

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

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

**For the Years Ended
December 31, 2018 and 2017**

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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 and subsidiaries which comprise the balance sheets as of December 31, 2018 and 2017, 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, which collectively comprise the Cooperative's basic financial statements as listed in the table of contents.

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 represent 2.17% and 5.37% respectively of the assets and revenues of the consolidated financial statements for the year ended December 31, 2018 and 2.18% and 4.41% respectively of the assets and revenues of the consolidated financial statements for the year ended December 31, 2017. 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.

Opinions

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, 2018 and 2017, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Other Information

Our audit was conducted for the purpose of forming opinions on the consolidated financial statements that collectively comprise Farmers Rural Electric Cooperative Corporation and subsidiaries' 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 18, 2019 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 and subsidiaries' internal control over financial reporting and compliance.

Campbell, Myers, and Rattledge, PLLC

Certified Public Accountants
Glasgow, Kentucky

March 18, 2019

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARIES
BALANCE SHEETS
December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Current assets:		
Cash and cash equivalents	\$ 1,277,840	\$ 812,838
Accounts and notes receivable, less allowance for doubtful accounts of \$87,378 in 2018 and \$90,335 in 2017	4,714,787	5,294,316
Materials and supplies, at average cost	1,018,083	1,037,487
Prepaid expenses	227,108	246,945
Total current assets	<u>7,237,818</u>	<u>7,391,586</u>
Other assets and investments:		
Cash - Special funds	15,485	-
Regulatory asset	-	8,963
Goodwill, net of amortization	458,052	458,052
Investments in subsidiary companies	28,153	28,089
Investment in associated organizations	31,137,985	29,291,224
Deferred charges	1,604,894	1,771,694
Note receivable	555,520	666,640
Total other assets	<u>33,800,089</u>	<u>32,224,662</u>
Utility plant in service	100,807,296	97,120,283
Construction work in progress	323,088	857,623
	101,130,384	97,977,906
Less accumulated depreciation	<u>(30,794,746)</u>	<u>(29,759,619)</u>
Utility plant, net	<u>70,335,638</u>	<u>68,218,287</u>
Total assets	<u>\$ 111,373,545</u>	<u>\$ 107,834,535</u>

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

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARIES
BALANCE SHEETS, CONCLUDED
December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Current liabilities:		
Accounts payable	\$ 4,582,835	\$ 5,341,641
Accrued expenses	1,518,887	1,402,021
Customer deposits	840,501	836,898
Notes payable	4,650,000	-
Current portion of long-term debt	2,405,681	2,704,712
Total current liabilities	<u>13,997,904</u>	<u>10,285,272</u>
Long-term liabilities:		
Long-term debt less current maturities	<u>50,129,578</u>	<u>53,292,044</u>
Total long-term liabilities	<u>50,129,578</u>	<u>53,292,044</u>
Noncurrent liabilities:		
Regulatory liability	15,485	-
Post retirement benefit obligations	945,589	945,589
Customer advances for construction	<u>327,537</u>	<u>350,775</u>
Total noncurrent liabilities	<u>1,288,611</u>	<u>1,296,364</u>
Members' equities:		
Memberships	555,005	550,050
Patronage capital	44,006,245	41,173,808
Accumulated other comprehensive income	(622,242)	(692,125)
Other equities	<u>2,018,444</u>	<u>1,929,122</u>
Total members' equities	<u>45,957,452</u>	<u>42,960,855</u>
Total liabilities and equity	<u>\$ 111,373,545</u>	<u>\$ 107,834,535</u>

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

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARIES
STATEMENTS OF REVENUE

For the years ended December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Operating revenue	\$ 55,105,518	\$ 50,261,513
Operating expenses:		
Cost of purchases	38,223,630	35,397,428
Distribution - operations	1,498,523	1,764,439
Distribution - maintenance	3,586,325	2,862,728
Consumer accounts	1,173,570	1,092,226
Customer services and informational expense	94,910	175,763
Administrative and general	3,071,932	2,676,654
Depreciation	3,380,686	3,241,922
Taxes	<u>760,024</u>	<u>750,627</u>
Total operating expenses	<u>51,789,600</u>	<u>47,961,787</u>
Operating margins	3,315,918	2,299,726
Interest on long-term debt to RUS and CFC	<u>1,976,176</u>	<u>1,807,653</u>
Operating margins after fixed charges	1,339,742	492,073
G & T and other capital credits	<u>1,867,073</u>	<u>1,069,124</u>
Net operating margins	<u>3,206,815</u>	<u>1,561,197</u>
Nonoperating margins:		
Interest income, net of expenses of \$27,473 in 2018 and \$21,016 in 2017	24,305	27,845
Other net nonoperating income (loss)	<u>700</u>	<u>197,987</u>
	<u>25,005</u>	<u>225,832</u>
Net margins	<u>\$ 3,231,820</u>	<u>\$ 1,787,029</u>

