FLEMING-MASON ENERGY
COOPERATIVE, INC.

ENERGY

P.O. BOX 328 • FLEMINGSBURG, KENTUCKY 41041 • (606) 845-2661 • FAX (606) 845-1008

April 6, 2012

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PUBLIC SERVICE
COMMISSION

Mr. Jeff D. Cline
Annual Report Branch Manager
Kentucky Public Service Commission
P. O. Box 615
Frankfort KY 40602

Dear Mr. Cline:

Enclosed is Fleming-Mason Energy Cooperative Inc.'s audit report for year ending December 31, 2011 as performed by Alan M. Zumstein, CPA.

Please contact the office if you have questions.

Sincerely,

Joni K Hazelrigg

Joni K. Hazelrigg
CFO

Enclosures

Kentucky 52
Fleming-Mason Energy Cooperative
Flemingsburg, Kentucky

Audited Financial Statements
December 31, 2011 and 2010

Alan M. Zumstein
Certified Public Accountant
1032 Chetford Drive
Lexington, Kentucky 40509

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• AICPA DIVISION FOR FIRMS
• TENNESSEE STATE BOARD OF ACCOUNTANCY

To the Board of Directors
Fleming Mason Energy Cooperative

I have audited the financial statements of Fleming Mason Energy Cooperative for the year ended December 31, 2011, and have issued my report thereon dated March 21, 2012. I conducted my audit in accordance with auditing standards generally accepted in the United States of America, 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, Policy on audits of the Rural Utilities Service (RUS) Borrowers. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing my audit of the financial statements of the Cooperative for the year ended December 31, 2011, I considered its internal control over financial reporting in order to determine my auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control over financial reporting.

My consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be a material weakness. A material weakness is a condition in which the design or operation of the specific internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. I noted no matters involving the internal control over financial reporting that I consider to be a material weakness.

7 CFR Part 1773.3 requires comments on specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions and other additional matters. I have grouped my comments accordingly. In addition to obtaining reasonable assurance about whether the financial statements are free from material misstatements, at your request, I performed tests of specific aspects of the internal control over financial reporting, of compliance with specific RUS loan and security instrument provisions and of additional matters. The specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and additional matters tested include, among other things, the accounting procedures and records, material control, compliance with specific RUS loan and security instrument provisions set forth in 7 CFR Part 1773.3(d)(1) related transactions, depreciation rates, a schedule of deferred debits and credits and a schedule of investments, upon which I express an opinion. In addition, my audit of the financial statements also included the procedures specified in 7 CFR Part 1773.38-.45. My Objective was not to provide an opinion on these specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, or additional matters, and accordingly, I express no opinion thereon.

No reports, other than my independent auditor's report, and my independent auditor's report on internal control over financial reporting and compliance and other matters, all dated March 21, 2012, or summary of recommendations related to my audit have been furnished to management.

My comments on specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions and other additional matters as required by 7 CFR Part 1773.33 are presented below.

Comments on Certain Specific Aspects of the Internal Control Over Financial Reporting

I noted no matters regarding the Cooperative's internal control over financial reporting and its operation that I consider to be a material weakness as previously defined with respect to:

- The accounting procedures and records;
- the process for accumulating and recording labor, material and overhead costs, and the distribution of these costs to construction, retirement, and maintenance and other expense accounts, and;
- the material controls.

Comments on Compliance with Specific RUS Loan and Security Instrument Provisions

At your request, I have performed the procedures enumerated below with respect to compliance with certain provisions of laws, regulations, and contracts. The procedures I performed are summarized as follows:

- Procedures performed with respect to the requirement for a borrower to obtain written approval of the mortgagee to enter into any contract for the operation or maintenance of property, or for the use of mortgaged property by others for the year ended December 31, 2011, of the Cooperative.
    1. The Cooperative has not entered into any contract during the year for the operation or maintenance of its property, or for the use of its property by others as defined in 1773.33(e)(1)(i).
- Procedures performed with respect to the requirement to submit RUS *Financial and Operating Report Electric Distribution* to RUS:
    1. Agreed amounts reported in RUS *Financial and Operating Report Electric Distribution* to the Cooperative's records as of December 31, 2011.

