Treasurer
Kevin P. Owens	General Manager

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Beartooth Electric Cooperative, Inc.
Red Lodge, Montana

Summers McNea, P.C.
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Billings, Montana 59102
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Toll-Free: 1.800.468.5333
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Report on Financial Statements

We have audited the accompanying financial statements of Beartooth Electric Cooperative, Inc. (a non-profit corporation) which comprise the balance sheets as of June 30, 2017 and 2016, and the related statements of revenues and patronage capital, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Beartooth Electric Cooperative, Inc. as of June 30, 2017 and 2016, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued a report dated August 25, 2017, on our consideration of Beartooth Electric Cooperative, Inc.'s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Beartooth Electric Cooperative, Inc.'s internal control over financial reporting and compliance.

A handwritten signature in blue ink that reads "Summers, McNea & Company, P.C." The signature is written in a cursive, flowing style.

Summers, McNea & Company, P.C.
Certified Public Accountant

August 25, 2017



INDEPENDENT AUDITORS' 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

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The Board of Directors
Beartooth Electric Cooperative, Inc.
Red Lodge, Montana

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 Beartooth Electric Cooperative, Inc. which comprise the balance sheets as of June 30, 2017 and 2016, and the related statements of revenues and patronage capital, and cash flows for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated August 25, 2017.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered Beartooth Electric Cooperative, Inc.'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 entity's internal control. Accordingly, we do not express an opinion on the effectiveness of Beartooth Electric Cooperative, Inc.'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 Beartooth Electric Cooperative, Inc.'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 result 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.

A handwritten signature in blue ink that reads "Summers, McNea & Company, P.C." The signature is written in a cursive style.

Summers, McNea & Company, P.C.
Certified Public Accountant

August 25, 2017

BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA
BALANCE SHEETS
June 30, 2017 and 2016

ASSETS-NOTE 11

EQUITIES, MARGINS, LIABILITIES AND OTHER CREDITS

	<u>June 30, 2017</u>	<u>June 30, 2016</u>		<u>June 30, 2017</u>	<u>June 30, 2016</u>
<u>Utility Plant (At Cost):</u>			<u>Equities and Margins-Note 10:</u>		
Electric Plant in Service	\$ 31,302,296	\$ 30,587,026	Patronage Capital	\$ 7,381,775	\$ 6,907,440
Construction Work-In-Progress	231,901	112,742	Other Equities	377,202	246,071
Total Utility Plant	<u>\$ 31,534,197</u>	<u>\$ 30,699,768</u>	Total Equities and Margins	<u>\$ 7,758,977</u>	<u>\$ 7,153,511</u>
Less: Accumulated Provision for Depreciation	14,796,782	14,087,028	<u>Long-Term Debt, Less Current Maturities-Note 11</u>	\$ 10,700,241	\$ 11,313,884
Net Utility Plant	<u>\$ 16,737,415</u>	<u>\$ 16,612,740</u>			
 <u>Other Property and Investments:</u>			 <u>Current Liabilities:</u>		
Investments in CFC-Note 2	\$ 278,907	\$ 280,543	Current Maturities of Long-Term Debt-Note 11	\$ 602,600	\$ 651,500
Investments in Associated Organizations-Note 3	424,017	385,881	Accounts Payable	468,500	455,262
Total Other Property and Investments	<u>\$ 702,924</u>	<u>\$ 666,424</u>	Consumers' Deposits	52,069	57,975
 <u>Current Assets:</u>			Taxes Accrued	125,645	116,394
Cash-General-Note 5	\$ 236,589	\$ 405,695	Interest Accrued	40,510	44,907
Cash-Loan Funds	1	1	Accrued Vacation	82,562	69,357
Temporary Cash Investments-Note 4	1,000,258	620,507	Total Current Liabilities	<u>\$ 1,371,886</u>	<u>\$ 1,395,395</u>
Accounts Receivable-Consumers-Note 6	828,195	927,865			
Accounts Receivable-Other-Note 7	3,986	82,995	 <u>Deferred Credits:</u>		
Interest Receivable	3,574	3,027	Consumer Energy Prepayments-Note 12	\$ 19,768	\$ 22,842
Materials and Supplies	450,889	345,898	Capital Credits Payable-Note 13	10,611	26,537
Prepayments	158,974	180,520	NorthWestern-Southern Refund-Note 14	1,112,068	1,112,068
Total Current Assets	<u>\$ 2,682,466</u>	<u>\$ 2,566,508</u>	Total Deferred Credits	<u>\$ 1,142,447</u>	<u>\$ 1,161,447</u>
 <u>Deferred Debits:</u>			 <u>Commitments and Contingencies-Note 14</u>	<u>-</u>	<u>-</u>
Unamortized Loan Fees	\$ 10,207	\$ 12,007			
Preliminary Surveys and Investigations-Note 8	4,879	14,637			
NorthWestern Transmission Deposit	59,880	59,880			
Southern Montana Exit Fee-Note 9	775,780	1,092,041			
Total Deferred Debits	<u>\$ 850,746</u>	<u>\$ 1,178,565</u>			
 TOTAL ASSETS	 <u><u>\$ 20,973,551</u></u>	 <u><u>\$ 21,024,237</u></u>	 TOTAL EQUITIES, MARGINS, LIABILITIES AND OTHER CREDITS	 <u><u>\$ 20,973,551</u></u>	 <u><u>\$ 21,024,237</u></u>

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

BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA
STATEMENTS OF REVENUES AND PATRONAGE CAPITAL
For the Years Ended June 30, 2017 and 2016