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

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARIES
 STATEMENTS OF COMPREHENSIVE INCOME
 For the years ended December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Net margins	\$ 3,231,820	\$ 1,787,029
Defined benefit pension plans:		
Net gain (loss) during period	35,275	20,825
Amortization of net gain (loss)	24,564	27,480
Amortization of transition obligation	<u>10,044</u>	<u>10,044</u>
Other comprehensive income (loss)	69,883	58,349
Total comprehensive income	<u>\$ 3,301,703</u>	<u>\$ 1,845,378</u>

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

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARIES
STATEMENTS OF PATRONAGE CAPITAL AND MEMBERSHIPS
For the years ended December 31, 2018 and 2017

	Memberships	Patronage Capital	Accumulated Other Comprehensive Income	Other Equities	Total
Balances, January 1, 2017	\$ 546,445	\$ 39,875,834	\$ (750,474)	\$ 1,863,638	\$ 41,535,443
Increase in memberships, net of terminations	3,605	-	-	-	3,605
Net margins for the year ended December 31, 2017	-	1,787,029	-	-	1,787,029
Retirement of patronage capital of estates of deceased members and adjustments	-	-	-	65,484	65,484
Other comprehensive income	-	-	58,349	-	58,349
Transfers to other equity and minority interests	-	(157,077)	-	-	(157,077)
Distributions of patronage capital	-	(331,978)	-	-	(331,978)
Balances, December 31, 2017	\$ 550,050	\$ 41,173,808	\$ (692,125)	\$ 1,929,122	\$ 42,960,855
Increase in memberships, net of terminations	4,955	-	-	-	4,955
Net margins for the year ended December 31, 2018	-	3,231,820	-	-	3,231,820
Retirement of patronage capital of estates of deceased members and adjustments	-	-	-	89,322	89,322
Other comprehensive income	-	-	69,883	-	69,883
Transfers to other equity and minority interests	-	-	-	-	-
Distributions of patronage capital	-	(399,383)	-	-	(399,383)
Balances, December 31, 2018	\$ 555,005	\$ 44,006,245	\$ (622,242)	\$ 2,018,444	\$ 45,957,452

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

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARIES
STATEMENTS OF CASH FLOWS
For the years ended December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Cash flows from operating activities:		
Net margins	\$ 3,231,820	\$ 1,787,029
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	3,380,686	3,241,922
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	579,529	(456,961)
(Increase) decrease in inventory	19,404	(52,821)
(Increase) decrease in prepaid expenses	19,837	(34,823)
(Increase) decrease in deferred charges	166,800	139,399
(Increase) decrease in regulatory asset	8,963	(8,963)
Increase (decrease) in accounts payable	(758,806)	225,407
Increase (decrease) in customer deposits	3,603	(19,499)
Increase (decrease) in accrued expenses	116,866	21,043
Increase (decrease) in customer advances for construction	<u>(23,238)</u>	<u>16,436</u>
Net cash provided (used) by operating activities	<u>6,745,464</u>	<u>4,858,169</u>
Cash flows from investing activities:		
Purchases of property, plant, and equipment	(4,734,771)	(5,143,345)
Plant removal costs	(854,783)	(658,075)
Salvage recovered from retirement of plant	161,400	123,648
Investments in subsidiary companies	(64)	(6,991)
(Increase) decrease in other receivable	111,120	111,120
(Increase) decrease in investments in associated organizations and other investments	<u>(1,846,761)</u>	<u>(1,046,563)</u>
Net cash provided (used) by investing activities	<u>(7,163,859)</u>	<u>(6,620,206)</u>

