

Kentucky 30
Shelby Energy Cooperative, Inc.
and Subsidiary
Shelbyville, Kentucky

Audited Financial Statements
December 31, 2013 and 2012

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Independent Auditor's Report

To the Board of Directors
Shelby Energy Cooperative

Report on the Financial Statements

I have audited the accompanying consolidated financial statements of Shelby Energy Cooperative and Subsidiary, which comprise the balance sheets as of December 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
Shelby Energy Cooperative - 2

Opinion

In my opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Shelby Energy Cooperative and Subsidiary as of December 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 February 13, 2014, on my consideration of Shelby Energy Cooperative and Subsidiary'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 Zumstein

Alan M. Zumstein, CPA
February 13, 2014

Shelby Energy Cooperative and Subsidiary
Consolidated Balance Sheets, December 31, 2013 and 2012

<u>Assets</u>	<u>2013</u>	<u>2012</u>
Utility Plant, at original cost:		
In service	\$ 80,705,470	\$ 78,515,870
Under construction	1,886,241	1,517,877
	82,591,711	80,033,747
Less accumulated depreciation	16,688,157	15,263,165
	65,903,554	64,770,582
Investments		
Associated organizations	17,305,631	14,661,376
Goodwill, net of amortization	368,414	368,414
	17,674,045	15,029,790
Current Assets:		
Cash and cash equivalents	2,490,228	1,921,218
Accounts receivable, less allowance for		
2013 of \$439,299 and 2012 of \$399,157	4,597,573	4,373,295
Material and supplies, at average cost	471,795	497,037
Prepayments and other current assets	297,092	341,029
	7,856,688	7,132,579
Deferred Charge	-	395,622
Total	\$ 91,434,287	\$ 87,328,573
<u>Members' Equities and Liabilities</u>		
Members' Equities:		
Patronage capital and retained earnings	\$ 34,232,084	\$ 31,232,431
Other equities and minority interests	2,032,498	1,779,961
Accumulated other comprehensive income	(306,833)	(329,274)
	35,957,749	32,683,118
Long Term Debt	44,952,660	41,825,199
Accumulated Postretirement Benefits	1,989,227	1,953,695
Current Liabilities:		
Accounts payable	3,703,093	3,493,271
Short term borrowings	943,456	3,297,316
Current portion of long term debt	1,750,000	1,525,000
Consumer deposits	1,249,198	1,245,575
Accrued expenses	351,916	370,851
	7,997,663	9,932,013
Consumer Advances for Construction	536,988	934,548
Total	\$ 91,434,287	\$ 87,328,573

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

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

	<u>2013</u>	<u>2012</u>
Operating Revenues	<u>\$ 46,043,686</u>	<u>\$ 43,796,602</u>
Operating Expenses:		
Cost of power and propane	34,616,144	33,204,954
Distribution - operations	1,801,998	1,941,730
Distribution - maintenance	1,879,052	1,950,365
Consumer accounts	723,890	674,947
Customer service and information	483,035	342,051
Sales	(8,118)	1,776
Administrative and general	1,166,079	1,021,969
Depreciation, excluding \$128,729 in 2013 and \$161,679 in 2012 charged to clearing accounts	2,602,354	2,354,762
Taxes	62,673	63,893
Other	5,391	7,568
	<u>43,332,498</u>	<u>41,564,015</u>
Operating Margins before Interest Charges	<u>2,711,188</u>	<u>2,232,587</u>
Interest Charges:		
Interest on long-term debt	1,730,450	1,775,826
Other interest	36,767	84,988
	<u>1,767,217</u>	<u>1,860,814</u>
Operating Margins after Interest Charges	<u>943,971</u>	<u>371,773</u>
Patronage Capital assigned from:		
East Kentucky Power Cooperative, Inc.	2,640,762	2,015,873
Other organizations	84,543	41,026
	<u>2,725,305</u>	<u>2,056,899</u>
Nonoperating Margins:		
Interest income	36,379	40,692
Subsidiary and others	(146,903)	150,510
	<u>(110,524)</u>	<u>191,202</u>
Net Margins	3,558,752	2,619,874
Other Comprehensive Income:		
Postretirement benefits	22,441	22,441
Noncontrolling interests	(86,377)	(44,275)
Total Comprehensive Income	<u>\$ 3,494,816</u>	<u>\$ 2,598,040</u>