	June 30, 2017		June 30, 2016		Increase (Decrease)
	Amount	Percent	Amount	Percent	
<u>Operating Revenues:</u>					
Residential Sales-Rural	\$ 7,258,942	82.29 %	\$ 7,839,506	82.12 %	\$ (580,564)
Irrigation	428,886	4.86	457,443	4.79	(28,557)
Commercial and Industrial-Small	922,033	10.45	1,061,825	11.12	(139,792)
Commercial and Industrial-Large	170,786	1.94	147,899	1.55	22,887
Subtotal	\$ 8,780,647	99.54 %	\$ 9,506,673	99.59 %	\$ (726,026)
Miscellaneous Electric Revenue	40,373	0.46	39,373	0.41	1,000
Total Operating Revenues	\$ 8,821,020	100.00 %	\$ 9,546,046	100.00 %	\$ (725,026)
<u>Operating Expenses:</u>					
Cost of Power	\$ 3,070,545	34.81 %	\$ 3,637,325	38.10 %	\$ (566,780)
Transmission-Operations and Maintenance	7,320	0.08	7,518	0.08	(198)
Distribution-Operations	966,764	10.96	863,697	9.05	103,067
Distribution-Maintenance	661,438	7.50	517,299	5.42	144,139
Consumer Accounts Expense	375,058	4.25	345,442	3.62	29,616
Administrative and General-Note 19	1,196,291	13.56	1,160,638	12.16	35,653
General Plant-Maintenance	106,694	1.21	90,295	0.95	16,399
Depreciation	979,471	11.10	960,944	10.07	18,527
Interest	563,698	6.39	611,307	6.40	(47,609)
Total Operating Expenses	\$ 7,927,279	89.87 %	\$ 8,194,465	85.84 %	\$ (267,186)
Net Operating Margins Before Patronage					
Capital Credits and Non-Operating Margins	\$ 893,741	10.13 %	\$ 1,351,581	14.16 %	\$ (457,840)
<u>Patronage Capital Credits</u>	57,577	0.65	48,166	0.50	9,411
Net Operating Margins	\$ 951,318	10.78 %	\$ 1,399,747	14.66 %	\$ (448,429)
<u>Non-Operating Margins:</u>					
Interest Income	\$ 16,865	0.19 %	\$ 12,298	0.13 %	\$ 4,567
Southern Montana Impairment Loss Recoveries-Note 15	4,474	0.05	79,068	0.83	(74,594)
Other Non-Operating Revenue	14,389	0.16	17,067	0.18	(2,678)
Total Non-Operating Margins	\$ 35,728	0.41 %	\$ 108,433	1.14 %	\$ (72,705)
NET MARGINS	\$ 987,046	11.19 %	\$ 1,508,180	15.80 %	\$ (521,134)
PATRONAGE CAPITAL-BEGINNING OF YEAR	6,907,440		5,441,465		
Less: Retirement of Capital Credits	(381,580)		(15,466)		
Less: Discounted Capital Credits Transferred to Other Equities	(16,527)		(9,883)		
Less: Non-Operating Margins Transferred to Other Equities	(114,604)		(16,856)		
PATRONAGE CAPITAL-END OF YEAR	\$ 7,381,775		\$ 6,907,440		

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

BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA
STATEMENTS OF CASH FLOWS
For the Years Ended June 30, 2017 and 2016

	<u>June 30, 2017</u>	<u>June 30, 2016</u>
<u>Cash Flows From Operating Activities:</u>		
Net Margins	\$ 987,046	\$ 1,508,180
Adjustments to Reconcile Net Margins to Net Cash Provided by Operating Activities:		
Depreciation on Utility Plant	1,109,428	1,078,657
Amortization of Loan Fees	1,800	1,800
Amortization Lower Valley Preliminary Surveys	-	52,957
Amortization Southern Montana Settlement Expense	141,051	112,005
Patronage Capital Credits Income	(57,577)	(48,166)
Changes in Operating Assets and Liabilities:		
Accounts Receivable-Consumers	99,670	64,299
Interest Receivable	(547)	(209)
Prepaid Assets	21,546	4,675
Accounts Payable and Current Liabilities	31,297	(395,676)
Consumer Energy Prepayments	(3,074)	(518)
Net Cash Provided by Operating Activities	\$ 2,330,640	\$ 2,378,004
 <u>Cash Flows from Investing Activities:</u>		
Additions to Utility Plant	\$ (1,188,856)	\$ (710,989)
Cost of Utility Plant Retired	354,427	202,660
Loss on Plant Retirements	(399,674)	(279,049)
Materials and Supplies	(104,991)	(101)
Decrease in Accounts Receivable-Other	79,009	56,765
Proceeds from Investments in CFC Term Certificates	1,636	1,539
Proceeds from Investments in Associated Organizations	19,441	21,268
NorthWestern Transmission Deposit	-	(59,880)
Southern Montana Prepayment Refund (Expense)	175,211	(1,204,046)
Decrease in Preliminary Surveys and Investigations	9,758	9,757
Net Cash (Used in) Investing Activities	\$ (1,054,039)	\$ (1,962,076)

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BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA
STATEMENTS OF CASH FLOWS (CONTINUED)
For the Years Ended June 30, 2017 and 2016

	<u>June 30, 2017</u>	<u>June 30, 2016</u>
<u>Cash Flows from Financing Activities:</u>		
Capital Credits Paid	\$ (381,580)	\$ (15,466)
Net Proceeds (Repayments) on NRUCFC Lines of Credit	-	1,625,000
Note Principal Payments:		
RUS	(23,376)	(24,701)
NRUCFC	(460,362)	(1,659,935)
FFB	(178,806)	(171,050)
(Decrease) in Consumers' Deposits	(5,906)	(1,245)
Increase in Consumer Contributions in Aid of Construction	-	(318,335)
(Decrease) in Capital Credits Payable	(15,926)	(16,173)
Proceeds NorthWestern-Southern Refund	-	1,112,068
Net Cash Provided By (Used In) Financing Activities	<u>\$ (1,065,956)</u>	<u>\$ 530,163</u>
Net Increase in Cash and Cash Equivalents	\$ 210,645	\$ 946,091
Cash and Cash Equivalents-Beginning of Year	<u>1,026,203</u>	<u>80,112</u>
Cash and Cash Equivalents-End of Year	<u>\$ 1,236,848</u>	<u>\$ 1,026,203</u>
Supplemental Information:		
Interest Paid	<u>\$ 568,095</u>	<u>\$ 611,967</u>

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

BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Basis of Accounting

The Cooperative maintains its accounting records and prepares its financial statements in accordance with the accounting regulations of the Rural Utilities Service (RUS). As a result, the application of accounting principles generally accepted in the United States of America by the Cooperative differs in certain respects from such applications used by non-regulated enterprises, primarily when various items are recognized in the determination of net margins.

Utility Plant

Utility plant is recorded at cost, which includes materials, contracted services, direct labor and benefits, pension costs, indirect charges for engineering, supervision and other similar overhead items. The costs of construction and retirements of utility plant are accumulated through a system of work orders. These are substantiated by detailed engineering staking sheets and work order cost sheets. Cost of materials, direct labor and overhead charges are posted to cost sheets monthly. Transportation expenses are distributed to construction, retirement and operating accounts on the basis of mileage or labor hours for power operated equipment. Generally, the utility plant is capitalized when the work order becomes part of an operating unit and is energized. However, certain items of the plant, referred to as special equipment items (meters and transformers), are capitalized at the time of purchase along with the related standard labor costs of installation. During the year ended June 30, 2013, the Cooperative changed its accounting procedures for special equipment, whereby transformers are charged and allocated directly to work orders, consistent with other material charges.

