2011.12.20 14:23:15
Kansas Corporation Commission
/S/ Patrice Petersen-Klein

Received
on
DEC 2 0 2011
by
State Corporation Commission
of Kansas

BEFORE THE KANSAS CORPORATION COMMISSION
OF THE STATE OF KANSAS

Application for Revised Rates, Tariffs, and Rate Design Changes

of

Mid-Kansas Electric Company, LLC

Docket No. 12-MKEE-380-RTS

December 19, 2011

PREFILED DIRECT TESTIMONY
CHANTRY C. SCOTT
CHIEF FINANCIAL OFFICER – VP OF FINANCE & ACCOUNTING
SOUTHERN PIONEER ELECTRIC COMPANY

ON BEHALF OF
MID-KANSAS ELECTRIC COMPANY, LLC

Q. Please state your name and business address.

A. My name is Chantry C. Scott. My business address is 1850 W. Oklahoma, PO Box 430, Ulysses Kansas 67880-0430.

Q. What is your profession?

A. I am the Chief Financial Officer – VP of Finance & Accounting ("CFO") of Southern Pioneer Electric Company, ("Southern Pioneer"), with its corporate office in Ulysses, Kansas and distribution-customer service offices located in both Liberal and Medicine Lodge, Kansas.

Q. Please describe the business activities of Southern Pioneer.

A. As a Mid-Kansas Electric Company, LLC ("Mid-Kansas") distribution member-system and owner, and pursuant to the July 2, 2007 Electric Customer Service Agreement approved by the Kansas Corporation Commission ("Commission" or "KCC") on December 21, 2007 in Docket No. 08-MKEE-099-MIS, Southern Pioneer provides retail and distribution service to approximately 17,200 retail consumers. Southern Pioneer also provides sub-transmission service to 34.5kV sub-transmission users.

Q. Please describe your responsibilities with Southern Pioneer.

A. As the CFO, I work directly for the President-Chief Executive Officer. I am responsible for assisting in establishing financial policy, implementing Board approved strategic programs, assisting with establishing rates and the overall financial operations of Southern

Pioneer to ensure reliable service at a competitive cost, all while using generally acceptable industry business practices.

Q. What is your educational background?

A. I graduated from the University of Kansas in 2000 with a Bachelor of Science in both Accounting and Business Administration and in 2001 with a Master of Accounting and Information Systems. I attended and completed various industry specific trainings including National Rural Electric Cooperative Association's Financial Planning and Strategies Workshop and the Cooperative Financial Professional Certificate program.

Q. What is your professional background?

A. I began work at Pioneer Electric Cooperative, Inc. ("Pioneer") in June of 2001 as Senior Accountant, where I assisted the Manager of Finance and Administration in completing general accounting activities. In December 2003, I was promoted to Manager of Accounting where I oversaw the Financial Accounting department's activities such as budgeting, financial forecasting, monthly and annual reporting, and various other accounting activities. In May 2011, I was promoted to my current position of Chief Financial Officer and VP of Finance and Accounting at Pioneer. Pursuant to the Services Agreement, dated July 7, 2006 between Pioneer and Southern Pioneer, I was also appointed Southern Pioneer's Chief Financial Officer and VP of Finance and Accounting.

Q. Have you previously presented testimony before the KCC?

A. No, I have not.

Q. What is the purpose of your testimony in this proceeding?

A. The purpose of my testimony is 1) to expand on why Southern Pioneer bought out of Rural Utility Services ("RUS") and refinanced its long-term debt with CoBank, as cited in Mr. Rich Macke's prefiled direct testimony as it relates to the long-term interest expense adjustment, and 2) emphasize the importance the requested rate adjustment, as outlined in the application and other testimony, has in meeting Southern Pioneer's financial goals and minimizing future rate adjustments.

Q. Are you sponsoring any exhibits?

Yes. I am sponsoring the 2010 audited financial statements of Southern Pioneer, which are attached to my testimony as Exhibit CCS-1.

Q. Before expanding on the specifics of the refinancing, please explain what you mean when you say, "bought out of RUS and refinanced its long-term debt with CoBank?"

A. Southern Pioneer's RUS debt was held by the Federal Finance Bank (FFB). On October 17, 2011, the Southern Pioneer Board of Directors authorized and directed Southern Pioneer to pursue refinancing its RUS long-term debt with CoBank.

Q. Did Southern Pioneer subsequently refinance its debt with CoBank?

A. Yes. On October 24, 2011, Southern Pioneer closed on a new $84,688,239 loan from CoBank, which was used to buy out of its long-term debt obligations with RUS, pay off its existing operating line of credit with CoBank, and established available funds for continuing necessary capital construction projects as specified in Southern Pioneer's construction work plan. The construction work plan, which is required and approved by RUS, lists the construction projects identified by Southern Pioneer and professional engineers as needed to provide efficient and reliable service to its consumers. Since RUS is no longer one of Southern Pioneer's lenders, the construction work plan is not required; however, Southern Pioneer will continue to perform this essential planning function to ensure continued reliability and safety for our consumers.

Q. Please explain why Southern Pioneer bought out of RUS?

A. There were two primary reasons why Southern Pioneer bought out of RUS. The first is the uncertainty of future RUS funding, and the second is the negative impact of RUS' prolonged approval process for construction work plan loans and other associated activities.

