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Taylor County Rural Electric Cooperative Corporation

Campbellsville, Kentucky

Audited Financial Statements
May 31, 2014 and 2013

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

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ALAN M. ZUMSTEIN
CERTIFIED PUBLIC ACCOUNTANT

1032 CHETFORD DRIVE
LEXINGTON, KENTUCKY 40509
(859) 264-7147
zumstein@windstream.net

MEMBER
• AMERICAN INSTITUTE OF CPA'S
• KENTUCKY SOCIETY OF CPA'S
• INDIANA SOCIETY OF CPA'S
• AICPA DIVISION FOR FIRMS

To the Board of Directors
Taylor County Rural Electric Cooperative

I have audited the financial statements of Taylor County Rural Electric Cooperative for the year ended May 31, 2014, and have issued my report thereon dated August 5, 2014. 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 May 31, 2014, 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 August 5, 2014, 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 May 31, 2014, 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, 2013.

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 RUS Financial and Operating Report, Electric Distribution, as of December 31, 2013, 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 May 31, 2014, 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 debits are as follows:

Deferred property retirement	$121,204

The deferred credits are as follows:

Consumer advances for construction	$932,951

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
August 5, 2014

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Independent Auditor's Report

To the Board of Directors
Taylor County Rural Electric Cooperative
Campbellsville, Kentucky

Report on the Financial Statements

I have audited the accompanying financial statements of Taylor County Rural Electric Cooperative, which comprise the balance sheets as of May 31, 2014 and 2013, and the related statements of revenue and comprehensive income, changes in equities, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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 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 I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

I believe the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards,* I have also issued a report dated August 5, 2014, on my consideration of Taylor County Rural Electric 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* in considering internal control over financial reporting and compliance.

Alan M. Zumstein

Alan M. Zumstein, CPA
August 5, 2014

Taylor County Rural Electric Cooperative Corporation
Balance Sheets, May 31, 2014 and 2013

Assets	2014	2013
Electric Plant, at original cost:		
In service	$ 77,650,041	$ 74,974,029
Under construction	96,867	470,624
	77,746,908	75,444,653
Less accumulated depreciation	22,981,532	21,046,839
	54,765,376	54,397,814
Investments in Associated Organizations	19,824,713	16,812,769
Current Assets:		
Cash and cash equivalents	2,243,453	2,473,153
Accounts receivable, less allowance for 2014 of $86,773 and 2013 of $202,599	968,539	712,160
Other receivables	271,285	270,615
Material and supplies, at average cost	654,044	622,367
Other current assets	123,324	145,400
	4,260,645	4,223,695
Deferred Property Retirement	121,204	190,463
Total	$ 78,971,938	$ 75,624,741

Members' Equities and Liabilities	2014	2013
Members' Equities:		
Memberships	$ 280,550	$ 281,610
Patronage capital	53,697,185	49,677,202
Other equities	114,327	99,178
Accumulated other comprehensive income	(3,462,739)	(3,672,283)
	50,629,323	46,385,707
Long Term Debt	19,152,999	19,947,521
Accumulated Postretirement Benefits	5,028,588	5,153,576
Current Liabilities:		
Accounts payable	254,164	353,882
Consumer deposits	1,401,587	1,327,654
Current portion of long term debt	1,150,000	1,100,000
Accrued expenses	422,326	415,077
	3,228,077	3,196,613
Consumer Advances	932,951	941,324
Total	$ 78,971,938	$ 75,624,741

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

Statements of Revenue and Comprehensive Income
for the years ended May 31, 2043 and 2013

