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Meade County Rural Electric
Cooperative Corporation
Brandenburg, Kentucky

Audited Financial Statements
October 31, 2013 and 2012

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Independent Auditor's Report

To the Board of Directors
Meade County Rural Electric Cooperative
Brandenburg, Kentucky

Report on the Financial Statements

I have audited the accompanying financial statements of Meade County Rural Electric Cooperative, which comprise the balance sheets as of October 31, 2013 and 2012, and the related statements of revenue and comprehensive income, changes in equities, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audits. I conducted my audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

I believe the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

To the Board of Directors
Meade County Rural Electric Cooperative - 2

Opinion

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Meade County Rural Electric Cooperative as of October 31, 2013 and 2012, and the results of their operations and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, I have also issued a report dated December 11, 2013, on my consideration of Meade County Rural Electric Cooperative's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering internal control over financial reporting and compliance.

Alan M. Zumstein

Alan M. Zumstein, CPA
December 11, 2013

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Report on Internal Control Over Financial Reporting and on Compliance
and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards*

To the Board of Directors
Meade County Rural Electric Cooperative

I have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Meade County Rural Electric Cooperative, which comprise the balance sheets as of October 31, 2013 and 2012, and the related statements of revenue and comprehensive income, members' equities and cash flows for the years then ended, and related notes to the financial statements, and have issued my report thereon dated December 11, 2013.

Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing my audit, I considered Meade County's internal control over financial reporting as a basis for designing my auditing procedures for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Meade County's internal control over financial reporting. Accordingly, I do not express an opinion on the effectiveness of Meade County's internal control over financial reporting.

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

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

To the Board of Directors
Meade County Rural Electric Cooperative
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Compliance and Other Matters

As part of obtaining reasonable assurance about whether Meade County's financial statements are free of material misstatement, I 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 my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

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

Alan M. Zumstein

Alan M. Zumstein, CPA
December 11, 2013

Meade County Rural Electric Cooperative Corporation
Balance Sheets, October 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
ASSETS		
Electric Plant, at original cost:		
In service	\$ 106,688,008	\$ 103,224,995
Under construction	1,538,827	1,602,152
	108,226,835	104,827,147
Less accumulated depreciation	31,052,910	29,784,758
	77,173,925	75,042,389
Investments in Associated Organizations	2,323,923	2,326,867
Current Assets:		
Cash and cash equivalents	5,986,537	8,058,045
Accounts receivable, less allowance for 2013 of \$318,415 and 2012 of \$344,105	3,269,434	2,447,560
Unbilled revenues	498,660	394,715
Other receivables	653,405	285,610
Material and supplies, at average cost	809,875	970,897
Other current assets	300,655	346,281
	11,518,566	12,503,108
Prepaid pension costs	1,642,951	-
Total	\$ 92,659,365	\$ 89,872,364
MEMBER'S EQUITIES AND LIABILITIES		
Members' Equities:		
Memberships	\$ 87,175	\$ 90,815
Patronage capital	29,129,011	27,545,416
Other equities	957,516	948,737
Accumulated other comprehensive income	(157,913)	(171,991)
	30,015,789	28,412,977
Long Term Debt	54,940,030	53,103,985
Accumulated Postretirement Benefits	1,438,704	1,372,138
Current Liabilities:		
Accounts payable	2,540,062	2,121,403
Current portion of long term debt	1,850,000	2,800,000
Consumer deposits	879,041	794,797
Accrued expenses	436,162	687,356
	5,705,265	6,403,556
Consumer Advances	559,577	579,708
Total	\$ 92,659,365	\$ 89,872,364

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

Statements of Revenue and Comprehensive Income
for the years ended October 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Operating Revenues		
Sale of electricity	\$ 38,208,992	\$ 35,085,146
Other electric revenue	<u>1,171,546</u>	<u>1,065,348</u>
	<u>39,380,538</u>	<u>36,150,494</u>
Operating Expenses:		
Cost of power	23,437,650	20,323,595
Distribution - operations	2,665,552	2,542,561
Distribution - maintenance	2,899,675	2,986,839
Consumer accounts	1,366,884	1,399,742
Customer services	342,068	277,331
Administrative and general	1,734,387	1,640,573
Depreciation, excluding \$369,536 in 2013 and \$354,017 in 2012 charged to clearing accounts	3,523,851	3,336,034
Taxes, other than income	47,872	37,921
Other deductions	<u>13,345</u>	<u>12,442</u>
	<u>36,031,284</u>	<u>32,557,038</u>
Operating margins before interest charges	<u>3,349,254</u>	<u>3,593,456</u>
Interest Charges:		
Long-term debt	1,899,746	2,106,109
Other	<u>5,870</u>	<u>11,847</u>
	<u>1,905,616</u>	<u>2,117,956</u>
Operating margins after interest charges	<u>1,443,638</u>	<u>1,475,500</u>
Nonoperating Margins		
Interest income	277,133	282,488
Others	<u>68,755</u>	<u>150,376</u>
	<u>345,888</u>	<u>432,864</u>
Patronage Capital Credits	<u>52,547</u>	<u>49,929</u>
Net Margins	1,842,073	1,958,293
Items of comprehensive income:		
Accumulated postretirement benefits	<u>14,078</u>	<u>15,358</u>
Net Comprehensive Income	<u>\$ 1,856,151</u>	<u>\$ 1,973,651</u>

