Kentucky 51
Nolin Rural Electric Cooperative Corporation
Elizabethtown, Kentucky

Audited Financial Statements
December 31, 2011 and 2010

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Independent Auditor's Report

To the Board of Directors
Nolin Rural Electric Cooperative Corporation

I have audited the balance sheets of Nolin Rural Electric Cooperative Corporation as of December 31, 2011 and 2010, and the related statements of income and patronage capital and cash flows for the years then ended. These financial statements are the responsibility of Nolin Rural Electric Cooperative Corporation'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 Nolin Rural Electric Cooperative Corporation as of December 31, 2011 and 2010, and the results of operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, I have also issued a report dated March 9, 2012, on my consideration of Nolin Rural Electric Cooperative Corporation's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of my audits.

Alan M. Zumstein

Alan M. Zumstein, CPA
March 9, 2012

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To the Board of Directors
Nolin Rural Electric Cooperative Corporation

I have audited the financial statements of Nolin Rural Electric Cooperative Corporation as of and for the years ended December 31, 2011 and 2010, and have issued my report thereon dated March 9, 2012. I conducted my audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Nolin Rural Electric's financial statements are free of material misstatement, I performed test of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the audit committee, management, the Rural Utilities Service, and supplemental lenders, and is not intended to be and should not be used by anyone other than these specified parties.

Alan M. Zumstein

Alan M. Zumstein, CPA
March 9, 2012

Nolin Rural Electric Cooperative Corporation

Balance Sheets, December 31, 2011 and 2010

Assets	2011	2010
Utility Plant, at original cost:		
In service	$ 97,248,645	$ 93,704,034
Under construction	4,060,577	5,819,353
	101,309,222	99,523,387
Less accumulated depreciation	35,029,136	32,564,487
	66,280,086	66,958,900
Investments in associated organizations	23,533,749	19,659,594
Long term portion of other receivables	51,623,256	51,623,256
Current Assets:		
Cash and cash equivalents	8,612,612	22,884,308
Accounts receivable, electric, less allowance for 2011 of $315,544 and 2010 of $237,306	10,968,990	10,133,022
Accounts receivable, other	14,735,254	4,887,908
Material and supplies, at average cost	1,301,975	1,181,227
Prepayments and others	30,149	29,857
	35,648,980	39,116,322
Total	$ 177,086,071	$ 177,358,072

Members' Equities and Liabilities		
Members' Equities:		
Memberships	$ 287,520	$ 293,320
Patronage capital	56,610,151	50,153,423
Other equities	1,719,730	1,594,715
Accumulated other comprehensive income	(1,037,716)	(1,173,316)
	57,579,685	50,868,142
Long Term Debt	93,876,400	99,802,927
Accumulated Postretirement Benefits	3,619,577	3,464,794
Current Liabilities:		
Accounts payable	8,400,770	10,541,289
Current portion of long term debt	9,375,000	8,500,000
Consumer deposits	2,066,423	1,983,243
Other current and accrued expenses	1,908,323	1,975,510
	21,750,516	23,000,042
Consumer Advances for Construction	259,893	222,167
Total	$ 177,086,071	$ 177,358,072

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

Statements of Revenue and Patronage Capital

for the years ended December 31, 2011 and 2010

	2011	2010
Operating Revenues	$ 71,990,665	$ 70,088,970
Operating Expenses:		
Cost of power	53,165,413	50,824,374
Distribution - operations	3,256,001	3,613,102
Distribution - maintenance	3,967,648	3,527,838
Consumer accounts	2,427,042	2,510,364
Customer service	895,984	905,886
Administrative and general	3,011,211	2,742,372
Depreciation, excluding $312,435 in 2011 and $312,435 in 2010 charged to clearing accounts	3,623,377	3,474,491
Other deductions	21,017	25,294
	70,367,693	67,623,721
Operating Margins before Interest Charges	1,622,972	2,465,249
Interest Charges:		
Interest on long-term debt	3,893,167	4,558,951
Other interest charges	133,760	132,651
	4,026,927	4,691,602
Operating Margins after Interest Charges	(2,403,955)	(2,226,353)
Nonoperating Margins:		
Interest income	3,271,501	3,867,878
Other non operating margins	1,791,909	1,128,072
	5,063,410	4,995,950
Patronage Capital assigned	4,030,726	2,489,312
Net Margins	6,690,181	5,258,909
Patronage Capital - beginning of year	50,153,423	45,077,266
Retirements to estates and others	(233,453)	(182,752)
Patronage Capital - end of year	$ 56,610,151	$ 50,153,423