	2014	2013
Operating Revenues		
Sales of electric energy	$ 47,038,236	$ 44,561,853
Other revenues	813,684	793,122
	47,851,920	45,354,975
Operating Expenses:		
Cost of power	36,867,820	35,557,861
Distribution - operations	1,952,039	1,806,967
Distribution - maintenance	1,915,986	1,698,093
Consumer accounts	1,022,283	916,911
Customer services	106,876	102,169
Administrative and general	1,525,577	1,699,730
Depreciation, excluding $106,389 in 2014 and $127,536 in 2013 charged to clearing accounts	2,597,917	2,376,807
Taxes	43,237	56,155
	46,031,735	44,214,693
Operating margins before interest charges	1,820,185	1,140,282
Interest Charges:		
Long-term debt	786,208	824,114
Other	12,862	10,745
	799,070	834,859
Operating margins after interest charges	1,021,115	305,423
Nonoperating Margins		
Interest income	59,928	74,531
Others	30	134
	59,958	74,665
Patronage Capital Credits	3,108,007	2,408,976
Net Margins	4,189,080	2,789,064
Comprehensive Income:		
Accumulated postretirement benefits	209,544	209,544
Net Comprehensive Income	$ 4,398,624	$ 2,998,608

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

Statement of Changes in Members' Equity
for the years ended May 31, 2014 and 2013

	Memberships	Patronage Capital	Other Equity	Accumulated Other Comprehensive Income	Total Members' Equity
Balance - Beginning of year	$ 282,610	$ 47,045,384	$ 98,178	$ (3,881,827)	$ 43,544,345
Comprehensive income:					
Net margins		2,789,064			2,789,064
Postretirement benefit obligation					
Amortization				209,544	
Adjustments				-	209,544
Total comprehensive income					2,998,608
Net change in memberships	(1,000)				(1,000)
Refunds to estates		(157,246)			(157,246)
Other equities			1,000		1,000
Balance - May 31, 2013	281,610	49,677,202	99,178	(3,672,283)	46,385,707
Comprehensive income:					
Net margins		4,189,080			4,189,080
Postretirement benefit obligation					
Amortization				209,544	
Adjustments				-	209,544
Total comprehensive income					4,398,624
Net change in memberships	(1,060)				(1,060)
Refunds to estates		(169,097)			(169,097)
Other equities			15,149		15,149
Balance - May 31, 2014	$ 280,550	$ 53,697,185	$ 114,327	$ (3,462,739)	$ 50,629,323

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

Statements of Cash Flows
for the years ended May 31, 2014 and 2013

	2014	2013
Cash Flows from Operating Activities:		
Net margins	$ 4,189,080	$ 2,789,064
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation:		
Charged to expense	2,597,917	2,376,807
Charged to clearing accounts	106,389	127,536
Patronage capital credits assigned	(3,108,007)	(2,408,976)
Accumulated postretirement benefits	84,556	136,419
Deferred property retirements	69,259	154,153
Change in assets and liabilities:		
Receivables	(257,049)	(606,019)
Material and supplies	(31,677)	(187,753)
Other assets	22,076	21,861
Payables	(99,718)	(92,269)
Consumer deposits and advances	65,560	102,200
Accrued expenses	7,249	(10,917)
	3,645,635	2,402,106
Cash Flows from Investing Activities:		
Plant additions	(2,800,061)	(3,678,723)
Plant removal costs	(284,732)	(385,007)
Salvage recovered from retired plant	12,925	17,661
Receipts from other investments, net	96,063	98,445
	(2,975,805)	(3,947,624)
Cash Flows from Financing Activities:		
Net increase in memberships	(1,060)	(1,000)
Increase in other equities	15,149	1,000
Retirements of capital credits	(169,097)	(157,246)
Advances of long term debt	-	-
Payments on long term debt	(1,065,049)	(1,019,428)
Advance payments on long term debt	320,527	(58,132)
	(899,530)	(1,234,806)
Net increase in cash	(229,700)	(2,780,324)
Cash and cash equivalents, beginning of year	2,473,153	5,253,477
Cash and cash equivalents, end of year	$ 2,243,453	$ 2,473,153
Supplemental cash flows information:		
Interest paid on long-term debt	$ 786,208	$ 824,114

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

Note 1. Summary of Significant Accounting Policies

Taylor County Rural Electric Cooperative Corporation ("Taylor County") 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 for distribution plant. Gain or loss is recognized on disposition of general plant items.