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

Statements of Changes in Members' Equity
for the years ended December 31, 2012 and 2013

	<u>Patronage Capital</u>	<u>Other Equity</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Total Members' Equity</u>
Balance - Beginning of year	\$ 29,162,204	\$ 1,621,957	\$ (351,715)	\$ 30,432,446
Comprehensive income:				
Net margins	2,619,874			2,619,874
Postretirement benefit obligation				
Amortization			22,441	
Adjustments			-	22,441
Total comprehensive income				2,642,315
Refunds of capital credits	(505,372)			(373,591)
Transfers to other equity and minority interests	(44,275)			(44,275)
Other equities		158,004		26,223
Balance - December 31, 2012	31,232,431	1,779,961	(329,274)	32,683,118
Comprehensive income:				
Net margins	3,558,752			3,558,752
Postretirement benefit obligation				
Amortization			22,441	
Adjustments			-	22,441
Total comprehensive income				3,581,193
Refunds of capital credits	(472,722)			(472,722)
Transfers to other equity and minority interests	(86,377)			(86,377)
Other equities		252,537		252,537
Balance - December 31, 2013	\$ 34,232,084	\$ 2,032,498	\$ (306,833)	\$ 35,957,749

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

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

	<u>2013</u>	<u>2012</u>
Cash Flows from Operating Activities:		
Net margins	\$ 3,472,375	\$ 2,443,818
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation		
Charged to expense	2,602,354	2,354,762
Charged to clearing accounts	128,729	161,679
Patronage capital credits	(2,725,305)	(2,056,899)
Accumulated postretirement benefits	57,973	49,813
Change in assets and liabilities:		
Receivables	(212,274)	(253,563)
Material and supplies	25,242	160
Prepayments	439,561	55,602
Payables	207,815	(430,389)
Consumer deposits	3,623	136,260
Accrued expenses and accumulated benefits	(18,935)	(5,476)
Consumer advances for construction	(397,560)	(2,957)
	<u>3,583,598</u>	<u>2,452,810</u>
Cash Flows from Investing Activities:		
Plant additions	(3,674,397)	(4,554,697)
Salvage, net of removal costs	(189,657)	(497,052)
Other investments, net	167,427	10,522
	<u>(3,696,628)</u>	<u>(5,041,228)</u>
Cash Flows from Financing Activities:		
Other equities and minority interests	166,161	113,729
Additional long term borrowings	5,000,000	3,000,000
Short term borrowings (repayments)	(2,363,860)	2,066,047
Payments on long term debt	(1,647,602)	(1,436,542)
Retirement of patronage capital	(472,722)	(373,591)
Invest in cushion of credit	63	61,653
	<u>682,040</u>	<u>3,431,296</u>
Net increase in cash	569,010	842,878
Cash balances - beginning of period	<u>1,921,218</u>	<u>1,078,340</u>
Cash balances - end of period	<u>\$ 2,490,228</u>	<u>\$ 1,921,218</u>
Supplemental cash flows information:		
Interest paid on long term debt	\$1,730,957	\$1,779,830

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

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies

Shelby Energy Cooperative ("Shelby Energy") 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:

Principles of Consolidation The consolidated financial statements include the accounts of Shelby Energy, Shelby Energy Services Corporation ("Service Corporation") and Shelby Propane Plus, LLC ("Propane Plus"). Shelby Energy owns 75% and East Kentucky Power Cooperative ("East Kentucky") owns 25% of Service Corporation's outstanding stock. Service Corporation owns 100% of the outstanding stock of Propane Plus. All significant inter company accounts and transactions have been eliminated.

Business Activity Shelby Energy provides distribution electric service to residential, business and commercial consumers in a ten (10) county area of central Kentucky. Service Corporation provides overall business direction to Propane Plus. Propane Plus sells propane and related accessories to residential and commercial customers in central Kentucky.

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

Restricted Cash Included in cash and cash equivalents are funds that are solely for economic development activities in the amount of \$430,895 and \$386,693, for 2013 and 2012, respectively. At December 31, 2013, Shelby Energy had \$186,110 advanced for economic development activities.

Off Balance Sheet Risk Shelby Energy has some off-balance sheet risk in that they maintain cash deposits in financial institutions in excess of the amounts insured by the Federal Deposit Insurance Corporation (FDIC). At December 31, 2013, the financial institutions reported deposits in excess of the \$250,000 FDIC insured limit several times during the audit period. Deposits in excess of the FDIC limit are 100% secured with collateral at the financial institution.