Q. Please clarify the uncertainty of RUS funding going forward?

A. RUS is a federally funded agency that is dependent upon receiving allocations annually from Congress. Prior administrations have attempted to eliminate allocations to RUS to trim government spending and, coupled with the down economy and increasing national deficit, RUS funding may be constrained in future years. This funding uncertainty, especially in a capital-intensive utility environment, has caused Southern Pioneer to re-evaluate its borrowing practices and choose a lender not solely dependent upon government financing.

Q. How has RUS' prolonged approval process for construction work plan loans affected Southern Pioneer?

A. Southern Pioneer received from Mid-Kansas its distribution and sub-transmission assets on April 1, 2007, in accordance with the Commission's approval of the Mid-Kansas acquisition of the Aquila properties in Docket No.06-MKEE-524-ACQ. At that time, it was anticipated that Southern Pioneer would invest in excess of 50 million dollars over a four (4) year period to address the age and condition of the facilities, support growth on the system, and to comply with National Electric Safety Code and other standards at both the distribution and sub-transmission level. The need for these investments were subsequently supported by a professional engineer who prepared Southern Pioneer's construction work plan.

Due to the capital-intensive nature of the utility industry and the required system improvements or replacements needed on the Southern Pioneer facilities, as identified in the construction work plan, Southern Pioneer prepared and submitted a loan application in the amount of $30,000,000 to RUS to finance, in part, these needed improvements. The loan application was submitted to the RUS on August 25, 2010, and the RUS did not provide loan documents to Southern Pioneer to execute until April 1, 2011, eight months after the submission. Even then, the RUS approved loan funds would not be available to Southern Pioneer until the RUS received satisfactory evidence that the loan documents had been duly executed and filed, a process that can take months or more. In addition, RUS borrowers are required to complete the individual projects identified in the construction work plan with internally generated funds or lines of credit prior to receiving loan funds from RUS. After each project is completed, and inspected by a professional engineer, the borrower is allowed to draw funds on an approved RUS loan. As a result, needed construction projects may be delayed further due to insufficient cash from operations or lines of credit.

In comparison, Southern Pioneer also submitted a similar loan application in the amount of $21,000,000 to CoBank while its application to the RUS was pending. CoBank began the review and approval process on March 7, 2011, after receiving a lien accommodation from RUS. CoBank gave credit approval on April 8, 2011. It completed the loan documents, including a new supplemental mortgage, and made funds available to Southern Pioneer by May 25, 2011, within three months of receiving the request.

As you can see, the timeframe to process the two similar loan applications by the two lenders (RUS and CoBank) and make the loan funds available is substantially different. RUS' protracted approval directly affects Southern Pioneer's ability to provide reliable service and mitigate risks, and it served as the primary reason underlying Southern Pioneer's decision to buy out of RUS.

Q. You indicate that RUS' prolonged approval process affected other associated areas other than loan approval. Please describe?

A. As a RUS borrower using a secondary lender such as CoBank, Southern Pioneer was required to seek various RUS approvals and lien accommodations prior to incurring additional non-RUS debt or expanding its non-RUS operating line of credit. This non-RUS credit was needed to finance infrastructure rebuild and other work until such time as long-term loan funds could be obtained. Because of RUS' numerous levels of approval and the additional time required to receive such approvals before increasing the operating line of credit or receiving long-term funds, Southern Pioneer's cash flow was severely restricted, construction projects were stalled or deferred, and ultimately our customers suffered as a result of receiving less than reliable service from an aging infrastructure and increased material and borrowing cost.

Q. Rather than buying out of RUS to eliminate the approval delays, could Southern Pioneer simply have changed lenders for future construction projects?

A. No. As long as Southern Pioneer has RUS debt, it would be subject to all of the required RUS approvals as defined in the loan covenants and federal regulations, even though it may not be seeking RUS loan funds.

Q. As the CFO, please explain why the requested rate adjustment and implementation of the Debt Service Coverage ("DSC") Ratemaking Plan, as proposed by Mr. Macke and Mr. Epperson, is critical to meeting Southern Pioneer's financial goals and minimizing the impact of future rate adjustments for the customers of the Mid-Kansas Southern Pioneer Division.

A. As a condition of past and future borrowing from Southern Pioneer's only lender, CoBank, Southern Pioneer is contractually obligated, through the executed CoBank-Southern Pioneer Master Loan Agreement and any amendments or additions thereto, to generate adequate margins to meet the various loan covenants and financial ratios contained therein. Since Southern Pioneer's only major source of revenue available to repay debt comes from rates, the rates charged must be adequate to generate the margins necessary to satisfy these covenants and respective ratios at any given time.

Q. Based on this obligation, are the current Commission approved rates in place and charged to customers adequate to consistently generate the margins necessary to meet the loan covenants and ratios as defined by CoBank?

A. No, they are not. As Mr. Macke and Mr. Epperson have each testified, because the rate adjustment for the Mid-Kansas Southern Pioneer Division in the first Mid-Kansas rate case[1] was a negotiated ten percent as opposed to the requested sixteen percent, this compromise amount, when coupled with Southern Pioneer's near zero equity (due to the acquisition being 100% financed with debt), has resulted in Southern Pioneer not consistently meeting the minimum loan covenants under the CoBank loan agreement. Projections establish that this will continue to be the case in the future under our present rates. As such, Southern Pioneer is unable to successfully work towards systematically building adequate equity, something all stakeholders should agree is in the best interests of our customers as it will allow us to borrow in the future as a stand-along company at possibly better or more favorable rates, and so that the company will have adequate capital to make necessary investments, meet operational demands, and make the necessary debt service payments to our lender.