The results of my tests indicate that, with respect to the items tested, the Cooperative complied in all material respects, with the specific RUS loan and security instrument provisions referred to below. With respect to items not tested, nothing came to my attention that caused me to believe that the Cooperative had not complied, in all material respects, with those provisions. The specific provisions tested, as well as any exceptions noted, include the requirements that:

- The borrower has submitted its RUS *Financial and Operating Report Electric Distribution* to RUS and the *Financial and Operating Report Electric Distribution*, as of December 31, 2011, represented by the borrower as having been submitted to RUS appears to be in agreement with its audited records in all material respects.
- During the period of this review, the Cooperative received no long term advances from CFC on loans controlled by the RUS/CFC Mortgage and Loan Agreement.

Comments on Other Additional Matters

In connection with my audit of the Cooperative, nothing came to my attention that caused me to believe that the Cooperative failed to comply with respect to:

- The reconciliation of continuing property records to controlling general ledger plant accounts addressed at 7 CFR Part 1773.33(c)(1);

- The clearing of the construction accounts and the accrual of depreciation on completed construction addressed at 7 CFR Part 1773.33(c)(2);
- The retirement of plant addressed at 7 CFR 1773.33(c)(3) and (4);
- Approval of the sale, lease, or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap addressed at 7 CFR Part 1773.33(c)(5);
- The disclosure of material related party transactions, in accordance with Statement of Financial Accounting Standard No. 57, Related party Transactions, for the year ended December 31, 2011, in the financial statements referenced in the first paragraph of this report addressed at 7 CFR Part 1773.33(f);
- The depreciation rates addressed at 7 CFR Part 1773.33(g);
- The detailed schedule of deferred debits and deferred credits; and
- The detailed schedule of investments.

My audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The detailed schedule of deferred debits and deferred credits required by 7 CFR Part 1773(h) and provided below is presented for purposes of additional analysis and is not a required part of the basic financial statements. This information has been subjected to the auditing procedures applied in my audit of the basic financial statements and, in my opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The deferred credits are as follows:

Consumer advances for construction	$10,407
Deferred meter installations	4,597
	$15,004

Fleming Mason has a wholly-owned subsidiary, Fleming Mason Service Corporation, which owns the rights to a Local Multipoint Distributions Serviced (LMDS) in areas in Kentucky where the license has been purchased. The investment is accounted for using the equity method of accounting. There was no original investment in capital stock. There is neither an investment nor profits to report.

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

Alan M. Zumstein

Alan M. Zumstein, CPA
March 21, 2012

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Independent Auditor's Report

To the Board of Directors
Fleming Mason Energy Cooperative

I have audited the accompanying balance sheets of Fleming Mason Energy Cooperative, as of December 31, 2011 and 2010, and the related statements of income and patronage capital and cash flows for the years then ended. These financial statements are the responsibility of Fleming Mason Energy Cooperative's management. My responsibility is to express an opinion on these financial statements based on my audits.

I conducted my audits in accordance with auditing standards generally accepted in the United States of America, 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, Policy on Audits of Rural Utilities Service (RUS) Borrowers. Those standards require that I plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audits provide a reasonable basis for my opinion.

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Fleming Mason Energy Cooperative as of December 31, 2011 and 2010, and the results of operations and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, I have also issued a report dated March 21, 2012, on my consideration of Fleming Mason Energy Cooperative's internal control over financial reporting and my 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 my 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* and should be considered in assessing the results of my audits.

Alan M. Zumstein

Alan M. Zumstein, CPA
March 21, 2012

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To the Board of Directors
Fleming Mason Energy Cooperative

I have audited the financial statements of Fleming Mason Energy Cooperative as of and for the years ended December 31, 2011 and 2010, and have issued my report thereon dated March 21, 2012. I conducted my audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing my audit, I considered the Cooperative's internal control over financial reporting as a basis for designing my auditing procedures for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Cooperative's internal control over financial reporting. Accordingly, I do not express an opinion on the effectiveness of the Cooperative's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more that a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

My consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. I did not identify any deficiencies in internal control over financial reporting that I consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Fleming Mason's financial statements are free of material misstatement, I performed test 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 my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the audit committee, management, 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.

