

**FARMERS RURAL ELECTRIC
COOPERATIVE CORPORATION AND SUBSIDIARY
GLASGOW, KENTUCKY**

**REPORT ON AUDIT OF CONSOLIDATED
FINANCIAL STATEMENTS AND ADDITIONAL INFORMATION**

**For the Years Ended
December 31, 2014 and 2013**

CONTENTS

	<u>Pages</u>
Independent Auditors' Report	1 - 2
Consolidated Financial Statements:	
Balance Sheets	3 - 4
Statements of Revenue	5
Statements of Comprehensive Income	6
Statements of Patronage Capital and Memberships	7
Statements of Cash Flows	8 - 9
Notes to Consolidated Financial Statements	10 - 19
Supplementary Information:	
Independent Auditors' Report on Consolidating Information	20
Schedule I - Consolidating Balance Sheet	21
Schedule II - Consolidating Statement of Revenue	22
Schedule of Expenditures of Federal Awards	23
Notes to Schedule of Expenditures of Federal Awards	24
Schedule of Findings and Questioned Costs	25 - 26
Schedule of Prior Audit Findings	27
Independent Auditors' Report on Compliance for Each Major Program and On Internal Control Over Compliance Required by OMB Circular A-133	28 - 29
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 <i>Government Auditing Standards</i>	30 - 31
Independent Auditors' Report on Compliance with Aspects of Contractual Agreements and Regulatory Requirements for Electric Borrowers	32 - 34



CAMPBELL, MYERS AND RUTLEDGE, PLLC

Cindy L. Greer, CPA ▪ L. Joe Rutledge, CPA ▪ Jonathan W. Belcher, CPA ▪ R. Brent Billingsley, CPA

Skip R. Campbell, CPA ▪ Sammie D. Parsley, CPA ▪ Ryan Mosier, CPA ▪ Jenna B. Pace, CPA

INDEPENDENT AUDITORS' REPORT

Board of Directors
Farmers Rural Electric
Cooperative Corporation
Glasgow, Kentucky

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Farmers Rural Electric Cooperative Corporation which comprise the balance sheets as of December 31, 2014 and 2013, and the related statements of revenue, comprehensive income, patronage capital and memberships, and cash flows, for the years then ended and related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the respective financial position of Farmers Rural Electric Cooperative Corporation as of December 31, 2014 and 2013, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise Farmers Rural Electric Cooperative Corporation's basic financial statements. The consolidating balance sheet and consolidating statement of revenue are presented for purposes of additional analysis and are not a required part of the basic financial statements. The schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements.

The consolidating balance sheet, consolidating statement of revenue and schedule of expenditures of federal awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating balance sheet, the consolidating statement of revenue, and the schedule of expenditures of federal awards are fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 9, 2015 on our consideration of the Cooperative's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Farmers Rural Electric Cooperative Corporation's internal control over financial reporting and compliance.

Campbell, Myers, and Rattledge, PLLC

Certified Public Accountants
Glasgow, Kentucky

March 9, 2015

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
BALANCE SHEETS
December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Current assets:		
Cash and cash equivalents	\$ 585,765	\$ 2,101,954
Accounts and notes receivable, less allowance for doubtful accounts of \$92,053 in 2014 and \$84,307 in 2013	5,249,910	5,462,231
Materials and supplies, at average cost	770,707	609,474
Prepaid expenses	201,368	209,549
Total current assets	6,807,750	8,383,208
Other assets and investments:		
Investments in subsidiary companies	1,924,481	1,764,828
Investment in associated organizations	23,360,199	20,698,602
Deferred charges	2,239,750	2,414,593
Note receivable	1,000,000	-
Total other assets	28,524,430	24,878,023
Electric plant in service	82,623,898	78,383,636
Construction work in progress	886,561	662,995
	83,510,459	79,046,631
Less accumulated depreciation	(24,476,870)	(23,501,969)
Electric plant, net	59,033,589	55,544,662
Total assets	\$ 94,365,769	\$ 88,805,893

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

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
BALANCE SHEETS
December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Current liabilities:		
Accounts payable	\$ 4,265,790	\$ 4,322,160
Accrued expenses	1,317,413	1,385,663
Customer deposits	900,227	924,319
Current portion of capital leases	33,905	11,615
Current portion of long-term debt	<u>2,110,120</u>	<u>1,887,000</u>
Total current liabilities	<u>8,627,455</u>	<u>8,530,757</u>
Long-term liabilities:		
Capital lease less current maturities	46,264	6,238
Long-term debt less current maturities	<u>46,280,237</u>	<u>44,570,255</u>
Total long-term liabilities	<u>46,326,501</u>	<u>44,576,493</u>
Noncurrent liabilities:		
Post retirement benefit obligations	531,973	501,055
Customer advances for construction	<u>369,932</u>	<u>390,737</u>
Total noncurrent liabilities	<u>901,905</u>	<u>891,792</u>
Members' equities:		
Memberships	536,810	534,305
Patronage capital	36,276,290	32,702,886
Accumulated other comprehensive income	(454,986)	(420,274)
Other equities	<u>1,680,165</u>	<u>1,556,613</u>
Total members' equities	<u>38,038,279</u>	<u>34,373,530</u>
Minority interests	<u>471,629</u>	<u>433,321</u>
Total equities	<u>38,509,908</u>	<u>34,806,851</u>
 Total liabilities and equity	 <u>\$ 94,365,769</u>	 <u>\$ 88,805,893</u>

