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Shelby Energy Cooperative, Inc.
and Subsidiary

Shelbyville, Kentucky

Audited Financial Statements
December 31, 2014 and 2013

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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, 2014 and 2013, 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.

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, 2014 and 2013, 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, 2015, 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.

Report on Supplemental Information

My audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included in the consolidated financial statements is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and related directly to underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In my opinion, the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Alan Zumstein

Alan M. Zumstein, CPA
February 13, 2015

Shelby Energy Cooperative and Subsidiary
Consolidated Balance Sheets, December 31, 2014 and 2013

Assets	2014	2013
Utility Plant, at original cost:		
In service	$ 85,976,010	$ 80,705,470
Under construction	760,075	1,886,241
	86,736,085	82,591,711
Less accumulated depreciation	18,041,406	16,688,157
	68,694,679	65,903,554
Investments		
Associated organizations	19,900,873	17,305,631
Goodwill, net of amortization	368,414	368,414
	20,269,287	17,674,045
Current Assets:		
Cash and cash equivalents	2,825,075	2,490,228
Accounts receivable, less allowance for 2014 of $502,611 and 2013 of $439,299	4,244,344	4,597,573
Material and supplies, at average cost	624,650	471,795
Prepayments and other current assets	241,728	297,092
	7,935,797	7,856,688
Deferred Charge	-	-
Total	$ 96,899,763	$ 91,434,287
Members' Equities and Liabilities		
Members' Equities:		
Patronage capital and retained earnings	$ 36,730,211	$ 34,232,084
Other equities and minority interests	2,557,702	2,032,498
Accumulated other comprehensive income	(220,780)	(306,833)
	39,067,133	35,957,749
Long Term Debt	45,305,359	44,952,660
Accumulated Postretirement Benefits	1,970,182	1,989,227
Current Liabilities:		
Accounts payable	3,532,708	3,703,093
Short term borrowings	2,934,118	943,456
Current portion of long term debt	1,700,328	1,750,000
Consumer deposits	1,517,534	1,249,198
Accrued expenses	395,049	351,916
	10,079,737	7,997,663
Consumer Advances for Construction	477,352	536,988
Total	$ 96,899,763	$ 91,434,287

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

Consolidated Statements of Revenue and Comprehensive Income
for the years ended December 31, 2014 and 2013

	2014	2013
Operating Revenues	$ 48,031,677	$ 46,043,686
Operating Expenses:		
Cost of power and propane	36,432,399	34,616,144
Distribution - operations	1,809,657	1,801,998
Distribution - maintenance	2,108,820	1,879,052
Consumer accounts	760,117	723,890
Customer service and information	437,118	483,035
Sales	(41,634)	(8,118)
Administrative and general	1,228,651	1,166,079
Depreciation, excluding $141,651 in 2014 and $128,729 in 2013 charged to clearing accounts	2,420,711	2,602,354
Taxes	185,762	62,673
Other	15,214	5,391
	45,356,815	43,332,498
Operating Margins before Interest Charges	2,674,862	2,711,188
Interest Charges:		
Interest on long-term debt	1,663,552	1,730,450
Other interest	28,933	36,767
	1,692,485	1,767,217
Operating Margins after Interest Charges	982,377	943,971
Patronage Capital assigned from:		
East Kentucky Power Cooperative, Inc.	2,305,926	2,640,762
Other organizations	72,480	84,543
	2,378,406	2,725,305
Nonoperating Margins:		
Interest income	66,708	36,379
Subsidiary and others	(103,126)	(146,903)
	(36,418)	(110,524)
Net Margins	3,324,365	3,558,752
Other Comprehensive Income:		
Postretirement benefits	86,053	22,441
Noncontrolling interests	(55,756)	(86,377)
Total Comprehensive Income	$ 3,354,662	$ 3,494,816

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

Statements of Changes in Members' Equity
for the years ended December 31, 2013 and 2014

	Patronage Capital	Other Equity	Accumulated Other Comprehensive Income	Total Members' Equity
Balance - Beginning of year	$ 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
Comprehensive income:				
Net margins	3,324,365			3,324,365
Postretirement benefit obligation				
Amortization			86,053	
Adjustments			-	86,053
Total comprehensive income				3,410,418
Refunds of capital credits	(499,051)			(499,051)
Transfers to other equity and minority interests	36,148			36,148
Other equities	(363,335)	525,204		161,869
Balance - December 31, 2014	$ 36,730,211	$ 2,557,702	$ (220,780)	$ 39,067,133