Alan M. Zumstein

Alan M. Zumstein, CPA
March 21, 2012

Fleming-Mason Energy Cooperative
Balance Sheets, December 31, 2011 and 2010

Assets	2011	2010
Electric Plant, at original cost:		
In service	$ 88,733,590	$ 86,671,705
Under construction	679,769	532,915
	89,413,359	87,204,620
Less accumulated depreciation	25,964,288	24,176,136
	63,449,071	63,028,484
Investments in Associated Organizations	24,039,793	19,458,512
Current Assets:		
Cash and cash equivalents	270,762	556,587
Accounts receivable, less allowance for 2011 of $98,276 and 2010 of $66,747	7,362,056	7,386,047
Other receivables	1,351,297	1,424,449
Material and supplies, at average cost	371,076	355,725
Other current assets	119,131	122,462
	9,474,322	9,845,270
Total	$ 96,963,186	$ 92,332,266
Members' Equities and Liabilities		
Members' Equities:		
Memberships	$ 231,010	$ 232,168
Patronage capital	38,480,487	33,525,189
Other equities	(3,287,928)	(3,332,588)
Accumulated other comprehensive income	(4,600,499)	(4,339,718)
	30,823,070	26,085,051
Long Term Liabilities:		
Long term debt	44,374,386	44,566,341
Accumulated operating provisions	7,291,827	6,872,726
	51,666,213	51,439,067
Current Liabilities:		
Short term borrowings	4,700,000	5,000,000
Accounts payable	6,105,909	6,196,968
Current portion of long term debt	2,125,000	1,925,000
Consumer deposits	738,156	712,085
Accrued expenses	789,834	861,236
	14,458,899	14,695,289
Deferred Credits	15,004	112,859
Total	$ 96,963,186	$ 92,332,266

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

Statements of Revenue and Patronage Capital
for the years ended December 31, 2011 and 2010

	2011	2010
Operating Revenues	$ 70,475,122	$ 67,143,177
Operating Expenses:		
Cost of power	57,792,373	53,534,623
Distribution - operations	1,729,787	1,522,939
Distribution - maintenance	2,750,240	2,635,800
Consumer accounts	1,774,064	1,779,564
Customer services	105,616	105,444
Sales	91,926	90,978
Administrative and general	1,395,351	1,403,023
Depreciation, excluding $214,280 in 2011 and $181,715 in 2010 charged to clearing account	2,845,963	2,742,464
Taxes, other than income	66,771	63,759
Other deductions	20,715	25,392
	68,572,806	63,903,986
Operating margins before interest charges	1,902,316	3,239,191
Interest Charges:		
Long-term debt	1,155,407	1,288,218
Other	187,044	186,415
	1,342,451	1,474,633
Operating margins after interest charges	559,865	1,764,558
Nonoperating Margins		
Interest income	42,576	43,719
Others	(25,286)	(18,524)
	17,290	25,195
Patronage Capital Credits	4,618,269	2,533,088
Net Margins	5,195,424	4,322,841
Patronage Capital, beginning of year	33,525,189	29,418,846
Refunds to estates of deceased members	(196,410)	(165,125)
Transfers to prior year's deficits and other equities	(43,716)	(51,373)
Patronage Capital, end of year	$ 38,480,487	$ 33,525,189

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

Statements of Cash Flows
for the years ended December 31, 2011 and 2010

	2011	2010
Cash Flows from Operating Activities:		
Net margins	$ 5,195,424	$ 4,322,841
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation:		
Charged to expense	2,845,963	2,742,464
Charged to clearing accounts	214,280	181,715
Patronage capital credits assigned	(4,618,269)	(2,533,088)
Accumulated postretirement benefits	158,320	165,847
Change in assets and liabilities:		
Receivables	97,143	(618,843)
Material and supplies	(15,351)	33,800
Other assets	3,331	(10,351)
Payables	(91,059)	744,415
Consumer deposits and advances	(71,784)	94,700
Accrued expenses	(71,402)	(285,090)
	3,646,596	4,838,410
Cash Flows from Investing Activities:		
Plant additions	(3,287,692)	(4,147,769)
Plant removal costs	(203,846)	(280,882)
Salvage recovered from retired plant	10,708	1,417
Receipts from other investments, net	36,988	31,624
	(3,443,842)	(4,395,610)
Cash Flows from Financing Activities:		
Net increase in memberships	(1,158)	(1,705)
Refund of patronage capital to members	(196,410)	(165,125)
Increase in other equities	944	2,018
Advances of long term debt	2,000,000	2,000,000
Payments on long term debt	(1,991,955)	(1,802,429)
Short term borrowings	(300,000)	(342,042)
Capital leases	-	(21,839)
	(488,579)	(331,122)
Net increase in cash	(285,825)	111,678
Cash and cash equivalents, beginning of year	556,587	444,909
Cash and cash equivalents, end of year	$ 270,762	$ 556,587
Supplemental cash flows information:		
Interest paid on long-term debt	$ 1,211,953	$ 1,327,755

