FINANCIAL STATEMENTS WITH
REPORT OF INDEPENDENT AUDITORS

EAST TEXAS ELECTRIC COOPERATIVE, INC.

December 31, 2015 and 2014

AXLEY & RODE, LLP
CERTIFIED PUBLIC ACCOUNTANTS

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REPORT OF INDEPENDENT AUDITORS

The Board of Directors
East Texas Electric Cooperative, Inc.
Nacogdoches, Texas

We have audited the accompanying financial statements of East Texas Electric Cooperative, Inc. (the "Cooperative") which comprise the balance sheets as of December 31, 2015 and 2014 and the related statements of revenue and expense, comprehensive income, patronage capital and other 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

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards for financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain 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 Cooperative'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 Cooperative's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of East Texas Electric Cooperative, Inc. as of December 31, 2015 and 2014, and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

In accordance with *Government Auditing Standards*, we have also issued our report dated April 13, 2016, on our consideration of the Cooperative's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on 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* and should be considered in assessing the results of our audit.

Axley & Rode LLP
CERTIFIED PUBLIC ACCOUNTANTS

Lufkin, Texas
April 13, 2016

EAST TEXAS ELECTRIC COOPERATIVE, INC.
BALANCE SHEETS
December 31, 2015 and 2014

	2015	2014
ASSETS		
Utility Plant:		
Utility plant in service	$ 938 254 621	$ 931 281 687
Construction work in progress	65 758 395	33 022 840
	1 004 013 016	964 304 527
Less accumulated provision for depreciation	185 595 065	150 945 217
	818 417 951	813 359 310
Investments and Other Assets:		
Investments in associated organizations	35 844 249	36 695 190
Other investments - RUS cushion of credit	12 874 908	11 275 770
Funds held in escrow	63 644 117	28 579 069
	112 363 274	76 550 029
Current Assets:		
Cash and cash equivalents	5 960 252	4 791 180
Accounts receivable from member cooperatives	20 808 926	26 285 696
Accounts receivable - Other	475 906	939 706
Certificates of deposit	5 622 102	4 634 824
Investment securities	3 642 734	3 815 179
Fuel stock	7 232 046	4 718 637
Materials and supplies	9 873 366	10 183 866
Other current assets	2 918 883	2 644 278
	56 534 215	58 013 366
Deferred debits	223 752	248 846
	$ 987 539 192	$ 948 171 551
EQUITIES AND LIABILITIES		
Equity and Margin:		
Memberships	$ 15 000	$ 15 000
Patronage capital	97 152 597	88 981 356
Accumulated comprehensive income (loss)	(3 467 288)	(3 656 568)
	93 700 309	85 339 788
Long-term debt, less current maturities	814 092 064	794 419 415
Derivative instrument liability, less current portion	2 749 165	3 004 871
Current Liabilities:		
Accounts payable - Purchased power	7 363 869	10 481 102
Accounts payable - Other	12 250 955	1 198 333
Accrued expenses	8 195 654	9 017 008
Line of credit - General	11 000 000	15 000 000
Current maturities of long-term debt	37 469 053	28 719 260
Derivative instrument liability - Current portion	718 123	651 697
	76 997 654	65 067 400
Deferred credits	-	340 077
	$ 987 539 192	$ 948 171 551

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

EAST TEXAS ELECTRIC COOPERATIVE, INC.
STATEMENTS OF REVENUE AND EXPENSE
For the Years Ended December 31, 2015 and 2014

	2015	2014
Operating Revenues:		
Power sales - Members	$ 279 019 928	$ 314 160 253
Other electric revenues	4 920 314	16 224 114
	283 940 242	330 384 367
Operating Expenses:		
Purchased power	113 521 847	178 722 705
Power Generation:		
Fuel	54 150 082	47 989 533
Other production expenses	36 121 905	29 804 351
Transmission	1 593 610	1 140 699
Administrative and general	8 120 312	8 256 625
Depreciation	34 649 847	28 400 028
	248 157 603	294 313 941
OPERATING MARGINS BEFORE INTEREST EXPENSE	35 782 639	36 070 426
Interest expense	31 801 196	29 724 937
OPERATING MARGINS	3 981 443	6 345 489
Nonoperating Margins:		
Interest income	2 182 400	1 915 463
Capital credits and patronage capital allocations	2 007 398	1 948 928
NET MARGINS	$ 8 171 241	$ 10 209 880

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

EAST TEXAS ELECTRIC COOPERATIVE, INC.
STATEMENTS OF COMPREHENSIVE INCOME
For the Years Ended December 31, 2015 and 2014