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

Statements of Cash Flows
for the years ended October 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Cash Flows from Operating Activities:		
Net margins	\$ 1,842,073	\$ 1,958,293
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation:		
Charged to expense	3,523,851	3,336,034
Charged to clearing accounts	369,536	354,017
Patronage capital credits assigned	(52,547)	(49,929)
Accumulated postretirement benefits	80,644	88,041
Change in assets and liabilities:		
Receivables	(1,293,614)	(627,136)
Material and supplies	161,022	249,542
Other assets	45,626	95,337
Deferred assets	(1,642,951)	-
Payables	418,659	330,721
Consumer deposits and advances	64,113	40,932
Accrued expenses	(251,194)	24,044
	<u>3,265,218</u>	<u>5,799,896</u>
Cash Flows from Investing Activities:		
Plant additions	(5,531,563)	(5,890,367)
Plant removal costs	(734,702)	(926,561)
Salvage recovered from retired plant	241,342	401,788
Receipts from other investments, net	55,491	58,459
	<u>(5,969,432)</u>	<u>(6,356,681)</u>
Cash Flows from Financing Activities:		
Net increase in memberships	(3,640)	(3,585)
Refund of patronage capital to members	(258,478)	(226,522)
Increase in other equities	8,779	(1,084)
Payments on long term debt	(3,204,868)	(2,753,447)
Advances of long term debt	7,810,000	2,000,000
Advance payment on long term debt	(3,719,087)	(2,016,974)
	<u>632,706</u>	<u>(3,001,612)</u>
Net increase in cash	(2,071,508)	(3,558,397)
Cash and cash equivalents, beginning of year	<u>8,058,045</u>	<u>11,616,442</u>
Cash and cash equivalents, end of year	<u>\$ 5,986,537</u>	<u>\$ 8,058,045</u>
Supplemental cash flows information:		
Interest paid on long-term debt	\$ 1,918,126	\$ 2,129,970

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

Statement of Changes in Members' Equity
for the years ended October 31, 2012 and 2013

	<u>Memberships</u>	<u>Patronage Capital</u>	<u>Other Equity</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Total Members' Equity</u>
Balance - Beginning of year	\$ 94,400	\$ 25,813,645	\$ 949,821	\$ (187,349)	\$ 26,670,517
Comprehensive income:					
Net margins		1,958,293			1,958,293
Postretirement benefit obligation					
Amortization				15,358	
Adjustments				-	15,358
Total comprehensive income				-	1,973,651
Net change in memberships	(3,585)				(3,585)
Refunds to estates		(226,522)			(226,522)
Transfers to other equities					-
Other equities			(1,084)		(1,084)
Balance - October 31, 2012	90,815	27,545,416	948,737	(171,991)	28,412,977
Comprehensive income:					
Net margins		1,842,073			1,842,073
Postretirement benefit obligation					
Amortization				14,078	
Adjustments				-	14,078
Total comprehensive income				-	1,856,151
Net change in memberships	(3,640)				(3,640)
Refunds to estates		(258,478)			(258,478)
Transfers to other equities					-
Other equities			8,779		8,779
Balance - October 31, 2013	<u>\$ 87,175</u>	<u>\$ 29,129,011</u>	<u>\$ 957,516</u>	<u>\$ (157,913)</u>	<u>\$ 30,015,789</u>

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

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies

Meade County Rural Electric Cooperative ("Meade County") maintains its records in accordance with the policies prescribed or permitted by the Kentucky Public Service Commission ("PSC") and the United States Department of Agriculture, Rural Utilities Service ("RUS"), which conform in all material respects with generally accepted accounting principles. The more significant of these policies are as follows:

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

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

	<u>2013</u>	<u>2012</u>
Distribution plant	\$99,243,549	\$95,315,530
General plant	<u>7,444,459</u>	<u>7,909,465</u>
Total	<u>\$106,688,008</u>	<u>\$103,224,995</u>

Depreciation Provision has been made for depreciation on the basis of the estimated lives of assets, using the straight-line method. Meade County uses a composite depreciation rate of 3.36% for distribution plant. General plant rates are as follows:

Structures and improvements	2.5% - 3%
Transportation equipment	12.5% - 25%
Other general plant	5% - 14.3%

Cash and Cash Equivalents Meade County considers all short-term, highly liquid investments with original maturities of three months or less to be cash equivalents. Meade County 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 conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates used in the preparation of the financial statements.

Revenue Meade County records revenue as billed to its consumers based on monthly meter-reading cycles. All consumers are required to pay a refundable deposit, however, it may be waived under certain circumstances. Meade County's sales are concentrated in a six county area of western Kentucky. There were no consumers whose individual account balance exceeded 10% of outstanding accounts receivable at October 31, 2013 or 2012. Consumers must pay their bill within 20 days of billing, then are subject to disconnect after another 10 days. Accounts are written off when they are deemed to be uncollectible. The allowance for uncollectible accounts is based on the aging of receivables.

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies, continued

Sales Tax Meade County is required to collect, on behalf of the State 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. Meade County'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.

Cost of Power Meade County is one of three (3) members of Big Rivers Electric Corporation, Inc. ("Big Rivers"). Under a wholesale power agreement, Meade County is committed to purchase its electric power and energy requirements from Big Rivers until 2043. The rates charged by Big Rivers 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 Big Rivers.

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

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities

Level 2: Quoted prices in markets that are not considered to be active or financial instruments for which all significant inputs are observable, either directly or indirectly.

Level 3: Prices or valuations that require inputs that are both significant to the fair value measure and unobservable.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

The carrying amounts of Meade County's cash and cash equivalents, other receivables, investments, inventories, other assets, trade accounts payable, accrued expenses and liabilities, and other liabilities approximate fair value due to their short maturity. Investments in associated organizations are not considered a financial instrument because they represent nontransferable interests in associated organizations. Other assets and liabilities are not considered financial instruments because they represent activities specifically related to Meade County. Long term debt can not be traded in the market, and is specifically for electric cooperatives and, therefore, a value other than its outstanding principal cannot be determined.

Meade County may, and also does, invest idle funds in local banks and in National Rural Utilities Cooperative Finance Corporation ("CFC") commercial paper. The inputs used to measure idle funds are Level 1 measurements, as these funds are exchange traded funds in an active market.

Risk Management Meade County 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.

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies, continued

Environmental Contingency Meade County 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 Meade County 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 Meade County's financial position or its future cash flows.

Generation and Transmission Corporation As discussed in the preceding notes, Meade County purchases electric power from Big Rivers, a generation and transmission cooperative association. The membership of Big Rivers is comprised of Meade County and two other distribution cooperatives.

On July 16, 2009, Big Rivers consummated an "unwind" transaction with E.ON US under which Big Rivers will assume from E.ON US full responsibility for operating its three generation facilities and the obligation to serve two aluminum smelters through Kenergy Corp. E.ON US provided cash payments, asset transfers and other benefits to Big Rivers, which resulted in Big Rivers booking extraordinary income of \$537,978,000 in 2009. These economic benefits allowed Big Rivers to pay down approximately \$140,000,000 of debt, provide \$253,000,000 of rate stabilization funds, and increase its equity to a positive \$379,391,000 from a deficit of (\$154,602,000) at December 31, 2009. After consideration of all relevant facts and information Meade County has elected to continue valuing the non-cash allocations received from Big Rivers at zero for financial accounting purposes, a practice it has followed since Big Rivers emerged from bankruptcy in 1998 during which all previous booked non-cash allocations were reduced to zero. Meade County will continue to make memorandum entries in its patronage subsidiary ledger of the face amount of the allocations received from Big Rivers. Refer to the subsequent footnote for the income tax treatment of these non-cash allocations.

Advertising Meade County expenses advertising costs as incurred.

Income Tax Status Meade County is exempt from federal and state income taxes under provisions of Section 501(c)(12). When applying the 85 percent test of IRC 501(c)(12), Meade County excludes the Big Rivers non-cash allocations from "gross income". Accordingly, the financial statements for Meade County include no provision for income taxes. Meade County'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 Meade County has no uncertain tax positions resulting in an accrual of tax expense or benefit. Meade County recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. Meade County did not recognize any interest or penalties during the years ended October 31, 2013 and 2012. Meade County'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. Other comprehensive income represents the change in funded status of the accumulated postretirement benefit obligation.