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

Note 1. Summary of Significant Accounting Policies

Fleming Mason Energy Cooperative ("Fleming Mason") maintains its records in accordance with the policies prescribed or permitted by the Kentucky Public Service Commission ("PSC") and the United States Department of Agriculture, Rural Utilities Service ("RUS"), which conform in all material respects with generally accepted accounting principles. The more significant of these policies are as follows:

Electric Plant Electric plant is stated at original cost, which is the cost when first dedicated to public service. Such amount includes applicable supervisory and overhead cost including any construction period interest and taxes. There was no interest required to be capitalized during the year.

The cost of maintenance and repairs, including renewals of minor items of property, is charged to operating expense. The cost of replacement of depreciable property units, as distinguished from minor items, is charged to electric plant. The units of property replaced or retired, including cost of removal, net of any salvage value, is charged to accumulated depreciation. Electric plant consists of:

	2011	2010
Distribution plant	$79,177,840	$77,222,863
General plant	9,555,750	9,448,842
Total	$88,733,590	$86,671,705

Depreciation Provision has been made for depreciation on the basis of the estimated lives of assets, using the straight-line method. Depreciation rates range from 1.44% to 10.0%, with a composite rate of 3.62% for distribution plant. General plant rates are as follows:

Structures and improvements	2.5%
Transportation equipment	10% - 20%
Other general plant	5% - 10%

Cash and Cash Equivalents Fleming Mason considers all short-term, highly liquid investments with original maturities of three months or less to be cash equivalents.

Off Balance Sheet Risk Fleming Mason has off-balance sheet risk in that they maintain cash deposits in financial institutions in excess of the amounts insured by the Federal Deposit Insurance Corporation (FDIC). At December 31, 2011, the financial institutions reported deposits in excess of the $250,000 FDIC insured limit several times during the audit period.

Estimates The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures 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 used in the preparation of the financial statements.

Revenue Fleming Mason records revenue as billed to its consumers based on monthly meter-reading cycles. All consumers are required to pay a refundable deposit that may be waived under certain circumstances. Fleming Mason's sales are concentrated in an eight county area of eastern Kentucky. Consumers must pay their bill within 20 days of billing, at which time a disconnect notice is sent with payment to be within 10 days. If not paid, then consumers are subject to disconnect. Accounts are written off when they are deemed to be uncollectible. The allowance for uncollectible accounts is based on the aging of receivables. There was one customer whose individual account balance exceeded 10% of outstanding accounts receivable at December 31, 2011 and 2010. See Note 9 for additional information.

Note 1. Summary of Significant Accounting Policies, continued

Cost of Power Fleming Mason is one of sixteen (16) members of East Kentucky Power Cooperative ("East Kentucky"). Under a wholesale power agreement, Fleming Mason is committed to purchase its electric power and energy requirements from East Kentucky until 2051. The rates charged by East Kentucky are subject to approval of the PSC. The cost of purchased power is recorded monthly during the period in which the energy is consumed, based upon billings from East Kentucky. There are certain surcharges, clauses, and credits that East Kentucky includes to Fleming Mason that are passed on to consumers using a methodology prescribed by the Commission.

Fair Value Measurements The Fair Value Measurements and Disclosures Topic of the FASB ASC 820, *Fair Value Measurements and Disclosures,* defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal, or most advantageous, market for the asset or liability in an orderly transaction between market participants at the measurement date. The Fair Values Measurements Topic establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of observable inputs when possible. The three levels of inputs used to measure fair value are as follows:

> Level 1: Quoted prices (unadjusted) or identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
>
> Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices of similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.
>
> Level 3: Significant unobservable inputs that reflect an organization's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The carrying amounts of Fleming Mason's cash and cash equivalents, other receivables, investments, inventories, other assets, trade accounts payable, accrued expenses and liabilities, and other liabilities approximate fair value due to their short maturity. Investments in associated organizations are not considered a financial instrument because they represent nontransferable interests in associated organizations. Other assets are not considered financial instruments because they represent activities specifically related to Fleming Mason. Long term debt can not be traded in the market, and is specifically for electric cooperatives and, therefore, a value other than its outstanding principal cannot be determined.