	2015	2014
NET MARGINS	$ 8 171 241	$ 10 209 880
Other Comprehensive Income:		
Unrealized Gains (Losses) on Cash Flow Hedge:		
Unrealized holding gains (losses) arising during the period	189 280	(1 014 620)
OTHER COMPREHENSIVE INCOME (LOSS)	189 280	(1 014 620)
COMPREHENSIVE INCOME	$ 8 360 521	$ 9 195 260

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

EAST TEXAS ELECTRIC COOPERATIVE, INC.
STATEMENTS OF PATRONAGE CAPITAL AND OTHER EQUITIES
For the Years Ended December 31, 2015 and 2014

	MEMBERSHIPS	PATRONAGE CAPITAL	ACCUMULATED COMPREHENSIVE INCOME (LOSS)	TOTAL
Balance, December 31, 2013	$ 15 000	$ 78 771 476	$ (2 641 948)	$ 76 144 528
Net margins	-	10 209 880	-	10 209 880
Other comprehensive income (loss)	-	-	(1 014 620)	(1 014 620)
Balance, December 31, 2014	15 000	88 981 356	(3 656 568)	85 339 788
Net margins	-	8 171 241	-	8 171 241
Other comprehensive income (loss)	-	-	189 280	189 280
Balance, December 31, 2015	$ 15 000	$ 97 152 597	$ (3 467 288)	$ 93 700 309

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

EAST TEXAS ELECTRIC COOPERATIVE, INC.
STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2015 and 2014

	2015	2014
Operating Activities:		
Net margins	$ 8 171 241	$ 10 209 880
Adjustments to Reconcile Net Margin to Net Cash Provided by Operating Activities:		
Depreciation	34 649 849	28 400 028
Patronage capital credits - Non-cash	(2 006 786)	(1 948 928)
Reinvested dividends on investment securities	(15 419)	(16 539)
Cash Provided by (Used for) the Change in:		
Accounts receivable - Members	5 476 770	2 840 758
Accounts receivable - Other	463 800	(556 812)
Fuel stock	(2 513 409)	197 686
Materials and supplies	310 500	(526 693)
Other current assets	(274 605)	(1 564 703)
Deferred debits	25 094	3 682 448
Accounts payable	(3 117 233)	(9 634 852)
Accounts payable - Other	3 315 802	486 499
Accrued expenses	(821 352)	865 958
Deferred credits	(340 077)	(32 340)
NET CASH PROVIDED BY OPERATING ACTIVITIES	43 324 175	32 402 390
Investing Activities:		
Capital expenditures (including interest capitalized)	(31 971 671)	(64 582 672)
Purchase of CFC loan certificates	-	(1 083 181)
Redemption of CFC loan certificates	1 652 262	1 615 796
Proceeds from retirement of patronage capital credits	1 205 465	1 152 147
RUS cushion of credit	(1 599 138)	(11 275 770)
Funds held in escrow	(35 065 048)	3 599 431
Certificates of deposit	(987 278)	(721 151)
Other investments	187 864	681 609
NET CASH USED BY INVESTING ACTIVITIES	(66 577 544)	(70 613 791)
Financing Activities:		
Loan advances - RUS	135 602 404	-
Loan advances - Others	-	39 666 112
Clean Renewable Energy Bonds issued	56 155 694	15 000 000
Loan payments to RUS	(14 164 387)	(10 719 122)
Loan payments - Others	(13 524 603)	(14 481 908)
Clean Renewable Energy Bonds	(5 838 543)	(5 160 711)
Net activity - Syndicated Facility/Lines of credit	(133 808 124)	8 509 786
NET CASH PROVIDED BY FINANCING ACTIVITIES	24 422 441	32 814 157
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1 169 072	(5 397 244)
Cash and cash equivalents, beginning of year	4 791 180	10 188 424
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 5 960 252	$ 4 791 180
Supplemental Disclosures of Cash Flow Information:		
Increase (decrease) in accounts payable for capital expenditures	$ 7 736 820	$ (15 533 622)
Cash paid for interest	$ 32 708 019	$ 29 590 150

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

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations:

East Texas Electric Cooperative, Inc. ("Cooperative") is an electric generating and transmission cooperative formed and operating pursuant to the Texas Electric Cooperative Corporation Act. The Cooperative was created by, and on behalf of, its members, Northeast Texas Electric Cooperative, Inc. ("NTEC"), Sam Rayburn G & T Electric Cooperative, Inc. ("SRG&T"), and Tex-La Electric Cooperative of Texas, Inc. ("Tex-La") ("Members") for the purpose of providing wholesale electric service to the Members. The Cooperative supplies a portion of each Member's power needs. Each of the Members in turn provides wholesale electric power to its member distribution cooperatives.