Subsequent Events Management has evaluated subsequent events through December 11, 2013, the date the financial statements were available to be issued. There were no significant subsequent events to report.

Notes to Financial Statements

Note 2. Investments in Associated Organizations

Meade County 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 0%, 3%, and 5% and are scheduled to mature at varying times from 2020 to 2080. Member Capital Securities have a 7.5% fixed interest rate and mature 35 years from the issuance date. Interest is paid each April and October 1.

Investments in associated organizations consist of:

	<u>2013</u>	<u>2012</u>
CFC, patronage capital	\$367,916	\$357,517
CFC, CTC's	881,516	913,133
CFC, Member Capital Security	310,000	310,000
Others	764,491	746,217
Total	<u>\$2,323,923</u>	<u>\$2,326,867</u>

Note 3. Patronage Capital

Under provisions of the long-term debt agreement, return to patrons of capital contributed by them is limited to amounts which would not allow the total equities and margins to be less than 30% of total assets, except that distributions may be made to estates of deceased patrons. The debt agreement provides, however, that should such distributions to estates not exceed 25% of the net margins for the next preceding year, Meade County may distribute the difference between 25% and the payments made to such estates. The equity at October 31, 2013 was 32% of total assets.

Patronage capital consists of:

	<u>2013</u>	<u>2012</u>
Assigned to date	\$36,111,056	\$35,141,464
Assignable margins	1,503,694	1,105,630
Unassigned	4,512,061	4,037,643
Retirements to date	(12,997,800)	(12,739,321)
Total	<u>\$29,129,011</u>	<u>\$27,545,416</u>

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 2041. Meade County has unadvanced loan funds available from FFB in the amount of \$23,049,000 at October 31, 2013. RUS assess 12.5 basis points to administer the FFB loans.

As of October 31, 2013, the annual principal portion of long term debt outstanding for the next five years are as follows: 2014 - \$1,850,000; 2015 - \$1,900,000; 2016 - \$2,000,000; 2017 - \$2,100,000; 2018 - \$2,200,000.

Notes to Financial Statements

Note 5. Long Term Debt, continued

Long term debt consists of:

	<u>2013</u>	<u>2012</u>
RUS:		
0.14% to 4.67%	\$32,510,010	\$33,314,608
Advance payments unapplied	<u>(6,316,866)</u>	<u>(2,597,779)</u>
	<u>26,193,144</u>	<u>30,716,829</u>
FFB, 0.148% to 6.049%	<u>26,747,209</u>	<u>19,571,345</u>
CFC:		
2.95% to 3.9% fixed rate notes	3,849,677	4,147,300
Refinance RUS loans 6.05%	<u>-</u>	<u>1,468,511</u>
	<u>3,849,677</u>	<u>5,615,811</u>
	56,790,030	55,903,985
Less current portion	<u>1,850,000</u>	<u>2,800,000</u>
Long term portion	<u>\$54,940,030</u>	<u>\$53,103,985</u>

Note 5. Short Term Borrowings

At October 31, 2013, Meade County had a short term line of credit of \$5,000,000 available from CFC. There were no advances against this line of credit during the audit period.

Note 6. Pension Plan

All eligible employees of Meade County participate in the NRECA Retirement and Security Plan ("R&S Plan"), a defined benefit pension plan qualified under section 401 and tax exempt under section 501(a) of the Internal Revenue Code. It is a multiemployer plan under the accounting standards. The Plan sponsor's identification number is 53-0116145 and the Plan Number is 333. Eligible employees include employees hired prior to August 31, 2002. Non-eligible employees are those hired after August 31, 2002. A unique characteristic of a multiemployer plan compared to a single employer plan is that all plan assets are available to pay benefits of any plan participant. Separate asset accounts are not maintained for participating employers. This means that assets contributed by one employer may be used to provide benefits to employees of other participating employers.

Meade County's contributions to the R&S Plan in 2013 and 2012 represent less than 5 percent of the total contributions made to the plan by all participating employers. Meade County made contributions to the plan of \$484,103 in 2013 and \$587,456 in 2012. There have been no significant changes that affect the comparability of 2013 and 2012.

