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Cumberland Valley Electric
Gray, Kentucky

Audited Financial Statements
May 31, 2014 and 2013

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

CONTENTS

ALAN M. ZUMSTEIN
CERTIFIED PUBLIC ACCOUNTANT

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

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Independent Auditor's Report

To the Board of Directors
Cumberland Valley Electric
Gray, Kentucky

Report on the Financial Statements

I have audited the accompanying financial statements of Cumberland Valley Electric, 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 Cumberland Valley Electric 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 July 21, 2014, on my consideration of Cumberland Valley Electric'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
July 21, 2014

Cumberland Valley Electric
Balance Sheets, May 31, 2014 and 2013

Assets	2014	2013
Electric Plant, at original cost:		
In service	$ 96,752,015	$ 92,575,223
Under construction	578,301	1,339,667
	97,330,316	93,914,890
Less accumulated depreciation	34,169,335	33,392,540
	63,160,981	60,522,350
Investments in Associated Organizations	22,246,572	19,254,797
Current Assets:		
Cash and cash equivalents	1,549,583	1,869,020
Accounts receivable, less allowance for 2014 of $198,491 and 2013 of $210,844	3,349,780	3,374,559
Other receivables	172,170	72,316
Material and supplies, at average cost	575,240	883,306
Other current assets	689,566	697,849
	6,336,339	6,897,050
Accelerated Pension Payments	858,945	914,847
Total	$ 92,602,837	$ 87,589,044

Members' Equities and Liabilities	2014	2013
Members' Equities:		
Memberships	$ 430,200	$ 430,680
Patronage capital	39,278,540	36,296,899
Other equities	2,235,303	2,223,418
Accumulated other comprehensive income	(854,804)	(907,424)
	41,089,239	38,043,573
Long Term Debt	40,185,578	38,242,743
Accumulated Postretirement Benefits	3,371,726	3,269,677
Current Liabilities:		
Accounts payable	2,852,293	3,160,437
Current portion of long term debt	2,000,000	2,000,000
Consumer deposits	1,357,571	1,328,650
Accrued expenses	1,604,711	1,476,939
	7,814,575	7,966,026
Consumer Advances	141,719	67,025
Total	$ 92,602,837	$ 87,589,044

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

Statements of Revenue and Comprehensive Income
for the years ended May 31, 2014 and 2013

	2014	2013
Operating Revenues		
Sale of electric energy	$ 45,573,223	$ 46,017,581
Other electric revenues	1,674,986	1,664,499
	47,248,209	47,682,080
Operating Expenses:		
Cost of power	36,371,745	36,835,475
Distribution - operations	1,411,200	1,286,428
Distribution - maintenance	2,682,015	2,815,620
Consumer accounts	1,831,927	1,863,503
Customer services	153,482	203,305
Administrative and general	1,382,382	1,289,879
Depreciation, excluding $307,098 in 2014 and $278,449 in 2013 charged to clearing account	3,177,095	3,027,045
Taxes	51,441	52,902
	47,061,287	47,374,157
Operating margins before interest charges	186,922	307,923
Interest Charges:		
Long-term debt	364,111	394,376
Other	2,550	9,761
	366,661	404,137
Operating margins after interest charges	(179,739)	(96,214)
Nonoperating Margins		
Interest income	120,344	123,477
Others	(9,713)	(9,305)
	110,631	114,172
Patronage Capital Credits	3,050,756	2,416,008
Net Margins	2,981,648	2,433,966
Other comprehensive income		
Accumulated postretirement benefits	52,620	52,620
Net Comprehensive Income	$ 3,034,268	$ 2,486,586

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	$ 428,615	$ 34,276,878	$ 1,985,731	$ (960,044)	$ 35,731,180
Comprehensive income:					
Net margins		2,433,966			2,433,966
Postretirement benefit obligation					
Amortization				52,620	
Adjustments				-	52,620
Total comprehensive income					2,486,586
Net change in memberships	2,065				2,065
Refunds of capital credits		(413,945)			(413,945)
Other equities			237,687		237,687
Balance - May 31, 2013	430,680	36,296,899	2,223,418	(907,424)	38,043,573
Comprehensive income:					
Net margins		2,981,648			2,981,648
Postretirement benefit obligation					
Amortization				52,620	
Adjustments				-	52,620
Total comprehensive income					3,034,268
Net change in memberships	(480)				(480)
Refunds of capital credits		(7)			(7)
Other equities			11,885		11,885
Balance - May 31, 2014	$ 430,200	$ 39,278,540	$ 2,235,303	$ (854,804)	$ 41,089,239