Revenue Shelby Energy records revenue as billed to its consumers based on monthly meter-reading cycles. Consumers are required to pay a refundable deposit, however, it may be waived under certain circumstances. Shelby Consumers must pay their bill within 15 days of billing, or consumers will forfeit a 10% discount, at which time a disconnect notice is sent with payment to be within 15 days. If not paid, then consumers are subject to disconnect. Accounts are written off when they are deemed to be uncollectible. The allowance for uncollectible accounts is based on the aging of receivables. There were no individual account balances that exceeded 10% of outstanding accounts receivable at December 31, 2013 and 2012.

Propane Plus recognizes revenue when earned, regardless of the period in which they are billed. Propane sales are recognized when deliveries are made; tank rental is recognized monthly; and sales of related accessories at the time of sale.

The Companies are 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. The Company'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.

Propane Inventory Propane is measured at the end of each month and valued based on the current purchase price of propane.

Notes to Financial Statements, continued

Note 1. Summary of Significant Accounting Policies, continued

Propane Purchased Propane Plus purchases all of its propane requirements from an unrelated party through Kentucky Propane Plus, LLC, which is a related party. Propane is delivered to bulk tanks owned by Propane Plus, then delivered to customers on an as needed basis.

Cost of Power Shelby Energy is one of sixteen (16) members of East Kentucky Power Cooperative ("East Kentucky"). Under a wholesale power agreement, Shelby Energy 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. There are certain surcharges, clauses, and credits that East Kentucky includes to Shelby Energy that are passed on to consumers using a methodology prescribed by the Commission.

Utility 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.

Propane Plus's fixed assets consist primarily of propane tanks located on customer's premises, bulk tanks, trucks used for delivery, and buildings and office equipment.

The major classifications of utility plant in service consist of:

	<u>2013</u>	<u>2012</u>
Distribution plant	\$74,664,345	\$72,548,174
General plant	<u>3,727,395</u>	<u>3,643,260</u>
Subtotal electric plant	<u>78,391,740</u>	<u>76,191,434</u>
Propane tanks on customer premises	1,199,724	1,214,180
Bulk tanks	289,898	286,148
Delivery and other trucks	445,908	445,908
Land and buildings	306,990	306,990
Office and other equipment	<u>71,210</u>	<u>71,210</u>
Subtotal propane plant	<u>2,313,730</u>	<u>2,324,436</u>
	<u>\$80,705,470</u>	<u>\$78,515,870</u>

Depreciation Shelby Energy's provision has been made for depreciation on the basis of the estimated lives of assets, using the straight-line method. Distribution plant depreciation is based on a composite rate of 2.98% per annum. General plant rates are as follows:

Structures and improvements	2.5%
Transportation equipment	10% - 20%
Other general plant	5% - 10%

Propane Plus' depreciation is computed using the straight-line method over the useful lives of its assets.

Notes to Financial Statements, continued

Note 1. Summary of Significant Accounting Policies, continued

Management Services Propane Plus is one of four (4) members of a group of propane companies that utilize the abilities of an individual who manages the day to day operations of each propane company and arranges for the purchase of bulk propane. Propane Plus shares the cost equally for the labor, benefits, and other costs of this manager.

Advertising Shelby Energy expenses advertising costs as incurred.

Goodwill The goodwill has been recorded in connection with the purchase of one-half (1/2) of the interest from an unrelated party on June 30, 2000. The excess of the payment price over the value of assets acquired has been recorded as goodwill. Goodwill was tested for impairment and it was determined that goodwill has not been impaired, therefore, there was no amortization for 2013 or 2012.

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 Shelby Energy'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 Shelby Energy. 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.

Shelby Energy may, and also does, invest idle funds in local banks and 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.

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.

Notes to Financial Statements, continued

Note 1. Summary of Significant Accounting Policies, continued

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

Income Tax Status Shelby Energy is exempt from federal and state income taxes under provisions of Section 501(c)(12). Accordingly, the financial statements for Shelby Energy include no provision for income taxes. Income taxes for Service Corporation are provided on income as reported in the accompanying statements regardless of when such taxes are payable. Propane Plus is a limited liability company treated as a partnership for federal income tax purposes. All tax related issues would be passed on to Service Corporation. Propane Plus uses the same depreciation for book and taxes, therefore, deferred taxes are considered immaterial and are not recorded.