Electric plant consists of:

	2014	2013
Distribution plant	$73,752,380	$71,195,936
General plant	3,897,661	3,778,093
Total	$77,650,041	$74,974,029

Depreciation Provision has been made for depreciation on the basis of the estimated lives of assets, using the straight-line method. Depreciation rates are as follows:

Distribution plant	3%
Structures and improvements	2%
Transportation equipment	16%
Other general plant items	6% - 16%

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

Off Balance Sheet Risk Taylor County maintains its cash balances, which may exceed the federally insured limit, with several financial institutions. These financial institutions have strong credit ratings and management believes that the credit risk related to the accounts is minimal.

Revenue Taylor County implemented an Automated Meter Reading ("AMR") program during 2009 where meters are remotely read on the 1st day of each month. All consumers are required to pay a refundable deposit, which may be waived under certain circumstances. Taylor County's sales are concentrated in a six county area of southeastern Kentucky. Consumers must pay their bill within 20 days of billing, then are subject to disconnect after another 10 days. Accounts are written off when they are deemed to be uncollectible. The allowance for uncollectible accounts is based on the aging of receivables. There were no customers whose individual account balance exceeded 10% of outstanding accounts receivable at May 31, 2014 or 2013.

Note 1. Summary of Significant Accounting Policies, continued

Sales Taxes Taylor County is required to collect, on behalf of the Commonwealth of Kentucky, sales taxes based on 6 percent of gross sales from non-residential consumers, a 3 percent school tax from certain counties on most gross sales, and franchise fees in certain cities. Taylor County' policy is to exclude sales tax from revenue when collected and expenses when paid and instead, record collection and payment of sales taxes through a liability account.

Cost of Power Taylor County is one of sixteen (16) members of East Kentucky Power Cooperative ("East Kentucky"). Under a wholesale power agreement, Taylor County 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 power bill is received, rather that the period of actual usage, based upon billings from East Kentucky. The cost of power purchased but not recorded was $2,527,539 for 2014 and $2,522,126 for 2013.

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: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities
>
> Level 2: Quoted prices in markets that are not considered to be active or financial instruments for which all significant inputs are observable, either directly or indirectly.
>
> Level 3: Prices or valuations that require inputs that are both significant to the fair value measure and unobservable.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

The carrying amounts of Taylor County'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 and liabilities are not considered financial instruments because they represent activities specifically related to Taylor County. 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.

Taylor County may, and also does, invest idle funds in local banks. 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 2014 and 2013.

Risk Management Taylor County 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.

Note 1. Summary of Significant Accounting Policies, continued

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.

Advertising Taylor County expenses advertising costs as incurred.

Income Tax Status Taylor County is exempt from federal and state income taxes under provisions of Section 501(c)(12). Accordingly, the financial statements for Taylor County include no provision for income taxes. Taylor County's accounting policy provides that a tax expense/benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits. Management believes Taylor County has no uncertain tax positions resulting in an accrual of tax expense or benefit. Taylor County recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. Taylor County did not recognize any interest or penalties during the years ended May 31, 2014 and 2013. Taylor County's income tax return is subject to possible examination by taxing authorities until the expiration of related statues of limitations on the return, which is generally three years.

Comprehensive Income Comprehensive income includes both net margin and other comprehensive income. Other comprehensive income represents the change in funded status of the accumulated postretirement benefit obligation.

Subsequent Events Management has evaluated subsequent events through August 5, 2014, 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:

	2014	2013
East Kentucky, patronage capital	$18,792,222	$15,847,108
CoBank	562,093	537,814
Others	470,398	427,847
Total	$19,824,713	$16,812,769

Taylor County records patronage capital assigned by associated organizations in the year in which such assignments are received. Investments and purchases from National Bank for Cooperatives ("CoBank") are a condition of borrowing loan funds.