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	$ 2,981,648	$ 2,433,966
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation:		
Charged to expense	3,177,095	3,027,045
Charged to clearing accounts	307,098	278,449
Patronage capital credits assigned	(3,050,756)	(2,416,008)
Accumulated postretirement benefits	154,669	174,766
Past service pension costs	55,902	(914,847)
Change in assets and liabilities:		
Receivables	(75,075)	217,506
Material and supplies	308,066	(190,365)
Other assets	8,283	(66,624)
Payables	(308,144)	125,156
Consumer deposits and advances	103,615	(85,062)
Accrued expenses	127,772	(4,302)
	3,790,173	2,579,680
Cash Flows from Investing Activities:		
Plant additions	(5,723,815)	(6,436,369)
Plant removal costs	(596,884)	(422,023)
Salvage recovered from retired plant	197,875	102,112
Receipts from other investments, net	58,981	22,652
	(6,063,843)	(6,733,628)
Cash Flows from Financing Activities:		
Net increase in memberships	(480)	2,065
Increase in other equities	11,885	237,687
Refund of capital credits	(7)	(413,945)
Advances of long term debt	3,900,000	5,340,000
Payments on long term debt	(1,891,930)	(1,874,964)
Advance payments on long term debt	(65,235)	(61,976)
	1,954,233	3,228,867
Net increase in cash	(319,437)	(925,081)
Cash and cash equivalents, beginning of year	1,869,020	2,794,101
Cash and cash equivalents, end of year	$ 1,549,583	$ 1,869,020
Supplemental cash flows information:		
Interest paid on long-term debt	$ 360,427	$ 393,359

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

Note 1. Summary of Significant Accounting Policies

Cumberland Valley Electric ("Cumberland 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 for distribution plant. Gain or loss is recognized on disposition of general plant items. Electric plant consists of:

	2014	2013
Distribution plant	$89,116,505	$85,492,778
General plant	7,635,510	7,082,445
Total	$96,752,015	$92,575,223

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 2.33% to 5.44%, with a composite rate of 3.37% for distribution plant. General plant rates are as follows:

Structures and improvements	2.5%
Transportation equipment	11.3%
Office furniture and equipment	5.0%
Other general plant	4.0% - 6.0%

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

Off Balance Sheet Risk Cumberland 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 various time during the month. These financial institutions have strong credit ratings and management believes that the credit risk related to the accounts is minimal. Cumberland Valley's primary bank deposits in excess of the FDIC limits are 100% secured with collateral from the financial institution.

Revenue Cumberland Valley records revenue as billed to its consumers based on monthly meter-reading cycles. All consumers are required to pay a refundable deposit, however, it may be waived under certain circumstances. Cumberland Valley's sales are concentrated in an eight 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.

Cumberland Valley 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. Cumberland Valley' 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.

Note 1. Summary of Significant Accounting Policies, continued

Cost of Power Cumberland Valley is one of sixteen (16) members of East Kentucky Power Cooperative ("East Kentucky"). Under a wholesale power agreement, Cumberland 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. The power bill includes a fuel adjustment and environmental surcharge component that is passed on to Cumberland Valley's customers using a methodology prescribed by the Commission.

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

Level 1: 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 Cumberland 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 are not considered financial instruments because they represent activities specifically related to Cumberland Valley. Long term debt cannot be traded in the market, and is specifically for electric cooperatives and, therefore, a value other than its outstanding principal cannot be determined.

Cumberland Valley 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 2014 and 2013.

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 Cumberland Valley expenses advertising costs as incurred.

Note 1. Summary of Significant Accounting Policies, continued

Risk Management Cumberland 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.