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

Consolidated Statements of Cash Flows
for the years ended December 31, 2014 and 2013

	2014	2013
Cash Flows from Operating Activities:		
Net margins	$ 3,360,513	$ 3,472,375
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation		
Charged to expense	2,420,711	2,602,354
Charged to clearing accounts	141,651	128,729
Patronage capital credits	(2,378,406)	(2,725,305)
Accumulated postretirement benefits	67,008	57,973
Change in assets and liabilities:		
Receivables	351,730	(212,276)
Material and supplies	(152,855)	25,242
Prepayments	55,364	439,559
Payables	(147,789)	207,819
Consumer deposits	268,336	3,623
Accrued expenses and accumulated benefits	43,133	(18,935)
Consumer advances for construction	(59,636)	(397,560)
	3,969,760	3,583,598
Cash Flows from Investing Activities:		
Plant additions	(4,985,641)	(3,674,397)
Salvage, net of removal costs	(367,845)	(189,657)
Other investments, net	(157,220)	167,427
	(5,510,707)	(3,696,628)
Cash Flows from Financing Activities:		
Other equities and minority interests	514,491	166,161
Additional long term borrowings	2,000,000	5,000,000
Short term borrowings (repayments)	1,920,662	(2,363,860)
Payments on long term debt	(1,696,973)	(1,647,602)
Retirement of patronage capital	(862,386)	(472,722)
Invest in cushion of credit	-	63
	1,875,794	682,040
Net increase in cash	334,847	569,010
Cash balances - beginning of period	2,490,228	1,921,218
Cash balances - end of period	$ 2,825,075	$ 2,490,228
Supplemental cash flows information:		
Interest paid on long term debt	$1,663,553	$1,730,957

The accompanying notes are an integral part of the 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 $200,466 and $430,895, for 2014 and 2013, respectively. At December 31, 2014, Shelby Energy had $449,476 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, 2014, 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, 2014 and 2013.

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.

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:

	2014	2013
Distribution plant	$79,812,477	$74,664,345
General plant	3,883,016	3,727,395
Subtotal electric plant	83,695,493	78,391,740
Propane tanks on customer premises	1,068,764	1,199,724
Bulk tanks	306,940	289,898
Delivery and other trucks	535,739	445,908
Land and buildings	306,990	306,990
Office and other equipment	62,084	71,210
Subtotal propane plant	2,280,517	2,313,730
	$85,976,010	$80,705,470

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.

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 2014 or 2013.

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.

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, 2014 or 2013. Shelby Energy's income tax return is subject to possible examination by taxing authorities until the expiration of related statues 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, 2015, 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:

	2014	2013
East Kentucky, patronage capital	$17,889,538	$15,583,612
CFC, CTC's	640,165	642,126
CFC, patronage capital	227,068	213,981
CFC, Member capital security	25,000	25,000
Other associated organizations	669,626	654,802
Economic development loans	449,476	186,110
Total	$19,900,873	$17,305,631

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.

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Note 3. Patronage Capital

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Snow storms

Under provisions of the long-te ... ontributed by them is limited to amounts which would ... ian 30% of total assets, except that distributions may b ... t agreement provides, however, that should such distrib ... for the next preceding year, Shelby Energy may distrib ... made to such estates. The equity at December 31, 2014 ... of:

		013
Assigned to date		84,101
Assignable margins		72,375
Unassigned margins		89,574
Retirements to date		3,966)
Total	$36,730,211	$34,232,084

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:

	2014	2013
RUS, 0.625% to 6.0%	$18,669,837	$19,163,462
FFB, 0.02% to 5.3%	23,191,290	21,859,459
CFC:		
3.20% to 6.65% notes	2,732,137	2,900,328
Refinance RUS loans 3.25% to 5.05%	2,337,095	2,577,726
	46,930,359	46,500,975
Less current portion	1,625,000	1,625,000
Long term portion	$45,305,359	$44,875,975

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, 2014, there was $20,000,000 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, 2014, the annual principal payments for the next five years are as follows: 2015 - $1,625,000; 2016 - $1,650,000; 2017 - $1,675,000; 2018 - $1,700,000; 2019 - $1,725,000.

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, 2014 was 2.75% and at 2013 was 2.75%.

As of December 31, 2014, the annual principal payments for the next five years are as follows: 2015 - $75,328; 2016 - none.

