

WELLS RURAL ELECTRIC COMPANY

Adopted: March 1976

Reviewed: August 21, 1998

Revised: May 10, 2006

POLICY NO. 4-1

FINANCIAL MANAGEMENT POLICY

I. OBJECTIVES

To establish sound principles and practices concerning the financial management of the Wells Rural Electric Company (“the Company”), to provide for adequate working capital and reserve funds, and to establish policy governing the prudent investment and use of these funds, all for the purpose that the financial management of the Company will be orderly, assure security of the Company's assets, provide assurance that the loans from Rural Utilities Service (RUS), National Rural Utilities Cooperative Finance Corporation (NRUCFC), and other lenders will be retired on schedule and to provide that service shall be rendered on a nonprofit, cooperative basis to the members at the lowest possible cost, consistent with an economically strong and well managed system.

II. SCOPE

This policy is based upon the assumption that RUS loans and NRUCFC loans will continue to be available at reasonable interest rates and to be repaid within 35 years:

A. Additions to Plant

1. Distribution Plant

All additions to distribution plant, including extensions constructed through Rule 9, increases in capacity and replacement for which RUS and NRUCFC loan funds are available, shall be financed with loan funds unless otherwise specified by management. Initially, general funds shall be used for all construction, except that done under contract, with reimbursement from loan funds immediately upon the approval of RUS and NRUCFC with the availability of such funds.

2. General Plant

Only major additions to general plant shall be financed by RUS loan and NRUCFC loan funds. All other additions, including replacement of general plant, shall be financed by general funds of the cooperative.

B. Retirement of Debt

Loans from NRUCFC and other lenders shall be retired according to the repayment schedule contained in the notes accompanying each loan. In addition, these loans may be structured in any form available at the time of borrowing, which could include term or interest calculation of fixed or variable. However, nothing in this Section II.B shall be construed as to prevent the restructuring and repricing of existing loans with respect to term, interest rate, and nature of rate (fixed or variable) provided that the Board has authorized management to pursue such restructuring and repricing. Additionally, nothing in this Section II.B prevents management, under approval of the Board, to elect

early repayment of existing loans provided that such early repayment does not adversely effect levels of working capital and reserves as required in Section II.C

#### C. Working Capital and Reserves

The funds necessary for 45 days working capital (consisting of operating expense, exclusive of depreciation and amortization, plus interest expense), retirement of debt principal, current year patronage capital retirement, and other specified reserves shall be set aside as a minimum general funds level. Other general funds uses shall be provided from general revenues. All other funds available from general revenues shall be used for plant additions or other approved budgeted uses.

#### D. Nonprofit Operation

With respect to the provision of electric energy, revenue in excess of operating expenses shall be considered as capital furnished by members to the Company. The Board of Directors (“the Board”) shall determine the amount of money available for distribution to the members in the form of patronage capital. The allocation and retirement of patronage capital shall be controlled by the Policy 4-2.

Services other than the provision of electric energy shall be operated on a non-patronage, taxable basis until the Board determines otherwise. For any service operated on a non-patronage, taxable basis, the Board may determine annually, after the close of the fiscal year, if the margin from these services (net of applicable income tax) shall be allocated to the members or if such net margin shall be retained as capital that is not allocated and distributed to the members, except upon dissolution of the Company.

The Board is authorized through the Bylaws of the Company to offer “other utility type services” to members and non-member patrons on a cooperative basis. The phrase “other utility type services” shall mean the sale and provision of services, which qualify for exemption under Section 501(c)(12) of the Internal Revenue Code, provided that the Board has adopted a resolution to offer such services on a cooperative basis. The resolution may take the form of an amendment to Policy 4-2 and may remain in effect indefinitely until revoked. However, the resolution must remain in effect for a minimum of one year. Additionally, the Board shall adopt the resolution on or before the latter of (1) January 1 of the year for which the activities are to be operated on a cooperative basis or (2) the date the patrons may start purchasing these services on a cooperative basis. For example, if the margins from “other utility type services” are to be operated on a cooperative basis and allocated to the patrons on the basis of patronage in the form of patronage capital during 2006 for the 2005 calendar year, then the resolution required to operate these services in this manner must be adopted on or before January 1, 2005. The methods associated with allocating and retiring patronage capital associated with operating “other utility type services” on a cooperative basis shall be controlled by Policy 4-2.