[1] Docket No. 09-MKEE-969-RTS

Q. Please identify the ratios that are affected by the existing rates?

A. Specifically, when looking at lender requirements, Equity to Total Assets and DSC are the two main ratios that have been impacted by the inadequate level of rates presently being charged by Southern Pioneer.

Q. Please explain the DSC ratios presented by Mid-Kansas in this case for use under the proposed DSC Ratemaking Plan.

A. Most financial lenders model loan covenants after established industry standards as it relates to minimum levels of equity and DSC. These covenants are not meant to be target levels for the borrowers, but represent minimum thresholds needed to preserve the borrower's financial health and ability to repay borrowed funds. Furthermore, the established minimum DSC level does not take into consideration what may be needed to maintain and grow equity. Mr. Macke, in his prefiled testimony, has outlined and summarized national and state median DSC levels compared to (1) Southern Pioneer's existing test year-end actual DSC level, (2) the 1.35 DSC level required by CoBank, which will apply if the requested DSC Ratemaking Plan is not approved by the Commission , and (3) Southern Pioneer's long-term equity to total asset targets.

Q. You indicate that Southern Pioneer's DSC level is normally 1.35. One, how does Southern Pioneer's lender, CoBank, define DSC and two, should the Commission approve the DSC Ratemaking Plan as part of this application, what will be the DSC levels going forward?

A. The minimum DSC schedule, as defined by CoBank, and starting in 2012 without approving

DSC Ratemaking Plan is as follows:

> **8.1 Debt Service Coverage Ratio.** The Company (on both a consolidated and an unconsolidated basis) will have at the end of each fiscal quarter of the Company set forth below, a Debt Service Coverage Ratio for the twelve month period ending with the end of such quarter of not less than the ratio set forth next to such quarter:

FISCAL QUARTER ENDING:	REQUIRED RATIO (Equal to or greater than)
12/31/2011	1.05
12/31/2012 and each fiscal quarter thereafter	1.35

Should the Commission approve the DSC Ratemaking Plan as requested in the application, upon Southern Pioneer providing notice to CoBank and a copy of the Commission's final order approving the DSC Ratemaking Plan, the minimum DSC schedule will be as follows:

> Notwithstanding the foregoing, in the event the Kansas Corporation Commission approves new ratemaking methodology based upon the Company's Debt Service Coverage Ratio, then in lieu of the Debt Service Coverage Ratio required above for the fiscal quarter ending on December 31, 2012 and each fiscal quarter thereafter, the Company shall have the following Debt Service Coverage Ratios for such quarters:

FISCAL QUARTER ENDING:	REQUIRED RATIO (Equal to or greater than)
12/31/2012	1.00
3/31/2013 and 6/30/2013	1.10
9/30/2013 and 12/31/2013	1.25
3/31/2014 through 12/31/2015	1.35
3/31/2016 and each fiscal quarter thereafter	1.50

> In the event the Kansas Corporation Commission approves such new ratemaking methodology, then the Company shall furnish written notice thereof to CoBank together with a copy of the order approving the new methodology.

Q. Why is this graduated scale used as opposed to the traditional 1.35 ratio, and is this DSC Ratemaking Plan methodology a departure from sound business planning on the part of CoBank and or Southern Pioneer?

A. First, let me reiterate that the values listed are minimums, not a ceiling, and it is typical for a utility to operate at a DSC and equity level in excess of these minimums so that the utility can efficiently and effectively respond to contingencies in fluctuating sales and unexpected costs. If the utility set its goals using only the minimum levels, and these inevitable fluctuations occur, then the utility would certainly fail to meet the covenants and would be in default unless cured through adjusting rates. Unfortunately, this impact and immediate need to correct is amplified significantly for companies such as Southern Pioneer that have little or no equity and require regulatory approval for rate increases.

Second, one of primary goals of this application is to create financial certainty for lenders while at the same time minimizing the magnitude of current and future rate adjustments for the consumer. These two components do not always go hand-in-hand, but Southern Pioneer and CoBank believe they have worked together to design such a vehicle.

Q. Please explain.

A. Southern Pioneer and CoBank have closely evaluated Southern Pioneer's historical financial performance (or the lack thereof), have identified the current and future drivers of required rate adjustments to provide service, and have addressed capital and operating needs. CoBank and Southern Pioneer have agreed that incremental DSC and equity targets bring certainty to CoBank that over a definitive period of time, Southern Pioneer will achieve acceptable industry level financial health without unnecessarily exposing CoBank to risks. At the same time, because the DSC Ratemaking Plan sets the DSC and equity targets at a lower level initially than they would have been absent the Plan, and then gradually increases them over time to improve the overall financial health of Southern Pioneer, any associated rate adjustments to support the targets will be more tolerable by the consumer as opposed to larger, unpredictable increases.

Southern Pioneer believes this DSC Ratemaking Plan, accompanied by acceptable incremental DSC and equity targets as proposed by Southern Pioneer, is a win-win for all parties concerned as it creates certainty for the lender, establishes appropriate but more streamlined levels of regulatory oversight to protect consumers, and breeds efficiency in the ratemaking process. Furthermore, it is my understanding CoBank feels the use of a five-year timeframe for the DSC Ratemaking approach creates more financial certainty for Southern Pioneer. Due to this financial certainty, CoBank has agreed to relax covenant levels in the short term as defined above. However, in the latter years of the plan, CoBank has increased the DSC requirements, beyond traditionally accepted minimum levels, to emphasize the need for Southern Pioneer to build equity. Without the financial certainty created by the Plan, CoBank feels Southern Pioneer's rates need to be immediately increased to levels required to meet financial goals in accordance with acceptable industry standards, regardless of the impact on Southern Pioneer's consumers.

