FLEMING-MASON ENERGY COOPERATIVE, INC.
KENTUCKY 52

FINANCIAL REPORT

December 31, 2019

C O N T E N T S

Jones, Nale & Mattingly PLC

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Fleming-Mason Energy Cooperative, Inc.
Flemingsburg, Kentucky

We have audited the accompanying financial statements of Fleming-Mason Energy Cooperative, Inc., which comprise the balance sheet as of December 31, 2019, and the related statements of revenue and comprehensive income, changes in members' equities, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit 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 financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, 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 financial statements.

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

Certified Public Accountants and Advisors
642 South Fourth Street, Suite 300 Louisville, Kentucky 40202 tel: 502.583.0248 fax: 502.589-1680 www.jnmcpa.com

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Fleming-Mason Energy Cooperative, Inc. as of December 31, 2019, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of a Matter

As discussed in Note 2, Fleming-Mason Energy Cooperative, Inc. has adopted Financial Accounting Standards Update 2014-09, *Revenue from Contracts with Customers.* Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued a report dated March 26, 2020, on our consideration of Fleming-Mason Energy Cooperative, Inc.'s internal control over financial reporting and 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 internal control over financial reporting and compliance.

Prior Period Financial Statements

The financial statements of Fleming-Mason Energy Cooperative, Inc., as of December 31, 2018, were audited by other auditors whose report dated February 7, 2019, expressed an unmodified opinion on those statements.

Jones, Nale & Mattingly PLC

Louisville, Kentucky
March 26, 2020

FLEMING-MASON ENERGY COOPERATIVE, INC.
BALANCE SHEETS
December 31, 2019 and 2018

Assets	2019	2018
Electric Plant, at original cost:		
In service	$ 111,397,185	$ 108,098,505
Under construction	608,448	35,669
	112,005,633	108,134,174
Less accumulated depreciation	42,015,655	39,827,366
	69,989,978	68,306,808
Investments in Associated Organizations	53,539,401	50,502,719
Current Assets:		
Cash and cash equivalents	566,558	254,565
Accounts receivable, less allowance for 2019 of $105,178 and 2018 of $98,936	6,668,854	7,101,518
Other receivables	1,443,527	1,664,249
Material and supplies, at average cost	366,816	483,994
Other current assets	217,195	231,217
Total current assets	9,262,950	9,735,543
Total	$ 132,792,329	$ 128,545,070

Members' Equities and Liabilities	2019	2018
Members' Equities:		
Memberships	$ 242,780	$ 240,395
Patronage capital	70,630,260	67,139,822
Other equities	61,176	58,162
Accumulated other comprehensive (loss)	(4,843,513)	(4,281,593)
	66,090,703	63,156,786
Long-Term Liabilities:		
Long-term debt, less current portion	36,773,212	37,657,649
Accumulated operating provisions	8,401,530	7,755,305
	45,174,742	45,412,954
Current Liabilities:		
Notes payable	8,400,000	6,700,000
Current portion of long-term debt	3,114,000	3,150,000
Accounts payable	6,116,768	6,450,492
Consumer deposits	706,110	695,440
Accrued expenses	3,185,536	2,972,688
Total current liabilities	21,522,414	19,968,620
Consumer Energy Prepayments	4,470	6,710
Total	$ 132,792,329	$ 128,545,070

The Notes to Financial Statements are an integral part of these statements.

FLEMING-MASON ENERGY COOPERATIVE, INC.
STATEMENTS OF REVENUE AND COMPREHENSIVE INCOME
Years Ended December 31, 2019 and 2018

	2019	2018
Operating Revenues:		
Sale of electric energy	$ 67,361,450	$ 71,651,254
Other electric revenues	1,062,304	1,109,458
	68,423,754	72,760,712
Operating Expenses:		
Cost of power	54,937,878	58,519,493
Distribution - operations	1,811,154	2,022,664
Distribution - maintenance	3,107,116	3,008,974
Consumer accounts	1,396,028	1,391,612
Customer services	117,863	117,516
Sales	70,544	80,838
Administrative and general	1,530,264	1,646,896
Depreciation, excluding $295,206 in 2019 and $229,599 in 2018 charged to clearing accounts	3,692,913	3,597,073
Taxes, other than income	84,690	89,328
Interest on long-term debt	1,193,501	1,189,081
Other interest expense	235,230	160,387
Other deductions	23,443	24,857
Total cost of electric service	68,200,624	71,848,719
Operating Margins	223,130	911,993
Non-operating Margins		
Interest income	301,426	305,681
Others	(22,737)	(89,657)
	278,689	216,024
Patronage Capital Credits		
Generation and transmission	3,078,937	3,038,993
Other associated organizations	172,535	261,413
	3,251,472	3,300,406
Net Margins	3,753,291	4,428,423
Other Comprehensive Income (Loss):		
Pension plan benefit (loss)	(561,920)	182,866
Postretirement benefits (expenses)	- -	(16,774)
	(561,920)	166,092
Total Comprehensive Income	$ 3,191,371	$ 4,594,515