Use of Estimates:

The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities. The estimates and assumptions used in the accompanying financial statements are based upon management's evaluation of the relevant facts and circumstances as of the date of the financial statements. Actual results may differ from the estimates and assumptions used in preparing the accompanying financial statements.

System of Accounts:

The Cooperative maintains its accounting records in accordance with the Federal Energy Regulatory Commission's ("FERC") Uniform System of Accounts as adopted by the USDA Rural Development's Rural Utilities Service ("RUS"), which conforms with U.S. generally accepted accounting principles in all material respects. The more significant accounting policies are described below.

Revenue Recognition:

Revenues from the sale of electricity are recorded based on billings to Members.

Cash Flows Statement:

For purposes of reporting cash flows, cash and cash equivalents consist of cash and temporary cash investments with original maturities of three months or less.

Accounts Receivable:

Accounts receivable from member cooperatives are recorded from the billings of the sale of electricity to the Members. The Cooperative considers accounts receivable to be fully collectible; accordingly, no allowance for doubtful accounts has been established. If accounts become uncollectible, they will be charged to operations when that determination is made. No accounts receivable from Member Cooperatives were past due more than 90 days at December 31, 2015 and 2014.

Utility Plant:

The utility plant is stated at original cost. The cost of additions to the electric plant includes contracted work, direct labor, materials, allocable overhead and interest on debt used for construction. The cost of maintenance and repairs, including renewals of minor items of property, is charged to operating expense. The cost of units replaced or retired, including cost of removal, net of any salvage value, is charged to accumulated depreciation.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Depreciation of the utility plant is provided on the composite straight-line method over the estimated useful lives of the various components. The method and rates are prescribed by RUS or as approved for rate-making purposes. The annual depreciation rates are:

Transmission	2.75%
Production plant	3.226% - 6.67%
Load dispatching equipment	6.67%

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the sum of the expected future undiscounted cash flows is less than the carrying amount of the asset, a loss is recognized for the difference between the fair value and the carrying value of the asset. At December 31, 2015, the Cooperative had not recognized any losses resulting from the impairment of long-lived assets.

Investments in Associated Organizations:

Investments in patronage capital credits of associated organizations are accounted for under the equity method. Patronage capital is recorded at the stated amount of the certificate when allocated by the associated organization.

Investment Securities:

The Cooperative carries all investments in government bonds, equity funds and fixed income funds with readily determinable fair values at their fair values based on quoted prices in active markets (all Level 1 or Level 2 measurements). Unrealized gains and losses are included in the change in net margin in the accompanying Statement of Revenue and Expenses.

Fair Value Measurements:

The fair value of financial assets and liabilities is measured according to the *Fair Value Measurements and Disclosure* topic of FASB Accounting Standards Codification. Fair Value is required to be evaluated and adjusted according to the following valuation techniques.

Level 1 - Fair value is determined using quoted market prices in active markets for identical assets and liabilities.

Level 2 - Fair value is determined using quoted market prices in active markets for similar assets and liabilities, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant inputs are observable in the market for substantially the full term of the assets or liabilities.

Level 3 - Fair value is determined using inputs that are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The market for assets and liabilities using Level 3 measures is typically inactive.

Inventories:

Inventory consists of fuel stock (primarily coal) for operation of the electric plants. Fuel inventory is carried at weighted average cost. Materials and supplies inventory used for the operation of the electric plants is valued at average cost and is stated at the lower of average cost or market.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Allowance for Borrowed Funds Used During Construction:

The Cooperative capitalizes the carrying costs on certain significant construction and development projects while in progress. Interest is capitalized based on the debt specifically borrowed to finance projects during construction and is reflected as a credit to interest expense in the Statement of Revenue and Patronage Capital. For the years ended December 31, 2015 and 2014, capitalized interest was approximately $837,000 and $3,263,000, respectively.

Income Taxes:

The Cooperative is exempt from Federal income tax under the provisions of Section 501(c)(12) of the Internal Revenue Code of 1986.

Uncertain Tax Positions:

Financial Accounting Standards Board Codification Section 740 requires recognition, measurement and disclosure of uncertain tax positions. The Cooperative currently accounts for uncertain tax positions based on the estimated likelihood of assessment and has not determined that any tax positions require an accrual based on current standards of accounting. For federal income tax purposes the tax returns essentially remain open for possible examination for a period of three years after the date on which those returns are filed.

Comprehensive Income:

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities and cash flow hedges are reported as a separate component of the stockholder's equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

Deferred Debits/Credits:

In accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 980: *Regulated Operations* (formerly FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*), certain costs have been capitalized as deferred assets that would otherwise be charged to expense. Such deferred assets are recorded when it is probable that future revenue in an amount at least equal to the capitalized costs will result from inclusion of those costs in future rates.