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

Statements of Cash Flows

for the years ended December 31, 2011 and 2010

	2011	2010
Cash Flows from Operating Activities:		
Net margins	$ 6,690,181	$ 5,258,909
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation		
Charged to expense	3,623,377	3,474,491
Charged to clearing accounts	334,849	312,435
Patronage capital credits allocated	(4,030,726)	(2,489,312)
Accumulated postretirement benefits	290,383	310,438
Change in assets and liabilities:		
Receivables	(835,968)	738,224
Material and supplies	(120,748)	(213,792)
Prepayments	(292)	171,061
Payables	(2,140,519)	3,060,275
Consumer deposits	83,180	70,891
Accrued expenses	(67,187)	40,608
Consumer advances for construction	37,726	(85,189)
	3,864,256	10,649,039
Cash Flows from Investing Activities:		
Plant additions	(3,032,403)	(8,111,005)
Salvage, net of removal costs	(247,009)	(215,118)
Receipts from associated organizations	156,571	17,232
	(3,122,841)	(8,308,891)
Cash Flows from Financing Activities:		
Net increase in memberships	(5,800)	(6,825)
Other receivables financing	(9,847,346)	16,910,377
Additional long-term borrowings	3,720,000	7,000,000
Payments on long-term debt	(8,771,527)	(8,021,383)
Payments of patronage capital	(233,453)	(182,752)
Other equities	125,015	99,753
	(15,013,111)	15,799,170
Net increase in cash	(14,271,696)	18,139,318
Cash balances - beginning of period	22,884,308	4,744,990
Cash balances - end of period	$ 8,612,612	$ 22,884,308
Supplemental cash flows information:		
Interest paid on long-term debt	$ 3,982,970	$ 4,590,187

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

Note 1. Summary of Significant Accounting Policies

Nolin Rural Electric Cooperative Corporation ("Nolin") 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:

Business Activities Nolin provides distribution electric service to residential, business and commercial consumers in a nine (9) county area of central Kentucky.

Nolin is operating the distribution system for a local government unit through a privatization process with the federal government. Nolin is reimbursed for all costs incurred, plus a management fee, on a monthly basis. Payments for the construction of plant facilities are recorded as contributions to plant for the total cost of each project, therefore, there is no net original cost for electric plant from the privatization process. The results of operating the government system are as follows:

	2011	2010
Operating revenues	$2,411,196	$1,775,416
Operating expenses	1,322,666	1,438,827

Other Business Activities Nolin also provides demand side management and energy efficiency services to the local federal government installation. Nolin subcontracts almost all work performed, then bills the government installation for the subcontractor costs, plus a management fee. The reimbursements are due over a ten (10) year period. Included in accounts receivable, other, is $65,486,688 for 2011 and $68,859,530 for 2010 for these projects. Nolin charges the government installation 1.05% times Nolin's current variable interest rate on the unpaid balance. Interest income recognized was $3,177,124 for 2011 and $3,798,900 for 2010. The government installation had a prepayment that Nolin applied to the amounts due at December 31, 2011 and 2010, respectively, of $344,686 and $13,756,435.

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

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.

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

Revenue Nolin records revenue as billed to its consumers based on monthly meter-reading cycles. Consumers are required to pay a refundable deposit, however, it may be waived under certain circumstances. 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 individual account balances that exceeded 10% of outstanding accounts receivable at December 31, 2011 and 2010.

Note 1. Summary of Significant Accounting Policies, continued

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

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.

The major classifications of utility plant in service consist of:

	2011	2010
Distribution plant	$82,636,441	$79,579,353
General plant	14,612,204	14,124,681
Total	$97,248,645	$93,704,034

Depreciation Nolin's provision has been made for depreciation on the basis of the estimated lives of assets, using the straight-line method. General plant rates are as follows:

Distribution plant	2.5% - 6.9%
Structures and improvements	2.5%
Transportation equipment	10% - 20%
Other general plant	5% - 10%

Inventory Inventory is stated at cost, which approximates market value.

Income Tax Status Nolin is exempt from federal and state income taxes under provisions of Section 501(c)(12). Accordingly, the financial statements for Nolin include no provision for income taxes. Income taxes for KVNet are provided on income as reported in the accompanying statements regardless of when such taxes are payable.

Effective January 1, 2008, Nolin adopted the provisions of the *Income Taxes Topic* of the FASB ASC that pertains to accounting for uncertainty in income taxes. Nolin 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. Nolin recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. Nolin did not recognize any interest or penalties during the years ended December 31, 2011 or 2010.

Note 1. Summary of Significant Accounting Policies, continued

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 Nolin's cash and cash equivalents, other receivables, investments, inventories, other assets, trade accounts payable, accrued expenses and liabilities, and other liabilities approximate fair value due to their short maturity. Investments in associated organizations are not considered a financial instrument because they represent nontransferable interests in associated organizations. Other assets are not considered financial instruments because they represent activities specifically related to Nolin. 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.

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

The only fair values measured on a recurring basis are cash and cash equivalents, which are valued at Level 1 and are recorded at cost.

Advertising Advertising costs are expensed as incurred.

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

Subsequent Events Management has evaluated subsequent events through March 9, 2012, the date the financial statements were available to be issued. There were no significant subsequent events to report.

Note 2. Investments in Associated Organizations

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.