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

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARIES
STATEMENTS OF CASH FLOWS, CONCLUDED
For the years ended December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Cash flows from financing activities:		
Memberships issued	\$ 4,955	\$ 3,605
Distributions of patronage capital	(399,383)	(331,978)
Retired capital credits - gain	89,322	65,484
Minority interest and other equities	-	(157,077)
Increase (decrease) in noncurrent liabilities	15,485	20,560
Other debt increase (decrease)	(160,433)	(155,106)
Principal payments under capital lease obligation	-	(18,597)
Principal payments to RUS	-	(2,993,862)
Advance principal payments unapplied (increase) decrease	(6,126,258)	20,153
Principal payments to CFC	(1,017,006)	(826,214)
Principal payments to FFB	(1,439,800)	(1,365,040)
Principal payments on short term debt	(350,000)	-
Loan advancements from RUS/FFB/CFC	5,282,000	7,486,430
Borrowings from short term debt	<u>5,000,000</u>	<u>-</u>
Net cash provided (used) by financing activities	<u>898,882</u>	<u>1,748,358</u>
Increase (decrease) in cash and cash equivalents	480,487	(13,679)
Cash and cash equivalents at beginning of year	<u>812,838</u>	<u>826,517</u>
Cash and cash equivalents at end of year	<u>\$ 1,293,325</u>	<u>\$ 812,838</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest	<u>\$ 1,976,176</u>	<u>\$ 1,807,653</u>

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

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARIES
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 Propane Plus. During 2018, Farmers Energy Services Corporation was dissolved. As a result of the dissolution, Farmers Energy Propane Plus, LLC, formerly a wholly owned subsidiary of Farmers Energy Service Corporation is now directly owned by Farmers Rural Electric Cooperative 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, 2018 and 2017 were:

	<u>2018</u>	<u>2017</u>
Distribution Plant	\$ 86,526,333	\$ 83,350,654
General Plant	9,627,559	9,196,869
Other Production Plant	1,502,071	1,502,072
Intangible Plant	3,625	3,625
Electric Plant	97,659,588	94,053,220
Propane Plant	3,147,708	3,067,063
Total Utility Plant	<u>\$ 100,807,296</u>	<u>\$ 97,120,283</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 SUBSIDIARIES
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, 2018 and 2017:

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, 2018 and 2017 was \$3,380,686 and \$3,241,922 respectively.

Cost Recovery:

Regulatory requirements authorized by the Kentucky Public Service Commission allow the electric supplier to impose a fuel adjustment surcharge upon the Cooperative. In turn, the Cooperative is required to pass on the fuel surcharge to the consumer. Due to the regulatory requirements in calculating the surcharge the Cooperative may experience an over or under recovery of the fuel adjustment surcharge.

Similarly, the Kentucky Public Service Commission has an environmental cost recovery mechanism that allows the electric supplier to recover certain costs incurred in complying with the Federal Clean Air Act as amended and those federal, state and local environmental requirements which apply to coal combustion wastes and byproducts from facilities utilized for the production of energy from coal. In turn, the Cooperative is required to pass on this environmental cost recovery mechanism to the consumer.

The Cooperative has implemented the Accounting Standards Codification (ASC) No. 980, Accounting for the Effects of Certain Types of Regulation, in the recording of the described regulatory deferred debits. Similarly, in accordance with RUS Bulletin 1767B-1, section 1767.13(d)(3), the deferral of these regulatory items is recorded without the need for prior written approval of RUS.

The amount recorded on the financial statements for the (over) under recovery of the fuel adjustment surcharge was \$106,732 at December 31, 2018, and \$180,116 at December 31, 2017. The amount of the (over) under recovery of the environmental cost recovery mechanism at December 31, 2018 and 2017 was \$(128,705) and \$(111,092), respectively.

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.

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

1. Summary of Significant Accounting Policies, Concluded:

Note Receivable:

The Cooperative has a note receivable from the City of Glasgow, Kentucky in the amount of \$555,520 without interest. Monthly installments of \$9,260 are due the first day of each month beginning January 1, 2017 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. The Cooperative is responsible for reporting unrelated business income associated with its wholly owned subsidiary Farmers Energy Propane Plus, a limited liability company. Farmers Energy Propane Plus uses the same depreciation for book and taxes, therefore, deferred taxes are considered immaterial and are not recorded.

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 18, 2019 the date which the financial statements were available to be issued.

Reclassifications

Certain amounts in the 2017 financial statements were reclassified to conform to the 2018 presentation.