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

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
STATEMENTS OF REVENUE

For the years ended December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Operating revenue	\$ 53,312,037	\$ 51,568,890
Operating expenses:		
Cost of power	38,924,102	36,935,158
Distribution - operations	1,660,558	1,490,539
Distribution - maintenance	2,960,807	3,469,189
Consumer accounts	1,093,049	1,097,853
Customer services and informational expense	169,746	171,863
Administrative and general	2,126,480	2,101,025
Depreciation	2,610,589	2,467,769
Taxes	<u>740,172</u>	<u>612,570</u>
Total operating expenses	<u>50,285,503</u>	<u>48,345,966</u>
Operating margins	3,026,534	3,222,924
Interest on long-term debt to RUS and CFC	<u>1,832,381</u>	<u>1,885,696</u>
Operating margins after fixed charges	1,194,153	1,337,228
G & T and other capital credits	<u>2,693,970</u>	<u>3,059,278</u>
Net operating margins	<u>3,888,123</u>	<u>4,396,506</u>
Nonoperating margins:		
Interest income, net of expenses of \$4,685 in 2014 and \$4,188 in 2013	57,134	70,723
Other net nonoperating income (loss)	<u>259,272</u>	<u>240,742</u>
	<u>316,406</u>	<u>311,465</u>
Net margins	<u>\$ 4,204,529</u>	<u>\$ 4,707,971</u>

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

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
 STATEMENTS OF COMPREHENSIVE INCOME
 For the years ended December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Net margins	\$ 4,204,529	\$ 4,707,971
Defined benefit pension plans:		
Net gain (loss) during period	(55,724)	28,975
Amortization of net gain (loss)	10,968	14,196
Less: amortization of transition obligation	<u>10,044</u>	<u>10,044</u>
Other comprehensive income (loss)	(34,712)	53,215
Total comprehensive income	<u>\$ 4,169,817</u>	<u>\$ 4,761,186</u>

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

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
 STATEMENTS OF PATRONAGE CAPITAL AND MEMBERSHIPS
 For the years ended December 31, 2014 and 2013

	Memberships	Accumulated Other Comprehensive Income	Patronage Capital					Total
			Unassigned	Assignable	Assigned	Retired	Distributed	
Balances, January 1, 2013	\$ 532,005	\$ (473,489)	\$ (1,092,440)	\$ 2,842,565	\$ 39,522,384	\$ (433,300)	\$ (12,378,568)	\$ 28,460,641
Increase in memberships, net of terminations	2,300	-	-	-	-	-	-	-
Net margins for the year ended December 31, 2013	-	-	-	4,707,971	-	-	-	4,707,971
Assignment of patronage capital for the year ended December 31, 2013 and old unassigned margins	-	-	-	(2,842,565)	2,842,565	-	-	-
Retirement of patronage capital of estates of deceased members and adjustments	-	-	-	-	-	-	-	-
Other comprehensive income	-	53,215	-	-	-	-	-	-
Distributions of patronage capital	-	-	-	-	-	-	(465,726)	(465,726)
Balances, December 31, 2013	\$ 534,305	\$ (420,274)	\$ (1,092,440)	\$ 4,707,971	\$ 42,364,949	\$ (433,300)	\$ (12,844,294)	\$ 32,702,886
Increase in memberships, net of terminations	2,505	-	-	-	-	-	-	-
Net margins for the year ended December 31, 2014	-	-	-	4,204,529	-	-	-	4,204,529
Assignment of patronage capital for the year ended December 31, 2014 and old unassigned margins	-	-	-	(4,707,971)	4,707,971	-	-	-
Retirement of patronage capital of estates of deceased members and adjustments	-	-	-	-	-	-	-	-
Other comprehensive income	-	(34,712)	-	-	-	-	-	-
Distributions of patronage capital	-	-	-	-	-	-	(631,125)	(631,125)
Balances, December 31, 2014	<u>\$ 536,810</u>	<u>\$ (454,986)</u>	<u>\$ (1,092,440)</u>	<u>\$ 4,204,529</u>	<u>\$ 47,072,920</u>	<u>\$ (433,300)</u>	<u>\$ (13,475,419)</u>	<u>\$ 36,276,290</u>

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

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
STATEMENTS OF CASH FLOWS
For the years ended December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Cash flows from operating activities:		
Net margins	\$ 4,204,529	\$ 4,707,971
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	2,610,589	2,467,769
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	212,321	(424,039)
(Increase) decrease in inventory	(161,233)	(177,484)
(Increase) decrease in prepaid expenses	8,181	(3,255)
Increase (decrease) in accounts payable	(56,370)	652,951
Increase (decrease) in customer deposits	(24,092)	(47,504)
Increase (decrease) in accrued expenses	(68,250)	114,442
Increase (decrease) in customer advances for construction	(20,805)	(14,915)
(Increase) decrease in deferred charges	<u>174,843</u>	<u>(1,709,591)</u>
Net cash provided (used) by operating activities	<u>6,879,713</u>	<u>5,566,345</u>
Cash flows from investing activities:		
Purchases of property, plant, and equipment	(5,458,166)	(4,920,551)
Plant removal costs	(674,525)	(496,397)
Salvage recovered from retirement of plant	67,117	82,868
Investments in subsidiary companies	159,653	207,025
(Increase) decrease in investments in associated organizations and other investments	<u>(2,661,597)</u>	<u>(3,023,616)</u>
Net cash provided (used) by investing activities	<u>(8,567,518)</u>	<u>(8,150,671)</u>

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

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
 STATEMENTS OF CASH FLOWS, CONCLUDED
 For the years ended December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Cash flows from financing activities:		
Memberships issued	\$ 2,505	\$ 2,300
Increase (decrease) in noncurrent liabilities	(30,918)	47,646
Distributions of patronage capital	(631,125)	(465,726)
Retired capital credits - gain	(123,552)	(85,596)
Minority interest - subsidiary	38,308	55,656
Principal payments under capital lease obligation	(16,703)	(31,492)
Principal payments to RUS	(112,270)	(107,099)
Advanced principal payments unapplied	478,033	(535,873)
Principal payments to CFC	(791,880)	(815,573)
Loan advancements from CFC	-	1,870,578
Loan advancements from RUS/FFB	2,300,000	4,651,999
Principal payments to RUS/FFB	<u>(940,782)</u>	<u>(810,361)</u>
Net cash provided (used) by financing activities	<u>171,616</u>	<u>3,776,459</u>
Increase (decrease) in cash and cash equivalents	(1,516,189)	1,192,133
Cash and cash equivalents at beginning of year	<u>2,101,954</u>	<u>909,821</u>
Cash and cash equivalents at end of year	<u>\$ 585,765</u>	<u>\$ 2,101,954</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest	<u>\$ 1,832,381</u>	<u>\$ 1,885,696</u>

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

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies:

Principles of Consolidation:

The consolidated financial statements include the accounts of Farmers Rural Electric Cooperative Corporation and its 75% owned subsidiary, Farmers Energy Services Corporation. All material intercompany transactions have been eliminated in consolidation.