Depreciation is recorded on the composite basis and is charged to capital and operating accounts at rates adopted by the Board of Directors in conformity with guidelines provided by the Rural Utilities Service. Depreciation provisions are computed on additions beginning the month after they are placed in service. When transmission and distribution units of property are retired, their average cost (specific unit cost for substantially all of the general plant) is removed from utility plant and the cost, less net salvage, is removed from allowances for depreciation. Costs of routine repairs and maintenance that do not improve or extend the useful lives of the related assets, and the replacement and renewal of items determined to be less than units of plant are charged to maintenance as incurred.

BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Utility Plant (Continued)

Depreciation expense is provided by the straight-line method over the composite rate or a specific unit basis for transportation and power operated equipment as follows:

<u>Classification</u>	<u>Rate</u>
Transmission	2.75%
Distribution	3.20% to 6.67%
General Plant:	
Structures and Improvements	3.00%
Transportation Equipment	15.00%
Power Operated Equipment	14.00%
Other General Plant	5.00% to 16.00%

Continuing property records are maintained on a current basis. These provide the average installed cost of the plant in service.

Contributions from consumers in aid of construction are credited to construction work orders in progress. Therefore only the net cost to the Cooperative is capitalized to the distribution plant.

Gains or losses from electric plant disposals are recorded as adjustments to the accumulated depreciation accounts.

Valuation of Long-Lived Assets

Management of the Cooperative periodically reviews the net carrying value of its assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset might not be recoverable. These reviews consider the net realizable value of each asset to determine whether impairment in value has occurred, and whether there is a need for any asset-impairment write-down. Impaired assets are reported at the lower of cost or fair value. At June 30, 2017 and 2016, no assets were considered to be impaired.

**BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investments

Investments in associated organizations are stated at cost and consist primarily of investments in National Rural Utilities Cooperative Finance Corporation (CFC), Federated Rural Electric Insurance Corporation and Basin Electric G&T Cooperative, Inc., including allocated patronage.

Cash and Cash Equivalents

The Cooperative considers all highly liquid investments with original maturities of less than three (3) months when purchased to be cash equivalents for purposes of the statements of cash flows.

Accounts Receivable

Accounts receivable are stated at the amount that management of the Cooperative expects to collect from outstanding balances. Management provides for probable uncollectible amounts through an allowance for doubtful accounts. Additions to the allowance for doubtful accounts are based on management's judgment, considering historical write-offs, review of specific past-due accounts, collections and current credit conditions. Generally, the Cooperative considers accounts receivable past due after 30 days. Balances which remain outstanding after management has used reasonable collection efforts are written off through a charge to the allowance for doubtful accounts and a credit to the applicable accounts receivable. Payments received on accounts subsequent to being written off are considered a bad debt recovery. Changes in the allowance for doubtful accounts have not been material to the financial statements.

Materials and Supplies

Materials and supplies consist primarily of items for construction and maintenance of the Cooperative's transmission and distribution system and are stated at lower of average unit cost or market, as prescribed by RUS. Usable material from plant retirements is returned to inventory at current average cost.

BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Deferred Debits and Deferred Credits

In accordance with the basis of accounting used by the Cooperative as described above, certain costs and income that would otherwise be recorded as expenses or revenues may be capitalized as regulatory assets or liabilities and amortized over a period of time when it is probable that future rate increases or rate reductions will permit recovery.

Unamortized Loan Fees

Unamortized loan fees represent costs incurred to refinance CFC debt obligations and are being amortized over the maturity of the loans.

Revenues

Revenues consist of consumer billings for the sale and distribution of electrical energy to consumers located in the south central area of Montana and the Clark, Wyoming area. The Cooperative consistently follows the industry practice of recording revenues concurrently with its billings to customers and recording cost of power upon receipt of their billing from the supplier. Rates charged to consumers are established by the Board of Directors and are not subject to other regulation.

Margins and Equities

In conformity with its bylaws, the Cooperative conducts its operations on a cooperative, nonprofit basis. Annual revenues in excess of the cost of providing service, commonly referred to as net margins, are allocated in the form of "capital credits" to the customers' capital accounts on the basis of patronage. Capital credits are returned to members in accordance with the Cooperative's policies and are classified as payable upon Board resolution authorizing retirement.

Non-operating margins, and operating margins which are not directly related to the delivery of electric services, may be credited to other equities. At the discretion of the Board, non-operating margins may also be allocated to members' capital credit accounts based upon their pro-rata share of patronage margins. The Board approved allocation of the Cooperative's fiscal year non-operating margins for 2016 and 2015 to other equities.

BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Pension Plan

The Cooperative's policy is to expense current pension costs as they accrue based on actuarial studies.

Income Taxes

The Cooperative is exempt from federal income taxes under Section 501 (c) (12) of the Internal Revenue Code. Accordingly, there is no provision for income taxes in the accompanying financial statements.

In accordance with FASB ASC 740-10, *Income Taxes*, which also requires the disclosure of open tax years subject to examination and the policy for classifying interest and penalties, the Cooperative has performed an evaluation and determined that no uncertain tax liabilities or positions exist for the years ended June 30, 2017 and 2016. The Cooperative's tax years of December 31, 2014 through December 31, 2016 remain subject to examination by federal and state taxing authorities.

Use of Estimates

The preparation of 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. Actual results could differ from those estimates.

Fair Value Measurements

ASC Topic 820, *Fair Value Measurement and Disclosures*, establishes a fair value hierarchy for those assets and liabilities measured at fair value, that distinguishes between assumptions based on market data (observable inputs) and the organization's own assumptions (unobservable inputs). The hierarchy consists of: Level 1 – quoted market prices in active markets for identical instruments; Level 2 – inputs other than Level 1 inputs that are observable; and Level 3 – unobservable inputs developed using estimates and assumptions determined by the organization.

BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

At June 30, 2017 and 2016, the only assets or liabilities that are measured at fair value on a recurring basis are temporary cash investments, which are reported using Level 1 inputs. Certain assets are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis, but subject to fair value adjustments only in certain circumstances (for example, when there is evidence of impairment). The Cooperative had no assets measured at fair value on a nonrecurring basis during June 30, 2017 and 2016.

Financial Instruments

ASC Topic 825, *Financial Instruments*, permits entities to choose to measure many financial assets and liabilities at fair value. The fair value of a financial instrument is the amount at which these instruments could be exchanged in a current transaction between willing parties, other than a forced liquidation sale. At June 30, 2017 and 2016, the carrying value of financial instruments, such as receivables, accounts payable, accrued liabilities and long-term debt approximated their fair values based on either the short-term maturities or the market rates of interest associated with those instruments.