Fleming Mason may, and also does, invest idle funds in local banks and in National Rural Utilities Cooperative Finance Corporation ("CFC") commercial paper. These investments are classified as held-to-maturity in accordance with provisions of the *Financial Instruments Topic* of FASB ASC 320. Held-to-maturity securities are presented at amortized cost. The fair value of held-to-maturity securities approximates cost at 2011 and 2010.

Principles of Consolidation Fleming Mason has a wholly-owned subsidiary, Fleming Mason Service Corporation ("Service Corporation"). Since there is no significant activity in the subsidiary, consolidated financial statements are not prepared.

The Service Corporation has purchased Local Multipoint Distribution Services ("LMDS") licenses in central and western Kentucky. This gives the Service Corporation the franchise to serve LMDS to the areas purchased. The licenses can be renewed with a minimum of application. The management of the Service Corporation has indicated this minimum will be met, and the license will have an indefinite life, therefore, there is no amortization of the license.

Note 1. Summary of Significant Accounting Policies, continued

Advertising Fleming Mason expenses advertising costs as incurred.

Income Tax Status Fleming Mason is exempt from federal and state income taxes under provisions of Section 501(c)(12). Accordingly, the financial statements include no provision for income taxes.

The Service Corporation is a "C" Corporation for income tax purposes. No taxes are due for 2010 or 2009.

Effective January 1, 2008, Fleming Mason adopted the provisions of the *Income Taxes Topic* of the FASB ASC that pertains to accounting for uncertainty in income taxes. Fleming Mason had no prior unrecognized tax benefits as a result of the implementation. Management evaluates its potential exposures from tax positions taken that have or could be challenged by taxing authorities. These potential exposures result because taxing authorities may take positions that differ from those taken by management in the interpretation and application of statures, regulations, and rules. There are no tax positions for which the ultimate deductibility is highly uncertain included in the accompanying financial statements. Fleming Mason recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. Fleming Mason did not recognize any interest or penalties during the years ended December 31, 2011 or 2010.

Risk Management Fleming Mason is exposed to various forms of losses of assets associated with, but not limited to, fire, personal liability, theft, vehicular accidents, errors and omissions, fiduciary responsibility, workers compensation, etc. Each of these areas is covered through the purchase of commercial insurance.

Subsequent Events Management has evaluated subsequent events through March 21, 2012, the date the financial statements were available to be issued. There were no significant subsequent events to report.

Note 2. Investments in Associated Organizations

Investments in associated organizations consist of:

	2011	2010
East Kentucky, patronage capital	$22,157,682	$17,641,925
CFC, CTC's	858,625	859,574
CFC, patronage capital	249,216	212,442
Others	774,270	744,571
Total	$24,039,793	$19,458,512

Fleming Mason records patronage capital assigned by associated organizations in the year in which such assignments are received. The Capital Term Certificates ("CTCs") of CFC are recorded at cost. The CTCs were purchased from CFC as a condition of obtaining long-term financing. The CTCs bear interest at 3% and 5% and are scheduled to mature at varying times from 2020 to 2080.

Note 3. Patronage Capital

Under provisions of the long-term debt agreement, return to patrons of capital contributed by them is limited to amounts which would not allow the total equities and margins to be less than 30% of total assets, except that distributions may be made to estates of deceased patrons. The debt agreement provides, however, that should such distributions to estates not exceed 25% of the net margins for the next preceding year, Fleming Mason may distribute the difference between 25% and the payments made to such estates. The equity at December 31, 2011 was 32% of total assets. Included in other equities is $3,369,902 of losses from prior years' that is being carried forward to be offset with future years' non operating margins.