Derivative Instruments:

The Cooperative is exposed to various market risks in the course of its business activities, including changes in interest rate. Management has established risk management policies and strategies to reduce the potentially adverse effects that the volatility of the markets may have on its operations. These policies and strategies include the use of derivative instruments in the form of interest rate swaps for the purpose of hedging volatility in interest rates. The Cooperative's policy is that derivatives are to be used only for hedging purposes and Management does not engage in transactions unrelated to the underlying financial exposures. The Cooperative does not enter into derivative financial instruments for trading purposes.

Regional Transmission Organizations:

On December 19th, 2013 the Cooperative joined the Regional Transmission Organization (RTO) operated by the Midcontinent Independent System Operator (MISO). Additionally, on March 1, 2014 the Cooperative began participating in the Integrated Marketplace launched by Southwest Power Pool (SPP) RTO. Both RTO's operate wholesale electric markets and are responsible for moving electricity over large interstate areas. They also coordinate, control and monitor the electric transmission grid within their areas. As a result of this, the Cooperative now sells all plant generation into the RTO markets and purchases power to serve a large portion of its load from markets. The Cooperative records RTO transactions on an hour-to-hour basis. Transactions within each individual hour are netted to a single purchase or sale based on actual load and net megawatt-hour generation.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Subsequent Events:

Management has evaluated subsequent events through April 13, 2016, the date the financial statements were available to be issued, and there have been no material subsequent events that would require recognition or disclosure in the 2015 financial statements.

NOTE 2 - UTILITY PLANT

The following summarizes utility plant at December 31, 2015 and 2014:

	2015	2014
Utility Plant, at Cost:		
Transmission	$ 48 988 165	$ 47 658 196
Production plant	889 045 205	883 402 240
Load dispatching equipment	221 251	221 251
	938 254 621	931 281 687
Construction work in progress	65 758 395	33 022 840
	1 004 013 016	964 304 527
Less accumulated depreciation	185 595 065	150 945 217
	$ 818 417 951	$ 813 359 310

The Cooperative has an undivided ownership in and is responsible for providing its share of the costs for its jointly owned and other power plant facilities that are currently in operation. The Cooperative's share of each operating facility at December 31, 2015, is as follows:

Nelson Unit 6 (50Mw)	9.10%
Independence Steam Electric Station Unit 2 ("ISES 2") (60Mw)	7.13%
Plum Point Energy Station ("Plum Point") (50Mw)	7.52%
John W. Turk Power Plant("Turk") (50Mw)	8.33%
Harrison County Power Project ("HCPP") (248Mw)	45.00%
Hardin County Units 1 and 2 (150Mw)	100.00%
San Jacinto Units 1 and 2 (150Mw)	100.00%
Hilton Lively Biomass Facility (49Mw)	100.00%

In connection with the Cooperative's ownership interest in Nelson Unit 6, ISES 2, Turk and Plum Point, the Cooperative receives its proportionate share of sulfur dioxide ("SO2") allowances. Each allowance represents the right to emit one ton of SO2 pollution in a specified calendar year. The allowances may be used to permit current emissions, sold on the open market, or held in reserve to cover emissions in future years. The Cooperative has the intention of holding these allowances for future use.

In addition to the above plants that are currently in operation, the Cooperative has additional significant investments in the following power plant project under construction or development:

R.C. Thomas Hydropower Facility (24Mw) (under development)	100.00%

The Cooperative is developing, in cooperation with the Trinity River Authority of Texas ("Authority") and the City of Houston, Texas, a hydropower facility with an installed capacity of approximately 24Mw to be located at the Lake Livingston Dam. The estimated total cost to construct the hydropower facility is $149,000,000. The project is under construction as of December 31, 2015. The Cooperative has been approved for and has issued a total of $106,355,693 in CREBS (Note 9). The Cooperative intends to finance the project with the use of allocated CREBS related to the project and to use RUS funds for their remaining financing needs.

NOTE 3 - INVESTMENTS IN ASSOCIATED ORGANIZATIONS

Investments in associated organizations at December 31, 2015 and 2014 consisted of the following:

	2015	2014
National Rural Utilities Cooperative Finance Corporation (CFC):		
Patronage capital and Membership	$ 4 751 759	$ 4 152 510
Loan capital term certificates	30 453 828	32 106 090
CoBank:		
Patronage capital and Membership	638 662	436 590
	$ 35 844 249	$ 36 695 190

Patronage capital allocations reported in the Statements of Revenue and Expenses in the amount of $2,007,398 and $1,948,928 for the fiscal years ended December 31, 2015 and 2014, respectively, represent patronage capital allocations from CoBank and CFC.