2. Investments in Associated Organizations:

Investments in associated organizations as of December 31, 2018 and 2017 are listed as follows:

	<u>2018</u>	<u>2017</u>
East Kentucky Power Cooperative, Inc.	\$ 29,163,892	\$ 27,365,700
National Rural Utilities Cooperative Finance Corp.	824,765	826,320
Other	1,149,328	1,099,204
Total	<u>\$ 31,137,985</u>	<u>\$ 29,291,224</u>

The Cooperative 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. Cash and Cash Equivalents:

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

	<u>2018</u>		<u>2017</u>	
	Carrying Amount	Bank Balance	Carrying Amount	Bank Balance
Insured (FDIC)	\$ 712,067	701,667	\$ 569,301	\$ 569,942
Pledged securities	581,258	456,033	243,537	167,501
Total deposits	<u>\$ 1,293,325</u>	<u>\$ 1,157,700</u>	<u>\$ 812,838</u>	<u>\$ 737,443</u>

Included in total deposits are special funds of \$15,485 at December 31, 2018 and \$0 at December 31, 2017 which were set aside to pay the regulatory liability.

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

4. 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 2051. Changes in rates are refunded to or recovered from the Cooperative's customers through a cost of power adjustment.

5. 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, 2018 and 2017 consisted of:

	<u>2018</u>	<u>2017</u>
Due United States of America:		
5.49% Mortgage Note-FFB	\$ 3,218,551	\$ 3,342,142
5.62% Mortgage Note-FFB	317,331	329,374
2.139-2.763% Mortgage Note-FFB	19,882,937	6,520,687
2.816 - 4.93% Mortgage Note-FFB	28,572,180	37,956,597
0% Rural Economic Development Loan	555,520	666,640
Total due United States of America	<u>52,546,519</u>	<u>48,815,440</u>
Due National Rural Utilities Cooperative Finance Corporation:		
2.25 - 4.4% First Mortgage Notes	5,778,418	6,795,423
Advance payments unapplied to long term debt	<u>(6,131,670)</u>	<u>(5,412)</u>
Total	52,193,267	55,605,451
Less current maturities	<u>(2,369,681)</u>	<u>(2,657,939)</u>
Farmers Rural Electric Cooperative Corporation	<u>\$ 49,823,586</u>	<u>\$ 52,947,512</u>
Due East Kentucky Power 2.75%	\$ 341,992	\$ 391,305
Less current maturities	<u>(36,000)</u>	<u>(46,773)</u>
Farmers Energy Propane Plus	<u>\$ 305,992</u>	<u>\$ 344,532</u>
Total all companies	\$ 52,535,259	\$ 55,996,756
Less current maturities	<u>(2,405,681)</u>	<u>(2,704,712)</u>
Total long term consolidated debt	<u>\$ 50,129,578</u>	<u>\$ 53,292,044</u>

In 2000, the Cooperative received approval from the Federal Financing Bank – Rural Utilities Service for loan funds in amount of \$5,053,000. These loans are for a period of thirty-five years, payable quarterly, and currently bearing interest rates from 5.491% - 5.617%. All funds were 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 loan funds in the amount of \$18,228,000. These loans are for a period of thirty-five years, payable quarterly, and currently bearing interest rates from 4.353% - 4.929%. All funds were advanced to the Cooperative.

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

5. Long-Term Debt, Concluded:

In 2008, the Cooperative received approval from the Federal Financing Bank-Rural Utilities Service for loan funds in the amount of \$17,402,000. These loans are for a period of thirty-five years, payable quarterly, and currently bearing interest rates from 1.065% - 4.449%. All funds were advanced to the Cooperative.

In 2013, the Cooperative received approval from the Federal Financing Bank-Rural Utilities Service for loan funds in the amount of \$17,582,000. As of December 31, 2018, all funds had been advanced to the Cooperative. Interest rates are determined at the time the loans are drawn. This final maturity date on the loan is December 31, 2047.

In 2017, the Cooperative received approval from the Federal Financing Bank-Rural Utilities Service for loan funds in the amount of \$19,951,000. As of December 31, 2018, \$4,000,000 had been advanced to the Cooperative.

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 (FESC) 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%. Farmers Energy Propane Plus, LLC, a wholly owned subsidiary of Farmers Rural Electric Cooperative Corporation, absorbed the debt of FESC upon its dissolution.

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

2019	\$	2,405,681
2020		2,499,758
2021		2,475,029
2022		2,585,162
2023		3,108,607
2024-2028		13,988,980
2029-2033		13,074,100
2034-2038		10,708,728
2039-2043		1,689,214
Total	\$	<u>52,535,259</u>

6. Short-term Debt:

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 June 10, 2020. 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, 2018, the balance of the line-of-credit was \$-0-.

The Cooperative has available a line of credit for short-term loans of up to \$5,000,000 with CoBank extending to August 31, 2019. Interest is payable monthly as a variable rate of interest established by the lender on the first business day of each week. At December 31, 2018, the balance of the line of credit was \$4,650,000.