Note 3. Patronage Capital, continued

Patronage capital consists of:

	2011	2010
Assigned to date	$37,961,492	$33,682,368
Assignable margins	5,195,424	4,322,841
Retirements to date	(4,676,429)	(4,480,020)
Total	$38,480,487	$33,525,189

Note 4. Accumulated Other Comprehensive Income

The changes in accumulated other comprehensive income, which includes the recording of unfunded pension costs and accumulated postretirement benefits, is as follows:

	2011	2010
Balance, beginning	($4,339,718)	($4,484,849)
Pension plan, amortize and adjust	(228,847)	168,309
Postretirement benefits, amortize and adjust	(31,934)	(23,178)
Balance, ending	($4,600,499)	($4,339,718)

The ending balance is comprised of the following:

	2011	2010
Pension plan	($4,028,475)	($3,735,760)
Postretirement benefits	(572,024)	(603,958)
Total	($4,600,499)	($4,339,718)

Note 5. Long Term Debt

All assets, except vehicles, are pledged as collateral on the long term debt to RUS, Federal Financing Bank ("FFB"), CFC, and National Bank for Cooperative ("CoBank") under a joint mortgage agreement. Long term debt consists of:

	2011	2010
RUS, 3.92 to 5.18%	$15,351,932	$15,621,156
RUS, Economic Development Loan, 0%	561,157	635,161
FFB, 0.22% (0.132% in 2010)	21,901,391	20,757,515
CFC, 4.05% to 5.95%	2,785,468	3,011,925
CoBank, 3.73%	5,899,438	6,465,584
	46,499,386	46,491,341
Less current portion	2,125,000	1,925,000
Long term portion	$44,374,386	$44,566,341

The interest rates on the notes to CFC are subject to change every seven years from the repricing date for each individual note. The long term debt is due in quarterly and monthly installments of varying amounts through 2039. Fleming Mason has a loan funds available from FFB in the amount of $4,334,000. RUS assess 12.5 basis points to administer the FFB loans. During October, 2010, Fleming Mason refinanced $6,649,662 of RUS 5% loans with 3.73% notes from CoBank.

Note 5. Long Term Debt, continued

Fleming Mason is participating in a RUS sponsored program which provides economic development funds to businesses in Fleming Mason's service area. Fleming Mason serves as a conduit for these funds and is contingently liable if the recipient fails to repay the loan.

As of December 31, 2011, the annual principal payments for the next five years are as follows: 2012 - $2,125,000; 2013 - $2,190,000; 2014 - $2,300,000; 2015 - $2,400,000; 2016 - $2,500,000.

Note 6. Short Term Borrowings

At December 31, 2011, Fleming Mason had a short term line of credit of $10,000,000 available from CFC. The outstanding balance under the line of credit at December 31, 2011 and 2010 was $4,700,000 and $5,000,000, respectively. The interest rate at December 31, 2011 and 2010 was 3.20% and 4.25%, respectively. Fleming-Mason also has a line of credit with CoBank in the amount of $10,000,000. There were no advances against this line of credit during the audit period.

Note 7. Pension Plan

Fleming Mason has a noncontributory defined benefit pension plan covering substantially all employees who meet minimum age and service requirements. The plan has pay-related pension benefit formula. Fleming Mason's policy is to fund such plans in accordance with the requirements of the Employee Retirement Income Security Act ("ERISA") of 1974. The plan is measured as of December 31, 2011 and 2010. Effective January 1, 2010, the benefit level will change from 2.0 to 1.8 and lump-sum payments will be discontinued. Benefits accrued prior to January 1, 2010 will not be affected.

The following is an assessment of the noncontributory defined benefit plan:

Change in Benefit Obligation:		
Beginning of year	$6,266,400	$5,950,704
Service cost	348,313	370,915
Interest cost	332,039	357,150
Actuarial (gain)/loss	250,824	274,607
Benefits paid	-	(686,976)
End of year	7,197,576	6,266,400
Change in Plan Assets:		
Beginning of year	2,136,280	1,682,270
Actual return on assets	9,396	208,986
Employer contributions	769,868	932,000
Benefits paid	-	(686,976)
End of year	2,915,544	2,136,280
Funded status of plan	($4,282,032)	($4,130,120)
Accumulated benefit obligation in plan	$4,293,406	$3,466,688

Note 7. Pension Plan

The amounts recognized in the statement of financial position are as follows:

	2011	2010
Accumulated operating provisions	($4,028,475)	($3,735,760)
Accrued benefit liability	(253,557)	(394,360)
Amount recognized in financial statements	($4,282,032)	($4,130,120)

The net periodic pension benefit cost was calculated as follows:

	2011	2010
Service cost	$348,313	$370,915
Interest cost	332,039	357,150
Expected return on plan assets	(219,016)	(200,627)
Amortization of actuarial (gain)/loss	167,729	205,887
Net periodic benefit cost	$629,065	$733,325

Assumptions used to develop the projected benefit obligation are as follows:

	2011	2010
Discount rate	5.75%	5.75%
Rate of increase in compensation level	4.50%	4.50%
Expected long-term rate of return on assets	8.00%	8.00%

The expected long term rate of return on plan assets for determining net periodic pension cost for each fiscal year is chosen from the best range determined by applying anticipated long term returns for various asset categories to the target asset allocation of the plan, as well as taking into account historical returns.