NOTE 4 - OTHER INVESTMENTS - RUS CUSHION OF CREDIT

The Cooperative established a Cushion of Credit Account with RUS. The account represents voluntary payments to RUS in excess of amounts due and is intended to enable the Cooperative to have funds available to make scheduled payments on RUS debt. By law, the account earns five percent interest annually and can only be used to make installments on RUS mortgage notes.

NOTE 5 - INVESTMENT SECURITIES AND FAIR VALUE MEASUREMENTS

Investments securities consisted of investments in fixed income mutual funds and government bonds with an estimated fair value of $3,642,734 and $3,815,179, which approximates costs, at December 31, 2015 and 2014, respectively. The amount of unrealized gain or (loss) included in income amounted to zero for the years ended December 31, 2015 and 2014.

Mutual funds are valued at the net asset value (NAV) of shares held which is considered a Level 1 valuation technique.

Government bonds are valued using quoted market prices in active markets for identical assets which is considered a Level 1 valuation technique.

The scheduled maturities of investment securities at December 31, 2015 were as follows:

	2015
2016	$ 55 378
2017	819 660
2018	1 371 729
2019	542 741
Mutual funds	853 226
	$ 3 642 734

NOTE 6 - FUNDS HELD IN ESCROW

The Cooperative has issued $106,355,693 in CREBS related to the R.C. Thomas Hydropower Facility. Bond proceeds which have not been utilized in the amount of $63,644,117 are held in escrow by CoBank. As of December 31, 2015, the funds held in escrow are fully available for use on construction for the project.

NOTE 7 - DEFERRED DEBITS/CREDITS

The following is a summary of the amounts recorded as deferred debits/credits as of December 31, 2015 and 2014:

	2015	2014
DEFERRED DEBITS		
Debt issuance costs	$ 223 752	$ 248 846
	$ 223 752	$ 248 846
DEFERRED CREDITS		
Overhead and maintenance	$ -	$ 340 077
	$ -	$ 340 077

Debt issuance costs represent the unamortized costs associated with the issuance of CREBS. The costs are being amortized over the life of the bonds.

The Board of Directors approves the Cooperative's rates, which allows recovery of overhead and maintenance ("O & M") expenses, including administrative and general expenses incurred by the Cooperative on behalf of the Members. Under this provision, the difference in the allowable customer charge computed under the Cooperative's rate and the actual amount of O & M expenses incurred by the Cooperative is to be accumulated by the Cooperative in a deferred account. The allowable customer charge is a monthly average of O & M expenses as budgeted by the Cooperative at the beginning of each twelve-month billing period. Subsequent periods reflect the adjustments between actual and estimated O & M expenses.

NOTE 8 - PATRONAGE CAPITAL

Patronage capital at December 31, 2015 and 2014 consists of the following:

	2015	2014
Assignable patronage capital	$ 8 171 241	$ 10 209 880
Assigned patronage capital	88 981 356	78 771 476
	$ 97 152 597	$ 88 981 356

The by-laws of the Cooperative provide that all amounts received and receivable from the furnishing of electric energy in excess of the sum of operating costs and expenses are to be assigned to Members' patronage capital credit accounts on a patronage basis. The bylaws permit the Cooperative to allocate losses to Members, offset losses with margins from future years, or offset losses with certain nonoperating margins from current or future years.

Pursuant to the RUS mortgage and related loan agreements, until the total of equities and margins equal or exceed 30% of total assets, the distribution of capital contributed by members in each year is limited generally to 25% of patronage capital and margins of the preceding year provided that, after giving effect to such distribution, the total equity will equal or exceed 20% of total assets. The equities and margins of the Cooperative represent 10% of the total assets at the balance sheet date. For the years ending December 31, 2015 and 2014, no patronage capital was retired.

NOTE 9 - LONG-TERM DEBT

Long-term debt at December 31, 2015 and 2014 consisted of the following:

	2015	2014
Federal Financing Bank ("FFB") mortgage notes guaranteed by RUS, fixed rates 2.54% to 5.27%, maturing at various times through 2040	$ 419 796 236	$ 298 358 218
CFC Fixed Rate Notes - 2.45% to 7.15%, maturing at various times from 2016 to 2041	171 064 309	180 368 068
CFC Financing Notes - Capital term certificates, fixed rates from 5.65% to 7.15%, maturing 2024 - 2041	27 556 664	28 444 174
CFC/Regions Syndicated Revolving Credit Facility - variable interest rates, maturing 2016	4 052 940	133 861 064
Clean Renewable Energy Bonds - R.C. Thomas Facility CFC, effective rate of 2.95%, maturing 2024	5 737 500	6 375 000
Clean Renewable Energy Bonds - Biomass Project CFC, effective rate of 1.36%, maturing 2035	47 401 780	50 164 835
Clean Renewable Energy Bonds - R.C. Thomas Facility CoBank, effective rate of 1.25%, maturing 2035 - 2040	90 951 688	37 233 982
CoBank Fixed Rate Note - 5.64%, maturing 2041	42 500 000	44 166 667
Regions Term Note - Variable rate 2.92%, maturing 2021	42 500 000	44 166 667
	851 561 117	823 138 675
Less current maturities	37 469 053	28 719 260
	$ 814 092 064	$ 794 419 415