Q. If the Commission does not accept the DSC Ratemaking approach or allow the requested increase over a five year time period as proposed, please explain the consequences of not consistently meeting the loan covenants as defined by CoBank?

A. Should the Commission not allow the DSC Ratemaking Plan as proposed in this Application, or alternatively, increase the Mid-Kansas Southern Pioneer Division rates using the full DSC level of 2.0 in order to achieve the revenue requirements identified in the cost to serve study as presented in Mr. Macke's testimony, then Southern Pioneer will be considered in default of the CoBank loan agreement, until it can obtain additional rate relief from the Commission. Allowing Southern Pioneer to stay in default on its loan covenants exposes Pioneer to becoming liable for loan repayment as the guarantor of Southern Pioneer's debt.

Q. Does this conclude your prefiled Direct Testimony for the Mid-Kansas Southern Pioneer division rates?

A. Yes, it does.

VERIFICATION

STATE OF KANSAS)
) ss
COUNTY OF GRANT)

The undersigned, Chantry C. Scott, upon oath first duly sworn, states that he is an officer of Southern Pioneer Electric Company, and that he has prepared the foregoing testimony, that he is familiar with the contents thereof, and that the statements contained therein are true and correct to the best of his knowledge and belief.

Chantry C. Scott

Subscribed and sworn to before me this 19 day of December, 2011.

OFFICIAL SEAL
JUDY J. PARSONS
MY COMMISSION EXPIRES
February 17, 2015

Judy J. Parsons
Notary Public

My appointment expires: Feb. 17, 2015

EXHIBIT

tabbies

CCS-1

SOUTHERN PIONEER ELECTRIC COMPANY

INDEPENDENT AUDITOR'S REPORT AND FINANCIAL STATEMENTS

January 1, 2010 to December 31, 2010

SOUTHERN PIONEER ELECTRIC COMPANY

TABLE OF CONTENTS

SOUTHERN PIONEER ELECTRIC COMPANY

BOARD OF DIRECTORS AND OFFICERS

Melvin Winger	Chairman	Johnson, Kansas
Alfred L. Alexander	Vice Chairman	Satanta, Kansas
Eugene Wright	Director	Sublette, Kansas
Fred Claassen	Director	Richfield, Kansas
Don R. Dunn	Director	Ulysses, Kansas
Martie Floyd	Director	Johnson, Kansas
Perry Rubart	Director	Ulysses, Kansas
Ralph Stoddard	Director	Hugoton, Kansas
Melvin H. Webb	Director	Moscow, Kansas
David L. Jesse	President/CEO	Ulysses, Kansas
Randall D. Magnison	Executive VP/COO	Ulysses, Kansas
Chantry C. Scott	Treasurer	Johnson, Kansas
M. Moran Tomson	Secretary	Johnson, Kansas

SCHMIDT & COMPANY LLC

Devoted to Audits of Rural Utility Industries
45 Years of Utility Accounting Experience

Board of Directors
Southern Pioneer Electric Company
Ulysses, Kansas

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying balance sheet of Southern Pioneer Electric Company as of December 31, 2010, and the related statements of revenue and retained earnings and cash flows for the period then ended. These financial statements are the responsibility of Southern Pioneer Electric Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to consolidated financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Southern Pioneer Electric Company as of December 31, 2010, and the results of operations and cash flows for the period then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 12, 2011, on our consideration of Southern Pioneer Electric Company's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Schmidt & Company, LLC

SCHMIDT & COMPANY, LLC
May 12, 2011

1701 SW US Highway 40, Suite 207 • Blue Springs, Missouri 64015
Phone 816.229.0277 • Fax 816.229.0634
www.schmidtandcompany.com

SOUTHERN PIONEER ELECTRIC COMPANY

BALANCE SHEET - DECEMBER 31

ASSETS (Notes 1 & 2)

	2010	2009
UTILITY PLANT (Note 3)		
Electric plant	$ 92,834,757.15	$ 88,370,430.80
Depreciation	22,752,041.36	25,983,733.96
Depreciated Value	70,082,715.79	62,386,696.84
INVESTMENTS (Note 4)	6,467,301.65	4,223,899.19
CURRENT ASSETS		
Cash and cash equivalents	186,012.06	1,442,932.69
Receivables	6,524,923.03	7,503,692.98
Materials	1,636,456.71	1,722,776.11
Prepayments	284,027.84	254,220.64
Total	8,631,419.64	10,923,622.42
DEFERRED EXPENSES (Note 5)	59,972.60	763,151.28
TOTAL ASSETS	$ 85,241,409.68	$ 78,297,369.73

LIABILITIES AND CAPITAL

	2010	2009
CAPITAL & RETAINED EARNINGS		
Retained earnings	$ 902,940.09	$ (810,838.33)
Other comprehensive income (loss)	(586,555.98)	(475,784.87)
Total	316,384.11	(1,286,623.20)
LONG-TERM LIABILITIES (Note 6)	59,967,980.68	60,883,218.14
OTHER LONG-TERM OBLIGATIONS (Note 7)	1,949,316.00	1,443,979.00
CURRENT LIABILITIES		
Notes payable	11,175,790.17	8,550,000.00
Accounts payable	7,738,391.92	6,282,995.17
Current maturities of long-term debt	1,135,323.69	207,959.61
Accrued expenses	1,018,846.10	868,949.00
Accrued taxes	867,588.34	723,889.53
Customer deposits	675,184.79	610,312.60
Total	22,611,125.01	17,244,105.91
DEFERRED REVENUES (Note 9)	396,603.88	12,689.88
TOTAL LIABILITIES AND CAPITAL	$ 85,241,409.68	$ 78,297,369.73

The accompanying notes are an integral part of these statements.