Note 7. Short Term Borrowings

At December 31, 2014, Shelby Energy had a short term line of credit of $6,000,000 available from CFC of which $2,934,118 was advanced at an interest rate of 2.90%.

Propane Plus advanced funds from Service Corporation in the amount of $40,000 and $110,000 at December 31, 2014 and 2013, respectively, using the "Federal Fund" interest rate of 2.25% at December 31, 2014 and 2013.

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 2014 and 2013 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 $272,407 in 2014 and $362,085 in 2013. There have been no significant changes that affect the comparability of 2014 and 2013. 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 $78,382 for 2014 and $83,280 for 2013.

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, 2014 and 2013 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.

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.

Note 8. Pension Plan, continued

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 choses 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 2014 was $8,296 and 2013 was $8,204.

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 5.0% for 2014 and 2013. The health care cost trend rate used to compute the APBO in an 8% annual rate of increase for 2014, and decreasing gradually to 5.5%, then remain at that level thereafter.

Projected retiree benefit payments for the next five years are expected to be as follows: 2015 - $120,000; 2016 - $115,000; 2017 - $110,000; 2018 - $95,000; 2019 - $94,000.

The funded status of the plan is as follows:

	2014	2013
Projected benefit obligation	($1,970,182)	($1,989,227)
Plan assets at fair value	-	-
Total	($1,970,182)	($1,989,227)

Note 9. Postretirement Benefits, continued

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

	2014	2013
Benefit obligation at beginning of year	$1,989,227	$1,953,695
Components of net periodic benefit cost:		
Service cost	59,882	60,294
Interest cost	98,985	98,573
Net periodic benefit cost	158,867	158,867
Benefits paid	(177,912)	(123,335)
Adjustments	-	-
Benefit obligation at end of year	$1,970,182	$1,989,227

Note 10. 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 11. 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 12. 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, 2013 between Shelby Energy and the International Brotherhood of Electric Workers ("IBEW").

Note 13. 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 14. 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.

* * * * *

Shelby Energy Cooperative and Subsidiary
Consolidating Balance Sheet, December 31, 2014

	Energy	Services	Propane	Eliminations	Consolidated
Utility Plant, at original cost:					
In service	$83,695,493		$2,280,517		$85,976,010
Under construction	760,075				760,075
	84,455,568		2,280,517		86,736,085
Less accumulated depreciation	16,910,364		1,131,042		18,041,406
	67,545,204		1,149,475		68,694,679
Investments and Other Assets:					
Associated organizations	19,900,873				19,900,873
Goodwill, net of amortization			368,414		368,414
Subsidiary	1,625,472	2,037,218		(3,662,690)	-
	21,526,345	2,037,218	368,414	(3,662,690)	20,269,287
Current Assets:					
Cash and cash equivalents	2,355,731	93,028	376,316		2,825,075
Accounts receivable, less allowance for Energy of $490,611 and Propane of $12,000	4,043,905	40,338	203,390	(43,289)	4,244,344
Material and supplies, at average cost	550,768		73,882		624,650
Prepayments	203,611		38,117		241,728
	7,154,015	133,366	691,705	(43,289)	7,935,797
Deffered charges					-
Total	$96,225,564	$2,170,584	$2,209,594	($3,705,979)	$96,899,763

	Energy	Services	Propane	Eliminations	Consolidated
Members' and Stockholder's Equities:					
Capital investment		$1,379,000	$860,941	($2,239,941)	$0
Patronage capital and retained earnings	36,730,211	246,472	1,175,802	(1,422,274)	36,730,211
Minority interests and other equities	2,016,354	541,823		(475)	2,557,702
Accum other comprehensive income	(220,780)				(220,780)
	38,525,785	2,167,295	2,036,743	(3,662,690)	39,067,133
Long Term Debt	45,305,359		-		45,305,359
Accumulated Postretirement Benefits	1,970,182				1,970,182
Current Liabilities:					
Accounts payable	3,475,185	3,289	57,523	(3,289)	3,532,708
Short term borrowings	2,934,118		40,000	(40,000)	2,934,118
Current portion of long term debt	1,625,000		75,328		1,700,328
Consumer deposits	1,517,534				1,517,534
Accrued expenses	395,049				395,049
	9,946,886	3,289	172,851	(43,289)	10,079,737
Consumer Advances for Construction	477,352				477,352
Total	$96,225,564	$2,170,584	$2,209,594	($3,705,979)	$96,899,763

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

Consolidating Statement of Revenue and Comprehensive Income
for the year ended December 31, 2014