2. INVESTMENTS IN CFC:

Investments in CFC include \$202,816 of capital term certificates, \$39,350 of loan term certificates, and \$36,741 of zero loan term certificates issued by the National Rural Utilities Cooperative Finance Corporation. The capital term certificates have a current yield of 5.00% and are due to mature October 1, 2070, 2075, and 2080 totaling \$71,521, \$47,615, and \$83,680, respectively. CFC loan term certificates yield 3.00% and \$1,150, \$18,950, and \$19,250 mature on October 1, 2020, 2025, and 2030, respectively. The zero loan term certificates totaling \$4,965, \$17,876 and \$13,900 mature on November 1, 2020, December 1, 2033 and July 1, 2036, respectively. These investments are carried at cost as it is not practicable to estimate the fair value because they consist of investments in securities of an untraded company and represent the Cooperative's initial and ongoing cost to have CFC be their supplemental lender.

BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

3. INVESTMENTS IN ASSOCIATED ORGANIZATIONS:

These investments consist of:

	<u>June 30, 2017</u>	<u>June 30, 2016</u>
National Rural Utilities Cooperative		
Finance Corporation:		
Membership	\$ 1,000	\$ 1,000
Patronage Capital	183,283	170,494
NISC:		
Membership	100	100
Patronage Capital	25,109	20,652
Basin Electric G&T Cooperative, Inc.		
Patronage Capital	80,566	80,566
NRTC Membership	1,000	1,000
Federated Rural Electric Insurance Exchange:		
Patronage Capital	98,260	88,748
RESCO-Patronage Capital and Stock	0	100
Triangle Telephone Cooperative Association, Inc.		
Patronage Capital	2,405	1,864
MECA Building Investment	8,000	8,000
CoBank - Patronage Capital	24,294	13,357
Total	<u>\$ 424,017</u>	<u>\$ 385,881</u>

4. TEMPORARY CASH INVESTMENTS:

This account consists of the following:

	<u>June 30, 2017</u>	<u>June 30, 2016</u>
0.10% First Interstate Bank of Red Lodge - Savings.	\$ 248,117	\$ 18,367
0.10% Bank of Red Lodge- Savings	1,121	1,121
0.02% Wells Fargo Bank of Red Lodge – Savings.	1,020	1,019
1.09% - 1.38% CFC Commercial Paper Notes- \$200,000 matures July, 2017; \$150,000 matures July, 2017; \$100,000 matures September, 2017; and \$300,000 matures October, 2017.	750,000	600,000
Total	<u>\$ 1,000,258</u>	<u>\$ 620,507</u>

BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

5. CONCENTRATION OF CREDIT RISK:

As noted above, the Cooperative maintains a general checking, construction fund checking, and money market savings account in one financial institution located in Red Lodge, Montana. All cash accounts are fully insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. At June 30, 2017 the Cooperative's cash accounts in this financial institution did not exceed the FDIC insured limits. The Cooperative did exceed the FDIC insured limits at June 30, 2016.

The Cooperative is engaged primarily in the delivery of electric utility service to its members. Assets that potentially subject the Cooperative to concentrations of credit risk consist principally of trade accounts receivable. The Cooperative performs ongoing credit evaluations of its customers' financial condition and generally requires no collateral from its customers other than minimal customer deposits. The customer base consists of the Cooperative's members.

6. ACCOUNTS RECEIVABLE-CONSUMERS:

This account consists of the following:

	<u>June 30, 2017</u>	<u>June 30, 2016</u>
Accounts Receivable-Consumers	\$ 865,801	\$ 949,863
Less: Provision for Doubtful Accounts	<u>(37,606)</u>	<u>(21,998)</u>
Net Accounts Receivable-Consumers	<u>\$ 828,195</u>	<u>\$ 927,865</u>

Aging of Accounts Receivable-Consumers is as follows:

	<u>June 30, 2017</u>	<u>June 30, 2016</u>
Current	\$ 749,370	\$ 831,328
1 to 2 months past due	82,916	81,048
2 to 3 months past due	18,524	23,891
3 months and over past due	<u>14,991</u>	<u>13,596</u>
Total Accounts Receivable-Consumers	<u>\$ 865,801</u>	<u>\$ 949,863</u>

BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

7. ACCOUNTS RECEIVABLE-OTHER:

This account consists of the following:

	<u>June 30, 2017</u>	<u>June 30, 2016</u>
Employee Retirement and Medical Insurance	\$ (645)	\$ 940
Consumers for Materials, Labor and Contribution In Aid of Construction	<u>4,631</u>	<u>82,055</u>
Total Accounts Receivable-Other	<u>\$ 3,986</u>	<u>\$ 82,995</u>

8. PRELIMINARY SURVEYS AND INVESTIGATION:

This account consists of engineering fees pertaining to the preparation of the Cooperative's four-year and long-range work plans and the five year cost of service and rate study totaling \$4,879 and \$14,637 at June 30, 2017 and 2016, respectively. These costs are being amortized to construction work orders on the straight-line basis over the four-year work plan once the work plan is finalized and approved by RUS.

9. DEFERRED DEBIT - SOUTHERN MONTANA EXIT FEE:

The Cooperative paid a fee in October, 2015 totaling \$1,204,046 as a condition of being released from its Southern Montana Electrical Generation and Transmission, Inc. (Southern Montana) wholesale power contract. The exit and settlement agreement required the Cooperative to prepay its share of the remaining debt on the Highwood Generating Station owed by Southern Montana to its note-holders under the terms of its bankruptcy reorganization plan as approved by the United States Bankruptcy Court. The Cooperative received permission from RUS to record this payment as a deferred debit. The Board of Directors elected to amortize the payment on a straight-line basis over seven years so as to recover it through future rates. The Cooperative amortized \$141,051 and \$112,005 during each of the years ended June 30, 2017 and 2016, respectively.

In July, 2016, Southern Montana paid off a mortgage owing to its note-holder and \$1,000,000 of Southern Montana's net operating cash reserves were released. The Cooperative received its pro rata share (17.5211%) of the released reserve funds in the amount of \$175,210. The proceeds were accounted for as a reduction in the remaining, unamortized exit and settlement fee previously paid to Southern Montana.

BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

10. RETURN OF CAPITAL:

Under the provisions of the Cooperative's long-term debt agreements, until the total of equities and margins equals or exceeds 30 percent (30%) of the total assets of the Cooperative, the return of patronage capital to patrons is limited, generally, to 25 percent (25%) of the patronage capital or margins received by the Cooperative in the next preceding year. If equities and margins exceed thirty percent (30%) of the total assets of the Cooperative, the Cooperative can exceed the 25% margin limitation provided the Cooperative is current on all payments due on RUS note borrowings and not in default under its credit facilities. The equities and margins of the Cooperative represent approximately 37% and 34% of the total assets at June 30, 2017 and 2016, respectively.

During the year ended June 30, 2010 the Board of Directors elected to discount capital credits to its deceased members. During the years ended June 30, 2017 and 2016, \$36,670 and \$25,349, respectively, of previously assigned margins were paid to the deceased member estates at discounted amounts totaling \$16,527 and \$15,466, respectively. In accordance with the IRS rulings, the unpaid, discounted amount will remain permanently assigned to those members and will be paid upon dissolution of the Cooperative if and when that event occurs.

11. PLEDGED ASSETS, LINE OF CREDIT AND LONG-TERM DEBT:

Note Payable-Bank-Line of Credit consists of the following:

	<u>June 30, 2017</u>	<u>June 30, 2016</u>
Perpetual Line of credit-CFC, authorized \$2,000,000, interest based on bank's prime rate, currently at 2.75%.	\$ 0	\$ 0
Line of credit-CoBank, authorized \$2,000,000, interest based on bank's prime rate, currently at 3.08%, matures December, 2017.	<u>0</u>	<u>0</u>
	<u>\$ 0</u>	<u>\$ 0</u>

**BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016**

11. PLEDGED ASSETS, LINE OF CREDIT AND LONG-TERM DEBT (Continued):

Long-term debt is as follows:

	<u>June 30, 2017</u>	<u>June 30, 2016</u>
5.12% - 5.75% RUS mortgage notes payable, due in monthly installments of \$4,126, including interest, with various maturities through October, 2030, secured by all assets.	\$ 464,989	\$ 488,364
3.95% - 7.50% mortgage notes payable to National Rural Utilities Cooperative Finance Corporation (CFC), due primarily in quarterly installments, including interest, of \$163,416 with various maturities through July, 2045, secured by all assets. (A)	4,020,947	4,481,309
2.472% - 5.401% mortgage notes payable to Federal Financing Bank (FFB), due in quarterly installments, including interest, of \$114,314, with various maturities through December, 2042, secured by all assets and guaranteed by RUS.	<u>6,816,905</u>	<u>6,995,711</u>
	\$ 11,302,841	\$ 11,965,384
Less Current Maturities	<u>(602,600)</u>	<u>(651,500)</u>
	<u>\$ 10,700,241</u>	<u>\$ 11,313,884</u>

The RUS, FFB and CFC mortgage notes payable are generally issued and mature over a 35-year amortization period.

BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

11. PLEDGED ASSETS, LINE OF CREDIT AND LONG-TERM DEBT (Continued):

(A) The Cooperative secured an additional \$3,200,000 power vision loan with CFC and has borrowed \$2,212,004 and \$2,282,082 at June 30, 2017 and 2016, respectively. \$2,200,000 of the power vision loan matures in March, 2039 and \$1,000,000 matures in May, 2046 and, therefore, they are classified as long-term debt in the accompanying balance sheets at June 30, 2017 and 2016. In 2015, the Cooperative secured an additional \$4,300,000 power vision line of credit with CFC that has a maturity date of February, 2050. At June 30, 2016, \$2,475,000 of the power vision line of credit remains available. Management secured this line of credit for the purpose of giving the Cooperative the additional ability to borrow on utility plant construction projects and to fund the Southern Montana exit and settlement fee as discussed in Note 9.

Aggregate maturities of long-term debt at June 30, 2017 are as follows for the years ending June 30:

2018	\$ 602,600
2019	617,700
2020	649,900
2021	464,000
2022	376,500
Thereafter	<u>8,592,141</u>
	<u>\$11,302,841</u>

The Cooperative had no unadvanced loan funds available on loan commitments from RUS and the Federal Financing Bank (FFB) as of June 30, 2017. The Federal Financing Bank (FFB) loans are serviced and guaranteed by RUS.

12. CONSUMER ENERGY PREPAYMENTS:

This account consists of consumers' prepayments for electrical services. Amounts are removed from this account monthly and applied to payment of accounts receivable-electric.

BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

13. CAPITAL CREDITS PAYABLE:

In November, 1992 the State of Montana ruled that all capital credit checks unclaimed after five years are to be escheated to the State of Montana or allowed to be used for educational programs. The Cooperative has elected to donate these funds for educational programs.

14. NORTHWESTERN – SOUTHERN REFUND:

Southern Montana was overcharged by NorthWestern Corporation (NorthWestern) for transmission costs going back through the year ended December 31, 2010. The Federal Energy Regulatory Commission (FERC) had a hearing after which it ordered NorthWestern to repay the transmission overcharges. In May, 2016, NorthWestern requested a rehearing of FERC's initial decision, which was denied. NorthWestern is appealing the FERC ruling. NorthWestern paid Southern Montana a refund totaling \$6,347,021 and Southern Montana, in turn, paid the Cooperative its 17.5211% pro rata share of the refund totaling \$1,112,068. Due to NorthWestern's appeal, the Cooperative signed an "assignment and recoupment agreement" whereby if NorthWestern wins the appeal process, the Cooperative will have to repay NorthWestern their prorated share of the Southern Montana refund. In accordance with FASB ASC 450, gain contingencies are not recognized before they are realized in the financial statements until all contingencies have been resolved. If NorthWestern loses the appeal, the Cooperative will have to restate prior years financial statements with an adjustment to previously recorded equities and margin since the refund resulted in an adjustment to Southern Montana's 2010 and prior years' transmission costs.

15. COMMITMENTS AND CONTINGENCIES:

The Cooperative has eleven employees who are covered by a collectively bargained union contract, which expires April 30, 2018. Under the terms of the contract, on May 1, 2017, the union employees received an annual cost of living pay increase of 2%. The Cooperative's remaining seven full time employees are not covered by any collective bargaining contract.

BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

15. COMMITMENTS AND CONTINGENCIES (Continued):

During the year ended June 30, 1994, the Cooperative became a participant in the Montana Electric and Telephone System Pool (METSPOOL), an organization to provide workers' compensation coverage to Montana electric and telephone cooperatives. METSPOOL is a self-insurance trust formed pursuant to the provisions of the Montana Electric and Telephone Systems self-insured workers' compensation pool resolution. Member cooperatives make contributions to the trust, which provides mutual insurance protection for all members of the trust, based on an actuarial study. In addition, Beartooth Electric Cooperative, Inc. has an excess indemnity policy for workers' compensation to provide for any unexpected loss experience in the METSPOOL trust. The Cooperative paid \$29,947 and \$32,374 under the METSPOOL program for the years ended June 30, 2017 and 2016, respectively.

