

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

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

**For the Years Ended
December 31, 2015 and 2014**

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Farmers Rural Electric
Cooperative Corporation
Glasgow, Kentucky

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Farmers Rural Electric Cooperative Corporation which comprise the balance sheets as of December 31, 2015 and 2014, and the related statements of revenue, comprehensive income, patronage capital and memberships, and cash flows, for the years then ended and related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of Farmers Energy Propane Plus, a wholly owned subsidiary, which statements reflect total assets of \$2,290,993 and \$2,217,779 as of December 31, 2015 and 2014, respectively, and total revenues of \$2,426,462 and \$2,701,641 respectively, for the years then ended. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Farmers Energy Propane Plus, is based solely on the report of the other auditor. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, based on our audits and the report of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the respective financial position of Farmers Rural Electric Cooperative Corporation and subsidiaries as of December 31, 2015 and 2014, and the results of their operations and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Our audit was conducted for the purpose of forming opinions on the consolidated financial statements that collectively comprise Farmers Rural Electric Cooperative Corporation's basic financial statements. The consolidating balance sheets and consolidating statements of revenue are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The consolidating balance sheets and consolidating statements of revenue are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information in Schedules I – IV, which insofar as it relates to Farmers Energy Propane Plus is based on the report of other auditors, is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 25, 2016 on our consideration of the Cooperative's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Farmers Rural Electric Cooperative Corporation's internal control over financial reporting and compliance.

Campbell, Myers, and Rattledge, PLLC

Certified Public Accountants
Glasgow, Kentucky

March 25, 2016

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
BALANCE SHEETS
December 31, 2015 and 2014

	<u>2015</u>	<u>Restated 2014</u>
Current assets:		
Cash and cash equivalents	\$ 559,476	\$ 643,145
Accounts and notes receivable, less allowance for doubtful accounts of \$92,514 in 2015 and \$92,053 in 2014	4,118,672	5,339,495
Materials and supplies, at average cost	952,521	902,388
Prepaid expenses	195,246	246,924
Total current assets	<u>5,825,915</u>	<u>7,131,952</u>
Other assets and investments:		
Cash - Special funds	453,668	-
Goodwill, net of amortization	458,052	458,052
Investments in subsidiary companies	21,479	19,464
Investment in associated organizations	25,802,197	23,360,199
Deferred charges	2,086,249	2,239,750
Note receivable	888,880	1,000,000
Total other assets	<u>29,710,525</u>	<u>27,077,465</u>
Utility plant in service	89,393,630	85,307,588
Construction work in progress	662,102	886,561
	<u>90,055,732</u>	<u>86,194,149</u>
Less accumulated depreciation	<u>(27,039,511)</u>	<u>(25,725,035)</u>
Utility plant, net	<u>63,016,221</u>	<u>60,469,114</u>
Total assets	<u>\$ 98,552,661</u>	<u>\$ 94,678,531</u>

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

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
BALANCE SHEETS, CONCLUDED
December 31, 2015 and 2014

	<u>2015</u>	<u>Restated 2014</u>
Current liabilities:		
Accounts payable	\$ 4,126,057	\$ 5,422,455
Accrued expenses	1,302,849	1,317,413
Customer deposits	861,686	900,227
Current portion of capital leases	27,667	33,905
Current portion of long-term debt	<u>2,359,392</u>	<u>2,186,793</u>
Total current liabilities	<u>8,677,651</u>	<u>9,860,793</u>
Long-term liabilities:		
Capital lease less current maturities	18,597	46,264
Long-term debt less current maturities	<u>49,418,236</u>	<u>46,280,237</u>
Total long-term liabilities	<u>49,436,833</u>	<u>46,326,501</u>
Noncurrent liabilities:		
Regulatory liability	453,668	-
Post retirement benefit obligations	878,967	531,973
Customer advances for construction	<u>347,450</u>	<u>369,932</u>
Total noncurrent liabilities	<u>1,680,085</u>	<u>901,905</u>
Members' equities:		
Memberships	540,380	536,810
Patronage capital	37,208,627	35,355,714
Accumulated other comprehensive income	(794,396)	(454,986)
Other equities	<u>1,803,481</u>	<u>1,680,165</u>
Total members' equities	<u>38,758,092</u>	<u>37,117,703</u>
Minority interests	<u>-</u>	<u>471,629</u>
Total equities	<u>38,758,092</u>	<u>37,589,332</u>
Total liabilities and equity	<u>\$ 98,552,661</u>	<u>\$ 94,678,531</u>

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

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
STATEMENTS OF REVENUE

For the years ended December 31, 2015 and 2014

	<u>2015</u>	<u>Restated 2014</u>
Operating revenue	\$ <u>51,899,243</u>	\$ <u>55,540,918</u>
Operating expenses:		
Cost of purchases	37,445,395	40,420,930
Distribution - operations	2,083,890	1,976,442
Distribution - maintenance	2,969,616	2,960,807
Consumer accounts	1,108,315	1,093,049
Customer services and informational expense	121,986	169,746
Administrative and general	2,689,996	2,541,388
Depreciation	2,918,159	2,752,062
Taxes	<u>824,116</u>	<u>782,422</u>
Total operating expenses	<u>50,161,473</u>	<u>52,696,846</u>
Operating margins	1,737,770	2,844,072
Interest on long-term debt to RUS and CFC	<u>1,769,176</u>	<u>1,832,381</u>
Operating margins after fixed charges	(31,406)	1,011,691
G & T and other capital credits	<u>2,471,313</u>	<u>2,693,970</u>
Net operating margins	<u>2,439,907</u>	<u>3,705,661</u>
Nonoperating margins:		
Interest income, net of expenses of \$11,144 in 2015 and \$4,685 in 2014	41,014	57,134
Other net nonoperating income (loss)	<u>13,557</u>	<u>(31,026)</u>
	<u>54,571</u>	<u>26,108</u>
Net margins	<u>\$ 2,494,478</u>	<u>\$ 3,731,769</u>