General:

The Cooperative maintains its records in accordance with policies prescribed or permitted by Kentucky Public Service Commission and United States Department of Agriculture, Rural Utilities Service, which conform in all material respects with generally accepted accounting principles.

Nature of Business:

Farmers Rural Electric Cooperative Corporation provides electric service in an eight-county area of south central Kentucky. The Cooperative grants credit to customers, substantially all of whom are local residents and commercial businesses.

Utility Plant:

Utility plant is stated substantially at original cost, net of contributions, which is the cost when first dedicated to public service. Such cost includes applicable supervisory and overhead cost.

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 utility plant. The cost of units of property replaced or retired, including cost of removal, net of any salvage value, is charged to accumulated depreciation. When property is sold, a gain or loss is reflected in income.

The major classifications of electric plant in service at December 31, 2014 and 2013 were:

	<u>2014</u>		<u>2013</u>
Distribution Plant	\$ 73,071,180	\$	69,226,847
General Plant	8,434,025		8,052,346
Other Production Plant	1,115,068		1,100,818
Intangible Plant	<u>3,625</u>		<u>3,625</u>
	<u>\$ 82,623,898</u>	<u>\$</u>	<u>78,383,636</u>

Cash and Cash Equivalents:

For purposes of the statement of cash flows, the Cooperative considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Materials and Supplies:

Materials and supplies inventories are stated at the lower of cost or market using the average cost method.

Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of management estimates and assumptions that affect the reporting amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reporting amounts of the revenues and expenses during the reporting period. Actual results could differ from those estimates.

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies, Continued:

Depreciation:

Provision has been made for depreciation on the basis of estimated lives of assets, using the straight-line method. Distribution plant depreciation is based on a composite rate of three and twenty-four hundredths percent (3.24%) per annum.

The following depreciation rates for the components of the general plant were in effect as of December 31, 2014 and 2013:

Structures and Improvements	2.5%
Office Furniture and Fixtures	20.0%
Transportation and Communication Equipment	14.0%
Power-Operated Equipment	12.0%
Office Equipment and Computers	20.0%
Telephone Equipment	14.0%
Other General Plant	6.0%

Depreciation expense for the years ended December 31, 2014 and 2013 was \$2,610,589 and \$2,467,769 respectively.

Revenue and Cost of Power:

Operating revenue and cost of purchased power include increases (decreases) under the fuel clause adjustment of approximately \$71, 096 for the year ended December 31, 2014, and \$62,266 for the year ended December 31, 2013.

Accounts Receivable:

Accounts receivable consists uncollected amounts due from customers for the sales of electric energy, which are not received by the Cooperative at year-end, billed and unbilled. Based on management's evaluation of uncollected accounts receivable at the end of each year, bad debts are provided for on the allowance method.

Note Receivable:

The Cooperative has a note receivable from the City of Glasgow, Kentucky in the amount of \$1,000,000 without interest. Monthly installments of \$9,260 are due the first day of each month beginning January 1, 2015 and continuing on the first day of each month until the principal sum has been paid in full.

Income Tax Status:

The Cooperative is exempt from federal and state income taxes under Code Section 501(c)(12) because more than 85% of its revenue is received from members. Accordingly, the financial statements include no provision for income taxes.

Investment in Subsidiary Companies:

This balance represents the Cooperative's investments in affiliates, together with other Cooperatives, for the purpose of providing other energy services and products. These investments are accounted for using the equity method.

Subsequent Events:

Management has evaluated subsequent events through March 9, 2015, the date which the financial statements were available to be issued.

On February 6, 2015, the Cooperative was approved for loan funds in the amount of \$1,000,000 from Federal Financing Bank.

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies, Concluded:

Reclassifications

Certain amounts in the 2013 financial statements were reclassified to conform to the 2014 presentation.

2. Investments in Associated Organizations:

Investments in associated organizations as of December 31, 2014 and 2013 are listed as follows:

	<u>2014</u>	<u>2013</u>
East Kentucky Power Cooperative, Inc.	\$ 21,631,260	\$ 19,040,885
National Rural Utilities Cooperative Finance Corp.	830,079	831,172
Other	898,860	826,545
Total	<u>\$ 23,360,199</u>	<u>\$ 20,698,602</u>

FRECC records patronage capital assigned by associated organizations in the year in which assignments are received. Investments in National Rural Cooperative Finance Corporation consist of a membership fee and capital term certificates which are also valued by patronage capital assigned in the year in which assignments are received.

3. Long-Term Debt:

All assets, except motor vehicles are pledged as collateral for the long-term debt to the United States of America and National Rural Utilities Cooperative Finance Corporation under a joint mortgage agreement.