The Cooperative had an investment in SME Electric G&T Cooperative, Inc. (SME) which, in turn, had an investment in real property that was secured by a mortgage. The Cooperative wrote off its SME investment as an impairment loss in the year ended June 30, 2013. In February of 2016, the real estate was sold and the net proceeds were distributed to the SME shareholders. The Cooperative's pro rata portion of the distribution of \$79,068 was recorded as a gain in the statement of revenues and patronage capital for the year ended June 30, 2016.

The Cooperative had an investment in Southern Montana Electric G&T Cooperative, Inc. (Southern Montana). Southern Montana filed for bankruptcy protection on October 22, 2011. On June 20, 2014, the United States Bankruptcy Court signed an order confirming the reorganization of Southern Montana effective July 1, 2014. Under the reorganization, the Cooperative's wholesale power contract to purchase power from Southern Montana that had been extended through December 31, 2048 was cancelled. The Cooperative signed a new four-year wholesale power contract with Southern Montana. The remaining four members of Southern Montana agreed to retire approximately \$22,000,000 of Southern Montana's mortgage with Prudential Insurance. As discussed in Note 9, the Cooperative was successful in their efforts to terminate their wholesale power commitment with Southern Montana on October 31, 2015. The agreement required Beartooth Electric to pay their 17.5211% pro rata share of Southern Montana's monthly administration and general operating expenses up until the time the mortgage was paid in full. The Prudential Insurance mortgage was paid off in June, 2016.

BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

15. COMMITMENTS AND CONTINGENCIES (Continued):

The Southern Montana settlement and exit agreement also provided that Beartooth Electric's allocation of 1.134 megawatts of power from Western Area Power Administration (WAPA), in a contract set to expire on December 31, 2050, that was previously assigned to Southern Montana be reassigned to the Cooperative.

Southern Montana had entered into a master power purchase and sale agreement with Twin Eagle Resource Management for the purchase of power through September 30, 2017. The settlement and exit agreement with Southern Montana allowed the Cooperative to assume and receive Southern Montana's allocation of purchased power from Twin Eagle Resource Management at a cost of 34.25 per megawatt hour through September 30, 2017.

On November 1, 2015, the Cooperative signed a network integration transmission contract with NorthWestern Corporation that continues through November 1, 2020.

The Cooperative entered into a purchase and sale of energy contract with Morgan Stanley Capital Group Inc. to purchase wholesale power effective October 1, 2017 through September 30, 2022. The Cooperative has also entered into a contract to purchase power from Energy Keepers, Inc. effective October 1, 2022 through September 30, 2024.

Total power purchased for the years ended June 30, 2017 and 2016 was as follows:

	<u>June 30, 2017</u>	<u>June 30, 2016</u>
Southern Montana	\$ 0	\$ 1,604,971
NorthWestern Energy	665,437	364,769
Western Area Power Administration	177,736	131,890
Twin Eagle Resource Management	2,227,172	1,533,362
Other	<u>200</u>	<u>2,333</u>
	<u>\$3,070,545</u>	<u>\$3,637,325</u>

BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

15. COMMITMENTS AND CONTINGENCIES (Continued):

On September 3, 2009 a fire, known as the Eagle Mountain Fire, started in a right-of-way of one of the Cooperative's distribution lines causing damage to several property owners. The Cooperative's commercial general liability insurer has settled all claims to of the affected property owners except with respect to two claimants who are seeking property and personal damages totaling \$2,100,000. The Cooperative's commercial general liability insurer has set aside \$40,000 of its policy limits to be available to the Cooperative for dealing with the unsettled claims; the remainder of the policy limits were utilized in settling the previously settled claims. The Cooperative's legal counsel believes that the two remaining claims can be resolved without any material adverse impact on the Cooperative's financial position when taking into consideration the \$40,000 of remaining insurance coverage available. Based on the Cooperative's legal counsel's opinion, no contingent liability has been accrued in the Cooperative's financial statement at June 30, 2017 as a result of the claims.

16. RETIREMENT PLANS:

Pension benefits are provided for all employees. The Cooperative participates in the NRECA Retirement and Security Program (R&S). The amount of the fund covers all vested benefits under the plan. The Cooperative funded their pension plan at rates ranging from 30.02% to 35.30% of the employees' base salary. The Cooperative paid pension benefits totaling \$282,620 and \$265,026 during the years ended June 30, 2017 and 2016, respectively. The Cooperative also pays 7.00% of the employees' base salary into a 401(k) employee savings plan, with optional amounts contributed by the employee. The Cooperative paid \$75,130 and \$60,939 into the 401(k) savings plan during the years ended June 30, 2017 and 2016, respectively. All pension plans have been approved by the Internal Revenue Service. Effective May 1, 2014, new union employees hired do not qualify for participation in the R&S defined benefit retirement plan. In lieu of participation in the R&S plan, 9% of their base pay is contributed to the 401(k) savings plan and the employee can match up to an additional 5% of their base pay.

**BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016**

16. RETIREMENT PLANS (Continued):

This NRECA Retirement and Security Program is a defined benefit, multi-employer pension plan and is available to all member cooperatives. A unique characteristic of a multiemployer plan compared to a single employer plan is that all plan assets are available to pay benefits to any plan participant. Separate pension asset and liability accounts are not maintained for participating employers. This means that assets contributed by one employer may be used to provide benefits to employees of other participating employers. The Cooperative contributions to the NRECA plan for the years ended June 30, 2017 and 2016 represented less than 5% of the total contributions made to the plan by all participating employers. A “zone status” determination under the Pension Protection Act (PPA) of 2006 is not required for the NRECA Retirement and Security Program. Therefore, information concerning the Cooperative’s proportionate share of the excess, if any, of the actuarially computed value of vested benefits over the pension plan’s net assets is not available from NRECA, the plan administrator. Withdrawal from the plan may result in the Cooperative having an obligation to the plan. The Cooperative does not currently intend to withdraw from the plan and, accordingly, no provision for a termination obligation has been included in the accompanying financial statements.

17. UNBILLED REVENUE:

Unbilled revenue as of June 30, 2017 and 2016 amounted to approximately \$0 and \$263,300, respectively.

18. FAIR VALUE OF FINANCIAL INSTRUMENTS:

The fair value of financial instruments is estimated to be the same as their book value (or carrying value) which has been reflected on these financial statements. The three categories of financial instruments are as follows:

Cash and temporary investments – The carrying amount approximates fair value due to the short maturity and current rates of interest for these instruments.

BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016

18. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued):

Long-term investments – A reasonable estimate of the fair value of the investments in associated organizations could not be made without incurring excessive costs as there are no quoted market prices available for these instruments. The book value of the capital term certificates approximates fair value based on the rates of return available to the Cooperative on similar investments.

Long-term debt – The fair value of the Cooperative’s long-term debt is estimated based on the borrowing rates currently available for loans with similar terms and average maturities. The fair value of the long-term debt and carrying value is estimated to be the same.

19. ADMINISTRATIVE AND GENERAL EXPENSES AND RELATED PARTY TRANSACTIONS:

Administrative and general expenses consist of the following:

	<u>June 30, 2017</u>	<u>June 30, 2016</u>
Administrative Salaries and Benefits	\$ 148,471	\$ 112,014
Office Supplies and Expenses	52,226	54,122
Outside Services	113,530	118,329
Property Insurance	14,733	13,485
Injury and Damages	24,719	18,757
Employee Welfare and Benefits	12,149	13,192
Property Taxes	19,229	18,207
Directors Expenses	85,458	90,564
Dues-Associated Organizations	70,181	68,509
Members Expense	45,780	36,803
Southern Montana Exit Fee Amortization	141,051	112,004
Management Expenses	449,654	496,251
Miscellaneous General Expenses	19,110	8,401
Total	<u>\$ 1,196,291</u>	<u>\$1,160,638</u>

**BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA
NOTES TO FINANCIAL STATEMENTS
June 30, 2017 and 2016**

19. ADMINISTRATIVE AND GENERAL EXPENSES AND RELATED PARTY TRANSACTIONS (Continued):

The Cooperative entered into a management agreement with Lower Valley Electric Cooperative, Inc. (Lower Valley), a related party, in November, 2014 with an effective date of April 1, 2015. The agreement provides for Lower Valley to manage the operations of the Cooperative and was entered into as a means to reduce operating expenses and better ensure reliability of services to the Cooperative's members. The agreement requires the Cooperative to pay Lower Valley an annual fee equal to \$100 per active meter, increasing each year to \$102 and then to \$104 per active member plus additional direct billed services as defined in the management agreement. During the years ended June 30, 2017 and 2016, the Cooperative paid Lower Valley management fees totaling \$585,747 and \$645,976, respectively of which \$136,093 and \$149,725, respectively, was allocated to construction work orders. Consideration by the two cooperatives was given to an eventual merger. After the second year of the management agreement, the Cooperative determined that it would not be in its best interest to merge with Lower Valley and the management agreement ended on July 31, 2017.

20. SUBSEQUENT EVENTS:

Management has evaluated subsequent events through August 25, 2017, the date on which the financial statements were available to be issued and has determined that there were no subsequent events that required recognition or additional disclosure in these financial statements.

**INDEPENDENT AUDITORS' REPORT ON
SUPPLEMENTARY INFORMATION**

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The Board of Directors
Beartooth Electric Cooperative, Inc.
Red Lodge, Montana

We have audited the financial statements of Beartooth Electric Cooperative, Inc. as of and for the year ended June 30, 2017, and our report thereon dated August 25, 2017, which contained an unmodified opinion on those financial statements, appears on pages 2 and 3. Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole.

The Schedule of Patronage Capital and Other Equities and Schedule of Electric Plant and Accumulated Depreciation 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 information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional 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 information is fairly stated in all material respects in relation to the financial statements as a whole.



Summers, McNea & Company, P.C.
Certified Public Accountant

August 25, 2017

**BEARTOOTH ELECTRIC COOPERATIVE, INC.
RED LODGE, MONTANA
SCHEDULE OF PATRONAGE CAPITAL AND OTHER EQUITIES
For the Year Ended June 30, 2017**

PATRONAGE CAPITAL

	<u>Assignable</u>	<u>Assigned</u>	<u>Retired</u>	<u>Balance</u>
Balance, June 30, 2016	\$1,046,465	\$8,542,963	\$(2,681,988)	\$6,907,440
Net Margins	987,046	0	0	987,046
Margins Assigned-12-31-2016	(1,301,333)	1,301,333	0	0
Non-Operating Margins Transferred (To) From Other Equities	(114,604)	(16,527)	0	(131,131)
Capital Credits Paid to Estates	0	0	(20,143)	(20,143)
Capital Credits Retired-General	<u>0</u>	<u>0</u>	<u>(361,437)</u>	<u>(361,437)</u>
Balance, June 30, 2017	<u>\$ 617,574</u>	<u>\$9,827,769</u>	<u>\$(3,063,568)</u>	<u>\$ 7,381,775</u>

OTHER EQUITIES

	<u>Capital Gains and Losses</u>	<u>Non Operating Margins (A)</u>	<u>Discounted Capital Credits</u>	<u>Total</u>
Balance June 30, 2016	\$ 3,097	\$ 109,971	\$ 133,003	\$ 246,071
Discounted Capital Credits Paid to Estates	0	0	16,527	16,527
Non-Operating Margins: 12-31-2016	<u>0</u>	<u>114,604</u>	<u>0</u>	<u>114,604</u>
Balance June 30, 2017	<u>\$ 3,097</u>	<u>\$ 224,575</u>	<u>\$ 149,530</u>	<u>\$ 377,202</u>

(A) During the year ended December 31, 2010, the board of directors elected not to assign and allocate the Cooperative's non-operating margins to its members.

BEARTOOTH ELECTRIC COOPERATIVE, INC
RED LODGE, MONTANA
SCHEDULE OF ELECTRIC PLANT AND ACCUMULATED DEPRECIATION
June 30, 2017