Income Tax Status Cumberland Valley is exempt from federal and state income taxes under provisions of Section 501(c)(12). Accordingly, the financial statements for Cumberland Valley include no provision for income taxes. Cumberland Valley'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 Cumberland Valley has no uncertain tax positions resulting in an accrual of tax expense or benefit. Cumberland Valley recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. Cumberland Valley did not recognize any interest or penalties during the years ended May 31, 2014 and 2013. Cumberland Valley'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 July 21, 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	$20,577,050	$17,620,031
CFC, patronage capital	193,916	189,530
CFC, CTC's	850,942	850,942
Others	624,664	594,294
Total	$22,246,572	$19,254,797

Cumberland 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 3% and 5% and are scheduled to mature at varying times from 2020 to 2080.

Note 3. Patronage Capital

Patronage capital consisted of:

	2014	2013
Assigned to date	$41,787,218	$38,755,362
Assignable margins	968,533	1,018,741
Retirements to date	(3,477,211)	(3,477,204)
Total	$39,278,540	$36,296,899

Note 3. Patronage Capital, continued

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, Cumberland Valley may distribute the difference between 25% and the payments made to such estates. At May 31, 2014, the equities and margins were 44% of total assets.

Note 4. Long Term Debt

All assets, except vehicles, are pledged as collateral on the long term debt to RUS, Federal Financing Bank (FFB), National Bank for Cooperatives (CoBank), CFC, and National Cooperative Services Corporation (NCSC) which is an affiliate of CFC, under a joint mortgage agreement. First mortgage notes consist of:

	2014	2013
RUS, 0.25% to 5.375%	$3,398,042	$3,523,655
Advance payments	(1,345,723)	(1,280,488)
	2,052,319	2,243,167
FFB, 0.041% (0.073% in 2013)	35,536,335	32,768,804
CoBank 1.86% to 3.86%	2,545,130	2,814,313
NCSC, 2.7% to 4.30%	2,051,793	2,416,459
	42,185,577	40,242,743
Less current portion	2,000,000	2,000,000
Long term portion	$40,185,577	$38,242,743

The long term debt payable is due in quarterly and monthly installments of varying amounts through 2039. During November 2010, $3,839,834 of RUS loans were refinanced with lower interest rate notes from NCSC. Cumberland Valley has loan funds available from FFB in the amount of $10,708,000 at May 31, 2014. These funds will be used for future plant additions. RUS assesses a fee of 25 basis points to administer the FFB loans.

As of May 31, 2014, annual current principal due for the next five years are as follows: 2015 - $2,000,000; 2016 - $2,000,000; 2017 - $2,000,000; 2018 - $2,050,000; 2019 - $2,100,000.

Note 5. Short Term Borrowings

Cumberland Valley has executed short term line of credit agreements with both CFC and CoBank in the amount of $5,000,000 each. At May 31, 2014 Cumberland Valley had repaid all advances against this line of credit.

Note 6. Pension Plan

All eligible employees of Cumberland Valley participate in the NRECA Retirement and Security Plan ("R&S Plan"), a defined benefit pension plan qualified under section 401 and tax exempt under section 501(a) of the Internal Revenue Code. It is a multiemployer plan under the accounting standards. The Plan sponsor's identification number is 53-0116145 and the Plan Number is 333. A unique characteristic of a multiemployer plan compared to a single employer plan is that all plan assets are available to pay benefits of any plan participant. Separate asset accounts are not maintained for participating employers. This means that assets contributed by one employer may be used to provide benefits to employees of other participating employers.

Cumberland Valley's contributions to the R&S Plan in 2014 and 2013 represent less than 5 percent of the total contributions made to the plan by all participating employers. Cumberland Valley Energy made contributions to the plan of $278,909 in 2014 and $338,436 in 2013. There have been no significant changes that affect the comparability of 2014 and 2013.

In the R&S Plan, a "zone status" determination is not required, and therefore not determined, under the Pension Protection Act ("PPA") of 2006. In addition, the accumulated benefit obligations and plan assets are not determined or allocated separately by individual employer. In total, the R&S Plan was between 65 percent and 80 percent funded at January 1, 2013 and 2012 based on the PPA funding target and PPA actuarial value of assets on those dates. Because the provisions of the PPA do not apply to the R&S Plan, funding improvement plans and surcharges are not applicable. Future contribution requirements are determined each year as part of the actuarial valuation of the plan and may change as a result of plan experience.