The Cooperative receives a performance discount rate reduction of 0.125% and a volume discount rate reduction of 0.125% on CFC fixed rate notes. The notes feature a combination of level debt service and level principal payment arrangements.

The Cooperative has secured long-term financing from RUS to finance an ownership interest in several power projects including HCPP, Nelson 6, San Jacinto, Hardin, and the Hilton Lively Biomass Facility. The RUS mortgage secures an amount up to $497,993,000, in the form of six separate RUS promissory notes. During the year ended December 31, 2015, the Cooperative secured long-term financing on the Hilton Lively Biomass Facility. The long-term financing consisted of a fixed rate RUS promissory note in the amount of $135,602,404. At December 31, 2015, the RUS notes aggregated $419,796,236.

The Cooperative has secured long-term financing from CFC and CoBank to finance its ownership in Plum Point. The long-term financing consists of fixed rate loans with CFC with a balance of $31,010,872 at December 31, 2015 and a fixed rate note with CoBank with a balance of $42,500,000 at December 31, 2015.

The Cooperative has secured long-term financing from CFC to finance its ownership interest in the Turk power plant. The long-term financing consists of fixed rate loans with CFC. At December 31, 2015, the CFC fixed rate notes had a balance of $117,745,033.

The Cooperative has secured long-term financing with Regions Bank to partially finance the Cooperative's 50Mw interest in the Turk power plant. The long-term financing consists of a ten year variable rate term loan of $50,000,000. While the term loan carries a variable rate, the Cooperative entered into an interest rate swap (Note 10) that effectively fixed the interest rate for this loan at 5.96%. There is $42,500,000 outstanding on the term loan as of December 31, 2015.

NOTE 9 - LONG-TERM DEBT - CONTINUED

The Cooperative has a syndicated revolving credit facility with CFC and Regions Bank. The facility consists of an aggregate commitment of $150,000,000. The facility has been utilized to provide unsecured interim financing for both the Hilton Lively Biomass Facility and the R.C. Thomas Hydropower Facility. During the year ended December 31, 2015, the Cooperative secured permanent financing from RUS for the Hilton Lively Biomass Facility. The Cooperative is continuing to utilize the syndicated facility to provide unsecured interim financing for the R.C. Thomas Hydropower Facility. The Cooperative had $4,052,940 outstanding on this facility as of December 31, 2015.

The Cooperative has been allocated and has issued a total of $106,355,693 in CREBS in coordination with R.C. Thomas Hydropower Facility. The initial issue was in the amount of $10,200,000 and was issued by CFC. The Cooperative utilized the funds to finance the initial stages of development of the hydropower facility. At December 31, 2015, the balance of the CREBS amounted to $5,737,500. The Cooperative applied for and was approved for three additional issuances of CREBS. The three separate CREBS allocations were issued in coordination with CoBank in the total amount of $96,155,693. The funds have been utilized to finance the continued construction or are being held in escrow and are currently available for use on construction of the hydropower facility (Note 6). At December 31, 2015, the balance of the CREBS amounted to $90,951,688.

The Cooperative has an approved commitment from RUS in the amount of $73,000,000 for the permanent financing of the R.C. Thomas Hydropower Facility.

The Cooperative also received an allocation and issued $55,000,000 of CREBS related to the Hilton Lively Biomass Facility. The funds have been utilized to finance the construction of the facility and had a balance of $47,401,780 at December 31, 2015.

The long-term debt agreements with lenders contain certain restrictive covenants and restrictions on payment of patronage capital. The covenants require the Cooperative to maintain certain annual minimum financial ratios. The restrictions on payment of patronage capital are related in general to the Cooperative's equity and assets as defined in the agreements. For the years ended December 31, 2015 and 2014, the Cooperative was in compliance with all restrictive covenants.

Substantially all owned assets of the Cooperative are pledged as collateral for the above-mentioned secured debt.