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

7. Deferred Charges:

The following is a summary of amounts recorded as deferred charges approved by RUS per 1773.33(h) as of December 31, 2018 and 2017 which have been approved in writing by RUS:

<u>Deferred Debits:</u>	<u>2018</u>	<u>2017</u>
Transportation Expense	\$ 3,916	\$ 2,492
GIS-Field Inventory Cost	374,140	408,412
Long Range Plans	19,737	29,606
ESRI and EDP costs	84,754	84,132
Pension Plan Prepayment	1,122,347	1,247,052
	<u>\$ 1,604,894</u>	<u>\$ 1,771,694</u>

<u>Deferred Credits:</u>		
Customer Advances for Construction	\$ 327,537	\$ 350,775
	<u>\$ 327,537</u>	<u>\$ 350,775</u>

8. 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 \$399,383 and \$331,978 were paid for the years ended December 31, 2018 and 2017, respectively.

9. Other Equities:

At December 31, 2018 and 2017 other equities consisted of retired capital credits – gain, in amounts of \$2,018,444 and \$1,929,122, respectively.

10. 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 SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

10. Pension Plan, Concluded:

Plan Information

Farmers Rural Electric Cooperative Corporation contributions to the RS Plan in 2018 and in 2017 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 \$571,721 in 2018 and \$569,454 in 2017. There have been no significant changes that affect the comparability of 2018 and 2017 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, 2018 and over 80% funded at January 1, 2017 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 from January 1, 2013. 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.

The Cooperative has two separate 401(K) Plans and a 457(b) Plan. The first 401(K) 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 401(K) 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 457(b) plan allows for employee contributions with no company match. Total employer contributions for all Plans for 2018 and 2017 were \$83,022 and \$73,556 respectively. Total employee contributions for all Plans for 2018 and 2017 were \$199,037 and \$174,217, 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 \$16,988 in 2018 and \$16,457 in 2017.

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

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.

12. 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, 2018 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 2015.

13. 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>2018</u>	<u>2017</u>
Accumulated Benefit Obligation		
Projected benefit obligation at end of year	\$ 945,589	\$ 945,589
Fair Value of plan assets at end of year	-	-
Unfunded status at end of year	<u>\$ 945,589</u>	<u>\$ 945,589</u>
Amounts recognized in the balance sheet		
Unfunded status	\$ 945,589	\$ 945,589
Current liabilities	-	-
Noncurrent liabilities	<u>\$ 945,589</u>	<u>\$ 945,589</u>
Change in Accumulated Benefit Obligation		
Accumulated post-retirement benefit obligation at beginning of year	\$ 945,589	\$ 918,254
Service cost	17,377	32,419
Interest cost	42,551	43,900
Actuarial loss (gain)	(35,275)	(20,824)
Amortization of transition obligation	-	-
Amortization of net actuarial gain	-	-
Disbursements	(24,653)	(28,160)
Accumulated post-retirement benefit obligation at end of year	<u>\$ 945,589</u>	<u>\$ 945,589</u>

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

13. Postretirement Benefit Plans, Concluded:

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

	<u>2018</u>	<u>2017</u>
Beginning of year	\$ 692,125	\$ 750,474
Net loss (gain)	(35,275)	(20,825)
Amortization of net loss (gain)	(24,564)	(27,480)
Amortization of transition obligation	(10,044)	(10,044)
Total recognized in other comprehensive income	<u>(69,883)</u>	<u>(58,349)</u>
End of year	<u>\$ 622,242</u>	<u>\$ 692,125</u>

Amounts recognized in accumulated other comprehensive income

Net loss (gain)	\$ 511,701	\$ 571,540
Transition obligation	110,542	120,585
	<u>\$ 622,243</u>	<u>\$ 692,125</u>

Net periodic benefit cost

Service cost	\$ 7,994	\$ 32,420
Interest cost	32,175	43,900
Amortization of transition obligation	10,044	10,044
Amortization of net actuarial gain	23,840	27,480
Net periodic benefit cost	<u>\$ 74,053</u>	<u>\$ 113,844</u>

Amounts in other comprehensive income expected to be realized in 2019

Amortization of net loss (gain)	\$ 23,840
Amortization of transition obligation	10,044
	<u>\$ 33,884</u>

The discount rate used in determining the accumulated postretirement benefit obligation was 4.5% in 2018 and 2017.