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

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
 STATEMENTS OF COMPREHENSIVE INCOME
 For the years ended December 31, 2015 and 2014

	<u>2015</u>	<u>Restated 2014</u>
Net margins	\$ 2,494,478	\$ 3,731,769
Defined benefit pension plans:		
Net gain (loss) during period	(362,162)	(55,724)
Amortization of net gain (loss)	12,708	10,968
Less: amortization of transition obligation	<u>10,044</u>	<u>10,044</u>
Other comprehensive income (loss)	(339,410)	(34,712)
Total comprehensive income	<u>\$ 2,155,068</u>	<u>\$ 3,697,057</u>

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

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
 STATEMENTS OF PATRONAGE CAPITAL AND MEMBERSHIPS
 For the years ended December 31, 2015 and 2014

	Memberships	Patronage Capital	Accumulated Other Comprehensive Income	Other Equities	Minority Interest	Total
Balances, January 1, 2014, Restated	\$ 534,305	\$ 32,255,070	\$ (420,274)	\$ 1,556,613	\$ 433,321	\$ 34,359,035
Increase in memberships, net of terminations	2,505	-	-	-	-	2,505
Net margins for the year ended December 31, 2014	-	3,731,769	-	-	-	3,731,769
Retirement of patronage capital of estates of deceased members and adjustments	-	-	-	123,552	-	123,552
Other comprehensive income	-	-	(34,712)	-	-	(34,712)
Transfers to other equity and minority interests	-	-	-	-	38,308	38,308
Distributions of patronage capital	-	(631,125)	-	-	-	(631,125)
Balances, December 31, 2014, Restated	\$ 536,810	\$ 35,355,714	\$ (454,986)	\$ 1,680,165	\$ 471,629	\$ 37,589,332
Increase in memberships, net of terminations	3,570	-	-	-	-	3,570
Net margins for the year ended December 31, 2015	-	2,494,478	-	-	-	2,494,478
Retirement of patronage capital of estates of deceased members and adjustments	-	-	-	123,316	-	123,316
Other comprehensive income	-	-	(339,410)	-	-	(339,410)
Transfers to other equity and minority interests	-	(25,187)	-	-	(471,629)	(496,816)
Distributions of patronage capital	-	(616,378)	-	-	-	(616,378)
Balances, December 31, 2015	<u>\$ 540,380</u>	<u>\$ 37,208,627</u>	<u>\$ (794,396)</u>	<u>\$ 1,803,481</u>	<u>\$ -</u>	<u>\$ 38,758,092</u>

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

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
STATEMENTS OF CASH FLOWS
For the years ended December 31, 2015 and 2014

	<u>2015</u>	<u>Restated 2014</u>
Cash flows from operating activities:		
Net margins	\$ 2,494,478	\$ 3,731,769
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	2,918,159	2,752,062
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	1,220,823	243,301
(Increase) decrease in inventory	(50,133)	(203,059)
(Increase) decrease in prepaid expenses	51,678	(2,719)
Increase (decrease) in accounts payable	(1,296,398)	1,073,480
Increase (decrease) in customer deposits	(38,541)	(24,092)
Increase (decrease) in accrued expenses	(14,564)	(68,250)
Increase (decrease) in customer advances for construction	(22,482)	(20,805)
(Increase) decrease in deferred charges	<u>153,501</u>	<u>174,843</u>
Net cash provided (used) by operating activities	<u>5,416,521</u>	<u>7,656,530</u>
Cash flows from investing activities:		
Purchases of property, plant, and equipment	(5,193,703)	(5,496,605)
Plant removal costs	(715,930)	(674,525)
Salvage recovered from retirement of plant	100,927	67,117
Investments in subsidiary companies	2,015	6,454
(Increase) decrease in other receivable	111,120	(1,000,000)
(Increase) decrease in investments in associated organizations and other investments	<u>(2,441,998)</u>	<u>(2,661,597)</u>
Net cash provided (used) by investing activities	<u>(8,137,569)</u>	<u>(9,759,156)</u>

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

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
 STATEMENTS OF CASH FLOWS, CONCLUDED
 For the years ended December 31, 2015 and 2014

	<u>2015</u>	<u>Restated 2014</u>
Cash flows from financing activities:		
Memberships issued	\$ 3,570	\$ 2,505
Increase (decrease) in noncurrent liabilities	800,662	30,918
Distributions of patronage capital	(616,378)	(631,125)
Retired capital credits - gain	123,316	123,552
Minority interest and other equities	(496,816)	195,384
Other debt increase (decrease)	452,224	(128,616)
Principal payments under capital lease obligation	(33,905)	(16,703)
Principal payments to RUS	(117,696)	(112,270)
Advanced principal payments unapplied	35,030	478,033
Principal payments to CFC	(848,463)	(791,880)
Loan advancements from RUS/FFB	5,018,522	2,300,000
Principal payments to RUS/FFB	<u>(1,229,019)</u>	<u>(940,782)</u>
Net cash provided (used) by financing activities	<u>3,091,047</u>	<u>509,016</u>
Increase (decrease) in cash and cash equivalents	369,999	(1,593,610)
Cash and cash equivalents at beginning of year	<u>643,145</u>	<u>2,236,755</u>
Cash and cash equivalents at end of year	<u>\$ 1,013,144</u>	<u>\$ 643,145</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest	<u>\$ 1,769,176</u>	<u>\$ 1,832,381</u>