The Notes to Financial Statements are an integral part of these statements.

FLEMING-MASON ENERGY COOPERATIVE, INC.
STATEMENT OF CHANGES IN MEMBERS' EQUITIES
Years Ended December 31, 2019 and 2018

		Patronage Capital						Accumulated Other Comprehensive Income (Loss)	Total Members' Equities
	Memberships	Assigned	Unasigned	Prior Deficits	Retirements	Total	Other Equities		
Balance - December 31, 2017	$ 239,200	$ 69,163,322	$ 2,704,305	$ (3,066,946)	$ (5,865,629)	$ 62,935,052	$ 55,563	$ (4,447,685)	$ 58,782,130
Allocate margins		2,501,670	(2,704,305)	202,635		- -			- -
Comprehensive income:									
Net margins			4,428,423			4,428,423			4,428,423
Pension plan									
Amortization								200,653	
Adjustment								(17,787)	182,866
Postretirement benefit obligation									
Amortization								(16,774)	
Adjustment								- -	(16,774)
Total comprehensive income									4,594,515
Net change in memberships	1,195								1,195
Refunds of capital credits					(223,653)	(223,653)			(223,653)
Other equities							2,599		2,599
Balance - December 31, 2018	240,395	71,664,992	4,428,423	(2,864,311)	(6,089,282)	67,139,822	58,162	(4,281,593)	63,156,786
Allocate margins		4,225,788	(4,428,423)	202,635		- -			- -
Comprehensive income:									
Net margins			3,753,291			3,753,291			3,753,291
Pension plan									
Amortization								199,093	
Adjustment								(761,013)	(561,920)
Total comprehensive income									3,191,371
Net change in memberships	2,385								2,385
Refunds of capital credits					(262,853)	(262,853)			(262,853)
Other equities							3,014		3,014
Balance - December 31, 2019	$ 242,780	$ 75,890,780	$ 3,753,291	$ (2,661,676)	$ (6,352,135)	$ 70,630,260	$ 61,176	$ (4,843,513)	$ 66,090,703

The Notes to Financial Statements are an integral part of these statements.

FLEMING-MASON ENERGY COOPERATIVE, INC.
STATEMENTS OF CASH FLOWS
Years Ended December 31, 2019 and 2018

	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Net margins	$ 3,753,291	$ 4,428,423
Adjustments to reconcile net margins to net cash provided by operating activities:		
Depreciation:		
Charged to expense	3,692,913	3,597,073
Charged to clearing accounts	295,206	229,599
Patronage capital credits assigned	(3,251,472)	(3,300,406)
Accumulated postretirement benefits	84,305	62,971
Change in assets and liabilities:		
Accounts and other receivables	653,386	683,986
Material and supplies	117,178	(34,076)
Other assets	14,022	(10,233)
Accounts payable	(333,724)	(308,733)
Consumer deposits and advances	8,430	(35,161)
Accrued expenses	212,848	295,047
Net cash provided by operating activities	5,246,383	5,608,490
CASH FLOWS FROM INVESTING ACTIVITIES		
Plant additions	(5,226,902)	(3,505,090)
Plant removal costs	(458,215)	(390,427)
Salvage recovered from retired plant	13,828	2,340
Receipts from other investments, net	214,790	163,134
Net cash (used in) investing activities	(5,456,499)	(3,730,043)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in memberships	2,385	1,195
Refund of patronage capital to members	(262,853)	(223,653)
Increase in other equities	3,014	2,599
Proceeds from long-term debt	1,000,000	- -
Payments on long-term debt	(3,070,121)	(3,142,891)
Cushion of credit uses (advances)	1,149,685	(263,607)
Short-term borrowings	1,700,000	1,700,000
Net cash provided by (used in) financing activities	522,110	(1,926,357)
Net increase (decrease) in cash and cash equivalents	311,993	(47,910)
Cash and cash equivalents, beginning of year	254,565	302,475
Cash and cash equivalents, end of year	$ 566,558	$ 254,565
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash payments for interest	$ 1,424,935	$ 1,189,278

The Notes to Financial Statements are an integral part of these statements.