#### E. Equity Management

Equity management shall be based upon the interactions of past, present and projected future conditions, and will be reviewed and set during the development of the Company's 10-Year Financial Forecast.

1. Information will be developed concerning the growth of rate base, the blended cost of debt, retirement of patronage capital, and operating budgets.
2. This information shall be reflected in the settings of appropriate levels of (1) Equity and TIER in order to meet the goal set by the Board and (2) DSC and Modified DSC to satisfy loan covenants.
3. The Company shall use the NRUCFC Equity Stabilization plan as a guide for setting financial goals.

#### F. Investment of Available Funds

All available funds shall be invested in securities issued, guaranteed or insured by the United States Government, NRUCFC Commercial Paper, or Certificates of Deposit, providing a reasonable rate of return. These investments must be of the type that can be converted to cash as the funds are needed. However, nothing in this Section II.F precludes investments in capital term certificates and other securities as may be required by the mortgage lender.

### III. PROCEDURE

The following practices shall be followed to implement the above policies:

#### A. Planning

Long and short-range plans shall be developed, reviewed with the Board and shall be analyzed periodically to determine if revisions are necessary to reflect changing circumstances and conditions.

##### 1. Long-Range Engineering Planning

Long-range engineering planning shall be prepared and maintained to reflect the anticipated system improvements and new construction necessary to adequately serve the needs of the members. These plans shall provide a basis for scheduling loan applications, for minimizing obsolescence and provide a basis for financial, as well as organizational, planning.

##### 2. Long-Range Financial Planning

Long-range financial plans, both capital and operating, projected at least ten years into the future, with more detailed financial plans for the first five years, shall be prepared which reflect anticipated additions to plant and the associated financing required. These long-range financial plans shall also contain estimates of revenue and expenses and cash flows to determine if the Company's rates are appropriate.

##### 3. Annual Budget

Annual budgets shall be prepared, which contain a detailed estimate of revenue and expenses and cash flows for the periods they reflect. These budgets will be reported to the Board on a bi-annual basis.

#### 4. Equity Management Planning

The equity management objectives of the Company will be reviewed and considered in conjunction with long-range forecasts, annual work plan and budget and retail rate development.

### B. General Funds Administration

#### 1. General Funds Level

The working capital and reserve funds required by the Company are based on its experience and needs as identified in II.C. The Company will maintain sufficient working capital and reserve funds to meet promptly its operating costs, taxes, purchase of Capitalized Time Certificate obligations, quarterly debt service payments, routine construction and replacement costs, and for contingencies.

#### 2. Deposits and Investments

Working capital and reserve funds shall be invested with primary considerations given to safety and liquidity. Cash funds shall be kept in banks whose deposits are insured by the FDIC, FSLIC, FCUA, or invested in securities of the United States Government, NRUCFC Commercial Paper or Certificates of Deposit. Investments shall be planned to mature or be converted into cash without loss to meet anticipated needs for future funds.

### C. Priority of General Funds Use

General Funds not needed for working capital and other reserve purposes shall be used for, including but not limited to, the following:

1. Plant Additions.
2. Retirement of Patronage Capital: Any retirement of patronage capital by the Company shall be consistent with cooperative principles, its Bylaws and mortgage provision agreements with RUS, NRUCFC, or other lenders. Policy 4-2 provides for the methods and basis for retiring patronage capital.
3. Other Identified Cash Needs: The Company may use general funds in excess of working capital and other reserves to fund purchases and other items not budgeted.

Management, with the approval of the Board, shall determine the amount of funds in excess of working capital to be used for plant additions and the retirement of patronage capital. It is the goal of this policy to allow the Company use of funds in excess of working capital to fund plant additions, the retirement of patronage capital and other necessary (but not budgeted) purchases in a manner that meets the

Company's targeted level of equity and otherwise satisfies the requirements of this policy.

D. NRUCFC/CoBank Lines of Credit

1. Notice and authorization for borrowing of funds through the NRUCFC or CoBank lines of credit must have approval from the Executive Committee as soon as possible and then be reported to the Board at the next board meeting for full approval.

IV. RESPONSIBILITY

- A. The chief executive officer is responsible for the overall administration of this policy.
- B. The chief executive officer, or other designated staff member(s), shall periodically review the needs for revisions and the implementation of this policy.