SOUTHERN PIONEER ELECTRIC COMPANY

STATEMENT OF REVENUE AND RETAINED EARNINGS
FOR THE PERIOD ENDED - DECEMBER 31

	2010	2009
OPERATING INCOME		
Sales	$ 56,761,383.15	$ 47,744,967.14
Miscellaneous revenue	3,687,945.68	1,726,234.87
Total Operating Income	60,449,328.83	49,471,202.01
COST OF POWER SOLD	45,368,417.73	39,947,241.22
GROSS PROFIT	15,080,911.10	9,523,960.79
OPERATING EXPENSES		
Operating expenses - transmission	709,169.99	-
Operating expenses - distribution	2,401,071.14	1,744,889.94
Maintenance of distribution plant	1,227,652.04	1,541,725.84
Accounting and collection expenses	1,269,992.11	1,260,109.04
Other customer expenses	62,260.73	85,907.17
Administrative and general	1,246,792.97	1,138,869.53
Interest expenses	3,194,247.48	2,127,268.39
Depreciation	2,201,657.22	1,832,428.20
Taxes	1,054,289.00	-
Total Expenses	13,367,132.68	9,731,198.11
NET INCOME (LOSS)	1,713,778.42	(207,237.32)
Retained Earnings (deficit) - Beginning of Period	(810,838.33)	(603,601.01)
Retained Earnings (deficit) - End of Period	$ 902,940.09	$ (810,838.33)

The accompanying notes are an integral part of these statements.

SOUTHERN PIONEER ELECTRIC COMPANY

STATEMENT OF COMPREHENSIVE INCOME
FOR THE PERIOD ENDED - DECEMBER 31

	2010	2009
NET INCOME (LOSS)	$ 1,713,778.42	$ (207,237.32)
OTHER COMPREHENSIVE INCOME		
Unrealized gains (losses) arising during the year	(301,489.24)	(47,031.95)
Unrealized gains (losses) MKEC	190,718.13	217,690.93
COMPREHENSIVE INCOME (LOSS)	$ 1,603,007.31	$ (36,578.34)

The accompanying notes are an integral part of these statements.

SOUTHERN PIONEER ELECTRIC COMPANY

STATEMENT OF CASH FLOWS
FOR THE PERIOD ENDED - DECEMBER 31

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Net profit (loss)	$ 1,713,778.42	$ (207,237.32)
Adjustments to reconcile net margin to net cash provided by operating activities:		
Depreciation	2,201,657.22	1,832,428.20
Decrease (Increase) in other comprehensive income	(110,771.11)	170,658.98
Patronage capital credits assigned by associated organizations	(642,263.20)	(599,514.54)
Decrease (Increase) In:		
Receivables (net)	978,769.95	(883,941.77)
Prepaid expenses	(29,807.20)	310,036.98
Deferred expenses	703,178.68	942,770.12
Increase (Decrease) In:		
Provision for Employee Benefits	505,337.00	275,053.00
Short term notes payable	2,625,790.17	2,801,336.99
Accounts payable	1,455,396.75	(34,799.60)
Accrued liabilities	293,595.91	(545,633.34)
Customer deposits	64,872.19	56,716.23
Deferred revenues	383,914.00	(24,276.17)
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	10,143,448.78	4,093,597.76
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment in plant (net)	(9,897,676.17)	(11,460,500.20)
Decrease (Increase) in materials inventory	86,319.40	(352,537.87)
Decrease (Increase) in other investments	(2,002,136.38)	(1,525,595.16)
Payments received from associated organizations	400,997.12	376,503.15
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	(11,412,496.03)	(12,962,130.08)

The accompanying notes are an integral part of these statements.

SOUTHERN PIONEER ELECTRIC COMPANY

STATEMENT OF CASH FLOWS (CONTINUED)
FOR THE PERIOD ENDED - DECEMBER 31

	2010	2009
CASH FLOWS FROM FINANCING ACTIVITIES		
Long-term borrowing	224,621.24	9,580,000.00
Principal payments on long-term debt	(212,494.62)	(193,522.42)
Increase (Decrease) in other capital	-	(486.05)
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	12,126.62	9,385,991.53
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(1,256,920.63)	517,459.21
CASH AND CASH EQUIVALENTS BEGINNING OF PERIOD	1,442,932.69	925,473.48
CASH AND CASH EQUIVALENTS END OF PERIOD	$ 186,012.06	$ 1,442,932.69
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the period for long term interest	$ 3,194,025.83	$ 2,906,459.54
Cash paid during the period for other interest	36,093.49	75,325.83
Cash paid during the period for income taxes	-	-
SUPPLEMENTAL DISCLOSURE OF NONCASH TRANSACTION		
NCSC debt paid with CoBank loan funds	$ -	$ -
Other comprehensive income (loss)	$ (110,771.11)	$ 170,658.98

The accompanying notes are an integral part of these statements.

SOUTHERN PIONEER ELECTRIC COMPANY

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

UTILITY PLANT

The Company employs the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission and the work order procedures suggested by the Rural Development Utilities Programs (RUS).

INVESTMENTS

Investments are generally included in the financial statements at cost. Equities in other organizations are included at face value of related certificates.