NOTES TO FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

Fleming-Mason Energy Cooperative, Inc. (Fleming-Mason) maintains its records in accordance with the policies prescribed or permitted by the Kentucky Public Service Commission (PSC) and the United States Department of Agriculture, Rural Utilities Service (RUS), which conform in all material respects with accounting principles generally accepted in the United States of America. The significant accounting policies are as follows:

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

The cost of maintenance and repairs, including renewals of minor items of property, is charged to operating expense. The cost of replacement of depreciable property units, as distinguished from minor items, is charged to electric plant. The units of property replaced or retired, including cost of removal, net of any salvage value, is charged to accumulated depreciation. Electric plant consists of the following as of December 31, 2019 and 2018:

	2019	2018
Distribution plant	$ 100,186,441	$ 97,310,491
General plant	11,210,744	10,788,014
Total	$ 111,397,185	$ 108,098,505

Depreciation Provision has been made for depreciation on the basis of the estimated lives of assets, using the straight-line method. Depreciation rates range from 1.44% to 10.00%, for a composite rate of 3.51% for distribution plant. General plant rates are as follows:

Structures and improvements	2.50%
Transportation equipment	10.00 - 20.00%
Other general plant	5.00 - 10.00%

Cash and Cash Equivalents Fleming-Mason considers all short-term, highly liquid investments with original maturities of three months or less to be cash equivalents. Fleming-Mason maintains its cash balances, which may exceed the federally insured limit, with several financial institutions. These financial institutions have strong credit ratings and management believes that credit risk related to the accounts is minimal.

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

Sales Tax Fleming-Mason is required to collect, on behalf of the Commonwealth of Kentucky, sales taxes based on 6 percent of gross sales from non-residential consumers, a 3 percent school tax from certain counties on most gross sales, and franchise fees in certain cities. Fleming-Mason's policy is to exclude sales tax from revenue when collected and expenses when paid and instead, record collection and payment of sales taxes through a liability account.

NOTES TO FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies (Continued)

Accounts Receivable Accounts receivable consists of amounts due for sales of electric energy which were not collected at year-end. Accounts receivable are recorded at net realizable value consisting of the carrying amount less an allowance for uncollectible accounts. Fleming-Mason uses the allowance method to account for uncollectible accounts receivable balances. Management charges off uncollectible receivables to the allowance when it is determined the amounts will not be realized.

Materials and Supplies Fleming-Mason values materials and supplies at the lower of average cost or net realizable value.

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

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

Credit Risk Fleming-Mason grants credit to residents of local counties. Concentrations of credit risk with respect to accounts receivables are limited due to its large number of customers.

Advertising Fleming-Mason expenses advertising costs as incurred. Advertising expenses were $5,448 and $6,662 for the years ended December 31, 2019 and 2018, respectively.

Income Tax Status Fleming-Mason is exempt from federal and state income taxes under provisions of Section 501(c)(12). Accordingly, the financial statements for Fleming-Mason include no provision for income taxes. Fleming-Mason's accounting policy provides that a tax expense/benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits. Management believes Fleming-Mason has no uncertain tax positions resulting in an accrual of tax expense or benefit. Fleming-Mason recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. Fleming-Mason did not recognize any interest or penalties during the years ended December 31, 2019 and 2018. Fleming-Mason's income tax return is subject to possible examination by taxing authorities until the expiration of related statutes of limitations on the return, which is generally three years.

Comprehensive Income Comprehensive income includes both net margin and other comprehensive income (loss). Other comprehensive income (loss) represents the change in funded status of the accumulated postretirement benefit obligation.