The general investment objectives are to invest in a diversified portfolio, comprised of debt investments, equity investments, and fixed income investments. The diversification is designed to minimize the risk of large losses while maximizing total return within reasonable and prudent levels of risk. The investment objectives specify a targeted investment allocation for the pension plan of approximately 50% equities. The remaining may be allocated among fixed income or cash equivalent investments.

Expected retiree pension benefit payments are projected to be as follows: 2012 - $63,000; 2013 - $65,000; 2014 - $69,000; 2015 - $73,000; 2016 - $77,000.

Fleming Mason expects to contribute approximately $750,000 during 2012. However, Fleming Mason reserves the right to contribute more or less depending on other considerations and circumstances.

Note 8. Postretirement Benefits

Fleming Mason sponsors a defined benefit plan that provides medical insurance coverage to retired employees, directors and attorney. The plan calls for benefits to be paid at retirement based primarily upon years of service with Fleming Mason. The following is a reconciliation of the postretirement obligation.

Note 8. Postretirement Benefits, continued

The status of the unfunded postretirement benefit plan is as follows:

	2011	2010
Change in Benefit Obligation:		
Beginning of year	$3,136,966	$2,994,297
Service cost	95,029	136,532
Interest cost	192,010	183,938
Actuarial (gain)/loss	-	-
Benefits paid	(160,653)	(177,801)
End of year	3,263,352	3,136,966
Plan assets	-	-
Funded status of plan	($3,263,352)	($3,136,966)

Projected retiree benefit payments for the next five years are expected to be as follows: 2012 - $106,000; 2013 - $112,000; 2014 - $98,000; 2015 - $96,000; 2016 - $92,000.

The discount rate used in determining the APBO was 6.0% for 2011 and 2010. The health care cost trend rate used to compute the APBO in an 8% annual rate of increase for 2011, and decreasing gradually to 5.5%, then remain at that level thereafter.

Note 9. Significant Patron Information

Operating revenues, cost of power, and accounts receivable as of December 31, 2011 and 2010, resulting from the sale of electric energy to the single industrial customer as shown below. In addition, Fleming Mason bills and collects steam and facility charges for East Kentucky to the industrial customer. There are no margins realized from this arrangement with East Kentucky, therefore, the amounts are not reflected in operating revenues or cost of power. The amount for steam was $14,333,054 for 2011 and $11,523,125 for 2010. The facility charge was $992,292 for 2011 and $1,089,708 for 2010.

Operating revenue, cost of power, and accounts receivable as of December 31, 2011 and 2010, resulting from the sale of electricity to the single industrial customers, are as follows:

	2011	2010
Operating revenues	$14,730,116	$13,110,602
Cost of power	14,227,092	12,600,552
Accounts receivable	2,850,320	2,575,076

Note 10. Related Party Transactions

Several of the Directors of Fleming Mason, its President & CEO, and another employee are on the boards of directors of various associated organizations.

Note 11. Commitments

Fleming Mason is contingently liable as guarantor for approximately $181,000 of long term obligations of East Kentucky to RUS, CFC, and institutional investors. Substantially all assets of Fleming Mason are pledged as collateral for this guarantee, in addition to the pledge in the mortgage agreement referred to in Note 5. This contingent liability was part of an overall financing plan for the construction of a generating facility near Maysville, Kentucky.

Fleming Mason has various other agreements outstanding with local contractors. Under these agreements, the contractors will perform certain meter reading, construction, and maintenance work at specified hourly rates or unit cost, or on an as needed basis. The duration of these contracts are one to three years.

Note 12. Rate Matters

East Kentucky increased its base rates to Fleming Mason during August 2007, by 2%, in April 2009, by 7%, and in January 2011 by another 5%. Fleming Mason passes East Kentucky's increases on to its customers using the methodology prescribed by the PSC.

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