Long-term debt at December 31, 2014 and 2013 consisted of:

	<u>2014</u>	<u>2013</u>
Due United States of America:		
5.12% First Mortgage Notes-Variable Rate	\$ 1,676,262	\$ 1,731,988
4.125 - 4.5% First Mortgage Notes-Variable Rate	1,558,668	1,615,211
5.49% Mortgage Note-FFB	3,671,341	3,769,963
5.62% Mortgage Note-FFB	361,362	370,922
2.87 - 4.93% Mortgage Note-FFB-Variable Rate	33,830,377	32,362,977
0% Rural Economic Development Loan	1,000,000	-
Total due United States of America	<u>\$ 42,098,010</u>	<u>\$ 39,851,061</u>
Due National Rural Utilities Cooperative Finance Corporation:		
2.4 - 6.8% First Mortgage Notes	6,419,128	7,211,008
Advance payments unapplied to long term debt	<u>(126,781)</u>	<u>(604,814)</u>
Total due all	48,390,357	46,457,255
Less current maturities	<u>(2,110,120)</u>	<u>(1,887,000)</u>
	<u>\$ 46,280,237</u>	<u>\$ 44,570,255</u>

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

3. Long-Term Debt, Concluded:

In 2000, the Cooperative received approval from the Federal Financing Bank – Rural Utilities Service for a loan in amount of \$5,053,000. This loan is for a period of thirty-five years and bears interest at the approximate rate of 5.5%. The total amount of this loan was advanced to the Cooperative in January, 2001. Principal payments began June 30, 2002, and are due quarterly.

In 2003, the Cooperative received approval from the Federal Financing Bank – Rural Utilities Service for a loan in the amount of \$18,228,000. This loan is for a period of thirty-five years, is payable quarterly, and currently bearing a variable interest rate of approximately 4.5%. The total amount of this loan was advanced to the Cooperative.

In 2008, the Cooperative received approval from the Federal Financing Bank-Rural Utilities Service for a loan in the amount of \$17,402,000. This loan is for a period of thirty-five years, is payable quarterly, and currently bearing a variable interest rate of approximately 3.63%. The total amount of this loan was advanced to the Cooperative.

In 2013, the Cooperative received approval from the Federal Financing Bank-Rural Utilities Service for a loan in the amount of \$17,582,000. This final maturity date on the loan is December 31, 2047, interest rates have not yet been established and the Cooperative had advanced \$2,300,000 of loan funds as of December 31, 2014.

The Cooperative has available a line of credit for short-term loans of up to \$5,000,000 with National Rural Utilities Cooperative Finance Corporation extending to September 30, 2016. The maximum interest rate is to be the prevailing bank prime rate published in the "money rates" column of The Wall Street Journal plus one percent (1%) per annum. At December 31, 2014, the balance of the line-of-credit was \$-0-.

In 2014, the Cooperative received a US Department of Agriculture Rural Economic Development Loan in the amount of \$1,000,000 without interest. Monthly installments of \$9,260 are due the last day of the month beginning January 31, 2015 and continuing until the principal sum has been paid in full.

The maturities of long-term debt for each of the five years succeeding the balance sheet are as follows:

2015	\$	2,110,120
2016		2,129,120
2017		2,131,120
2018		2,147,120
2019		1,807,120
2020-2024		10,273,400
2025-2029		10,505,000
2030-2034		10,382,000
2035-2039		6,264,000
2040		641,357
Total	\$	<u>48,390,357</u>

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

4. Deferred Charges:

Following is a summary of amounts recorded as deferred charges approved by RUS per 1773.33(h) as of December 31, 2014 and 2013 which have been approved in writing by RUS:

Deferred Debits:	<u>2014</u>	<u>2013</u>
Transportation Expense	\$ 8,339	\$ 8,276
Gis-Field Inventory Cost	511,228	545,500
Long Range Plans	59,213	69,082
ESRI and EDP costs	39,802	45,863
Pension Plan Prepayment	1,621,168	1,745,872
	<u>\$ 2,239,750</u>	<u>\$ 2,414,593</u>
Deferred Credits:		
Customer Advances for Construction	\$ 369,932	\$ 390,737
	<u>\$ 369,932</u>	<u>\$ 390,737</u>

5. Return of 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 members' equities to be less than thirty percent (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 twenty-five percent (25%) of net margins for the next preceding year, the Cooperative may distribute the difference between twenty-five percent (25%) and the payments made to such estates.

Capital credit retirements in the amount of \$631,125 and \$465,726 were paid for the years ended December 31, 2014 and 2013, respectively.

6. Other Equities:

At December 31, 2014 and 2013 other equities consisted of retired capital credits – gain, in amounts of \$1,680,165 and \$1,556,613, respectively.

7. Pension Plan:

Narrative Description

The Retirement Security Plan (RS Plan), sponsored by the National Rural Electric Cooperative Association (NRECA), is a defined benefit pension plan qualified under Section 401 and tax exempt under Section 501(a) of the Internal Revenue Code. It is considered a multi-employer plan under the accounting standards. The plan sponsor's Employer Identification Number is 53-0116145 and the Plan Number is 333.

A unique characteristic of a multi-employer plan compared to a single employer plan is that all plan assets are available to pay benefits of any plan participant. Separate asset 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.

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

7. Pension Plan, Continued:

Plan Information

Farmers Rural Electric Cooperative Corporation contributions to the RS Plan in 2014 and in 2013 represented less than 5 percent of the total contributions made to the RS Plan by all participating employers. Farmers Rural Electric Cooperative Corporation made contributions to the RS Plan of \$577,100 in 2014 and \$622,512 in 2013. Contributions in 2013 are significantly higher than those in 2014 due to the Co-op electing to participate in the prepayment option offered to participating employers. See footnote description for more information on prepayment program.

For the RS Plan, a “zone status” determination is not required, and therefore not determined, under the Pension Protection Act (PPA) of 2006. In addition, the accumulated benefit obligations and plan assets are not determined or allocated separately by individual employer. In total, the RS Plan was over 80% funded at January 1, 2014 and over 80% funded at January 1, 2013 based on the PPA funding target and PPA actuarial value of assets on those dates.

Because the provisions of the PPA do not apply to the RS Plan, funding improvement plans and surcharges are not applicable. Future contribution requirements are determined each year as part of the actuarial valuation of the plan and may change as a result of the plan experience.