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

Notes to Financial Statements

Note 6. Pension Plan, continued

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

Two prepayment options were available to participating cooperatives:

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

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

Section 6.13(e) of the RUS Loan Contract limits the amount of unsecured debt that a borrower may incur to 15% on Net Utility Plant if the equity level of the borrower, after considering such unsecured debt, is below 30% of its Total Assets, unless the borrower obtains RUS consent. RUS will consider any unsecured debt associated with the R&S Plan prepayment to be "Permitted Debt" and accordingly, it will be excluded from the application of Section 6.13(e). On March 15, 2013, the Corporation made a prepayment of \$1,656,757 to the R&S Plan. The Corporation is amortizing this amount over 10 years. Interest expense associated with the prepayment loan is being accounted for in accordance with the USoA.

Note 7. Savings Plan

Meade County participates in the NRECA Savings Plan, a multiemployer, defined contribution master pension plan. All employees are eligible to participate in the Savings Plan upon completion of six (6) months employment. Eligible employees, as defined above, participate in the Savings Plan with Meade County contributing 3% of annual base pay, and the employee contributing from 1% to 3%. Non-eligible employees, as defined above, participate in the Savings Plan with Meade County contributing 12% of annual base pay, and the employee contributing from 1% to 3%. Employer contributions to the plan were \$276,671 for 2013 and \$256,909 for 2012, and vest immediately.

Notes to Financial Statements

Note 8. Postretirement Benefits

Meade County sponsors a defined benefit plan that provides medical insurance coverage to retirees by contributing 50% of the cost of a single policy. For measurement purposes, an annual rate of increase of 8.5%, then decreasing by 0.5% per year until 5% per year, in the per capita cost of covered health care benefit was assumed. The discount rate used in determining the accumulated postretirement benefit obligation was 5.5%. A portion of the net periodic benefit cost is allocated to construction of electric plant.

The funded status of the plan is as follows:

	<u>2013</u>	<u>2012</u>
Projected benefit obligation	(\$1,438,704)	(\$1,372,138)
Plan assets at fair value	-	-
Funded status	(\$1,438,704)	(\$1,372,138)

The reconciliation of the benefits obligations of postretirement benefits are as follows:

	<u>2013</u>	<u>2012</u>
Benefit obligation - beginning of period	\$1,372,138	\$1,299,455
Adjust comprehensive income	-	-
Net periodic benefit cost:		
Service cost	50,468	59,516
Interest cost	77,298	73,469
Net periodic benefit cost	127,766	132,985
Benefit payments to participants	(61,200)	(60,302)
Benefit obligation - end of period	\$1,438,704	\$1,372,138

Projected retiree benefit payments for the next five years are expected to be as follows: 2014 - \$55,500; 2015 - \$57,000; 2016 - \$52,000; 2017 - \$46,000; 2018 - \$36,000.

Note 9. Related Party Transactions

Several of the Directors of Meade County and its President & CEO are on the Boards of Directors of various associated organizations. Meade County occasionally sells old vehicles to employees and others. One of the vehicles sold was to the daughter of the President & CEO during 2012.

Note 10. Commitments

Meade County 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 11. Environmental Contingency

Meade County 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 Meade County 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 Meade County's financial position or its future cash flows.

Notes to Financial Statements

Note 12. Rate Matters

Meade County was granted a general rate increase by the PSC in the amount of approximately \$965,000, or 2% of base revenues during 2013. Big Rivers increased its base rates to Meade County during September 2012 by approximately 7%. Big Rivers is proposing to increase its rates by another approximately 20% during 2013. Meade County passes these increases on to its customers using the methodology prescribed by the PSC.

Note 12. Contingencies

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

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To the Board of Directors
Meade County Rural Electric Cooperative

I have audited the financial statements of Meade County Rural Electric Cooperative for the year ended October 31, 2013, and have issued my report thereon dated December 11, 2013. I conducted my audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and 7 CFR Part 1773, Policy on audits of the Rural Utilities Service (RUS) Borrowers. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing my audit of the financial statements of the Cooperative for the year ended October 31, 2013, I considered its internal control over financial reporting in order to determine my auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control over financial reporting.

My consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be a material weakness. A material weakness is a condition in which the design or operation of the specific internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. I noted no matters involving the internal control over financial reporting that I consider to be a material weakness.