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

2019	\$27,600
2020	\$14,628
2021	\$15,433
2022	\$16,281
2023	\$17,177

For measurement purposes, a 6.0% annual medical rate increase was used for the first year. The rate is assumed to decline by .25% per year until level at 3% 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	\$ 1,007,000
Net periodic benefit cost	\$ 78,800



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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 and subsidiaries as of and for the years ended December 31, 2018 and 2017, and our report thereon dated March 18, 2019, 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 Schedules I – IV 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 18, 2019

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARIES

SCHEDULE I – CONSOLIDATING BALANCE SHEET

December 31, 2018

ASSETS	Farmers Rural Electric Cooperative Corporation, Inc.	Farmers Energy Services Corporation	Farmers Energy Propane Plus	Consolidating Entries	Consolidated Totals
Current assets:					
Cash	\$ 941,857	\$ -	\$ 335,983	\$ -	\$ 1,277,840
Accounts and notes receivable, less allowance for doubtful accounts of \$87,378 in 2018	4,506,240	-	208,547	-	4,714,787
Materials and supplies, at average cost	890,553	-	127,530	-	1,018,083
Prepaid expenses	211,608	-	15,500	-	227,108
Total current assets	6,550,258	-	687,560	-	7,237,818
Other assets and investments:					
Goodwill	-	-	458,052	-	458,052
Cash-special funds	15,485	-	-	-	15,485
Investments in subsidiary companies	1,921,236	-	-	(1,893,083)	28,153
Investments in associated organizations	31,137,985	-	-	-	31,137,985
Deferred charges	1,604,894	-	-	-	1,604,894
Note receivable	555,520	-	-	-	555,520
	35,235,120	-	458,052	(1,893,083)	33,800,089
Utility plant, at cost					
Utility plant in service	97,659,588	-	3,147,708	-	100,807,296
Construction work-in-progress	323,088	-	-	-	323,088
	97,982,676	-	3,147,708	-	101,130,384
Less accumulated depreciation and amortization	(28,914,575)	-	(1,880,171)	-	(30,794,746)
Utility plant, net	69,068,101	-	1,267,537	-	70,335,638
TOTAL ASSETS	\$ 110,853,479	\$ -	\$ 2,413,149	\$ (1,893,083)	\$ 111,373,545
LIABILITIES AND MEMBERS' EQUITIES					
Current liabilities:					
Accounts payable	\$ 4,404,761	\$ -	\$ 178,074	\$ -	\$ 4,582,835
Accrued expenses	1,518,887	-	-	-	1,518,887
Customer deposits	840,501	-	-	-	840,501
Notes payable	4,650,000	-	-	-	4,650,000
Current portion of long-term debt	2,369,681	-	36,000	-	2,405,681
Total current liabilities	13,783,830	-	214,074	-	13,997,904
Long-term liabilities					
Long-term debt less current maturities	49,823,586	-	305,992	-	50,129,578
Total long-term liabilities	49,823,586	-	305,992	-	50,129,578
Noncurrent liabilities:					
Regulatory liability	15,485	-	-	-	15,485
Post retirement benefit obligations	945,589	-	-	-	945,589
Customer advances for construction	327,537	-	-	-	327,537
Total noncurrent liabilities	1,288,611	-	-	-	1,288,611
Members' equities:					
Memberships	555,005	-	-	-	555,005
Patronage capital and retained earnings	44,006,245	-	485,805	(485,805)	44,006,245
Accumulated other comprehensive income	(622,242)	-	-	-	(622,242)
Other equities	2,018,444	-	-	-	2,018,444
Minority interests and other equities	-	-	1,407,278	(1,407,278)	-
Total members' equities	45,957,452	-	1,893,083	(1,893,083)	45,957,452
TOTAL LIABILITIES AND MEMBERS' EQUITIES	\$ 110,853,479	\$ -	\$ 2,413,149	\$ (1,893,083)	\$ 111,373,545

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARIES
SCHEDULE II – CONSOLIDATING STATEMENT OF REVENUE
For the Year Ended December 31, 2018