Footnote: RS Plan Prepayment Option

At the December 2012 meeting of the I&FS Committee of the NRECA Board of Directors, the Committee approved an option to allow participating cooperatives in the RS Plan to make a contribution prepayment and reduce future required contributions. The prepayment amount is a cooperative's share, as of January 1, 2013, of future contributions required to fund the RS Plan's unfunded value of benefits earned to date using RS Plan actuarial valuation assumptions. The prepayment amount will typically equal approximately 2.5 times a cooperative's annual RS Plan required contribution as of January 1, 2013. After making the prepayment, for most cooperatives the billing rate is reduced by approximately 25%, retroactive to January 1 of the year in which the amount is paid to the RS Plan. The 25% differential in billing rates is expected to continue for approximately 15 years. However changes in interest rates, asset returns and other plan experience different from expected, plan assumption changes and other factors may have an impact on the differential in billing rates and the 15 year period.

Additionally, the Cooperative has two 401(K) Plans and a 457(b) Plan. The first Plan is for those employees hired before January 1, 2012. The terms of the Plan call for an elective contribution from employees of 0.5% - 1.0% or more of their salaries while the Cooperative matches 100% of employees' contributions up to 1.0%. The second Plan is for those employees hired on or after January 1, 2012. The terms of the Plan call for an elective contribution from employees of 1.0% - 4.0% or more of their salaries while the Cooperative matches 100% of employees' contributions up to 4.0%. Also, the Cooperative will make a 6.0% matching contribution to the second Plan. The third plan allows for employee contributions with no company match. Total employer contributions for all Plans for 2014 and 2013 were \$37,888 and \$34,843 respectively. Total employee contributions for all Plans for 2014 and 2013 were \$153,025 and \$128,611, respectively.

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

8. Self-Funded Health Insurance Plan:

In October, 1995, the Cooperative's Board of Directors approved the establishment of the FRECC Group Medical Program. The Plan is self-funded and is re-insured through Houston Casualty Company. The Plan was designed to duplicate the Cooperative's prior plan. The third-party administrator is North America Administrators. The Cooperative is protected against any individual claim in excess of \$30,000 and any aggregate claims in excess of \$1,220,000 by the re-insurance. The current funding levels are designed to allow for the maximum claim liability that the Cooperative could incur under the Plan. At December 31, 2014 and 2013, the Cooperative held \$214,793 and \$137,314 in cash designated for payment of claims in 2014 and 2013, respectively, and included \$102,478 as a liability in accrued expenses at December 31, 2014, and \$25,121 at December 31, 2013.

9. Related Party Transactions:

The Cooperative is a member of the National Rural Utilities Cooperative Finance Corporation, which furnishes a portion of the Cooperative's financing.

The Cooperative is a member of East Kentucky Power Cooperative which is a generating and transmission cooperative. The Cooperative has entered into an agreement with East Kentucky Power Cooperative to supply substantially all of the Cooperative's future power needs. Under its wholesale power agreement, the Cooperative has agreed to purchase the majority of its electric power and energy requirements from East Kentucky Power Cooperative until January 2040. Changes in rates are refunded to or recovered from the Cooperative's customers through a cost of power adjustment.

10. Cash and Cash Equivalents:

All deposits are in various financial institutions and are carried at cost.

	2014		2013	
	Carrying Amount	Bank Balance	Carrying Amount	Bank Balance
Insured (FDIC)	\$ 585,765	\$ 973,458	\$ 1,687,051	\$ 1,722,181
Uninsured	-	-	414,903	550,924
Total deposits	<u>\$ 585,765</u>	<u>\$ 973,458</u>	<u>\$ 2,101,954</u>	<u>\$ 2,273,105</u>

11. Litigation:

The Cooperative is subject to claims and investigations that arise in the ordinary course of business. One legal investigation is ongoing, and the Cooperative intends to vigorously contest any alleged violations. Management and the Cooperative's legal counsel do not anticipate any material effect on the Cooperative's financial statements as a result of these actions.

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

12. Postretirement Benefit Plans:

The Cooperative provides postretirement life insurance benefits to all current employees and provides certain retired and active employees with postretirement health care benefits.

The annual measurement date is December 31 for other postretirement benefits. The following tables provide information about changes in the benefit obligation and plan assets and the funded status of the Cooperative's postretirement benefit plan:

	<u>2014</u>	<u>2013</u>
Accumulated Benefit Obligation		
Projected benefit obligation at end of year	\$ 531,973	\$ 501,055
Fair Value of plan assets at end of year	-	-
Unfunded status at end of year	<u>\$ 531,973</u>	<u>\$ 501,055</u>
Amounts recognized in the balance sheet		
Unfunded status	\$ 531,973	\$ 501,055
Current liabilities	-	-
Noncurrent liabilities	<u>\$ 531,973</u>	<u>\$ 501,055</u>
Change in Accumulated Benefit Obligation		
Accumulated post-retirement benefit obligation at beginning of year	\$ 501,055	\$ 548,701
Service cost	31,263	17,988
Interest cost	25,053	28,248
Actuarial loss (gain)	55,724	(28,975)
Amortization of transition obligation	-	-
Amortization of net actuarial gain	-	-
Benefits paid	(81,122)	(64,907)
Accumulated post-retirement benefit obligation at end of year	<u>\$ 531,973</u>	<u>\$ 501,055</u>

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

12. Postretirement Benefit Plans, Concluded:

Change in plan assets and benefit obligations recognized in other comprehensive income

	<u>2014</u>	<u>2013</u>
Beginning of year	\$ 420,274	\$ 473,489
Net loss (gain)	55,724	(28,975)
Amortization of net loss (gain)	(10,968)	(14,196)
Amortization of transition obligation	(10,044)	(10,044)
Total recognized in other comprehensive income	<u>34,712</u>	<u>(53,215)</u>
End of year	<u>\$ 454,986</u>	<u>\$ 420,274</u>

Amounts recognized in accumulated other comprehensive income

Net loss (gain)	\$ 304,268	\$ 259,512
Transition obligation	150,718	160,762
	<u>\$ 454,986</u>	<u>\$ 420,274</u>

Net periodic benefit cost

Service cost	\$ 31,263	\$ 17,988
Interest cost	25,053	28,248
Amortization of transition obligation	10,044	10,044
Amortization of net actuarial gain	10,968	14,196
Net periodic benefit cost	<u>\$ 77,328</u>	<u>\$ 70,476</u>

Amounts in other comprehensive income expected to be realized in 2015

Amortization of net loss (gain)	\$ 12,708	
Amortization of transition obligation	10,044	
	<u>\$ 22,752</u>	

The discount rate used in determining the accumulated postretirement benefit obligation was 5.0% in 2014 and 2013.