Effective January 1, 2008, Shelby Energy adopted the provisions of the *Income Taxes Topic* of the FASB ASC that pertains to accounting for uncertainty in income taxes. Shelby Energy had no prior unrecognized tax benefits as a result of the implementation. Management evaluates its potential exposures from tax positions taken that have or could be challenged by taxing authorities. These potential exposures result because taxing authorities may take positions that differ from those taken by management in the interpretation and application of statutes, regulations, and rules. There are no tax positions for which the ultimate deductibility is highly uncertain included in the accompanying financial statements. Shelby Energy recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. Shelby Energy did not recognize any interest or penalties during the years ended December 31, 2013 or 2012. Shelby Energy'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 February 13, 2014, the date the financial statements were available to be issued. There were no significant subsequent events to report.

Note 2. Investments in Associated Organizations

Investments in associated organizations consist of:

	<u>2013</u>	<u>2012</u>
East Kentucky, patronage capital	\$15,583,612	\$12,942,850
CFC, CTC's	642,126	643,963
CFC, patronage capital	213,981	196,457
CFC, Member capital security	25,000	25,000
Other associated organizations	654,802	623,372
Economic development loans	186,110	229,734
Total	<u>\$17,305,631</u>	<u>\$14,661,376</u>

Notes to Financial Statements, continued

Note 2. Investments in Associated Organizations, continued

Shelby Energy 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.

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, Shelby Energy may distribute the difference between 25% and the payments made to such estates. The equity at December 31, 2013 was 39% of total assets.

Patronage capital consists of:

	<u>2013</u>	<u>2012</u>
Assigned to date	\$36,697,882	\$34,433,558
Assignable margins	3,472,375	2,443,818
Unassigned margins	889,574	711,769
Retirements to date	<u>(6,827,747)</u>	<u>(6,356,714)</u>
Total	<u>\$34,232,084</u>	<u>\$31,232,431</u>

Note 4. 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. Long term debt consists of:

	<u>2013</u>	<u>2012</u>
RUS, 1.98% to 6.0%	\$19,163,462	\$19,635,416
FFB, 0.02% to 5.3%	21,859,459	17,439,829
CFC:		
3.20% to 6.65% notes	2,900,328	3,080,936
Refinance RUS loans 3.0% to 5.05%	<u>2,577,726</u>	<u>2,869,399</u>
	46,500,975	43,025,580
Less current portion	<u>1,625,000</u>	<u>1,400,000</u>
Long term portion	<u>\$44,875,975</u>	<u>\$41,625,580</u>

The interest rates on the notes to CFC are subject to repricing at various dates for each individual note. The long term debt is due in quarterly and monthly installments of varying amounts through 2039. RUS assesses 12.5 basis points to administer the FFB loans. At December 31, 2013, there was \$2,000,000 of FFB loan funds unadvanced. During 2011, Shelby Energy refinanced \$3,154,070 of higher interest rate loans from RUS with funds from CFC.

As of December 31, 2013, the annual principal payments for the next five years are as follows: 2014 - \$1,625,000; 2015 - \$1,650,000; 2016 - \$1,675,000; 2017 - \$1,700,000; 2018 - \$1,725,000.

Notes to Financial Statements, continued

Note 5. Note Payable to Related Party

On September 12, 2000, East Kentucky issued a "Commercial Note With Guaranty" in the amount of \$1,061,193 to Propane Plus. The interest rate is variable, with the rate being the "Index Rate" as published in the Wall Street Journal, minus one-half (1/2) percent. The rate as of December 31, 2013 was 2.75% and at 2012 was 2.75%.

As of December 31, 2013, the annual principal payments for the next five years are as follows: 2014 - \$125,000; 2015 - \$76,685; 2016 - none.

Note 7. Short Term Borrowings

At December 31, 2013, Shelby Energy had a short term line of credit of \$6,000,000 available from CFC of which \$943,456 was advanced at an interest rate of 2.90%.

Propane Plus advanced funds from Service Corporation in the amount of \$110,000 and \$130,000 at December 31, 2013 and 2012, respectively, using the "Federal Fund" interest rate of 2.25% at December 31, 2013 and 2012.