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

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

1. Summary of Significant Accounting Policies:

Principles of Consolidation:

The consolidated financial statements include the accounts of Farmers Rural Electric Cooperative Corporation and its 100% owned subsidiary, Farmers Energy Services Corporation. All material intercompany transactions have been eliminated in consolidation.

General:

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

Nature of Business:

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

Utility Plant:

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

The cost of maintenance and repairs, including renewals of minor items of property, is charged to operating expense. The cost of replacement of depreciable property units, as distinguished from minor items, is charged to utility plant. The cost of units of property replaced or retired, including cost of removal, net of any salvage value, is charged to accumulated depreciation. When property is sold, a gain or loss is reflected in income.

The major classifications of electric plant in service at December 31, 2015 and 2014 were:

	<u>2015</u>	<u>2014</u>
Distribution Plant	\$ 76,550,072	\$ 73,071,180
General Plant	8,701,347	8,434,025
Other Production Plant	1,270,916	1,115,068
Intangible Plant	<u>3,625</u>	<u>3,625</u>
Electric Plant	<u>86,525,960</u>	<u>82,623,898</u>
Propane Plant	<u>2,867,670</u>	<u>2,683,690</u>
Total Utility Plant	<u>\$ 89,393,630</u>	<u>\$ 85,307,588</u>

Cash and Cash Equivalents:

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

Materials and Supplies:

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

Estimates:

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

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

1. Summary of Significant Accounting Policies, Continued:

Depreciation:

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

The following depreciation rates for the components of the general plant were in effect as of December 31, 2015 and 2014:

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

Depreciation expense for the years ended December 31, 2015 and 2014 was \$2,918,159 and \$2,752,062 respectively.

Revenue and Cost of Power:

Operating revenue and cost of purchased power include increases (decreases) under the fuel clause adjustment of approximately \$34,437 for the year ended December 31, 2015, and \$71,096 for the year ended December 31, 2014.

Accounts Receivable:

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

Note Receivable:

The Cooperative has a note receivable from the City of Glasgow, Kentucky in the amount of \$888,880 without interest. Monthly installments of \$9,260 are due the first day of each month beginning January 1, 2015 and continuing on the first day of each month until the principal sum has been paid in full.

Income Tax Status:

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

Investment in Subsidiary Companies:

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

Subsequent Events:

Management has evaluated subsequent events through March 25, 2016, the date which the financial statements were available to be issued. On March 11, 2016, the Cooperative was approved for loan funds in the amount of \$1,200,000 from Federal Financing Bank.

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

1. Summary of Significant Accounting Policies, Concluded:

Reclassifications

Certain amounts in the 2014 financial statements were reclassified to conform to the 2015 presentation.

2. Investments in Associated Organizations:

Investments in associated organizations as of December 31, 2015 and 2014 are listed as follows:

	<u>2015</u>	<u>2014</u>
East Kentucky Power Cooperative, Inc.	\$ 24,003,706	\$ 21,631,260
National Rural Utilities Cooperative Finance Corp.	828,910	830,079
Other	969,581	898,860
Total	<u>\$ 25,802,197</u>	<u>\$ 23,360,199</u>

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

3. Long-Term Debt:

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

Long-term debt at December 31, 2015 and 2014 consisted of:

	<u>2015</u>	<u>2014</u>
Due United States of America:		
5.12% First Mortgage Notes-Variable Rate	\$ 1,617,611	\$ 1,676,262
4.125 - 4.5% First Mortgage Notes-Variable Rate	1,499,623	1,558,668
5.49% Mortgage Note-FFB	3,567,192	3,671,341
5.62% Mortgage Note-FFB	351,253	361,362
2.87 - 4.93% Mortgage Note-FFB-Variable Rate	37,845,258	33,830,377
0% Rural Economic Development Loan	888,880	1,000,000
Total due United States of America	<u>\$ 45,769,817</u>	<u>\$ 42,098,010</u>
Due National Rural Utilities Cooperative Finance Corporation:		
2.4 - 6.8% First Mortgage Notes	5,570,665	6,419,128
Advance payments unapplied to long term debt	(91,751)	(126,781)
Total	51,248,731	48,390,357
Less current maturities	(2,265,120)	(2,110,120)
Farmers Rural Electric Cooperative Corporation	<u>\$ 48,983,611</u>	<u>\$ 46,280,237</u>
Due East Kentucky Power 2.75%	\$ -	\$ 76,673
Due Other	50,000	-
Less current maturities	(50,000)	(76,673)
Farmers Energy Propane Plus	<u>\$ -</u>	<u>\$ -</u>
Due East Kentucky Power 2.75%	\$ 478,897	\$ -
Less current maturities	(44,272)	-
Farmers Energy Services Corporation	<u>\$ 434,625</u>	<u>\$ -</u>
Total all companies	\$ 51,777,628	\$ 48,467,030
Less current maturities	(2,359,392)	(2,186,793)
Total long term consolidated debt	<u>\$ 49,418,236</u>	<u>\$ 46,280,237</u>

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

3. Long-Term Debt, Concluded:

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

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

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

In 2013, the Cooperative received approval from the Federal Financing Bank-Rural Utilities Service for a loan in the amount of \$17,582,000. This final maturity date on the loan is December 31, 2047, interest rates have not yet been established and the Cooperative had advanced \$7,300,000 of loan funds as of December 31, 2015.