NOTES TO FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies (Continued)

Pension Accounting Pronouncement   In May 2017, the Financial Accounting Standards Board (FASB) issued ASU 2017-07, *Improving the Presentation of Net periodic Pension Cost and Net Periodic Postretirement Benefit Cost.* The standard specifies how the amount of pension costs and costs for post-retirement benefits other than pensions (PBOP) should be presented on the income statement under accounting principles generally accepted in the United States of America, and what components of those costs are eligible for capitalization in assets. This standard is effective for years beginning after December 15, 2018. The Federal Energy Regulatory Commission (FERC) issued Docket No. AI18-1-000 that allowed jurisdictional public utilities to continue to record PBOP costs in their entirety, less amounts capitalized, without change. Pension and PBOP costs are made up of several components: service cost, interest cost, actual return on plan assets, gain or loss, amortization of prior service cost or credit, and amortization of ASC Subtopic 715-30. Though pension and PBOP costs are computed using the aggregate total of these various components, the Commission's longstanding policy is to consider the amount as a singular cost to the employer. This cost is calculated based on Statement of Financial Accounting Standards No. 106 and reported as an expense under net margins from continuing operations.

Recent Accounting Pronouncements   In February 2016, the FASB issued ASU 2016-02, *Leases.* The standard requires all leases with lease terms over 12 months to be capitalized as a right-of-use asset and lease liability on the balance sheet at the date of lease commencement. Leases will be classified as either finance or operating. This distinction will be relevant for the pattern of expense recognition in the statement of revenue and comprehensive income. This standard will be effective for the year ending December 31, 2021.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments-Credit Losses.* The standard requires a financial asset (including trade receivables) measured at amortized cost basis to be presented at the net amount expected to be collected. Thus, the statement of revenue and comprehensive income will reflect the measurement of credit losses for newly recognized financial assets as well as the expected increases or decreases of expected credit losses that have taken place during the period. This standard will be effective for the year ending December 31, 2023.

Fleming-Mason is currently in the process of evaluating the impact of the adoption of these ASUs on the financial statements.

Subsequent Events   Management has evaluated subsequent events through March 26, 2020, the date the financial statements were available to be issued.

Note 2.   Revenue Recognition

Adoption of accounting pronouncement

Fleming-Mason adopted ASU 2014-09, *Revenue from Contracts with Customers* as of January 1, 2019. The new standard replaces existing revenue recognition rules with a single comprehensive model to use in accounting for revenue arising from contracts with customers. The standard was adopted using the modified retrospective method and had no effect on Fleming-Mason's financial position or results of operations.

Under ASU 2014-09, the timing of recognition of revenue for each performance obligation may differ from the timing of the customer billing, creating a contract asset or contract liability. Short-term contract liabilities are classified as consumer deposits. Fleming-Mason has no contract assets or long-term contract liabilities.

Note 2. Revenue Recognition (Continued)

Revenue from contracts

Fleming-Mason is engaged in the distribution and sale of electricity to residential and commercial customers in nine counties in eastern Kentucky. Revenue from these activities is generated from tariffs approved by the PSC. Fleming-Mason satisfies their performance obligation upon the delivery of electricity to customers. Revenue is recognized over-time as the customer simultaneously receives and consumes the benefits provided by Fleming-Mason. The amount of revenue recognized is the billed volume of electricity multiplied by a tariff rate per-unit of energy, plus any applicable fixed or additional regulatory charges. Customers are billed monthly and outstanding amounts are typically due within 20 days of the date of the bill.

Significant judgements

Fleming-Mason has multiple billing cycles that process customer bills on approximately the same day each month. The amounts billed are based on actual meter readings of kilowatt hours used for the billing period. The amount of revenue recorded each month represent a full month of kilowatt hour usage. There are no significant judgements for over or under-billed revenues because each month's revenue is based on actual meter readings. This method of revenue recognition presents fairly, Fleming-Mason's transfer of electricity to customers as the amount recognized is based on actual volumes delivered and the tariff rate per-unit of energy plus any applicable fixed charges as set by the PSC.

Performance obligations

Fleming-Mason customers generally have no minimum purchase commitments. Fleming-Mason recognizes revenue as each performance obligation is satisfied. Performance obligations are limited to the service requested and received to date. Accordingly, there is no unsatisfied performance obligation to recognize as of December 31, 2019 and 2018.

Disaggregation of revenue

The following table shows revenues from contracts with customers disaggregated by customer class for the years ended December 31:

	2019	2018
Large industrial	$ 33,711,813	$ 36,548,133
Residential	30,041,778	31,407,079
Small commercial	3,277,183	3,356,686
Public lights	330,676	339,356
Total	$ 67,361,450	$ 71,651,254

Contract cost liabilities

Contract cost liabilities include consumer deposits. The balance in contract liabilities was $706,110 and $695,440 as of December 31, 2019 and 2018, respectively.