	Energy	Services	Propane	Eliminations	Consolidated
Operating Revenues	$45,771,621		$2,260,056		$48,031,677
Operating Expenses:					
Cost of purchases	35,260,862		1,171,537		36,432,399
Distribution - operations	1,411,500		398,157		1,809,657
Distribution - maintenance	2,108,820				2,108,820
Consumer accounts	658,157		101,960		760,117
Customer service and information	437,118				437,118
Sales	(41,634)				(41,634)
Administrative and general	1,104,495	7,453	116,703		1,228,651
Depreciation, excluding $141,651 charged to clearing accounts	2,332,129		88,582		2,420,711
Taxes	53,080	122,005	10,677		185,762
Other	15,214				15,214
	43,339,741	129,458	1,887,616		45,356,815
Operating Margins before Interest	2,431,880	(129,458)	372,440		2,674,862
Interest Charges:					
Interest on long term debt	1,659,590		3,962		1,663,552
Other interest	28,933				28,933
	1,688,523		3,962		1,692,485
Operating Margins after Interest	743,357	(129,458)	368,478		982,377
Patronage Capital assigned from:					
East Kentucky Power Cooperative	2,305,926				2,305,926
Other organizations	72,480				72,480
	2,378,406				2,378,406
Nonoperating Margins:					
Interest income	64,419	1,699	590		66,708
Subsidiary and others	174,331	355,351	(14,299)	(618,509)	(103,126)
	238,750	357,050	(13,709)	(618,509)	(36,418)
Net Margins	3,360,513	227,592	354,769	(618,509)	3,324,365
Other comprehensive Income:					
Postretirement benefits	86,053				86,053
Noncontrolling interests		(59,616)		3,860	(55,756)
Total Comprehensive Income	$3,446,566	$167,976	$354,769	($614,649)	$3,354,662

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

ALAN M. ZUMSTEIN
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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, 2014 and 2013, and the related statements of revenue and comprehensive income, member' 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, 2015.

Internal Control Over Financial Reporting

In planning and performing my audit of the financial statements, I considered Shelby Energy's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, I do not express an opinion on the effectiveness of Shelby Energy's internal control.

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether 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, 2015

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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, 2014, 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, 2015. In accordance with *Government Auditing Standards*, we have also issued my report dated February 13, 2015, 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 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, 2015, 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;
- 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, which are listed below.

The deferred credits are as follows:

Consumer advances for construction	$477,352

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:

	Investment	Profits
Balance, beginning of year	$1,379,000	$78,496
Activity for 2014	-	167,976
Balance, end of year	$1,379,000	$246,472

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, 2015

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February 13, 2015

To the Board of Directors
Shelby Energy Cooperative

I have audited the financial statements of Shelby Energy Cooperative for the year ended December 31, 2014, and have issued my report thereon dated February 13, 2015. Professional standards require that I provide you with the following information related to my audit.

My Responsibility under U.S. Generally Accepted Auditing Standards As stated in my engagement letter, my responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. My audit of the financial statements does not relieve you or management of your responsibilities.

Planned Scope and Timing of the Audit I performed the audit according to the planned scope and timing previously communicated to you in our meeting about planning matters.

Significant Audit Findings There was no significant findings as a result of my audit procedures performed.

Adoption of New Accounting Principles Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of my engagement letter, I will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by Shelby Energy are described in the Notes to the financial statements. During the year ended December 31, 2014, there were no significant new accounting principles adopted.

Unusual Transactions Lacking Authoritative Guidance I noted no transactions entered into by Shelby Energy during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Accounting Estimates Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

Difficulties Encountered in Performing the Audit I encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatement Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. There were no significant audit adjustments required, nor were there any significant uncorrected misstatements not posted into the general ledger of Shelby Energy.

Disagreements with Management For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. I am pleased to report that no such disagreements arose during the course of my audit.

Management Representations I have requested certain representations from management that are included in the management representation letter dated February 13, 2015.

Consultation with Other Accountants In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to Shelby Energy's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, my professional standards require the consulting accountant to check with me to determine that the consultant has all the relevant facts. I did not consult with any outside accountants regarding accounting and auditing issues relevant to Shelby Energy

Other Audit Findings or Issues There were no other audit findings or other issues required by my professional standards to be reported to the audit committee.

This information is intended solely for the use of the Audit Committee, Board of Directors, and management of Shelby Energy and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

Alan Zumstein
Alan M. Zumstein, CPA