Note 8. Pension Plan

All eligible employees of Shelby Energy 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 September 2, 2009. Non-eligible employees are those hired after September 2, 2009. 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.

Shelby Energy'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. Shelby Energy made contributions to the plan of \$362,085 in 2013 and \$327,596 in 2012. There have been no significant changes that affect the comparability of 2013 and 2012. Employees hired after September 2, 2009 can only participate in the NRECA 401(k) plan. Shelby Energy will contribute 6% of base wages, plus it will match the employee contribution up to an additional 4%. Employer contributions to the 401(k) plan amounted to \$83,280 for 2013 and \$39,855 for 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, continued

Note 8. 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 \$810,566 to the R&S Plan. The amount was expensed during the current year.

Propane Plus has a profit sharing plan of 10% of net profits before the pension amount, where managers receive 5% of the plan amount and the remaining employees sharing 5%. The pension amount for 2013 was \$8,204 and 2012 was \$7,962.

Note 9. Postretirement Benefits

Shelby Energy sponsors a defined benefit plan that provides medical insurance coverage to retired employees hired prior to July 1, 1996. Employees hired after July 1, 1996 are not eligible to participate. The plan calls for benefits to be paid at retirement based primarily upon years of service with Shelby Energy. The following is a reconciliation of the postretirement obligation.

The discount rate used in determining the APBO was 5.5% for 2013 and 6.0% for 2012. The health care cost trend rate used to compute the APBO in an 8% annual rate of increase for 2013, and decreasing gradually to 5.5%, then remain at that level thereafter.

Notes to Financial Statements, continued

Note 9. Postretirement Benefits, continued

The funded status of the plan is as follows:

	<u>2013</u>	<u>2012</u>
Projected benefit obligation	(\$1,989,227)	(\$1,953,695)
Plan assets at fair value	-	-
Total	<u>(\$1,989,227)</u>	<u>(\$1,953,695)</u>

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

	<u>2013</u>	<u>2012</u>
Benefit obligation at beginning of year	<u>\$1,953,695</u>	<u>\$1,926,323</u>
Components of net periodic benefit cost:		
Service cost	60,294	61,867
Interest cost	<u>98,573</u>	<u>97,000</u>
Net periodic benefit cost	158,867	158,867
Benefits paid	(123,335)	(131,495)
Adjustments	-	-
Benefit obligation at end of year	<u>\$1,989,227</u>	<u>\$1,953,695</u>

Projected retiree benefit payments for the next five years are expected to be as follows: 2014 - \$120,000; 2015 - \$115,000; 2016 - \$110,000; 2017 - \$95,000; 2018 - \$94,000.

Note 10. Lease

Shelby Energy leases space for its branch office from an unrelated party. The lease, dated October 31, 2013, is for a period of 5 years, with a renewal option for 5 additional years. This is an operating lease with monthly payments of \$525 per month.

Note 11. Commitments

Shelby Energy has various other agreements outstanding with local contractors. Under these agreements, the contractors will perform certain construction, maintenance, and other 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. Related Party Transactions

Several of the Directors of Shelby Energy, its President & CEO, and another employee are on the boards of directors of various associated organizations.

Note 13. Labor Force

Approximately 35% of Shelby Energy's labor force is subject to a collective bargaining agreement. A three (3) year agreement was negotiated and approved for the period starting September, 2012 between Shelby Energy and the International Brotherhood of Electric Workers ("IBEW").

Notes to Financial Statements, continued

Note 14. Environmental Contingency

Shelby Energy 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 Shelby Energy 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 Shelby Energy's financial position or its future cash flows.

Note 15. Contingencies

Shelby Energy, 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 final outcome will not have a material adverse effect on the financial statements.

* * * * *

ADDITIONAL CONSOLIDATING INFORMATION

Independent Auditor's Report

To the Board of Directors
Shelby Energy Cooperative

My report on the audits of the consolidated financial statements of Shelby Energy Cooperative and Subsidiary as of December 31, 2013 and 2012, and for the years then ended appears on page 1 - 2. My audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The consolidating information 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. The supplementary consolidating information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and, in my opinion, is fairly stated, in all material respects, in relation to the basic consolidated financial statements taken as a whole.