CASH AND CASH EQUIVALENTS

For purposes of the statement of cash flows, the Company considers all highly liquid debt instruments purchased with maturity of three months or less to be cash equivalents.

ACCOUNTS RECEIVABLE

Provision is made for accounts deemed uncollectible.

CONCENTRATION OF CREDIT RISK

Southern Pioneer Electric Company is an electric distribution system. The Company grants credit to customers, substantially all are local residents.

ACCOUNTING ESTIMATES

The presentation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure 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.

MATERIALS AND SUPPLIES

Materials and supplies are included in the financial statements at average cost. Usable material from plant retirements is returned to inventory at current average cost. A physical inventory is taken at least once each year.

ELECTRIC ENERGY SALES

Meters are read on cycles throughout each month. Estimated unbilled energy sales in the amount of $1,852,658.23 are included in the December 31, 2010 energy sales figures.

INCOME TAX STATUS

The Company files Form 1120 for Federal and State income tax purposes.

(2) ASSETS PLEDGED:

Substantially all assets are pledged as security for long-term debt to RUS & CoBank.

(3) ELECTRIC PLANT AND DEPRECIATION PROCEDURES:

Listed below are the major classes of the electric plant as of December 31:

	2010	2009
Transmission plant	$ 15,251,789.10	$ 14,615,171.35
Distribution plant	37,156,168.71	34,529,424.49
General plant	5,852,843.95	4,811,606.74
Electric plant in service	58,260,801.76	53,956,202.58
Acquisition adjustment(net)	21,207,399.34	21,992,843.20
Construction work in progress	13,366,556.05	12,421,385.02
Total	$ 92,834,757.15	$ 88,370,430.80

The Company provides for depreciation on a straight line basis at annual rates which will amortize the depreciable property over its estimated useful life.

(4) INVESTMENTS:

At December 31, investments included:

	2010	2009
Net investment in MKEC	$ 4,419,249.00	$ 2,753,769.76
Fair value of plan assets	1,526,991.00	1,195,874.00
Investment in other organizations	507,416.89	266,150.81
Line extgension contracts receivable	13,644.76	8,104.60
Total	$ 6,467,301.65	$ 4,223,899.17

(5) DEFERRED EXPENSES:

At December 31, deferred items were as follows:

	2010	2009
Programming costs	$ 59,811.23	$ 92,614.91
Sales tax credits	161.37	161.37
Deferred tax asset (net)	-	670,375.00
Total	$ 59,972.60	$ 763,151.28

Temporary differences giving rise to the deferred tax asset consist of the excess of the amount for financial reporting purposes over the amount for tax purposes of allowance for bad debt, accrued compensated absence, capitalized startup costs, investment basis differences, and aid to construction. Temporary differences giving rise to the deferred tax liability consist of the excess of the amounts for tax purposes over the amount for financial reporting purposes for prepaid accounts, amortization, and depreciation.

(6) LONG-TERM LIABILITIES:

Substantially all assets of the Company are mortgaged to the United States RUS and CoBank. Long-term debt is represented principally by mortgage notes payable to RUS (FFB) and CoBank. The Company's parent, Pioneer Electric Cooperative, has fully guaranteed the outstanding RUS debt.

Following is a summary of outstanding long-term debt as of December 31:

	2010	2009
CoBank, variable rate note	$ -	$ 45,000,000.00
CoBank, fixed rate note, 6.66%, maturing 4/20/27	6,304,365.95	6,511,177.75
CoBank capital lease	161,401.42	-
RUS(FFB) 3.714% to 4.232% notes, maturing through 2035	54,637,537.00	9,580,000.00
Subtotal	61,103,304.37	61,091,177.75
Less: Current maturities	(1,135,323.69)	(207,959.61)
Total	$ 59,967,980.68	$ 60,883,218.14

As of December 31, 2010 annual maturities of long-term debt outstanding for the next five years are as follows:

Year Ending December 31	Principal Payment
2011	$ 1,135,324
2012	1,605,300
2013	1,661,300
2014	1,738,800
2015	1,819,900

(7) OTHER LONG-TERM OBLIGATIONS:

The following schedule exhibits the unfunded status as shown in the Company's balance sheet at December 31, 2010.

Pension benefit obligation	2010	2009
Benefit obligation at beginning of period	$ 1,443,979.00	$ 1,168,926.00
Service cost	239,145.00	155,155.00
Interest cost	86,588.00	63,503.00
Actuarial (gain) loss	179,604.00	56,395.00
Accrued benefit cost recognized in the balance sheet	$ 1,949,316.00	$ 1,443,979.00

Plan assets	2010	2009
Fair value of plan assets at beginning of period	$ 1,195,874.00	$ 514,485.00
Actual return on plan assets	168,153.00	201,384.00
Employer contributions	163,704.00	105,590.00
Other	-	375,000.00
Benefits paid	(740.00)	(585.00)
Accrued benefit cost recognized in the balance sheet	$ 1,526,991.00	$ 1,195,874.00
Funded status at end of period (underfunded) overfunded	(422,325.00)	(248,105.00)
Discount rate	6.00%	6.00%
Expected long-term return on plan assets	7.50%	7.50%
Rate of compensation increase	4.40%	4.33%

The Company adopted the recognition and disclosure requirements of SFAS 158 as of December 31, 2007. SFAS 158 requires recognition of the funded status of postretirement benefits on the balance sheet, on a prospective basis. The change in the liability for postretirement benefits is recorded as an adjustment to Accumulated Other Comprehensive Income.

(8) LINE OF CREDIT:

The Company has a line of credit with CoBank in the amount of $13,000,000. At December 31, 2010, $10,631,624.53 was advanced on the line of credit.