The approximate annual maturities of long-term debt that are not expected to be refinanced are as follows:

2016	$	37 469 000
2017	$	38 182 000
2018	$	38 822 000
2019	$	39 410 000
2020	$	40 086 000

The Cooperative has a $12,000,000 line of credit with CFC that matures on August 1, 2017. At December 31, 2015 and 2014, no funds were advanced or owed under this line of credit.

The Cooperative also has an additional line of $12,000,000 with CoBank that matures on July 31, 2018. At December 31, 2015 and 2014, no funds were advanced or owed under this line of credit.

The Cooperative established two additional lines of credit with Regions Bank and Bank of America for amounts up to $15,000,000 and $11,000,000, respectively. At December 31, 2015, the Cooperative has drawn $-0- on the Regions Bank line of credit and $11,000,000 on the Bank of America line of credit.

NOTE 10 - DERIVATIVE INSTRUMENTS

In June 2011, the Cooperative entered into a floating-to-fixed interest rate swap. The interest rate swap agreements effectively convert floating rates into fixed rates so that the Cooperative can predict with greater assurance what its future interest costs will be and protect itself against increases in floating rates. The term of the interest rate swap extends over the term of the associated ten year loan. The variable component of the interest rate swap agreement was based on LIBOR plus 2.75%. In exchange for this variable rate over the ten year term, the Cooperative received a fixed rate of 5.96% over the ten year term. The interest rate swap is recorded at fair value and any unrealized gains and losses on the derivative instrument are recorded in Accumulated Comprehensive Income (ACI) for the effective portion. As of December 31, 2015, the entire hedge is considered effective and the total unrealized loss of $3,467,288 is recorded in ACI. The Cooperative expects the entire hedge to remain effective throughout the term of the related debt and does not expect to reclassify ACI into earnings in the future.

NOTE 11 - OPERATING LEASES AND FACILITIES AGREEMENTS

The Cooperative has accepted an assignment of a transmission lease obligation between one of its Members, NTEC, and a distribution cooperative, Wood County Electric Cooperative, Inc., in connection with a 5Mw load served by the Cooperative. The annual lease payments are based upon an estimate using various factors. An annual true-up of this estimate is performed once actual amounts have been determined. This lease obligation has no fixed term, but will remain in effect until terminated by the mutual agreement of both parties. For the years ended December 31, 2015 and 2014, the total transmission lease payments were $148,044 and $138,690, respectively. Estimated lease payments for each of the next five (5) years will approximate $150,000.

The Cooperative has entered into a transmission and interconnection agreement with Rayburn Country ("transmission electric cooperative") and Southwestern Electric Power Company in connection with a 138 kV switching station located near Jacksonville, Texas. Under the agreement, the Cooperative agrees to pay the transmission electric cooperative lease payments equal to $25,000 per month so long as the transmission electric cooperative provides transmission service to the Cooperative over the Jacksonville to Overton Transmission Line, which is owned by the transmission electric cooperative. This obligation will remain in effect until the earlier of: (1) the date upon which the transmission electric cooperative interconnects with the transmission facilities of the Cooperative or any of its members to serve added load of the transmission electric cooperative, or (2) the agreement terminates. During the year ended December 31, 2015, the Cooperative developed and completed additional transmission facilities to interconnect to the transmission electric cooperative and as a result terminated the interconnection agreement. At December 31, 2015 and 2014, total transmission lease payments amounted to $100,000 and $300,000, respectively.

NOTE 12 - POWER CONTRACTS

The Cooperative has entered into Wholesale Power Contracts (the "Contracts") with each of its Members extending through December 31, 2044. Pursuant to the Contracts, the Cooperative has agreed to serve all of the Members' power needs, except for the power supply responsibility that is specifically retained in the Contracts by the Members.

The Cooperative has a Power Supply Agreement with SWEPCO, whereby SWEPCO agrees to provide the Cooperative's requirements at certain points of delivery. SWEPCO, the Cooperative and NTEC entered into an agreement dated November 2, 2009, that replaced an agreement among those parties that expired on December 31, 2009. The new agreement has a twenty (20) year term and provides for the sale of partial requirements service for the first five years and 80Mw for the remaining fifteen years.

NOTE 13 - RELATED PARTY TRANSACTIONS

The Cooperative, Tex-La, and SRG&T share facilities and personnel. The Cooperative and SRG&T reimburse Tex-La for their proportionate shares of related expenses and equipment purchases. The Cooperative's share of cost for the years ended December 31, 2015 and 2014 was $856,211 and $786,087 respectively.

The Cooperative has various electrical facilities operating agreements with its Members' distribution cooperative members for the operation and maintenance of certain transmission facilities.