Classified Electric Plant in Service:	Electric Plant Showing Additions and Retirements				Accumulated Provision for Depreciation				Depreciation Rate
	Balance 6/30/2016	Additions and Transfers	Retirements	Balance 6/30/2017	Balance 6/30/2016	Accruals	Retirements	Balance 6/30/2017	
Transmission Plant:									
Land and Land Rights	\$ 27,632	\$ -	\$ -	\$ 27,632	\$ -	\$ -	\$ -	\$ -	
Station Equipment	6,112	-	-	6,112					
Poles, Towers and Fixtures	168,693	-	-	168,693					
Overhead Conductors and Devices	223,696	-	-	223,696					
Total Transmission Plant	\$ 426,133	\$ -	\$ -	\$ 426,133	\$ 398,501	\$ -	\$ -	\$ 398,501	2.75%
Distribution Plant:									
Land and Land Rights	\$ 84,196	\$ -	\$ -	\$ 84,196	\$ -	\$ -	\$ -	\$ -	--
Station Equipment	2,185,205	-	-	2,185,205					3.20%
Poles, Towers and Fixtures	9,064,458	378,814	104,788	9,338,484					4.00%
Overhead Conductors and Devices	4,177,433	94,197	24,134	4,247,496					2.80%
Underground Conductors and Devices	5,624,608	154,498	9,417	5,769,689					2.90%
Line Transformers	3,267,501	83,662	30,454	3,320,709					3.10%
Services	953,787	34,174	5,575	982,386					3.60%
Meters	872,996	-	-	872,996					6.67%
Total Distribution Plant	\$ 26,230,184	\$ 745,345	\$ 174,368	\$ 26,801,161	\$ 11,178,781	\$ 915,571	\$ 233,538	\$ 11,860,814	
General Plant:									
Land and Land Rights	\$ 20,784	\$ -	\$ -	\$ 20,784	\$ -	\$ -	\$ -	\$ -	--
Structures and Improvements	1,299,815	-	-	1,299,815	498,902	38,995	-	537,897	3.00%
Office Equipment	260,802	13,000	-	273,802	215,628	11,112	-	226,740	6.00% - 16.00%
Transportation Equipment	443,838	54,519	25,734	472,623	337,974	31,801	25,734	344,041	15.00%
Stores Equipment	43,157	-	-	43,157	30,363	1,700	-	32,063	5.00%
Tools, Shop and Garage Equipment	69,075	-	-	69,075	44,577	2,642	-	47,219	5.00%
Laboratory Equipment	116,252	-	-	116,252	86,951	3,356	-	90,307	5.00%
Power Operated Equipment	1,576,791	256,833	154,325	1,679,299	1,281,451	98,156	142,825	1,236,782	14.00%
Communications Equipment	80,627	-	-	80,627	54,895	4,921	-	59,816	8.00%
Miscellaneous Equipment	19,568	-	-	19,568	8,837	1,174	-	10,011	6.00%
Total General Plant	\$ 3,930,709	\$ 324,352	\$ 180,059	\$ 4,075,002	\$ 2,559,578	\$ 193,857	\$ 168,559	\$ 2,584,876	
Total Classified Plant in Service	\$ 30,587,026	\$ 1,069,697	\$ 354,427	\$ 31,302,296	\$ 14,136,860	\$ 1,109,428	\$ 402,097	\$ 14,844,191	
Construction Work-in-Progress	112,742	119,159	-	231,901	-	-	-	-	
Retirements Work-in-Progress	-	-	-	-	(49,832)	0	(2,423)	(47,409)	
Total Utility Plant	\$ 30,699,768	\$ 1,188,856	\$ 354,427	\$ 31,534,197	\$ 14,087,028	\$ 1,109,428	\$ 399,674	\$ 14,796,782	
						\$ 979,471			Depreciation Expense
						129,957			Charged to Clearing Accounts
						\$ 1,109,428			Total Depreciation Accruals

Contributions-In-Aid of Construction received through June 30, 2017 totaled approximately \$16,733,800.

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

The Board of Directors
Beartooth Electric Cooperative, Inc.
Red Lodge, Montana

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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, and 7 CFR Part 1773, the financial statements of Beartooth Electric Cooperative, Inc., which comprise the balance sheet as of June 30, 2017, and the related statements of revenues and patronage capital, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated August 25, 2017. In accordance with *Government Auditing Standards*, we have issued our report dated August 25, 2017, on our consideration of Beartooth Electric Cooperative, Inc.'s internal control over financial reporting and on our tests of its compliance with certain provision of laws, regulations, contracts and grant agreements and other matters. No reports other than our independent auditors' report, and our independent auditors' report on compliance and on internal control over financial reporting, all dated August 25, 2017, have been issued. There is no schedule of findings and/or recommendations related to our audit which were required to be furnished to management.

In connection with our audit, nothing came to our attention that caused us to believe that Beartooth Electric Cooperative, Inc. 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, 7 CFR 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 Beartooth Electric Cooperative, Inc.'s noncompliance with the above-reference 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 Beartooth Electric Cooperative, Inc.'s accounting and records to indicate that Beartooth Electric Cooperative, Inc. did not:

- Maintain adequate and effective accounting procedures;
- Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and the distributions of these costs to construction, retirement, and maintenance or other expense accounts;
- Reconcile continuing property records to the controlling general ledger plant accounts;
- 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 material and supplies;
- Prepare accurate and timely Financial and Operating Reports;
- Obtain written RUS approval to enter into any contract for the maintenance, 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 requirement (See RUS Bulletin 183-1, Depreciation rates and Procedures);
- Comply with the requirements for the detailed schedule of deferred debits and deferred credits; and
- Comply with the requirements for the detailed schedule of investments.

Schedule of Deferred Debits and Deferred Credits

Deferred Debits

	<u>June 30, 2017</u>	<u>June 30, 2016</u>
Unamortized Loan Fees	\$ 10,207	\$ 12,007
Preliminary Surveys and Investigations	4,879	14,637
NorthWestern Transmission Deposit	59,880	59,880
Southern Montana Exit Fee	<u>775,780</u>	<u>1,092,041</u>
Total Deferred Debits	<u>\$ 850,746</u>	<u>\$1,178,565</u>

<u>Deferred Credits</u>	<u>June 30, 2017</u>	<u>June 30, 2016</u>
Consumer Energy Prepayments	\$ 19,768	\$ 22,842
Consumer Contributions in Aid of Construction	0	0
Patronage Capital Payable	10,611	26,537
NorthWestern –Southern Refund	<u>1,112,068</u>	<u>1,112,068</u>
Total Deferred Credits	<u>\$1,142,447</u>	<u>\$1,161,447</u>

The Southern Montana Exit Fee required prior RUS approval. None of the other deferred debits or credits required prior RUS approval.

Schedule of Investments in Affiliated Companies

At June 30, 2017 and 2016, the Cooperative had no investment in affiliated or equity companies. The Cooperative's investments in associated organizations relate to miscellaneous memberships and patronage allocation from NRUCFC, Federated Rural Electric Insurance Exchange and other vendors, as more fully discussed in Note 2 to the financial statements.

Other Matters

We also discussed with management the following:

- Discussed Lower Valley management agreement ending and the cooperative management going forward.
- Discussed options of changing out TS1 and TS2 turtle meters.
- Discussed need for new work plan.

This report is intended solely for the information and use of the Board of Directors, management, and the Rural Utilities Service, and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties.



Summers, McNea & Company, P.C.
Certified Public Accountant

August 25, 2017