The following expected benefit payments from the plan, which reflect anticipated future services, are as follows:

2015	\$	81,855
2016		69,904
2017		73,749
2018		77,805
2019		82,084

For measurement purposes, a 6.0% annual medical rate increase was used for the year ended December 31, 2014. The rate is assumed to decline by .25% per year until level at 5% per year.

The effect of a 1% increase in the health care trend rates would have the following effects on the plan:

Postemployment benefit obligation	\$ 570,000	
Net periodic benefit cost		92,000

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

13. Leases:

The Corporation is the lessee of office equipment under capital leases expiring December 2017. The asset and liabilities under capital leases are recorded at the lower of present value of the minimum lease payments or the fair value of the asset. The assets are depreciated over their estimated productive lives.

Following is a summary of property held under capital leases:

Office equipment	\$ 109,001
Accumulated depreciation	<u>(15,900)</u>
	<u>\$ 93,101</u>

Minimum future lease payments under capital leases as of December 31, 2014 were as follows:

	Amount
2015	\$ 33,905
2016	27,667
2017	<u>18,597</u>
Net minimum lease payments	80,169
Amount representing interest	-
Present value of net minimum lease payments	<u>\$ 80,169</u>

14. Provision for Income Taxes

The Cooperative follows the recognition requirements for uncertain income tax positions as required by generally accepted accounting principles. The Cooperative has no tax position at December 31, 2014 for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. The Cooperative's policy is to classify income tax related interest and penalties in interest expense and other expenses, respectively. No such interest or penalties were recognized during the periods presented.

The Cooperative files income tax returns in the U.S. federal jurisdiction, and various state and local jurisdictions. The Cooperative is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years before 2011.



CAMPBELL, MYERS AND RUTLEDGE, PLLC

Cindy L. Greer, CPA ▪ L. Joe Rutledge, CPA ▪ Jonathan W. Belcher, CPA ▪ R. Brent Billingsley, CPA

Skip R. Campbell, CPA ▪ Sammie D. Parsley, CPA ▪ Ryan Mosier, CPA ▪ Jenna B. Pace, CPA

Independent Auditors' Report
on Consolidating Information

Board of Directors
Farmers Rural Electric
Cooperative Corporation
Glasgow, Kentucky

We have audited the consolidated financial statements of Farmers Rural Electric Cooperative Corporation as of and for the years ended December 31, 2014 and 2013, and our report thereon dated March 9, 2015, which expressed an unmodified opinion on those financial statements appears on pages one and two. Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information presented in Schedule I and II is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual companies, and it is not a required part of the consolidated 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 consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Campbell, Myers & Rutledge, PLLC

Certified Public Accountants
Glasgow, Kentucky

March 9, 2015

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
SCHEDULE I – CONSOLIDATING BALANCE SHEET
December 31, 2014

ASSETS	Farmers Rural Electric Cooperative Corporation, Inc.	Farmers Energy Services Corporation	Consolidating Entries	Consolidated Totals
Current assets:				
Cash	\$ 528,703	\$ 57,062	\$ -	\$ 585,765
Accounts and notes receivable, less allowance for doubtful accounts of \$92,053 in 2014 and \$84,307 in 2013	5,249,910	-	-	5,249,910
Materials and supplies, at average cost	770,707	-	-	770,707
Prepaid expenses	201,368	-	-	201,368
Total current assets	<u>6,750,688</u>	<u>57,062</u>	<u>-</u>	<u>6,807,750</u>
Other assets and investments:			(1) (1,117,837)	
Investments in subsidiary companies	1,509,914	1,905,016	(2) (372,612)	1,924,481
Investments in associated organizations	23,360,199	-	-	23,360,199
Deferred charges	2,239,750	-	-	2,239,750
Note receivable	1,000,000	-	-	1,000,000
	<u>28,109,863</u>	<u>1,905,016</u>	<u>(1,490,449)</u>	<u>28,524,430</u>
Electric plant, at cost				
Electric plant in service	82,623,898	-	-	82,623,898
Construction work-in-progress	886,561	-	-	886,561
	<u>83,510,459</u>	<u>-</u>	<u>-</u>	<u>83,510,459</u>
Less accumulated depreciation	(24,476,870)	-	-	(24,476,870)
Electric plant, net	<u>59,033,589</u>	<u>-</u>	<u>-</u>	<u>59,033,589</u>
	<u>\$ 93,894,140</u>	<u>\$ 1,962,078</u>	<u>\$ (1,490,449)</u>	<u>\$ 94,365,769</u>
LIABILITIES AND MEMBERS' EQUITIES				
Current liabilities:				
Accounts payable	\$ 4,265,790	\$ -	\$ -	\$ 4,265,790
Accrued expenses	1,317,413	-	-	1,317,413
Customer deposits	900,227	-	-	900,227
Current portion of capital leases	33,905	-	-	33,905
Current portion of long-term debt	2,110,120	-	-	2,110,120
Total current liabilities	<u>8,627,455</u>	<u>-</u>	<u>-</u>	<u>8,627,455</u>
Long-term liabilities				
Capital lease less current maturities	46,264	-	-	46,264
Long-term debt less current maturities	46,280,237	-	-	46,280,237
Total long-term liabilities	<u>46,326,501</u>	<u>-</u>	<u>-</u>	<u>46,326,501</u>
Noncurrent liabilities:				
Post retirement benefit obligations	531,973	-	-	531,973
Customer advances for construction	369,932	-	-	369,932
Total noncurrent liabilities	<u>901,905</u>	<u>-</u>	<u>-</u>	<u>901,905</u>
Members' equities:				
Memberships	536,810	-	-	536,810
Patronage capital	36,276,290	-	-	36,276,290
Accumulated other comprehensive income	(454,986)	-	-	(454,986)
Other equities	1,680,165	-	-	1,680,165
Capital stock	-	1,040,000	(1) (1,117,837)	(77,837)
Retained earnings	-	922,078	(2) (372,612)	549,466
	<u>38,038,279</u>	<u>1,962,078</u>	<u>(1,490,449)</u>	<u>38,509,908</u>
	<u>\$ 93,894,140</u>	<u>\$ 1,962,078</u>	<u>\$ (1,490,449)</u>	<u>\$ 94,365,769</u>

