PUBLIC SERVICE COMMISSION
ANNUAL REPORT BRANCH

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Licking Valley Rural Electric Cooperative Corporation
West Liberty, Kentucky

Audited Financial Statements

October 31, 2011 and 2010

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Independent Auditor's Report

To the Board of Directors
Licking Valley Rural Electric Cooperative

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

I conducted my audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and 7 CFR Part 1773, Policy on Audits of Rural Utilities Service (RUS) Borrowers. Those standards require that I plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audits provide a reasonable basis for my opinion.

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

In accordance with *Government Auditing Standards*, I have also issued a report dated December 29, 2011, on my consideration of Licking Valley 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* and should be considered in assessing the results of my audits.

Alan M. Zumstein

Alan M. Zumstein, CPA
December 29, 2011

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To the Board of Directors
Licking Valley Rural Electric Cooperative

I have audited the financial statements of Licking Valley Rural Electric as of and for the years ended October 31, 2011 and 2010, and have issued my report thereon dated December 29, 2011. I conducted my audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing my audit, I considered Licking Valley'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 Licking Valley's internal control over financial reporting. Accordingly, I do not express an opinion on the effectiveness of Licking Valley's internal control over financial reporting.

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

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

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

Compliance and Other Matters

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

This report is intended solely for the information and use of the Board of Directors, 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
December 29, 2011

Licking Valley Rural Electric Cooperative Corporation
Balance Sheets, October 31, 2011 and 2010

Assets	2011	2010
Electric Plant, at original cost:		
In service	$ 59,101,583	$ 56,957,448
Under construction	1,169,540	964,590
	60,271,123	57,922,038
Less accumulated depreciation	20,233,293	18,925,710
	40,037,830	38,996,328
Investments in Associated Organizations	8,269,323	7,447,485
Current Assets:		
Cash and cash equivalents	367,197	910,746
Accounts receivable, less allowance for 2011 of $98,596 and 2010 of $98,596	4,356,596	4,077,430
Other receivables	86,756	131,434
Material and supplies, at average cost	438,745	410,770
Other current assets	29,330	32,315
	5,278,624	5,562,695
Total	$ 53,585,777	$ 52,006,508

Members' Equities and Liabilities	2011	2010
Members' Equities:		
Memberships	$ 211,930	$ 212,240
Patronage capital	24,500,465	23,111,701
Other equities	88,570	88,570
Accumulated other comprehensive income	(1,101,808)	(1,169,848)
	23,699,157	22,242,663
Long Term Debt	20,940,797	22,072,146
Accumulated Postretirement Benefits	3,008,239	3,084,325
Current Liabilities:		
Notes payable	1,068,366	-
Accounts payable	1,527,634	1,317,933
Current portion of long term debt	1,200,000	1,250,000
Consumer deposits	1,278,972	1,277,677
Accrued expenses	523,583	431,583
	5,598,555	4,277,193
Consumer Advances	339,029	330,181
Total	$ 53,585,777	$ 52,006,508

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

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

	2011	2010
Operating Revenues	$ 28,637,903	$ 27,796,931
Operating Expenses:		
Cost of power	19,760,238	18,596,860
Distribution - operations	1,622,996	1,461,491
Distribution - maintenance	1,901,577	2,007,147
Consumer accounts	912,464	725,116
Customer services	102,435	165,057
Administrative and general	1,155,182	1,093,099
Depreciation, excluding $186,367 in 2011 and $188,326 in 2010 charged to clearing account	1,908,065	1,883,464
Taxes, other than income	34,317	25,982
Other deductions	20,031	16,129
	27,417,305	25,974,345
Operating margins before interest charges	1,220,598	1,822,586
Interest Charges:		
Long-term debt	593,015	622,495
Other	107,581	89,002
	700,596	711,497
Operating margins after interest charges	520,002	1,111,089
Nonoperating Margins, principally interest	31,631	33,103
Patronage Capital Credits	837,131	890,228
Net Margins	1,388,764	2,034,420
Patronage Capital, beginning of year	23,111,701	21,077,281
Patronage Capital, end of year	$ 24,500,465	$ 23,111,701