Alan Zumstein

Alan M. Zumstein, CPA
February 13, 2014

Shelby Energy Cooperative and Subsidiary
Consolidating Balance Sheet, December 31, 2013

<u>Assets</u>	<u>Energy</u>	<u>Services</u>	<u>Propane</u>	<u>Eliminations</u>	<u>Consolidated</u>
Utility Plant, at original cost:					
In service	\$78,391,740		\$2,313,730		\$80,705,470
Under construction	1,886,241				1,886,241
	80,277,981		2,313,730		82,591,711
Less accumulated depreciation	15,488,662		1,199,495		16,688,157
	64,789,319		1,114,235		65,903,554
Investments and Other Assets:					
Associated organizations	17,305,631				17,305,631
Goodwill, net of amortization			368,414		368,414
Subsidiary	1,457,496	1,801,867		(3,259,363)	-
	18,763,127	1,801,867	368,414	(3,259,363)	17,674,045
Current Assets:					
Cash and cash equivalents	1,969,357	30,028	490,843		2,490,228
Accounts receivable, less allowance for Energy of \$432,054 and Propane of \$7,245	4,415,371	110,000	184,394	(112,192)	4,597,573
Material and supplies, at average cost	429,320		42,475		471,795
Prepayments	280,474		16,618		297,092
	7,094,522	140,028	734,330	(112,192)	7,856,688
Deferred charges					-
Total	\$90,646,968	\$1,941,895	\$2,216,979	(\$3,371,555)	\$91,434,287
<u>Members' Equities and Liabilities</u>					
Members' and Stockholder's Equities:					
Capital investment		\$1,379,000	\$860,941	(\$2,239,941)	\$0
Patronage capital and retained earnings	34,232,084	78,496	941,033	(1,019,529)	34,232,084
Minority interests and other equities	1,550,184	482,207		107	2,032,498
Accum other comprehensive income	(306,833)				(306,833)
	35,475,435	1,939,703	1,801,974	(3,259,363)	35,957,749
Long Term Debt	44,875,975		76,685		44,952,660
Accumulated Postretirement Benefits	1,989,227				1,989,227
Current Liabilities:					
Accounts payable	3,599,773	2,192	103,320	(2,192)	3,703,093
Short term borrowings	943,456		110,000	(110,000)	943,456
Current portion of long term debt	1,625,000		125,000		1,750,000
Consumer deposits	1,249,198				1,249,198
Accrued expenses	351,916				351,916
	7,769,343	2,192	338,320	(112,192)	7,997,663
Consumer Advances for Construction	536,988				536,988
Total	\$90,646,968	\$1,941,895	\$2,216,979	(\$3,371,555)	\$91,434,287

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

Consolidating Statement of Revenue and Comprehensive Income
for the year ended December 31, 2013

	<u>Energy</u>	<u>Services</u>	<u>Propane</u>	<u>Eliminations</u>	<u>Consolidated</u>
Operating Revenues	<u>\$43,961,520</u>		<u>\$2,082,166</u>		<u>\$46,043,686</u>
Operating Expenses:					
Cost of purchases	33,538,636		1,077,508		34,616,144
Distribution - operations	1,452,191		349,807		1,801,998
Distribution - maintenance	1,879,052				1,879,052
Consumer accounts	634,311		89,579		723,890
Customer service and information	483,035				483,035
Sales	(8,118)				(8,118)
Administrative and general	1,057,067	6,482	102,530		1,166,079
Depreciation, excluding \$128,729 charged to clearing accounts	2,516,331		86,023		2,602,354
Taxes	46,330		16,343		62,673
Other	5,391				5,391
	<u>41,604,226</u>	<u>6,482</u>	<u>1,721,790</u>		<u>43,332,498</u>
Operating Margins before Interest Charges	<u>2,357,294</u>	<u>(6,482)</u>	<u>360,376</u>		<u>2,711,188</u>
Interest Charges:					
Interest on long term debt	1,719,403		11,047		1,730,450
Other interest	36,767				36,767
	<u>1,756,170</u>		<u>11,047</u>		<u>1,767,217</u>
Operating Margins after Interest Charges	<u>601,124</u>	<u>(6,482)</u>	<u>349,329</u>		<u>943,971</u>
Patronage Capital assigned from:					
East Kentucky Power Cooperative	2,640,762				2,640,762
Other organizations	84,543				84,543
	<u>2,725,305</u>				<u>2,725,305</u>
Nonoperating Margins:					
Interest income	33,507	2,622	250		36,379
Subsidiary and others	112,439	354,373	4,794	(618,509)	(146,903)
	<u>145,946</u>	<u>356,995</u>	<u>5,044</u>	<u>(618,509)</u>	<u>(110,524)</u>
Net Margins	<u>3,472,375</u>	<u>350,513</u>	<u>354,373</u>	<u>(618,509)</u>	<u>3,558,752</u>
Other comprehensive Income:					
Postretirement benefits	22,441				22,441
Noncontrolling interests		(90,237)		3,860	(86,377)
Total Comprehensive Income	<u>\$3,494,816</u>	<u>\$260,276</u>	<u>\$354,373</u>	<u>(\$614,649)</u>	<u>\$3,494,816</u>