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
SCHEDULE II – CONSOLIDATING STATEMENT OF REVENUE
For the Year Ended December 31, 2014

	Farmers Rural Electric Cooperative Corporation, Inc.	Farmers Energy Services Corporation	Consolidating Entries	Consolidated Totals
Operating revenues	\$ 53,312,037	\$ -	\$ -	\$ 53,312,037
Operating expenses:				
Cost of power	38,924,102	-	-	38,924,102
Distribution - operations	1,660,558	-	-	1,660,558
Distribution - maintenance	2,960,807	-	-	2,960,807
Consumer accounts	1,093,049	-	-	1,093,049
Customer services and informational expense	169,746	-	-	169,746
Administrative and general	2,125,970	510	-	2,126,480
Depreciation	2,610,589	-	-	2,610,589
Taxes	603,454	136,718	-	740,172
Total operating expenses	<u>50,148,275</u>	<u>137,228</u>	<u>-</u>	<u>50,285,503</u>
Operating margins	3,163,762	(137,228)	-	3,026,534
Interest on long-term debt to RUS and CFC	\$ 1,832,381	-	-	1,832,381
Operating margins after fixed charges	1,331,381	(137,228)	-	1,194,153
G & T and other capital credits	\$ 2,693,970	-	-	2,693,970
Net operating margins	<u>4,025,351</u>	<u>(137,228)</u>	<u>-</u>	<u>3,888,123</u>
Nonoperating margins:				
Interest income, net of interest expense of \$4,685	56,976	158	-	57,134
Other net nonoperating income (loss)	827	-	-	827
Income (loss) from equity investments	121,375	290,298	(2) (38,307)	258,445
	<u>179,178</u>	<u>290,456</u>	<u>(1) (114,921)</u>	<u>316,406</u>
Net margins	<u>\$ 4,204,529</u>	<u>\$ 153,228</u>	<u>\$ (153,228)</u>	<u>\$ 4,204,529</u>

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
 SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
 For the Year Ended December 31, 2014

<u>Federal Grantor/Pass-Through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Federal Expenditures</u>
<u>United States Department of Agriculture Direct Programs</u>		
Rural Economic Development Loans and Grants	10.854	\$ 1,000,000
Total Expenditures of Federal Awards		<u>\$ 1,000,000</u>

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended December 31, 2014

1. Basis of Presentation:

The accompanying schedule of expenditures of federal awards includes the federal grant activity of Farmers Rural Electric Cooperative Corporation and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Therefore, some amounts presented in this schedule may differ from the amounts presented in, or used in the preparation of the basic financial statements.

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
 SCHEDULE OF FINDINGS AND QUESTIONED COSTS
 For the Year Ended June 30, 2014

I. SUMMARY OF AUDITORS RESULTS

Financial Statements

Type of auditor's report issued (unmodified):

Internal Control over financial reporting:

- Material weakness(es) identified? _____ Yes X No
- Significant deficiencies identified that are not considered to be material weaknesses? _____ Yes X None Reported
- Noncompliance material to financial Statements noted? _____ Yes X No

Federal Awards

Internal Control over major programs:

- Material weakness(es) identified? X Yes _____ No
- Significant deficiencies identified that are not considered to be material weaknesses? _____ Yes X None Reported

Type of auditor's report issued on compliance for major programs: Unmodified

Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of Circular A-133? _____ Yes X No

Identification of Major Programs:

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number
United States Department of Agriculture Direct Programs Rural Economic Development Loans and Grants	10.854

Dollar threshold used to distinguish Between type A and type B programs: \$300,000

Auditee qualified as low-risk auditee? _____ Yes X No

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For the Year Ended December 31, 2014

II. FINANCIAL STATEMENTS FINDINGS

A. None Reported.

III. FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

A. 2014-1

Criteria: The Corporation participated in the USDA Rural Economic Development Loan and Grant Program and operated as an intermediary to a sub-recipient of these funds.

Condition: The Corporation did not have a formal discussion with the sub-recipient concerning the Single Audit Act Amendments of 1996 and OMB Circular No. A-133.

Cause: The Single Audit Act Amendments of 1996 and OMB Circular No. A-133 were not specifically addressed with the sub-recipient.

Effect: The sub-recipient was not in compliance with the requirements of the Single Audit Act Amendments of 1996 and OMB Circular No. A-133.

Recommendation: We feel that the personnel of the Corporation are now aware of the importance of communicating the requirements of the Single Audit Act Amendments of 1996 and OMB Circular A-133 to all parties involved. We recommend that the Corporation have meetings with the sub recipient of these program funds along with the engineer of such projects and the Program Manager of USDA and discuss the applicability of the Single Audit Act Amendments of 1996 and OMB Circular No. A-133 and obtain specific written guidance as to which assurances are not applicable to these funds.

Response: The Corporation believes that the sub-recipient should have been aware of the Single Audit Act Amendments of 1996 and OMB Circular A-133 since the requirements were included in the application for federal assistance. However, the Corporation concurs with the recommendation. In the event of future projects, the Corporation agrees to meet with all associated parties to discuss the requirements of the Single Audit Act Amendments of 1996 and OMB Circular No. A-133.