The Cooperative has available a line of credit for short-term loans of up to \$5,000,000 with National Rural Utilities Cooperative Finance Corporation extending to September 30, 2016. The maximum interest rate is to be the prevailing bank prime rate published in the "money rates" column of The Wall Street Journal plus one percent (1%) per annum. At December 31, 2015, the balance of the line-of-credit was \$-0-.

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

In 2015, Farmers Energy Services Corporation received approval from East Kentucky Power Cooperative Corporation for a loan in the amount of \$496,817. This loan is for 10 years, and is payable monthly at an interest rate of 2.75%.

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

2016	\$	2,359,392
2017		2,329,626
2018		2,354,893
2019		2,013,195
2020		2,072,534
2021-2025		11,740,137
2026-2030		11,560,000
2031-2035		10,956,000
2036-2040		6,391,851
Total	\$	<u>51,777,628</u>

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

4. Deferred Charges:

Following is a summary of amounts recorded as deferred charges approved by RUS per 1773.33(h) as of December 31, 2015 and 2014 which have been approved in writing by RUS:

<u>Deferred Debits:</u>	<u>2015</u>	<u>2014</u>
Transportation Expense	\$ 116	\$ 8,339
GIS-Field Inventory Cost	476,956	511,228
Long Range Plans	49,344	59,213
ESRI and EDP costs	63,371	39,802
Pension Plan Prepayment	1,496,462	1,621,168
	<u>\$ 2,086,249</u>	<u>\$ 2,239,750</u>

<u>Deferred Credits:</u>		
Customer Advances for Construction	\$ 347,450	\$ 369,932
	<u>\$ 347,450</u>	<u>\$ 369,932</u>

5. Return of Capital:

Under provisions of the long-term debt agreement, return to patrons of capital contributed by them is limited to amounts which would not allow the total members' equities to be less than thirty percent (30%) of total assets, except that distributions may be made to estates of deceased patrons. The debt agreement provides, however, that should such distributions to estates not exceed twenty-five percent (25%) of net margins for the next preceding year, the Cooperative may distribute the difference between twenty-five percent (25%) and the payments made to such estates.

Capital credit retirements in the amount of \$616,378 and \$631,125 were paid for the years ended December 31, 2015 and 2014, respectively.

6. Other Equities:

At December 31, 2015 and 2014 other equities consisted of retired capital credits – gain, in amounts of \$1,803,481 and \$1,680,165, respectively.

7. Pension Plan:

Narrative Description

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

A unique characteristic of a multi-employer plan compared to a single employer plan is that all plan assets are available to pay benefits of any plan participant. Separate asset accounts are not maintained for participating employers. This means that assets contributed by one employer may be used to provide benefits to employees of other participating employers.

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

7. Pension Plan, Continued:

Plan Information

Farmers Rural Electric Cooperative Corporation contributions to the RS Plan in 2015 and in 2014 represented less than 5 percent of the total contributions made to the RS Plan by all participating employers. Farmers Rural Electric Cooperative Corporation made contributions to the RS Plan of \$596,520 in 2015 and \$577,100 in 2014. There have been no significant changes that affect the comparability of 2015 and 2014 contributions.

For the RS Plan, a “zone status” determination is not required, and therefore not determined, under the Pension Protection Act (PPA) of 2006. In addition, the accumulated benefit obligations and plan assets are not determined or allocated separately by individual employer. In total, the RS Plan was over 80% funded at January 1, 2015 and over 80% funded at January 1, 2014 based on the PPA funding target and PPA actuarial value of assets on those dates.

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

Footnote: RS Plan Prepayment Option

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

Additionally, the Cooperative has two 401(K) Plans and a 457(b) Plan. The first Plan is for those employees hired before January 1, 2012. The terms of the Plan call for an elective contribution from employees of 0.5% - 1.0% or more of their salaries while the Cooperative matches 100% of employees’ contributions up to 1.0%. The second Plan is for those employees hired on or after January 1, 2012. The Cooperative makes a 6.0% base contribution to this second plan. Also, the terms of the Plan call for an elective contribution from employees of 1.0% - 4.0% or more of their salaries while the Cooperative matches 100% of employees’ contributions up to 4.0%. The third plan allows for employee contributions with no company match. Total employer contributions for all Plans for 2015 and 2014 were \$42,846 and \$37,888 respectively. Total employee contributions for all Plans for 2015 and 2014 were \$185,896 and \$153,025, respectively.

All full time employees of Farmers Energy Propane Plus are eligible to participate in the NRECA 401(k) Plan. The Company contributes 5% annual wages to the plan, which totaled \$11,426 in 2015 and \$9,993 in 2014.