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, Taylor County may distribute the difference between 25% and the payments made to such estates. At May 31, 2014, the equities and margins were 64% of total assets.

Note 3. Patronage Capital, continued

Patronage capital consisted of:

	2014	2013
Assigned to date	$53,131,499	$49,022,585
Assignable margins	1,024,609	1,001,374
Retirements to date	(4,178,465)	(4,009,369)
Unassigned	3,719,542	3,662,612
Total	$53,697,185	$49,677,202

Note 4. Long Term Debt

All assets, except vehicles, are pledged as collateral on the long term debt to RUS, Federal Financing Bank (FFB), and CoBank under a joint mortgage agreement. First mortgage notes consist of:

	2014	2013
RUS, 0.25% to 5.375%	$6,647,274	$6,933,148
Advance payments, earns 5.0%	(879,563)	(1,200,090)
	5,767,711	5,733,058
FFB, 3.306%	5,584,065	5,712,618
CoBank, 2.99% (3.35% in 2013) to 6.95%	5,219,770	5,382,908
Refinance RUS loans, 4.52%	3,731,453	4,218,937
	8,951,223	9,601,845
	20,302,999	21,047,521
Less current portion	1,150,000	1,100,000
Long term portion	$19,152,999	$19,947,521

The long term debt payable to RUS and CoBank are due in quarterly and monthly installments of varying amounts through 2039. RUS assess 25 basis points to administer the FFB loans. Taylor County has $6,000,000 of unadvanced loans funds available from FFB. During August 2010, Taylor County refinanced $5.42 million of RUS loans with lower interest rate loans from CoBank.

As of May 31, 2014, annual current principal due for the next five years are as follows: 2015 - $1,150,000; 2016 - $1,200,000; 2017 - $1,250,000; 2018 - $1,300,000; 2019 - $1,400,000.

Note 5. Short Term Borrowings

Taylor County has executed short term line of credit agreements in the amount of $3,000,000 each with CoBank and with National Rural Utilities, Cooperative Finance Corporation ("CFC"). At May 31, 2014 Taylor County had repaid all advances against this line of credit.

Note 6. Pension Plan

Effective January 1, 1995, Taylor County implemented a Retirement Savings Plan for all employees who are eligible to participate in Taylor County's benefit programs. The plan allows participants to make contributions by salary reduction, pursuant to Section 401(k) of the Internal Revenue Code. Taylor County makes contributions for each participant equal to 10% of participants' base compensation with employees required to make a minimum contribution of 3% of base wages. Taylor County contributed $276,495 in 2014 and $276,210 in 2013. Participants vest immediately in their contributions and the contributions of Taylor County.

Note 7. Postretirement Benefits

Taylor County sponsors a defined benefit plan that provides medical insurance coverage for retired employees and their spouses. Taylor County pays all the premiums for retirees and their dependents. For measurement purposes, an annual rate of increase of 5% in 2014, then decreasing by 0.5% per year until 5% per year, in the per capita cost of covered health care benefit was assumed. The discount rate used in determining the accumulated postretirement benefit obligation was 5% in 2014 and 2013.

The funded status of the plan is as follows:

	2014	2013
Projected benefit obligation	($5,028,588)	($5,153,576)
Plan assets at fair value	-	-
Total	($5,028,588)	($5,153,576)

The components of net periodic postretirement benefit cost are as follows:

	2014	2013
Benefit obligation at beginning of year	$5,153,576	$5,226,701
Components of net periodic benefit cost:		
Service cost	101,426	70,522
Interest cost	254,554	285,458
Net periodic benefit cost	355,980	355,980
Benefits paid	(480,968)	(429,105)
Accumulated other comprehensive accounting	-	-
Benefit obligation at end of year	$5,028,588	$5,153,576

Projected retiree benefit payments for the next five years are expected to be as follows: 2014 - $475,537; 2015 - $477,017; 2016 - $445,188; 2017 - $393,710; 2018 - $338,833.

Note 8. Related Party Transactions

Several of the Directors of Taylor County and its General Manager & CEO are on the Boards of Directors of various associated organizations.