NOTES TO FINANCIAL STATEMENTS

Note 3. Investments in Associated Organizations

Investments in associated organizations consist of the following as of December 31:

	2019	2018
East Kentucky, patronage capital	$ 51,202,898	$ 48,233,104
CFC, CTC's	823,110	824,622
CFC, patronage capital	291,881	292,420
Others	1,221,512	1,152,573
	$ 53,539,401	$ 50,502,719

Fleming-Mason records patronage capital assigned by associated organizations in the year in which such assignments are received. The Capital Term Certificates (CTCs) of CFC are recorded at cost. The CTCs were purchased from CFC as a condition of obtaining long-term financing. The CTCs bear interest at 3.00% and 5.00% and are scheduled to mature at varying times from 2020 to 2080.

Note 4. Patronage Capital

Under provisions of the long-term debt agreement, return to patrons of capital contributed by them is limited to amounts which would not allow the total equities and margins to be less than 30.00% of total assets, except that distributions may be made to estates of deceased patrons. The debt agreement provides, however, that should such distributions to estates not exceed 25.00% of the net margins for the next preceding year, Fleming-Mason may distribute the difference between 25.00% and the payments made to such estates. Fleming-Mason's equity as of December 31, 2019 and 2018 were 50.00% and 49.00% of total assets, respectively.

Note 5. Long-Term Debt

All assets, except vehicles, are pledged as collateral on the long-term debt to RUS, Federal Financing Bank (FFB), and CFC under a joint mortgage agreement. The long-term debt is due in quarterly and monthly installments of varying amounts through 2053. RUS assesses 12.5 basis points to administer the FFB loans. Long-term debt consists of the following as of December 31, 2019 and 2018:

	2019	2018
FFB, 1.57% and 2.77%	$ 30,792,452	$ 30,869,616
RUS, advance payment earns 5.00% interest	(4,288,241)	(5,437,925)
RUS, Economic Development loan, no interest	907,210	1,143,674
CFC, 3.10% to 3.85%	1,310,527	1,460,480
CoBank, 3.73%	524,403	1,287,045
CoBank, 3.26%	10,640,861	11,484,759
	39,887,212	40,807,649
Less current portion	3,114,000	3,150,000
	$ 36,773,212	$ 37,657,649

NOTES TO FINANCIAL STATEMENTS

Note 5. Long-Term Debt (Continued)

Fleming-Mason had unadvanced loan funds from FFB that will be used for future plant additions in the amount of $17,257,000 as of December 31, 2019. There were no unadvanced loan funds from FFB as of December 31, 2018. Fleming-Mason is participating in a RUS sponsored program which provides economic development funds to businesses in Fleming-Mason's service area. Fleming-Mason serves as a conduit for these funds and is contingently liable if the recipient fails to repay the loan.

As of December 31, 2019, the annual principal portion of long-term debt outstanding for the next five years are as follows: 2020 - $3,114,000; 2021 - $3,204,000; 2022 - $3,297,000; 2023 - $3,392,000; 2024 - $3,432,000.

Note 6. Short-Term Notes Payable

As of December 31, 2019 and 2018, Fleming-Mason has a short-term line of credit of $10,000,000 available from CFC and a short-term line of credit of $5,000,000 available from CoBank. The outstanding balance under the CFC line of credit was $8,400,000 and $6,700,000 as of December 31, 2019 and 2018, respectively. The interest rate was 3.25% and 3.00% as of December 31, 2019 and 2018, respectively. The line of credit matures in 2049. There were no outstanding balances on the CoBank line of credit as of December 31, 2019 and 2018.

Note 7. Pension Plan

Fleming-Mason has a noncontributory defined benefit pension plan covering substantially all employees who meet minimum age and service requirements. The plan has a pay-related pension benefit formula. Fleming-Mason's policy is to fund such plans in accordance with the requirements of the Employee Retirement Income Security Act (ERISA). The plan was measured as of December 31, 2019 and 2018. There have been no significant changes that affect the comparability of 2019 and 2018.