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

Statements of Cash Flows

for the years ended October 31, 2011 and 2010

	2011	2010
Cash Flows from Operating Activities:		
Net margins	$ 1,388,764	$ 2,034,420
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation:		
Charged to expense	1,908,065	1,883,464
Charged to clearing accounts	186,367	188,326
Patronage capital credits assigned	(837,131)	(890,228)
Accumulated postretirement benefits	(8,046)	78,965
Change in assets and liabilities:		
Receivables	(234,488)	600,339
Material and supplies	(27,975)	68,223
Other assets	2,985	2,099
Payables	209,701	(11,857)
Consumer deposits and advances	10,143	(684)
Accrued expenses	92,000	97,290
	2,690,385	4,050,357
Cash Flows from Investing Activities:		
Plant additions	(2,908,877)	(3,262,360)
Plant removal costs	(493,803)	(378,219)
Salvage recovered from retired plant	266,746	194,784
Receipts from other investments, net	15,293	19,952
	(3,120,641)	(3,425,843)
Cash Flows from Financing Activities:		
Net increase in memberships	(310)	155
Increase in other equities	-	-
Short term borrowings	1,068,366	-
Payments on long term debt	(1,181,349)	(1,200,398)
Advances of long term debt	-	-
	(113,293)	(1,200,243)
Net increase in cash	(543,549)	(575,729)
Cash and cash equivalents, beginning of year	910,746	1,486,475
Cash and cash equivalents, end of year	$ 367,197	$ 910,746
Supplemental cash flows information:		
Interest paid on long-term debt	$ 598,480	$ 640,798

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

Note 1. Summary of Significant Accounting Policies

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

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

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

	2011	2010
Distribution plant	$54,849,803	$52,830,329
General plant	4,251,780	4,127,119
Total	$59,101,583	$56,957,448

Depreciation Provision has been made for depreciation on the basis of the estimated lives of assets, using the straight-line method. Depreciation rates range from 2.2% to 6.67% for distribution plant and from 3% to 15% for general plant.

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

Off Balance Sheet Risk Licking Valley has off-balance sheet risk in that they maintain cash deposits in financial institutions in excess of the amounts insured by the Federal Deposit Insurance Corporation (FDIC). At October 31, 2011, the financial institution reported deposits in excess of the $250,000 FDIC insured limit on several of the accounts. Deposits and repurchase agreements in excess of the FDIC limits are 100% secured with collateral from each respective financial institution. Licking Valley's primary banks participate in a temporary "Transaction Account Guarantee Program" through the FDIC that provides unlimited coverage through December 31, 2011 for non-interest bearing transaction accounts. The local banks expect this coverage to continue after that time.

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

Revenue Licking Valley records revenue as billed to its consumers based through the 20th of each month. All consumers are required to pay a refundable deposit, which may be waived under certain circumstances. Licking Valley's sales are concentrated in an eight county area of eastern Kentucky. There were no consumers whose individual account balance exceeded 10% of outstanding accounts receivable at October 31, 2011 or 2010. Consumers must pay their bill within 20 days of billing, at which time a 5% discount is forfeited, 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.

Note 1. Summary of Significant Accounting Policies, continued

Cost of Power Licking Valley is one of sixteen (16) members of East Kentucky Power Cooperative ("East Kentucky"). Under a wholesale power agreement, Licking Valley is committed to purchase its electric power and energy requirements from East Kentucky until 2051. The rates charged by East Kentucky are subject to approval of the PSC. The cost of purchased power is recorded monthly during the period in which the energy is consumed, based upon billings from East Kentucky.

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

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

The carrying amounts of Licking Valley'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 Licking Valley. 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.

Licking Valley may, and also does, invest idle funds in CFC Commercial Paper and with 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 2011 and 2010.

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

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

Note 1. Summary of Significant Accounting Policies, continued

Risk Management Licking Valley 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.

Advertising Licking Valley expenses advertising costs as incurred.

Subsequent Events Management has evaluated subsequent events through December 29, 2011, the date the financial statements were available to be issued. There were no significant subsequent events to report.

Note 2. Investments in Associated Organizations

Licking Valley records patronage capital assigned by associated organizations in the year in which such assignments are received.

The Capital Term Certificates ("CTCs") of CFC are recorded at cost. The CTCs were purchased from CFC as a condition of obtaining long-term financing. The CTCs bear interest at 0%, 3%, and 5% and are scheduled to mature at varying times from 2020 to 2080.