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

SUPPLEMENTARY INFORMATION

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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
Shelby Energy 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 Shelby Energy Cooperative, which comprise the balance sheets as of December 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 February 13, 2014.

Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing my audit, I considered Shelby Energy'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 Shelby Energy's internal control over financial reporting. Accordingly, I do not express an opinion on the effectiveness of Shelby Energy'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
Shelby Energy Cooperative - 2

Compliance and Other Matters

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

Purpose of this Report

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

Alan Zumstein

Alan M. Zumstein, CPA
February 13, 2014

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

Board of Directors
Shelby Energy Cooperative

Independent Auditor's Report

I have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Shelby Energy Cooperative ("the Cooperative"), which comprise the balance sheet as of December 31, 2013, and the related statements of revenue and comprehensive income, patronage capital, and changes in cash flows for the year then ended, and the related notes to the financial statements, and have issued my report thereon dated February 13, 2014. In accordance with *Government Auditing Standards*, we have also issued my report dated February 13, 2014, on my consideration of the Cooperative's internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. No reports other than the reports referred to above and my schedule of findings and recommendations related to my audit have been furnished to management.

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

- Maintain adequate and effective accounting procedures;
- Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts;
- Reconcile continuing property records to the controlling general ledger plant accounts;
- Clear construction accounts and accrue depreciation on completed construction;
- Record and properly price the retirement of plant;
- Seek approval of the sale, lease, or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap;
- Maintain adequate control over material and supplies;

Board of Directors
Shelby Energy Cooperative - 2

- Prepare accurate and timely Financial and Operating Reports;
- Obtain written RUS approval to enter into any contract for the management, operation, or maintenance of the borrower's system if the contract covers all or substantially all of the electric system;
- Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles;
- Record depreciation in accordance with RUS requirements ("See RUS Bulletin 183-1, Depreciation Rates and Procedures");
- Comply with the requirements for the detailed schedule of deferred debits and deferred credits; and
- Comply with the requirements for the detailed schedule of investments.

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

Alan Zumstein

Alan M. Zumstein, CPA
February 13, 2014

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To the Board of Directors
Shelby Energy Cooperative

I have audited the financial statements of Shelby Energy Cooperative for the year ended December 31, 2013, and have issued my report thereon dated February 13, 2014. 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 Shelby Energy for the year ended December 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 February 13, 2014, or summary of recommendations related to my audit have been furnished to management.

To the Board of Directors
Shelby Energy 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 December 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, 2013.

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 *Financial and Operating Report Electric Distribution*, as of December 31, 2013, 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 Shelby Energy, nothing came to my attention that caused me to believe that Shelby Energy 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);
- The clearing of the construction accounts and the accrual of depreciation on completed construction addressed at 7 CFR Part 1773.33(c)(2)

To the Board of Directors
Shelby Energy Cooperative - 3

- 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 December 31, 2012, 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.

Consumer advances for construction	<u>\$536,988</u>
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Shelby Energy is a 75% owner of a subsidiary, Shelby Energy Services Corporation, which is engaged in the distribution sales of propane gas through a limited liability company (LLC) in and around the areas in which Shelby Energy provides electric service. The investment is accounted for using the equity method of accounting. The original investment was \$7,500. The investment is as follows:

	<u>Investment</u>	<u>Profits</u>
Balance, beginning of year	\$1,379,000	(\$185,640)
Activity for 2013	<u>-</u>	<u>264,136</u>
Balance, end of year	<u>\$1,379,000</u>	<u>\$78,496</u>

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 Zumstein

Alan M. Zumstein, CPA
February 13, 2014