The following is an assessment of the noncontributory defined benefit plan:

	2019	2018
Change in Benefit Obligation:		
Beginning of year	$ 11,859,202	$ 12,336,872
Service cost	502,503	550,507
Interest cost	476,312	447,305
Actuarial loss (gain)	1,501,941	(703,529)
Benefits paid	(364,101)	(771,953)
End of year	13,975,857	11,859,202
Change in Plan Assets:		
Beginning of year	5,403,046	5,835,188
Actual return (loss) on assets	1,142,839	(260,189)
Employer contributions	600,000	600,000
Benefits paid	(364,101)	(771,953)
End of year	6,781,784	5,403,046
Funded status of plan (deficit)	$ (7,194,073)	$ (6,456,156)
Accumulated benefit obligation in plan	$ 9,927,444	$ 8,445,812

Note 7. Pension Plan (Continued)

The amounts recognized in the balance sheets are as follows as of December 31, 2019 and 2018:

	2019	2018
Accumulated other comprehensive (loss)	$ (4,843,513)	$ (4,281,593)
Accrued benefit liability	(2,350,560)	(2,174,563)
Amount recognized in financial statements	$ (7,194,073)	$ (6,456,156)

The net periodic pension benefit cost was calculated as follows:

	2019	2018
Service cost	$ 502,503	$ 550,507
Interest cost	476,312	447,305
Expected return on plan assets	(401,911)	(461,127)
Amortization of actuarial loss	199,093	200,653
Net periodic benefit cost	$ 775,997	$ 737,338

Assumptions used to develop the projected benefit obligation are as follows:

	2019	2018
Discount rate	3.25%	4.25%
Rate of increase in compensation level	3.50%	3.50%
Expected long-term rate of return on assets	8.00%	8.00%

The expected long-term rate of return on plan assets for determining net periodic pension cost for each fiscal year is chosen from the best range determined by applying anticipated long-term returns for various asset categories to the target asset allocation of the plan, as well as taking into account historical returns.

The general investment objectives are to invest in a diversified portfolio, comprised of debt investments, equity investments, and fixed income investments. The diversification is designed to minimize the risk of large losses while maximizing total return within reasonable prudent levels of risk. The investment objectives specify a targeted investment allocation for the pension plan of approximately 50.00% equities. The remaining may be allocated among fixed income or cash equivalent investments.

Expected retiree pension benefit payments are projected to be as follows: 2020 - $534,276; 2021 - $148,132; 2022 - $144,859; 2023 - $951,139; 2024 - $132,751.

Fleming-Mason expects to contribute approximately $675,000 during the year ending December 31, 2020. However, Fleming-Mason reserves the right to contribute more less depending on other considerations and circumstances.

NOTES TO FINANCIAL STATEMENTS

Note 8. Postretirement Benefits

Fleming-Mason sponsors a defined benefit plan that provides medical insurance coverage to retired employees, directors and attorney. The plan calls for benefits to be paid at retirement based primarily upon years of service with Fleming-Mason. There have been no significant changes that affect the comparability of 2019 and 2018. The following is a reconciliation of the postretirement obligation.

The status of the unfunded postretirement benefit plan is as follows:

	2019	2018
Change in Benefit Obligation:		
Beginning of year	$ 3,473,712	$ 3,393,967
Net periodic benefit cost:		
Service cost	67,317	76,002
Interest cost	163,107	154,246
	230,424	230,248
Actuarial loss	- -	16,774
Benefits paid	(146,119)	(167,277)
End of year	3,558,017	3,473,712
Plan assets	- -	- -
Funded status of plan (deficit)	$ (3,558,017)	$ (3,473,712)

Effect of 1% increase in the health care trend:	
Postemployment benefit obligation	$ 3,754,000
Net periodic benefit cost	$ 243,000

Projected retiree benefit payments for the next five years are expected to be as follows: 2020 - $176,000; 2021 - $170,000; 2022 - $182,000; 2023 - $188,000; 2024 - $151,000.

The discount rate used in determining the accumulated pension benefit obligation was 5.00% for 2019 and 2018. The healthcare cost trend rate used to compute the accumulated pension benefit obligation is an 8.00% annual rate of increase for 2019, and decreasing gradually to 5.00% and then remain at that level thereafter.

Note 9. Significant Patron Information

One member accounted for approximately 21% and 18% of electric revenues for the years ended December 31, 2019 and 2018, respectively. Fleming-Mason has a contract in place with the member. Management does not expect the business relationship to change with this member. In addition, Fleming-Mason bills and collects steam charges for East Kentucky to the industrial customer. There are no margins realized from this arrangement with East Kentucky, therefore, the amounts are not reflected in operating revenues or cost of power.