Note 2. Investments in Associated Organizations, continued

Nolin records patronage capital assigned by associated organizations in the year in which such assignments are received. Investments in associated organizations consist of:

	2011	2010
East Kentucky, patronage capital	$19,049,184	$15,388,918
CFC, patronage capital	1,035,054	878,884
CFC, CTC's	2,404,998	2,389,686
Others	1,044,513	1,002,106
Total	$23,533,749	$19,659,594

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, Nolin may distribute the difference between 25% and the payments made to such estates. The equity at December 31, 2011 was 33% of total assets.

Patronage capital consists of:

	2011	2010
Assigned to date	$64,890,276	$59,642,878
Assignable margins	6,690,181	5,258,909
Unassigned	48,062	48,062
Retirements to date	(15,018,368)	(14,796,426)
Total	$56,610,151	$50,153,423

Note 4. Accumulated Other Comprehensive Income

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

	2011	2010
Balance, beginning of period	($1,173,316)	($1,308,916)
Amortization	135,600	135,600
Adjustments	-	-
Total	($1,037,716)	($1,173,316)

Note 5. Long Term Debt

The 4.6% to 7.1% interest rates on the notes to CFC are subject to change every seven years from the repricing date for each individual note. The long term debt is due in quarterly and monthly installments of varying amounts through 2039. RUS assesses 12.5 basis points to administer the FFB loans. Nolin has funds available from CFC in the amount of $20,000,000 to finance the demand side management activities of the local government unit.

Note 5. Long Term Debt, continued

During 2003, Nolin refinanced $3,875,392 of RUS 5% interest rate loans with funds advanced from CFC. The long term debt to pay RUS loans is due in eight (8) annual installments of $484,424.

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. Long term debt consists of:

	2011	2010
RUS:		
5% notes	$1,578,534	$1,644,247
0.375% - 5.19%	26,411,886	27,026,599
	27,990,420	28,670,846
FFB, 0.222% (0.164% in 2010) -7.157%	22,625,775	19,839,344
CFC:		
7.00% -7.10%	4,027,054	4,303,258
5.55% to refinance RUS loans	-	365,699
3.20% for local government programs	48,608,151	55,123,780
	52,635,205	59,792,737
	103,251,400	108,302,927
Less current portion	9,375,000	8,500,000
Long term portion	$93,876,400	$99,802,927

As of December 31, 2011, the annual principal payments for the next five years are as follows: 2012 - $9,375,000; 2013 - $9,900,000; 2014 - $10,400,000; 2015 - $11,000,000; 2016 - $11,500,000.

Note 6. Short Term Borrowings

At December 31, 2011, Nolin had a short term line of credit of $7,000,000 available from CFC. At December 31, 2011, Nolin had repaid all advances against the line of credit.

Note 7. Pension Plan

All eligible employees of Nolin Energy participate in the NRECA Retirement and Security Program, a defined benefit pension plan qualified under section 401 and tax exempt under section 501(a) of the Internal Revenue Code. Nolin Energy makes annual contributions to the Program equal to the amounts accrued for pension expense. Contributions were $1,257,794 for 2011 and $1,186,753 for 2010. In this multiemployer plan, which is available to all member cooperatives of NRECA, the accumulated benefits and plan assets are not determined or allocated separately by individual employer.

Note 8. Postretirement Benefits

Nolin Rural Electric sponsors a defined benefit plan that provides medical insurance coverage to retired employees. Participating retirees and dependents do not contribute to the projected cost of coverage. The following is a reconciliation of the postretirement obligation.

Note 8. Postretirement Benefits, continued

The funded status of the plan is as follows:

	2011	2010
Projected benefit obligation	($3,619,577)	($3,464,794)
Plan assets at fair value	-	-
Total	($3,619,577)	($3,464,794)

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

	2011	2010
Benefit obligation at beginning of year	$3,464,794	$3,289,956
Components of net periodic benefit cost:		
Service cost	98,891	141,976
Interest cost	177,109	157,024
Net periodic benefit cost	276,000	299,000
Benefits paid	(121,217)	(124,162)
Accumulated other comprehensive income	-	-
Benefit obligation at end of year	$3,619,577	$3,464,794

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

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

Note 9. Related Party Transactions

Several of the Directors of Nolin Rural Electric, its President & CEO, and another employee are on the boards of directors of various associated organizations. Nolin entered a six (6) year lease with a member of the Board of Directors for 12 acres of land at $420 per year.

Note 10. Commitments and Contingencies

Nolin is contingently liable as guarantor for approximately $115,000 of long term obligations of East Kentucky to RUS, CFC, and institutional investors. Substantially all assets of Nolin are pledged as collateral for this guarantee, in addition to the pledge in the mortgage agreement referred to in Note 5. This contingent liability was part of an overall financing plan for the construction of a generating facility near Maysville, Kentucky.

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

Note 11. Environmental Contingency

Nolin 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 Nolin 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 Nolin's financial position or its future cash flows.

Note 13. Rate Matters

East Kentucky increased its base rates to Nolin during August 2007, by 2%, in April 2008, by another 7%, and in January, 2011 by another 5%. Nolin passed each of East Kentucky's increases on to its customers using the methodology prescribed by the PSC.

Note 13. Contingencies

Nolin 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.

* * * * *