	Farmers Rural Electric Cooperative Corporation, Inc.	Farmers Energy Services Corporation	Farmers Energy Propane Plus	Consolidating Entries	Consolidated Totals
Operating revenues	\$ 52,146,644	\$ -	\$ 2,958,874	\$ -	\$ 55,105,518
Operating expenses:					
Cost of purchases	36,762,605	-	1,461,025	-	38,223,630
Distribution - operations	1,498,523	-	-	-	1,498,523
Distribution - maintenance	3,586,325	-	-	-	3,586,325
Consumer accounts	1,173,570	-	-	-	1,173,570
Customer services and informational expense	94,910	-	-	-	94,910
Administrative and general	1,959,726	1,015	1,111,191	-	3,071,932
Depreciation	3,162,299	-	218,387	-	3,380,686
Taxes	746,346	331	13,347	-	760,024
Total operating expenses	48,984,304	1,346	2,803,950	-	51,789,600
Operating margins	\$ 3,162,340	\$ (1,346)	\$ 154,924	\$ -	\$ 3,315,918
Interest on long-term debt to RUS and CFC	1,969,012	7,164	-	-	1,976,176
Operating margins after fixed charges	1,193,328	(8,510)	154,924	-	1,339,742
G & T and other capital credits	1,867,073	-	-	-	1,867,073
Net operating margins	\$ 3,060,401	\$ (8,510)	\$ 154,924	\$ -	\$ 3,206,815
Nonoperating margins:					
Interest income, net of interest expense of \$27,473	23,498	113	694	-	24,305
Other net nonoperating income (loss)	14,215	-	(4,139)	-	10,076
Income (loss) from equity investments	133,706	534	-	(143,616)	(9,376)
	171,419	647	(3,445)	(143,616)	25,005
Net margins	\$ 3,231,820	\$ (7,863)	\$ 151,479	\$ (143,616)	\$ 3,231,820

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARIES
SCHEDULE III – CONSOLIDATING BALANCE SHEET
December 31, 2017

ASSETS	Farmers Rural Electric Cooperative Corporation, Inc.	Farmers Energy Services Corporation	Farmers Energy Propane Plus	Consolidating Entries	Consolidated Totals
Current assets:					
Cash	\$ 585,130	\$ 57,217	\$ 170,491	\$ -	\$ 812,838
Accounts and notes receivable, less allowance for doubtful accounts of \$90,335 in 2017	5,091,834	-	202,482	-	5,294,316
Materials and supplies, at average cost	942,028	-	95,459	-	1,037,487
Prepaid expenses	220,945	-	26,000	-	246,945
Total current assets	6,839,937	57,217	494,432	-	7,391,586
Other assets and investments:					
Goodwill, net of amortization	-	-	458,052	-	458,052
Special funds	8,963	-	-	-	8,963
Investments in subsidiary companies	1,843,515	2,149,515	-	(3,964,941)	28,089
Investments in associated organizations	29,291,224	-	-	-	29,291,224
Deferred charges	1,771,694	-	-	-	1,771,694
Note receivable	666,640	-	-	-	666,640
	33,582,036	2,149,515	458,052	(3,964,941)	32,224,662
Utility plant, at cost					
Utility plant in service	94,053,220	-	3,067,063	-	97,120,283
Construction work-in-progress	857,623	-	-	-	857,623
	94,910,843	-	3,067,063	-	97,977,906
	(28,090,300)	-	(1,669,319)	-	(29,759,619)
Less accumulated depreciation	66,820,543	-	1,397,744	-	68,218,287
Utility plant, net	107,242,516	2,206,732	2,350,228	(3,964,941)	107,834,535
LIABILITIES AND MEMBERS' EQUITIES					
Current liabilities:					
Accounts payable	\$ 5,140,927	\$ -	\$ 200,714	\$ -	\$ 5,341,641
Accrued expenses	1,402,021	-	-	-	1,402,021
Customer deposits	836,898	-	-	-	836,898
Current portion of long-term debt	2,657,939	46,773	-	-	2,704,712
Total current liabilities	10,037,785	46,773	200,714	-	10,285,272
Long-term liabilities					
Long-term debt less current maturities	52,947,512	344,532	-	-	53,292,044
Total long-term liabilities	52,947,512	344,532	-	-	53,292,044
Noncurrent liabilities:					
Regulatory liability	-	-	-	-	-
Post retirement benefit obligations	945,589	-	-	-	945,589
Customer advances for construction	350,775	-	-	-	350,775
Total noncurrent liabilities	1,296,364	-	-	-	1,296,364
Members' equities:					
Memberships	550,050	-	-	-	550,050
Patronage capital and retained earnings	41,173,808	543,183	864,313	(1,407,496)	41,173,808
Accumulated other comprehensive income	(692,125)	-	-	-	(692,125)
Other equities	1,929,122	-	-	-	1,929,122
Minority interest and other equities	-	1,272,244	1,285,201	(2,557,445)	-
	42,960,855	1,815,427	2,149,514	(3,964,941)	42,960,855
	\$ 107,242,516	\$ 2,206,732	\$ 2,350,228	\$ (3,964,941)	\$ 107,834,535