Note 10. Related Party Transactions

Several of the Directors of Fleming-Mason, its President and CEO, and another employee, serve on the Boards of Directors of various associated organizations.

NOTES TO FINANCIAL STATEMENTS

Note 11. Commitments

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

Note 12. Contingencies

Fleming-Mason, on occasion, is involved in litigation arising in the normal course of business. While the results of such litigation cannot be predicted with certainty, management, based upon advice of counsel, believes that the outcome will not have a material adverse effect on the financial statements.

Note 13. Environmental Contingency

Fleming-Mason from time to time is required to work with and handle PCBs, herbicides, automotive fluids, lubricants, and other hazardous materials in the normal course of business. As a result, there is the possibility that environmental conditions may arise which would require Fleming-Mason to incur cleanup costs. The likelihood of such an event, or the amount of such costs, if any, cannot be determined at this time. However, management does not believe such costs, if any, would materially affect Fleming-Mason's financial position or its future cash flows.

Note 14. Risks and Uncertainties

Subsequent to December 31, 2019, local, U.S., and world governments have encouraged self-isolation to curtail the spread of the global pandemic, coronavirus disease (COVID-19), by mandating temporary work stoppage in many sectors and imposing limitations on travel and size and duration of group meetings. Most industries are experiencing disruption to business operations and the impact of reduced consumer spending. There is unprecedented uncertainty surrounding the duration of the pandemic, its potential economic ramifications, and any government actions to mitigate them. Accordingly, while management cannot quantify the financial and other impact to Fleming-Mason as of March 26, 2020, management believes that a material impact on Fleming-Mason's financial position and results of future operations is reasonably possible.

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

To the Board of Directors
Fleming-Mason Energy Cooperative, Inc.
Flemingsburg, 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 financial statements of Fleming-Mason Energy Cooperative, Inc. (the Cooperative), which comprise the balance sheet as of December 31, 2019 and the related statements of revenue and comprehensive income, changes in members' equities and cash flows for the year then ended, and related notes to the financial statements, and have issued our report thereon dated March 26, 2020.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Cooperative'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 opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Cooperative's internal control. Accordingly, we do not express an opinion on the effectiveness of the Cooperative'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.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Cooperative's financial statements are free of 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 result 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.

Jones, Nale & Mattingly PLC

Louisville, Kentucky
March 26, 2020

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

To the Board of Directors
Fleming-Mason Energy Cooperative, Inc.
Flemingsburg, Kentucky

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 Fleming-Mason Energy Cooperative, Inc. (the Cooperative), which comprise the balance sheet as of December 31, 2019, and the related statements of revenue and comprehensive income, changes in members' equities, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated March 26, 2020. In accordance with *Government Auditing Standards*, we have also issued our report dated March 26, 2020, 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. No reports other than the reports referred to above and our schedule of findings and recommendations related to our audit have been furnished to management.

In connection with our audit, nothing came to our attention that caused us to believe that the Cooperative failed to comply with the terms, covenants, provisions, or conditions of their loan, grant, and security instruments as set forth in 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers and Grantees*, §1773.33, 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 the Cooperative's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters. In connection with our audit, we noted no matters regarding the Cooperative's accounting and records to indicate that the Cooperative did not:

- Maintain adequate and effective accounting procedures;
- Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts;
- Reconcile continuing property records to the controlling general ledger plant accounts;
- Clear construction accounts and accrue depreciation on completed construction;

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- Record and properly price the retirement of plant;
- Seek approval of the sale, lease, or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap;
- Maintain adequate control over material and supplies;
- Prepare accurate and timely Financial and Operating Reports;
- Obtain written RUS approval to enter into any contract for the management, operation, or maintenance of the borrower's system if the contract covers all or substantially all of the electric system;
- Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles;
- Record depreciation in accordance with RUS requirements ("See RUS Bulletin 183-1, Depreciation Rates and Procedures");
- Comply with the requirements for the detailed schedule of deferred debits and deferred credits, which are listed below; and
- Comply with the requirements for the detailed schedule of investments, of which there were none.

The deferred credits are as follows:

Consumer energy prepayments	$ 4,470

The purpose of this report is solely to communicate, in connection with the audit of the financial statements, on compliance with aspects of contractual agreements and the regulatory requirements for electric borrowers based on the requirements of 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers and Grantees*. Accordingly, this report is not suitable for any other purpose.

Jones, Nale & Mattingly PLC

Louisville, Kentucky
March 26, 2020