Investments in associated organizations consist of:

	2011	2010
East Kentucky, patronage capital	$6,898,928	$6,105,129
CFC, patronage capital	151,807	141,823
CFC, CTC's	662,663	663,491
Others	555,925	537,042
Total	$8,269,323	$7,447,485

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, Licking Valley may distribute the difference between 25% and the payments made to such estates. The equity at October 31, 2011 was 46% of total assets. Nonoperating margins are used to offset the prior year losses. Patronage capital consists of:

	2011	2010
Assigned to date	$25,130,991	$22,984,515
Assignable margins	60,734	797,757
Unassigned	19,739	19,739
Prior year losses	(710,999)	(690,310)
Total	$24,500,465	$23,111,701

Note 4. Accumulated Other Comprehensive Income

The changes in accumulated other comprehensive income, which includes the effects of accounting for accumulated postretirement benefits, follows:

	2011	2010
Balance, beginning of period	($1,169,848)	($1,226,548)
Amortization	68,040	56,700
Adjustments	-	-
Total	($1,101,808)	($1,169,848)

Note 5. Long Term Debt

All assets, except vehicles, are pledged as collateral on the long term debt to RUS, Federal Financing Bank ("FFB"), and CFC under a joint mortgage agreement. The long term debt is due in quarterly and monthly installments of varying amounts through 2041. RUS assess 12.5 basis points to administer the FFB loans. The interest rates on notes payable to CFC at 5.50% are subject to change every seven years. The 3.20% interest rate notes to CFC adjusts monthly and may be converted to a fixed rate at any time upon board approval by Licking Valley. Long term debt consists of:

	2011	2010
RUS, 0.25% to 6.875%	$6,353,666	$6,843,780
FFB, 0.220% (0.164% in 2010) and 6.048%	12,651,609	13,129,243
CFC:		
5.50% fixed rate notes	2,866,889	2,939,983
3.20% (4.95% in 2010) variable rate	268,633	409,140
	3,135,522	3,349,123
	22,140,797	23,322,146
Less current portion	1,200,000	1,250,000
Long term portion	$20,940,797	$22,072,146

As of October 31, 2011, the annual principal portion of long term debt outstanding for the next five years are as follows: 2012 - $1,200,000; 2013 - $1,190,000; 2014 - $1,190,000; 2015 - $1,200,000; 2016 - $1,210,000.

Note 6. Short Term Borrowings

At October 31, 2011, Licking Valley had a short term line of credit of $2,000,000 available from CFC. At October 31, 2011, Licking Valley had advanced $1,068,366 of funds at an interest rate of 3.20%.

Note 7. Savings Plan

All eligible employees of Licking Valley participate in the NRECA Retirement and Security Program, a defined contribution pension plan qualified under section 401(k) and tax-exempt under section 501(a) of the Internal Revenue Code. Licking Valley makes annual contributions to the Program equal to the amounts accrued for pension expense. Contributions to this plan were $236,995 for 2011 and $226,078 for 2010. In this multiemployer plan, which is available to all member corporations of NRECA, the accumulated benefits and plan assets are not determined or allocated separately by individual employer. A portion of this cost is allocated to construction of electric plant.

Note 8. Postretirement Benefits

Licking Valley sponsors a defined benefit plan that provides medical insurance coverage to retirees by contributing 50% of the cost of the policy. For measurement purposes, an annual rate of increase of 8.5%, 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 6.50%. A portion of the net periodic benefit cost is allocated to construction of electric plant.

The funded status of the plan is as follows:

	2011	2010
Projected benefit obligation	($3,008,239)	($3,084,325)
Plan assets at fair value	-	-
Funded status	($3,008,239)	($3,084,325)

The reconciliation of the benefits obligations of postretirement benefits are as follows:

	2011	2010
Benefit obligation - beginning of period	$3,084,325	$3,062,060
Adjust accumulated other comprehensive income	-	-
Net periodic benefit cost:		
Service cost	54,740	52,141
Interest cost	132,220	153,659
Benefit payments to participants	(263,046)	(183,535)
Benefit obligation - end of period	$3,008,239	$3,084,325

Projected retiree benefit payments for the next five years are expected to be as follows: 2012 - $125,500; 2013 - $127,000; 2014 - $127,000; 2015 - $126,000; 2016 - $126,000.

Note 9. Commitments

Licking Valley is contingently liable as guarantor for approximately $60,000 of long term obligations of East Kentucky to RUS and CFC. Substantially all assets of Licking Valley are pledged as collateral for this guarantee, in addition to the pledge in the mortgage agreement referred to in Note 5. This contingent liability was part of an overall financing plan for the construction of generating facilities near Maysville, Kentucky.

Licking Valley 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 three years.

Note 10. Related Party Transactions

Several of the Directors of Licking Valley and its President & General Manager are on the Boards of Directors of various associated organizations.

Note 11. Environmental Contingency

Licking Valley 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 Licking Valley 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 Licking Valley's financial position or its future cash flows.

Note 12. Rate Matters

East Kentucky increased its base rates to Licking Valley during August 2007, by 2%, in April 2009, by 7%, and again in January 2011 by another 5%. Licking Valley passed each of East Kentucky's increases on to its customers using the methodology prescribed by the PSC.

Note 13. Contingencies

Licking Valley 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.

* * * * * *