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

8. Self-Funded Health Insurance Plan:

In October, 1995, the Cooperative's Board of Directors approved the establishment of the FRECC Group Medical Program. The Plan is self-funded and is re-insured through Houston Casualty Company. The Plan was designed to duplicate the Cooperative's prior plan. The third-party administrator is North America Administrators. The Cooperative is protected against any individual claim in excess of \$30,000 and any aggregate claims in excess of \$1,220,000 by the re-insurance. The current funding levels are designed to allow for the maximum claim liability that the Cooperative could incur under the Plan. At December 31, 2015 and 2014, the Cooperative held \$214,793 and \$137,314 in cash designated for payment of claims in 2015 and 2014, respectively, and included \$102,950 as a liability in accrued expenses at December 31, 2015, and \$102,478 at December 31, 2014.

9. Related Party Transactions:

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

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

10. Cash and Cash Equivalents:

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

	2015		2014	
	Carrying Amount	Bank Balance	Carrying Amount	Bank Balance
Insured (FDIC)	\$ 680,907	\$ 686,161	\$ 643,145	\$ 1,030,838
Pledged securities	332,237	378,086	-	-
Total deposits	\$ 1,013,144	\$ 1,064,247	\$ 643,145	\$ 1,030,838

Included in total deposits are special funds of \$453,668 which were set aside to pay the regulatory liability recorded on the financial statements at December 31, 2015.

11. Litigation:

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

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

12. Postretirement Benefit Plans:

The Cooperative provides certain retired employees with postretirement health care benefits.

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

	<u>2015</u>	<u>2014</u>
Accumulated Benefit Obligation		
Projected benefit obligation at end of year	\$ 878,967	\$ 531,973
Fair Value of plan assets at end of year	-	-
Unfunded status at end of year	<u>\$ 878,967</u>	<u>\$ 531,973</u>
Amounts recognized in the balance sheet		
Unfunded status	\$ 878,967	\$ 531,973
Current liabilities	-	-
Noncurrent liabilities	<u>\$ 878,967</u>	<u>\$ 531,973</u>
Change in Accumulated Benefit Obligation		
Accumulated post-retirement benefit obligation at beginning of year	\$ 531,973	\$ 501,055
Service cost	36,960	31,263
Interest cost	26,148	25,053
Actuarial loss (gain)	362,162	55,724
Amortization of transition obligation	-	-
Amortization of net actuarial gain	-	-
Benefits paid	<u>(78,276)</u>	<u>(81,122)</u>
Accumulated post-retirement benefit obligation at end of year	<u>\$ 878,967</u>	<u>\$ 531,973</u>

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

12. Postretirement Benefit Plans, Concluded:

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

	<u>2015</u>	<u>2014</u>
Beginning of year	\$ 454,986	\$ 420,274
Net loss (gain)	362,162	55,724
Amortization of net loss (gain)	(12,708)	(10,968)
Amortization of transition obligation	(10,044)	(10,044)
Total recognized in other comprehensive income	<u>339,410</u>	<u>34,712</u>
End of year	<u>\$ 794,396</u>	<u>\$ 454,986</u>

Amounts recognized in accumulated other comprehensive income

Net loss (gain)	\$ 653,722	\$ 304,268
Transition obligation	140,674	150,718
	<u>\$ 794,396</u>	<u>\$ 454,986</u>

Net periodic benefit cost

Service cost	\$ 36,960	\$ 31,263
Interest cost	26,148	25,053
Amortization of transition obligation	10,044	10,044
Amortization of net actuarial gain	12,708	10,968
Net periodic benefit cost	<u>\$ 85,860</u>	<u>\$ 77,328</u>

Amounts in other comprehensive income expected to be realized in 2016

Amortization of net loss (gain)	\$ 16,436	
Amortization of transition obligation	10,044	
	<u>\$ 26,480</u>	

The discount rate used in determining the accumulated postretirement benefit obligation was 4.5% in 2015 and 5% in 2014.

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

2016	\$	64,200
2017		68,534
2018		72,303
2019		76,279
2020		80,475

For measurement purposes, a 7.0% annual medical rate increase was used for the year ended December 31, 2015. The rate is assumed to decline by .25% per year until level at 5% per year.

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

Postemployment benefit obligation	\$ 945,000	
Net periodic benefit cost		121,000

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

13. Leases:

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

Following is a summary of property held under capital leases:

Office equipment	\$ 109,001
Accumulated depreciation	(37,700)
	\$ 71,301

Minimum future lease payments under capital leases as of December 31, 2015 were as follows:

	Amount
2016	\$ 27,667
2017	18,597
Net minimum lease payments	46,264
Amount representing interest	-
Present value of net minimum lease payments	\$ 46,264

14. Prior Period Restatement:

The Cooperative bills its customers each month an environmental surcharge for the overhead associated with the cost of power. This rate is provided by its supplier, East Kentucky Power Cooperative Corporation. The Cooperative restated its 2014 financial statements to reflect the amounts that were determined to be over billed to its customers. Periodically, an assessment is made to determine if this rate is accurate. An assessment was made in 2015 and therefore the amount determined to be refundable to its customers is shown as a regulatory liability. Going forward, the amounts determined to be recoverable from its customers and refundable to its customers are shown as regulatory assets and regulatory liabilities, respectively. Estimated amounts recoverable from its customers and refundable to its customers are shown in accounts receivable and accounts payable.

The Cooperative also restated its 2014 financial statements to reflect the detailed activity of Farmers Energy Propane Plus, a single member LLC of its wholly owned subsidiary, Farmers Energy Services Corporation.