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
SCHEDULE OF PRIOR AUDIT FINDINGS
For the Year Ended December 31, 2014

No prior year audit findings.



CAMPBELL, MYERS AND RUTLEDGE, PLLC

Cindy L. Greer, CPA ▪ L. Joe Rutledge, CPA ▪ Jonathan W. Belcher, CPA ▪ R. Brent Billingsley, CPA

Skip R. Campbell, CPA ▪ Sammie D. Parsley, CPA ▪ Ryan Mosier, CPA ▪ Jenna B. Pace, CPA

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133.

To the Board of Directors
Farmers Rural Electric
Cooperative Corporation

Report on Compliance for Each Major Federal Program

We have audited Farmers Rural Electric Cooperative Corporation's compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Farmers Rural Electric Cooperative Corporation's major federal programs for the year ended December 31, 2014. Farmers Rural Electric Cooperative Corporation's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Farmers Rural Electric Cooperative Corporation's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance 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 OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Farmers Rural Electric Cooperative Corporation's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of Farmers Rural Electric Cooperative Corporation's compliance.

Opinion on Each Major Federal Program

In our opinion, Farmers Rural Electric Cooperative Corporation, complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2014.

Report on Internal Control over Compliance

Management of Farmers Rural Electric Cooperative Corporation, is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Farmers Rural Electric Cooperative Corporation's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Farmers Rural Electric Cooperative Corporation's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified a certain deficiency in internal control over compliance that we consider to be a material weaknesses.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiency in internal control over compliance described in the accompanying schedule of finding and questioned costs as item 2014-1 to be a material weakness.

A *significant deficiency* in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Farmers Rural Electric Cooperative Corporation's response to the internal control over compliance findings identified in our audit is described in the accompanying schedule of findings and questioned costs. Farmers Rural Electric Cooperative Corporation's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly we express no opinion on the response.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Campbell, Myers and Ratledge, PLLC

Glasgow, Kentucky
March 9, 2015



Cindy L. Greer, CPA ▪ L. Joe Rutledge, CPA ▪ Jonathan W. Belcher, CPA ▪ R. Brent Billingsley, CPA

Skip R. Campbell, CPA ▪ Sammie D. Parsley, CPA ▪ Ryan Mosier, CPA ▪ Jenna B. Pace, CPA

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*

Board of Directors
Farmers Rural Electric
Cooperative Corporation
Glasgow, Kentucky

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Farmers Rural Electric Cooperative Corporation, which comprise the balance sheets as of December 31, 2014 and 2013 and the related statements of revenue, comprehensive income, patronage capital and memberships, and cash flows for the years then ended, and related notes to the consolidated financial statements, and have issued our report thereon dated March 9, 2015.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Farmers Rural Electric Cooperative Corporation's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Farmers Rural Electric Cooperative Corporation's internal control. Accordingly, we do not express an opinion on the effectiveness of Farmers Rural Electric Cooperative Corporation'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 Farmers Rural Electric Cooperative Corporation's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Campbell, Myers, & Rutledge, PLLC

Certified Public Accountants
Glasgow, Kentucky

March 9, 2015



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

Board of Directors
Farmers Rural Electric
Cooperative Corporation
Glasgow, Kentucky

Independent Auditor's Report

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, the financial statements of Farmers Rural Electric Cooperative Corporation (FRECC), which comprise the balance sheets as of December 31, 2014 and 2013 and the related statements of revenue, comprehensive income, patronage capital and memberships, changes in cash flows for the years ended, and the related notes to the financial statements, and have issued our report thereon dated March 9, 2015. In accordance with *Government Auditing Standards*, we have also issued our report dated March 9, 2015, on our consideration of FRECC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. No reports other than the reports referred to above have been furnished to management.

In connection with our audit, nothing came to our attention that caused us to believe that FRECC 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, &1773.33 clarified in the RUS policy memorandum dated March 9, 2015, 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 FRECC's noncompliance with the above-referenced 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 FRECC's accounting and records to indicate that FRECC did not:

Maintain adequate and effective accounting procedures;

Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts;

Reconcile continuing property records to the controlling general ledger plant accounts;

Clear construction accounts and accrue depreciation on completed construction;

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 materials and supplies;

Prepare accurate and timely Financial and Operating Reports;

Obtain RUS approval to enter into any contract for the management, 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 requirements (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. A detailed schedule of investments is as follows:

Farmers Energy Service Corporation is a 75% owned subsidiary of the Cooperative. The subsidiary is the sole owner of a limited company which sells propane gas. The Cooperative accounts for the investment on the equity basis.

Investment in Subsidiary Company:		
Original Investment Cost - 1997		<u>\$ 225,000</u>
Investment Advances:		
	12/31/1998	120,000
	12/31/1999	135,000
	12/31/2000	225,000
	12/31/2001	<u>75,000</u>
		<u>555,000</u>
Total Contributions:		<u>\$ 780,000</u>

Undistributed (Losses) Earnings:

12/31/1997	(45,263)
12/31/1998	(55,962)
12/31/1999	(40,973)
12/31/2000	(135,639)
12/31/2001	(99,613)
12/31/2002	(23,182)
12/31/2003	61,207
12/31/2004	18,357
12/31/2005	145,423
12/31/2006	99,535
12/31/2007	54,546
12/31/2008	88,742
12/31/2009	99,980
12/31/2010	89,059
12/31/2011	74,484
12/31/2012	97,859
12/31/2013	166,968
12/31/2014	<u>114,921</u>
Total Undistributed (Losses) Earnings:	710,449
Original Investment and Investment Activities:	<u>780,000</u>
Book Value 12/31/14	<u>1,490,449</u>

This report is intended solely for the information and use of the board of directors, management, and the RUS and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Campbell, Myers & Rutledge, PLLC
Glasgow, Kentucky

March 9, 2015