7 CFR Part 1773.3 requires comments on specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions and other additional matters. I have grouped my comments accordingly. In addition to obtaining reasonable assurance about whether the financial statements are free from material misstatements, at your request, I performed tests of specific aspects of the internal control over financial reporting, of compliance with specific RUS loan and security instrument provisions and of additional matters. The specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and additional matters tested include, among other things, the accounting procedures and records, material control, compliance with specific RUS loan and security instrument provisions set forth in 7 CFR Part 1773.3(d)(1) related transactions, depreciation rates, a schedule of deferred debits and credits and a schedule of investments, upon which I express an opinion. In addition, my audit of the financial statements also included the procedures specified in 7 CFR Part 1773.38-.45. My objective was not to provide an opinion on these specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, or additional matters, and accordingly, I express no opinion thereon.

No reports, other than my independent auditor's report, and my independent auditor's report on internal control over financial reporting and compliance and other matters, all dated December 11, 2013, or summary of recommendations related to my audit have been furnished to management.

To the Board of Directors
Meade County Rural Electric Cooperative – 2

My comments on specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions and other additional matters as required by 7 CFR Part 1773.33 are presented below.

Comments on Certain Specific Aspects of the Internal Control Over Financial Reporting

I noted no matters regarding the Cooperative's internal control over financial reporting and its operation that I consider to be a material weakness as previously defined with respect to:

- The accounting procedures and records;
- the process for accumulating and recording labor, material and overhead costs, and the distribution of these costs to construction, retirement, and maintenance and other expense accounts, and;
- the material controls.

Comments on Compliance with Specific RUS Loan and Security Instrument Provisions

At your request, I have performed the procedures enumerated below with respect to compliance with certain provisions of laws, regulations, and contracts. The procedures I performed are summarized as follows:

- Procedures performed with respect to the requirement for a borrower to obtain written approval of the mortgagee to enter into any contract for the operation or maintenance of property or for the use of mortgaged property by others for the year ended October 31, 2013, of the Cooperative.
 1. The Cooperative has not entered into any contract during the year for the operation or maintenance of its property, or for the use of its property by others as defined in 1773.33(e)(1)(i).
- Procedures performed with respect to the requirement to submit RUS Financial and Operating Report, Electric Distribution to RUS:
 1. Agreed amounts reported in RUS Financial and Operating Report, Electric Distribution to the Cooperative's records as of December 31, 2012.

The results of my tests indicate that, with respect to the items tested, the Cooperative complied in all material respects, with the specific RUS loan and security instrument provisions referred to below. With respect to items not tested, nothing came to my attention that caused me to believe that the Cooperative had not complied, in all material respects, with those provisions. The specific provisions tested, as well as any exceptions noted, include the requirements that:

- The borrower has submitted its RUS Financial and Operating Report, Electric Distribution to RUS and the RUS Financial and Operating Report, Electric Distribution, as of December 31, 2012, represented by the borrower as having been submitted to RUS appears to be in agreement with its audited records in all material respects.
- During the period of this review, the Cooperative received no long term advances from CFC on loans controlled by the RUS/CFC Mortgage and Loan Agreement.

Comments on Other Additional Matters

In connection with my audit of the Cooperative, nothing came to my attention that caused me to believe that the Cooperative failed to comply with respect to:

- The reconciliation of continuing property records to controlling general ledger plant accounts addressed at 7 CFR Part 1773.33(c)(1);

To the Board of Directors
Meade County Rural Electric Cooperative -- 3

- The clearing of the construction accounts and the accrual of depreciation on completed construction addressed at 7 CFR Part 1773.33(c)(2);
- The retirement of plant addressed at 7 CFR 1773.33(c)(3) and (4);
- Approval of the sale, lease, or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap addressed at 7 CFR Part 1773.33(c)(5);
- The disclosure of material related party transactions, in accordance with Statement of Financial Accounting Standard No. 57, Related party Transactions, for the year ended October 31, 2013, in the financial statements referenced in the first paragraph of this report addressed at 7 CFR Part 1773.33(f);
- The depreciation rates addressed at 7 CFR Part 1773.33(g);
- The detailed schedule of deferred debits and deferred credits; and
- The detailed schedule of investments.

My audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The detailed schedule of deferred debits and deferred credits required by 7 CFR Part 1773(h) and provided below is presented for purposes of additional analysis and is not a required part of the basic financial statements. This information has been subjected to the auditing procedures applied in my audit of the basic financial statements and, in my opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The deferred debits are as follows:

Prepaid pension costs	<u>\$1,642,951</u>
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The deferred credits are as follows:

Consumer advances for construction	<u>\$559,577</u>
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This report is intended solely for the information and use of the Board of Directors, management, RUS, and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties.

Alan M. Zumstein

Alan M. Zumstein, CPA
December 11, 2013