Patronage Capital as previously reported, December 31, 2014	\$ 36,276,290
Environmental surcharge adjustment	(1,077,652)
Equity adjustment in subsidiary	157,076
Patronage Capital as restated, December 31, 2014	\$ 35,355,714

15. Provision for Income Taxes:

The Cooperative follows the recognition requirements for uncertain income tax positions as required by generally accepted accounting principles. The Cooperative has no tax position at December 31, 2015 for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. The Cooperative's policy is to classify income tax related interest and penalties in interest expense and other expenses, respectively. No such interest or penalties were recognized during the periods presented. The Cooperative files income tax returns in the U.S. federal jurisdiction, and various state and local jurisdictions. The Cooperative is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years before 2012.

Independent Auditors' Report
on Consolidating Information

Board of Directors
Farmers Rural Electric
Cooperative Corporation
Glasgow, Kentucky

We have audited the consolidated financial statements of Farmers Rural Electric Cooperative Corporation as of and for the years ended December 31, 2015 and 2014, and our report thereon dated March 25, 2016, which expressed an unmodified opinion on those financial statements appears on pages one and two. Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information presented in Schedule I and II is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual companies, and it is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information in Schedules I – IV, which insofar as it relates to Farmers Energy Propane Plus, LLC is based on the report of other auditors, is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Campbell, Myers & Rutledge, PLLC
Certified Public Accountants
Glasgow, Kentucky

March 25, 2016

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
SCHEDULE I – CONSOLIDATING BALANCE SHEET
December 31, 2015

ASSETS	Farmers Rural Electric Cooperative Corporation, Inc.	Farmers Energy Services Corporation	Farmers Energy Propane Plus	Consolidating Entries	Consolidated Totals
Current assets:					
Cash	\$ 385,991	\$ 56,676	\$ 116,809	\$ -	\$ 559,476
Accounts and notes receivable, less allowance for doubtful accounts of \$92,514 in 2015	3,998,892	-	119,780	-	4,118,672
Materials and supplies, at average cost	824,947	-	127,574	-	952,521
Prepaid expenses	195,246	-	-	-	195,246
Total current assets	5,405,076	56,676	364,163	-	5,825,915
Other assets and investments:					
Goodwill	-	-	458,052	-	458,052
Special funds	453,668	-	-	-	453,668
Investments in subsidiary companies	1,497,806	1,716,284	-	(3,192,611)	21,479
Investments in associated organizations	25,802,197	-	-	-	25,802,197
Deferred charges	2,086,249	-	-	-	2,086,249
Note receivable	888,880	-	-	-	888,880
	<u>30,728,800</u>	<u>1,716,284</u>	<u>458,052</u>	<u>(3,192,611)</u>	<u>29,710,525</u>
Utility plant, at cost					
Utility plant in service	86,525,960	-	2,867,670	-	89,393,630
Construction work-in-progress	662,102	-	-	-	662,102
	<u>87,188,062</u>	<u>-</u>	<u>2,867,670</u>	<u>-</u>	<u>90,055,732</u>
Less accumulated depreciation and amortization	(25,640,619)	-	(1,398,892)	-	(27,039,511)
Utility plant, net	61,547,443	-	1,468,778	-	63,016,221
TOTAL ASSETS	\$ 97,681,319	\$ 1,772,960	\$ 2,290,993	\$ (3,192,611)	\$ 98,552,661
LIABILITIES AND MEMBERS' EQUITIES					
Current liabilities:					
Accounts payable	\$ 3,915,501	\$ -	\$ 210,556	\$ -	\$ 4,126,057
Accrued expenses	1,302,849	-	-	-	1,302,849
Customer deposits	861,686	-	-	-	861,686
Current portion of capital leases	27,667	-	-	-	27,667
Current portion of long-term debt	2,265,120	44,272	50,000	-	2,359,392
Total current liabilities	8,372,823	44,272	260,556	-	8,677,651
Long-term liabilities					
Capital lease less current maturities	18,597	-	-	-	18,597
Long-term debt less current maturities	48,983,611	434,625	0	-	49,418,236
Total long-term liabilities	49,002,208	434,625	-	-	49,436,833
Noncurrent liabilities:					
Regulatory liability	453,668	-	-	-	453,668
Post retirement benefit obligations	878,967	-	-	-	878,967
Customer advances for construction	347,450	-	-	-	347,450
Total noncurrent liabilities	1,680,085	-	-	-	1,680,085
Members' equities:					
Memberships	540,380	-	-	-	540,380
Patronage capital and retained earnings	37,076,738	386,107	664,878	(919,096)	37,208,627
Accumulated other comprehensive income	(794,396)	-	-	-	(794,396)
Other equities	1,803,481	-	-	-	1,803,481
Minority interests and other equities	-	907,956	1,365,559	(2,273,515)	-
Total members' equities	38,626,203	1,294,063	2,030,437	(3,192,611)	38,758,092
TOTAL LIABILITIES AND MEMBERS' EQUITIES	\$ 97,681,319	\$ 1,772,960	\$ 2,290,993	\$ (3,192,611)	\$ 98,552,661

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARY
SCHEDULE II – CONSOLIDATING STATEMENT OF REVENUE
For the Year Ended December 31, 2015