(9) DEFERRED REVENUES:

At December 31, deferred items were as follows:

	2010	2009
Advances for construction	$ 12,689.88	$ 12,689.88
Deferred tax liability	383,914.00	-
Total	$ 396,603.88	$ 12,689.88

Temporary differences giving rise to the deferred tax asset consist of the excess of the amount for financial reporting purposes over the amount for tax purposes of allowance for bad debt, accrued compensated absence, capitalized startup costs, investment basis differences, and aid to construction. Temporary differences giving rise to the deferred tax liability consist of the excess of the amounts for tax purposes over the amount for financial reporting purposes for prepaid accounts, amortization, and depreciation.

(10) PENSION PLAN:

The Company has a pension plan for its employees. The plan is administered by the Principal Financial Group. The pension costs for the years ended December 31, 2010 and 2009 amounted to approximately $163,700 and $106,000, respectively.

The Company has a 401(k) savings plan for employees. The Company's 401(k) contributions amounted to approximately $134,000 and $110,000, during 2010 and 2009, respectively.

(11) LOAN GUARANTEE:

The Company is a 29.10614% owner of MKEC and has loan guarantees of $5,619,087 on MKEC's $118,358,221 outstanding loan balance and the credit facility. The MKEC credit facility is for $20,000,000 of which $10,225,000 had been used to issue letters of credit against.

SCHMIDT & COMPANY LLC

Devoted to Audits of Rural Utility Industries
45 Years of Utility Accounting Experience

Board of Directors
Southern Pioneer Electric Company
Ulysses, Kansas

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF CONSOLIDATED FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

We have audited the consolidated financial statements of Southern Pioneer Electric Company as of and for the years ended December 31, 2010 and 2009, and have issued our report thereon dated May 12, 2011. We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

COMPLIANCE

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

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered Southern Pioneer Electric Company's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Southern Pioneer Electric Company's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Southern Pioneer Electric Company's internal control over financial reporting.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects Southern Pioneer Electric Company's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of Southern Pioneer Electric Company's financial statements that is more than inconsequential will not be prevented or detected by Southern Pioneer Electric Company's internal control.

1701 SW US Highway 40, Suite 207 • Blue Springs, Missouri 64015
Phone 816.229.0277 • Fax 816.229.0634
www.schmidtandcompany.com

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by Southern Pioneer Electric Company's internal control. Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

This report is intended for the information of the Board of Directors, management, and the Federal Emergency Management Agency. However, this report is a matter of public record and its distribution is not limited.

Schmidt & Company, LLC

SCHMIDT & COMPANY, LLC
May 12, 2011

SCHMIDT & COMPANY LLC

Devoted to Audits of Rural Utility Industries
45 Years of Utility Accounting Experience

Board of Directors
Southern Pioneer Electric Company
Ulysses, Kansas

INDEPENDENT AUDITOR'S REPORT ON REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

COMPLIANCE

We have audited the compliance of Southern Pioneer Electric Company with the type of compliance requirements described in the U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that is applicable to its major federal program for the year ended December 31, 2010. Southern Pioneer Electric Company's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of Southern Pioneer Electric Company's management. Our responsibility is to express an opinion on Southern Pioneer Electric Company's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States; and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Southern Pioneer Electric Company's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Southern Pioneer Electric Company's compliance with those requirements.

In our opinion, Southern Pioneer Electric Company complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended December 31, 2010.

INTERNAL CONTROL OVER COMPLIANCE

The management of Southern Pioneer Electric Company is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Southern Pioneer Electric Company's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

1701 SW US Highway 40, Suite 207 • Blue Springs, Missouri 64015
Phone 816.229.0277 • Fax 816.229.0634
www.schmidtandcompany.com

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

We have audited the financial statements of Southern Pioneer Electric Company as of and for the year ended December 31, 2010 and have issued our report thereon dated May 12, 2011. Our audit was performed for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

This report is intended for the information of the Board of Directors, management, and the Federal Emergency Management Agency. However, this report is a matter of public record and its distribution is not limited.

Schmidt & Company, LLC

SCHMIDT & COMPANY, LLC
May 12, 2011

SOUTHERN PIONEER ELECTRIC COMPANY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
DECEMBER 31, 2010

SECTION I--SUMMARY OF AUDITOR'S RESULTS

FINANCIAL STATEMENTS

Type of auditor's report issued:	Unqualified
Internal control over financial report:	
Material weakness(es) identified?	No
Reportable condition(s) identified that are not considered to be material weakness(es)?	None reported
Noncompliance material to financial statements noted?	No

FEDERAL AWARDS

Internal control over major programs:	
Material weakness(es) identified?	No
Reportable condition(s) identified that are not considered to be material weakness(es)?	None reported
Type of auditor's report issued on compliance for major programs:	Unqualified
Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133?	No

IDENTIFICATION OF MAJOR PROGRAMS

Name of Federal Program of Cluster:	Federal Emergency Management Agency Emergency Management State and Local Assistance
CFDA Number:	97.036
Dollar threshold used to distinguish between type A and type B programs:	$300,000
Auditee qualified as low-risk auditee?	No

SOUTHER PIONEER ELECTRIC COMPANY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
DECEMBER 31, 2010

SECTION II--FINANCIAL STATEMENT FINDINGS

This section identifies the reportable conditions, material weaknesses, and instances of noncompliance related to the financial statements that are required to be reported in accordance with paragraphs 5.18 through 5.20 of *Government Auditing Standards*.