Note 9. Commitments and Contingencies

Taylor County has various other agreements outstanding with local contractors. Under these agreements, the contractors will perform certain 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 two years.

Note 10. Environmental Contingency

Taylor County from time to time is required to work with and handle PCBs, herbicides, automotive fluids, lubricants, and other hazardous materials in the normal course of business. As a result, there is the possibility that environmental conditions may arise which would require Taylor County to incur cleanup costs. The likelihood of such an event, or the amount of such costs, if any, cannot be determined at this time. However, management does not believe such costs, if any, would materially affect Taylor County's financial position or its future cash flows.

Note 11. Rate Matters

East Kentucky has increased its base rates to Taylor County at various times since 2007. Taylor County has passed these increases on to its customers using the methodology prescribed by the PSC.

Note 12. Contingencies

Taylor County is involved in litigation arising in the normal course of business. While the results of such litigation cannot be predicted with certainty, management, based upon advice of counsel, believes that the final outcome will not have a material adverse effect on the financial statements.

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ALAN M. ZUMSTEIN
CERTIFIED PUBLIC ACCOUNTANT

1032 CHETFORD DRIVE
LEXINGTON, KENTUCKY 40509
(859) 264-7147
zumstein@windstream.net

MEMBER
• AMERICAN INSTITUTE OF CPA'S
• KENTUCKY SOCIETY OF CPA'S
• INDIANA SOCIETY OF CPA'S
• AICPA DIVISION FOR FIRMS

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*

To the Board of Directors
Taylor County Rural Electric Cooperative

I have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Taylor County Rural Electric Cooperative, which comprise the balance sheets as of May 31, 2014 and 2013, and the related statements of revenue and comprehensive income, members' equities and cash flows for the years then ended, and related notes to the financial statements, and have issued my report thereon dated August 5, 2014.

Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing my audit, I considered Taylor County'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 Taylor County's internal control over financial reporting. Accordingly, I do not express an opinion on the effectiveness of Taylor County's internal control over financial reporting.

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.

My consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, 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 previously.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Taylor County'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*.

Purpose of this Report

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
August 5, 2014

ALAN M. ZUMSTEIN
CERTIFIED PUBLIC ACCOUNTANT

1032 CHETFORD DRIVE
LEXINGTON, KENTUCKY 40509
(859) 264-7147
zumstein@windstream.net

MEMBER
• AMERICAN INSTITUTE OF CPA'S
• KENTUCKY SOCIETY OF CPA'S
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• AICPA DIVISION FOR FIRMS

Independent Auditor's Report on Compliance with Aspects of Contractual Agreements and Regulatory Requirements for Electric Borrowers

To the Board of Directors
Taylor County Rural Electric Cooperative

Independent Auditor's Report

I 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 Taylor County Rural Electric Cooperative ("the Cooperative"), which comprise the balance sheet as of May 31, 2014, and the related statements of revenue and comprehensive income, patronage capital, and changes in cash flows for the year then ended, and the related notes to the financial statements, and have issued my report thereon dated August 5, 2014. In accordance with *Government Auditing Standards*, we have also issued my report dated August 5, 2014, on my consideration of the Cooperative's internal control over financial reporting and on my 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 and my schedule of findings and recommendations related to my audit have been furnished to management.

In connection with my audit, nothing came to my attention that caused me to believe that the Cooperative 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 and clarified in the RUS policy memorandum dated February 7, 2014, insofar as they relate to accounting matters as enumerated below. However, my audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had I performed additional procedures, other matters may have come to my attention regarding the Cooperative'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 my audit, I noted no matters regarding the Cooperative's accounting and records to indicate that the Cooperative 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 material and supplies;
- Prepare accurate and timely Financial and Operating Reports;
- Obtain written 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.

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. However, this report is a matter of public record and its distributions is not limited.

Alan Zumstein

Alan M. Zumstein, CPA
August 5, 2014