	Farmers Rural Electric Cooperative Corporation, Inc.	Farmers Energy Services Corporation	Farmers Energy Propane Plus	Consolidating Entries	Consolidated Totals
Operating revenues	\$ 49,472,781	\$ -	\$ 2,426,462	\$ -	\$ 51,899,243
Operating expenses:					
Cost of purchases	36,226,666	-	1,218,729	-	37,445,395
Distribution - operations	1,740,525	-	343,365	-	2,083,890
Distribution - maintenance	2,969,616	-	-	-	2,969,616
Consumer accounts	1,108,315	-	-	-	1,108,315
Customer services and informational expense	121,986	-	-	-	121,986
Administrative and general	2,147,127	6,121	536,748	-	2,689,996
Depreciation	2,744,248	-	173,911	-	2,918,159
Taxes	662,286	115,591	46,239	-	824,116
Total operating expenses	<u>47,720,769</u>	<u>121,712</u>	<u>2,318,992</u>	<u>-</u>	<u>50,161,473</u>
Operating margins	1,752,012	(121,712)	107,470	-	1,737,770
Interest on long-term debt to RUS and CFC	\$ 1,769,176	-	-	-	1,769,176
Operating margins after fixed charges	(17,164)	(121,712)	107,470	-	(31,406)
G & T and other capital credits	\$ 2,471,313	-	-	-	2,471,313
Net operating margins	<u>2,454,149</u>	<u>(121,712)</u>	<u>107,470</u>	<u>-</u>	<u>2,439,907</u>
Nonoperating margins:					
Interest income, net of interest expense of \$11,144	40,894	120	-	-	41,014
Other net nonoperating income (loss)	11,543	-	-	-	11,543
Income (loss) from equity investments	(12,108)	107,470	-	(93,348)	2,014
	<u>40,329</u>	<u>107,590</u>	<u>-</u>	<u>(93,348)</u>	<u>54,571</u>
Net margins	<u>\$ 2,494,478</u>	<u>\$ (14,122)</u>	<u>\$ 107,470</u>	<u>\$ (93,348)</u>	<u>\$ 2,494,478</u>

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

ASSETS	Farmers Rural Electric Cooperative Corporation, Inc.	Farmers Energy Services Corporation	Farmers Energy Propane Plus	Consolidating Entries	Consolidated Totals
Current assets:					
Cash	\$ 528,703	\$ 57,062	\$ 57,380	\$ -	\$ 643,145
Accounts and notes receivable, less allowance for doubtful accounts of \$92,053 in 2014	5,249,910	-	89,585	-	5,339,495
Materials and supplies, at average cost	770,707	-	131,681	-	902,388
Prepaid expenses	201,368	-	45,556	-	246,924
Total current assets	6,750,688	57,062	324,202	-	7,131,952
Other assets and investments:					
Goodwill, net of amortization	-	-	458,052	-	458,052
Investments in subsidiary companies	1,509,914	1,747,940	-	(3,238,390)	19,464
Investments in associated organizations	23,360,199	-	-	-	23,360,199
Deferred charges	2,239,750	-	-	-	2,239,750
Note receivable	1,000,000	-	-	-	1,000,000
	28,109,863	1,747,940	458,052	(3,238,390)	27,077,465
Utility plant, at cost					
Utility plant in service	82,623,898	-	2,683,690	-	85,307,588
Construction work-in-progress	886,561	-	-	-	886,561
	83,510,459	-	2,683,690	-	86,194,149
Less accumulated depreciation	(24,476,870)	-	(1,248,165)	-	(25,725,035)
Utility plant, net	59,033,589	-	1,435,525	-	60,469,114
	\$ 93,894,140	\$ 1,805,002	\$ 2,217,779	\$ (3,238,390)	\$ 94,678,531
LIABILITIES AND MEMBERS' EQUITIES					
Current liabilities:					
Accounts payable	\$ 5,343,442	\$ -	\$ 79,013	\$ -	\$ 5,422,455
Accrued expenses	1,317,413	-	-	-	1,317,413
Customer deposits	900,227	-	-	-	900,227
Current portion of capital leases	33,905	-	-	-	33,905
Current portion of long-term debt	2,110,120	-	76,673	-	2,186,793
Total current liabilities	9,705,107	-	155,686	-	9,860,793
Long-term liabilities					
Capital lease less current maturities	46,264	-	-	-	46,264
Long-term debt less current maturities	46,280,237	-	-	-	46,280,237
Total long-term liabilities	46,326,501	-	-	-	46,326,501
Noncurrent liabilities:					
Post retirement benefit obligations	531,973	-	-	-	531,973
Customer advances for construction	369,932	-	-	-	369,932
Total noncurrent liabilities	901,905	-	-	-	901,905
Members' equities:					
Memberships	536,810	-	-	-	536,810
Patronage capital and retained earnings	35,198,638	1,040,000	696,534	(1,579,458)	35,355,714
Accumulated other comprehensive income	(454,986)	-	-	-	(454,986)
Other equities	1,680,165	-	-	-	1,680,165
Minority interest and other equities	-	765,002	1,365,559	(1,658,932)	471,629
	36,960,627	1,805,002	2,062,093	(3,238,390)	37,589,332
	\$ 93,894,140	\$ 1,805,002	\$ 2,217,779	\$ (3,238,390)	\$ 94,678,531