FARMERS RURAL ELECTRIC COOPERATIVE CORPORATION AND SUBSIDIARIES
SCHEDULE IV – CONSOLIDATING STATEMENT OF REVENUE
For the Year Ended December 31, 2017

	Farmers Rural Electric Cooperative Corporation, Inc.	Farmers Energy Services Corporation	Farmers Energy Propane Plus	Consolidating Entries	Consolidated Totals
Operating revenues	\$ 48,047,685	\$ -	\$ 2,213,828	\$ -	\$ 50,261,513
Operating expenses:					
Cost of purchases	34,419,738	-	977,690	-	35,397,428
Distribution - operations	1,603,362	-	161,077	-	1,764,439
Distribution - maintenance	2,862,728	-	-	-	2,862,728
Consumer accounts	1,092,226	-	-	-	1,092,226
Customer services and informational expense	175,763	-	-	-	175,763
Administrative and general	1,893,380	1,015	782,259	-	2,676,654
Depreciation	3,024,746	-	247,176	-	3,241,922
Taxes	716,569	18,216	15,842	-	750,627
Total operating expenses	45,788,512	19,231	2,154,044	-	47,961,787
Operating margins	\$ 2,259,173	\$ (19,231)	\$ 59,784	\$ -	\$ 2,299,726
Interest on long-term debt to RUS and CFC	1,793,685	13,968	-	-	1,807,653
Operating margins after fixed charges	465,488	(33,199)	59,784	-	492,073
G & T and other capital credits	1,069,124	-	-	-	1,069,124
Net operating margins	\$ 1,534,612	\$ (33,199)	\$ 59,784	\$ -	\$ 1,561,197
Nonoperating margins:					
Interest income, net of interest expense of \$21,016	27,332	235	278	-	27,845
Other net nonoperating income (loss)	33,919	-	-	-	33,919
Income (loss) from equity investments	191,166	60,062	-	(87,160)	164,068
	252,417	60,297	278	(87,160)	225,832
Net margins	\$ 1,787,029	\$ 27,098	\$ 60,062	\$ (87,160)	\$ 1,787,029



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**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 and subsidiaries, which comprise the balance sheets as of December 31, 2018 and 2017 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 18, 2019. 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 and subsidiaries' 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 and subsidiaries' internal control. Accordingly, we do not express an opinion on the effectiveness of Farmers Rural Electric Cooperative Corporation and subsidiaries' 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 and subsidiaries' 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, & Ratledge, PLLC

Certified Public Accountants
Glasgow, Kentucky

March 18, 2019



CAMPBELL, MYERS AND RUTLEDGE, PLLC

Cindy L. Greer, CPA ■ R. Brent Billingsley, CPA

Skip R. Campbell, CPA ■ L. Joe Rutledge, CPA ■ Ryan A. Mosier, CPA ■ Jenna B. Glass, CPA ■ Van Shepard, CPA

**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 and subsidiaries (FRECC), which comprise the balance sheets as of December 31, 2018 and 2017 and the related statements of revenue, comprehensive income, patronage capital and memberships, and cash flows for the years ended, and the related notes to the financial statements, and have issued our report thereon dated March 18, 2019. In accordance with *Government Auditing Standards*, we have also issued our report dated March 18, 2019, 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:

During 2018, Farmers Energy Service Corporation, a wholly owned subsidiary of Farmers Rural Electric Cooperative Corporation, was dissolved. As a result of that dissolution, Farmers Energy Propane Plus, LLC, formerly a wholly owned subsidiary of Farmers Energy Service Corporation is now directly owned by Farmers Rural Electric Cooperative Corporation. The subsidiary is 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	\$	225,000
Investment Advances/Withdrawals:		
12/31/1998		120,000
12/31/1999		135,000
12/31/2000		225,000
12/31/2001		75,000
12/31/2018		(73,823)
		<u>481,177</u>
Total Contributions:	\$	<u>706,177</u>

Undistributed (Losses) Earnings:

Prior Years' Earnings	\$	752,606
12/31/2014		114,921
12/31/2015		(14,122)
12/31/2016		154,924
12/31/2017		27,098
12/31/2018		151,479
Total Undistributed (Losses) Earnings:		1,186,906
Original Investment and Investment Activities:		<u>706,177</u>
Book Value 12/31/18	\$	<u>1,893,083</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 & Rathledge, PLLC

Glasgow, Kentucky

March 18, 2019