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

Two prepayment options were available to participating cooperatives:

1. Use current assets to make the prepayment over a period of not more than 4 years, or,
2. Borrow funds sufficient to make the prepayment in a lump sum, with the prepayment of the borrowed amount determined by the loan's amortization schedule.

On February 14, 2013, RUS issued a memorandum to all of its borrowers regarding the proper accounting treatment of the R&S Plan prepayment. RUS stipulated that the prepayment shall be recorded as a long term prepayment in Account 186, Miscellaneous Deferred Debits. This prepaid expense shall be amortized to Account 926, Employee Pensions and Benefits, over a ten year period. Alternatively, RUS borrowers may calculate the amortization period by subtracting the cooperative's average age of its workforce as provided by NRECA from the cooperative's normal retirement age under the R&S Plan, up to a maximum period of 20 years. If the entity choses to finance the prepayment, interest expense associated with the loan shall be recorded in the year incurred as is required under the RUS Uniform System of Accounts ("USoA").

Note 6. Pension Plan, continued
Section 6.13(e) of the RUS Loan Contract limits the amount of unsecured debt that a borrower may incur to 15% on Net Utility Plant if the equity level of the borrower, after considering such unsecured debt, is below 30% of its Total Assets, unless the borrower obtains RUS consent. RUS will consider any unsecured debt associated with the R&S Plan prepayment to be "Permitted Debt" and accordingly, it will be excluded from the application of Section 6.13(e). During May, 2013, the Corporation made a prepayment of $914,847 to the R&S Plan. The amount is being amortized over 15 years.

Cumberland Valley also sponsors a Retirement Savings Plan available to all eligible employees. The plan allows participants to make contributions by salary reduction, pursuant to Section 401(k) of the Internal Revenue Code. Cumberland Valley makes contributions of 10% for non-salaried employees and 5% for salaried employees of the participant's base compensation. Contributions for both plans were $253,357 for 2014 and $249,474 for 2013.

Note 7. Postretirement Benefits

Cumberland Valley sponsors a defined benefit plan that provides medical insurance coverage for retired employees and their spouses. Cumberland Valley pays all the premiums for retirees and their dependents. For measurement purposes, an annual rate of increase of 8.0% in 2013, 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 5.0% in 2014 and 2013.

The funded status of the plan is as follows:

	2014	2013
Projected benefit obligation	($3,371,726)	($3,269,677)
Plan assets at fair value	-	-
Total	($3,371,726)	($3,269,677)

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

	2014	2013
Benefit obligation at beginning of year	$3,269,677	$3,147,531
Components of net periodic benefit cost:		
Service cost	57,345	59,366
Interest cost	166,035	164,014
Net periodic benefit cost	223,380	223,380
Benefits paid	(121,331)	(101,234)
Actuarial gain/loss	-	-
Benefit obligation at end of year	$3,371,726	$3,269,677

Projected retiree benefit payments for the next five years are expected to be as follows: 2015 - $109,333; 2016 - $107,661; 2017 - $105,034; 2018 - $88,817; 2019 - $79,452.

Note 8. Related Party Transactions

Several of the Directors of Cumberland Valley and its President & CEO are on the Boards of Directors of various associated organizations.

Note 9. Commitments

Cumberland 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 two years.

Note 10. Environmental Contingency

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

Note 11. Labor Force

Approximately 80% of Cumberland Valley's labor force is subject to a collective bargaining agreement. A four (4) year agreement was negotiated and approved for the period starting September, 2012 between Cumberland Valley and the United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service Workers International Union.

Note 12. Contingencies

Cumberland Valley, on occasion, is involved in litigation arising in the normal course of business. Presently, there are no such litigations pending.

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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
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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
Cumberland Valley Electric

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 Cumberland Valley Electric, 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 July 21, 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 Cumberland 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 Cumberland Valley's internal control over financial reporting. Accordingly, I do no express an opinion on the effectiveness of Cumberland Valley'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 Cumberland Valley'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
July 21, 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
• INDIANA SOCIETY OF CPA'S
• AICPA DIVISION FOR FIRMS

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

Board of Directors
Cumberland Valley Electric

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 Cumberland Valley Electric ("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 July 21, 2014. In accordance with *Government Auditing Standards*, we have also issued my report dated July 21, 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
July 21, 2014