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

	Farmers Rural Electric Cooperative Corporation, Inc.	Farmers Energy Services Corporation	Farmers Energy Propane Plus	Consolidating Entries	Consolidated Totals
Operating revenues	\$ 52,839,277	\$ -	\$ 2,701,641	\$ -	\$ 55,540,918
Operating expenses:					
Cost of purchases	38,924,102	-	1,496,828	-	40,420,930
Distribution - operations	1,660,558	-	315,884	-	1,976,442
Distribution - maintenance	2,960,807	-	-	-	2,960,807
Consumer accounts	1,093,049	-	-	-	1,093,049
Customer services and informational expense	169,746	-	-	-	169,746
Administrative and general	2,125,970	510	414,908	-	2,541,388
Depreciation	2,610,589	-	141,473	-	2,752,062
Taxes	603,454	136,718	42,250	-	782,422
Total operating expenses	50,148,275	137,228	2,411,343	-	52,696,846
Operating margins	\$ 2,691,002	\$ (137,228)	\$ 290,298	\$ -	\$ 2,844,072
Interest on long-term debt to RUS and CFC	1,832,381	-	-	-	1,832,381
Operating margins after fixed charges	858,621	(137,228)	290,298	-	1,011,691
G & T and other capital credits	2,693,970	-	-	-	2,693,970
Net operating margins	\$ 3,552,591	\$ (137,228)	\$ 290,298	\$ -	\$ 3,705,661
Nonoperating margins:					
Interest income, net of interest expense of \$4,685	56,976	158	-	-	57,134
Other net nonoperating income (loss)	827	-	-	-	827
Income (loss) from equity investments	121,375	290,298	-	(443,526)	(31,853)
	179,178	290,456	-	(443,526)	26,108
Net margins	\$ 3,731,769	\$ 153,228	\$ 290,298	\$ (443,526)	\$ 3,731,769

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Board of Directors
Farmers Rural Electric
Cooperative Corporation
Glasgow, Kentucky

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Farmers Rural Electric Cooperative Corporation, which comprise the balance sheets as of December 31, 2015 and 2014 and the related statements of revenue, comprehensive income, patronage capital and memberships, and cash flows for the years then ended, and related notes to the consolidated financial statements, and have issued our report thereon dated March 25, 2016. Our report includes a reference to other auditors who audited the financial statements of Farmers Energy Propane Plus, a wholly owned subsidiary of the Cooperative, as described in the report on the Cooperative's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Farmers Rural Electric Cooperative Corporation's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Farmers Rural Electric Cooperative Corporation's internal control. Accordingly, we do not express an opinion on the effectiveness of Farmers Rural Electric Cooperative Corporation's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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

Purpose of this Report

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

Campbell, Myers, & Rutledge, PLLC

Certified Public Accountants
Glasgow, Kentucky

March 25, 2016

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

Board of Directors
Farmers Rural Electric
Cooperative Corporation
Glasgow, Kentucky

Independent Auditor's Report

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Farmers Rural Electric Cooperative Corporation (FRECC), which comprise the balance sheets as of December 31, 2015 and 2014 and the related statements of revenue, comprehensive income, patronage capital and memberships, changes in cash flows for the years ended, and the related notes to the financial statements, and have issued our report thereon dated March 25, 2016. In accordance with *Government Auditing Standards*, we have also issued our report dated March 25, 2016, on our consideration of FRECC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. No reports other than the reports referred to above have been furnished to management.

In connection with our audit, nothing came to our attention that caused us to believe that FRECC failed to comply with the terms, covenants, provisions, or conditions of their loan, grant, and security instruments as set forth in 7 CFR Part 1773, Policy on Audits of Rural Utilities Service Borrowers, & 1773.33 clarified in the RUS policy memorandum dated February 7, 2014, insofar as they relate to accounting matters as enumerated below. However, our audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding FRECC's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters. In connection with our audit, we noted no matters regarding FRECC's accounting and records to indicate that FRECC did not:

Maintain adequate and effective accounting procedures;

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

Reconcile continuing property records to the controlling general ledger plant accounts; Clear construction accounts and accrue depreciation on completed construction;

Record and properly price the retirement of plant;

Seek approval of the sale, lease or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap;

Maintain adequate control over materials and supplies;

Prepare accurate and timely Financial and Operating Reports;

Obtain RUS approval to enter into any contract for the management, operation, or maintenance of the borrower's system if the contract covers all or substantially all of the electric system;

Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles;

Record depreciation in accordance with RUS requirements (See RUS Bulletin 183-1, Depreciation Rates and Procedures);

Comply with the requirements for the detailed schedule of deferred debits and deferred credits; and

Comply with the requirements for the detailed schedule of investments. A detailed schedule of investments is as follows:

As of July 1, 2015, Farmers Energy Service Corporation is a 100% owned subsidiary of the Cooperative. The subsidiary is the sole owner of a limited liability company which sells propane gas. The Cooperative accounts for the investment on the equity basis.

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

Undistributed (Losses) Earnings:

12/31/1997	(45,263)
12/31/1998	(55,962)
12/31/1999	(40,973)
12/31/2000	(135,639)
12/31/2001	(99,613)
12/31/2002	(23,182)
12/31/2003	61,207
12/31/2004	18,357
12/31/2005	145,423
12/31/2006	99,535
12/31/2007	54,546
12/31/2008	88,742
12/31/2009	99,980
12/31/2010	89,059
12/31/2011	74,484
12/31/2012	97,859
12/31/2013	166,968
12/31/2014	114,921
12/31/2015	<u>(14,122)</u>
Total Undistributed (Losses) Earnings:	696,327
Original Investment and Investment Activities:	<u>780,000</u>
Book Value 12/31/15	<u>\$ 1,476,327</u>

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

Campbell, Myers & Rutledge, PLLC
 Glasgow, Kentucky

March 25, 2016