None

SECTION III--FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

This section identifies the audit findings required to be reported by section 510(a) of Circular A-133.

None

SOUTHERN PIONEER ELECTRIC COMPANY

SCHEDULE OF FEDERAL AWARDS FOR THE YEAR ENDED DECEMBER 31, 2010

Federal Grantor/Pass-through Grantor/Program	Federal CFDA Number		Receipts		Expenditures	
Federal Awards:						
Federal Emergency Management Agency Emergency Management State and Local Assistance	FEMA-1741-DR-KS	$	2,328,589	$	3,104,786	*
Total Federal Awards		$	2,328,589	$	3,104,786	

Note: The information on this schedule has been prepared on the cash basis of accounting. Receipts are recognized when received rather than when earned and expenditures are recognized when paid rather than when obligations are incurred.

* Major program per OMB Circular A-133

SCHMIDT & COMPANY LLC

Devoted to Audits of Rural Utility Industries
45 Years of Utility Accounting Experience

Board of Directors
Southern Pioneer Electric Company
Ulysses, Kansas

We have audited the financial statements of Southern Pioneer Electric Company for the year ended December 31, 2010, and have issued our report thereon dated May 12, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States, 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 Rural Development Utilities Programs (RUS) Borrowers. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit of the financial statements of Southern Pioneer Electric Company for the year ended December 31, 2010, we considered its internal control over financial reporting in order to determine our 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.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the 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. We noted no matters involving the internal control over financial reporting that we consider to be material weaknesses.

Section 1773.33 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. We have grouped our comments accordingly. In addition to obtaining reasonable assurance about whether the financial statements are free from material misstatements, we 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, materials control, compliance with specific RUS loan and security instrument provisions set forth in 7 CFR 1773.33(e)(1), related party transactions, depreciation rates, and a schedule of deferred credits, and a schedule of investments, upon which we express an opinion. In addition, our audit of the financial statements also included the procedures specified in 7 CFR 1773.38-.45. Our 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, we express no opinion thereon.

1701 SW US Highway 40, Suite 207 • Blue Springs, Missouri 64015
Phone 816.229.0277 • Fax 816.229.0634
www.schmidtandcompany.com

No reports other than our independent auditor's report and our independent auditor's report on compliance and on internal control over financial reporting, all dated May 12, 2011 or summary of recommendations related to our audit have been furnished to management.

Our 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 1773.33 are presented below.

COMMENTS ON CERTAIN SPECIFIC ASPECTS OF THE INTERNAL CONTROL OVER FINANCIAL REPORTING

We noted no matters regarding Southern Pioneer Electric Company's internal control over financial reporting and its operation that we 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 or other expense accounts; and

- The materials control.

COMMENTS ON COMPLIANCE WITH SPECIFIC RUS LOAN AND SECURITY INSTRUMENT PROVISIONS

We have performed the procedures enumerated below with respect to compliance with certain provisions of laws, regulations, and contracts. The procedures we 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, 2010:

We noted no new contracts during the audit period.

Procedure performed with respect to the requirement to submit RUS Form 7 to the RUS:

- Agreed amounts reported in Form 7 to Southern Pioneer Electric Company's records.

The results of our tests indicate that, with respect to the items tested, Southern Pioneer Electric Company complied, in all material respects, with the specific RUS loan and security instrument provisions referred to below. The specific provisions tested, as well as any exceptions noted, include the requirements that:

- The borrower has obtained written approval of the RUS to enter into any contract for the operation or maintenance of property, or for the use of mortgaged property by others as defined in §1773.33(e)(1)(i); and

- The borrower has submitted its Form 7 to the RUS and the Form 7, Financial and Statistical Report, as of December 31, 2010, represented by the borrower as having been submitted to RUS is in agreement with Southern Pioneer Electric Company's audited records in all material respects, and appears reasonable based upon the audit procedures performed.

COMMENTS ON OTHER ADDITIONAL MATTERS

In connection with our audit of the financial statements of Southern Pioneer Electric Company, nothing came to our attention that caused us to believe that Southern Pioneer Electric Company failed to comply with respect to:

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

- The clearing of the construction accounts and the accrual of depreciation on completed construction addressed at 7 CFR 1773.33 (c)(2);

- The retirement of plant addressed at 7 CFR 1773.33 (c)(3) and (4);

- Approval of the sale, lease or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap addressed at 7 CFR 1773.33 (c)(5);

- The disclosure of material related party transactions, in accordance with Statement of Financial Accounting Standards No. 57, Related Party Transactions, for the year ended December 31, 2010, in the financial statements referenced in the first paragraph of this report addressed at 7 CFR 1773.33 (f);

- The depreciation rates addressed at 7 CFR 1773.33 (g);

- The detailed schedule of deferred debits and deferred credits; and

- The detailed schedule of investments.

Our 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 1773.33 (h), and the detailed schedule of investments required by 7 CFR 1773.33 (i), and provided below, are presented for purposes of additional analysis and are not a required part of the basic financial statements. This information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

DEFERRED DEBITS

At December 31, 2010 deferred items were as follows:

Programming costs	$ 59,811.23
Deferred tax asset	161.37
Total	$ 59,972.60

DEFERRED CREDITS

At December 31, 2010 deferred items were as follows:

Advances for construction	$ 12,689.88
Deferred tax liability	383,914.00
Total	$ 396,603.88

INVESTMENT IN AFFILIATED COMPANIES

None.

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

Schmidt & Company, LLC

SCHMIDT & COMPANY, LLC
May 12, 2011