NOTE 14 - RATE MATTERS

In 1999, the Texas Legislature approved Senate Bill 7, which provided, among other things, that the Cooperative's rates for the sale of wholesale power are no longer regulated by the Public Utility Commission of Texas ("PUCT"). Similarly, the rates of the Members for the sale of electricity are no longer regulated by the PUCT. The law permits cooperatives' boards of directors to set rates.

Investor-owned utilities in the Electric Reliability Council of Texas ("ERCOT") were required to allow their retail customers to select generation suppliers of electricity as of January 2002. The law gives cooperatives' boards of directors sole authority to allow, or not allow, generating suppliers to attempt to sell electricity to retail customers of a cooperative. Allowing retail customer choice is called "opting in". Even if a cooperative's board decides to opt in, retail customers will continue to use the transmission and distribution facilities of the Cooperative's Members. The Cooperative monitors whether any of its Members will decide to opt in and thus evaluate the potential effects of a change in generation sales. The law allows the Cooperative to recover stranded costs if it experiences a loss of load which would impair payment of debt service and payment of purchased power fixed charges. As of December 31, 2015, none of the distribution cooperatives who are served by the Cooperative's Members have elected to opt in.

NOTE 15 - COMMITMENTS AND CONTINGENCIES

General

In the normal course of business the Cooperative has ongoing disputes with some of its power suppliers. Additionally, some of the billings received by the Cooperative for purchased power are subject to adjustment based on the actual costs of the seller.

The electric utility industry is subject to standards and procedures under government laws and regulations related to environmental and other matters. These standards and procedures are subject to change; as a result, uncertainties and outcomes are not predictable with assurance. The Cooperative is unaware of any noncompliance with current governmental laws and regulations related to environmental matters.

The Cooperative may be involved in various claims and litigation arising in the normal course of business. Although management is unable to predict the outcome of such proceedings, management and the Cooperative's legal counsel do not believe that the ultimate resolution of these matters will have a material adverse effect on the Cooperative's results of operations and financial condition.

NOTE 15 - COMMITMENTS AND CONTINGENCIES - CONTINUED

Power Supply Resources and Investments in Utility Plant Projects

To ensure adequate power supplies for its Members, the Cooperative enters into purchase commitments with electric energy suppliers. These contracts have various terms covering minimum required megawatts of power to be purchased, prices to be paid and period covered. On an ongoing basis, the Cooperative evaluates its power supply requirement obligations to its Members. The Cooperative continues to evaluate projects including renewable power and further ownership in natural gas-fired generation. The Cooperative is also evaluating purchase power agreements with various power suppliers.

See Note 2 for a description of the utility plant projects that were in progress as of December 31, 2015. At that date, the Cooperative had commitments of approximately the following amounts, excluding debt service, related to completion of construction for the jointly-owned and other power plant projects that were in progress:

	Total Commitment	Cost as of December 31, 2015	Remaining Commitment
R.C. Thomas Hydropower Facility	$ 149 000 000	$ 65 080 000	$ 83 920 000

The Cooperative has also entered into a purchase power agreement with Grant Wind, LLC, a subsidiary of APEX Clean Energy, to purchase 50Mw of output from a wind-powered generating facility for a fixed price. The facility is anticipated to have a total of 150Mw of installed capacity and is expected to be completed in April 2016. The agreement is for a 20-year term.

The Cooperative has also entered into a purchase power agreement with Redbed Plains Wind Farm, LLC, a subsidiary of EDP Renewables, to purchase 50Mw of output from a wind-powered generating facility for a fixed price. The facility is anticipated to have a total of 100Mw of installed capacity and is expected to be completed in December 2017. The agreement is for a 20-year term.

Subsequent to the year ended December 31, 2015, the Cooperative began an evaluation into potentially suspending operations at the Hilton Lively Biomass Facility. The consideration is primarily due to sustained low natural gas and wholesale energy prices and the high cost structure of the facility. The Cooperative must receive approval from MISO prior to suspending operations. If the Cooperative elects to suspend operations at the facility, it anticipates contract termination charges, lost tax abatements, demobilization, and other associated costs to be incurred to approximate $4,085,000. At this time, Management is not able to make a meaningful estimate of the amount or range of loss that could result if the decision is made to idle the facility, however Management anticipates requesting regulatory approvals to defer any related losses that could result and anticipates fully recovering the cost of the facility through rates in future periods.

Environmental Regulation

There are efforts underway in the United States to regulate greenhouse gas emissions through regulatory changes. These efforts culminated in the issuance by the Environmental Protection Agency of a final rule for both new and existing power plants in August 2015, and published in the Federal Register in October 2015. That rule has been appealed to the US Court of Appeals for the District of Columbia and the Supreme Court has issued a stay on implementation of the rule. The Cooperative is currently unable to predict with any degree of certainty when (or if) a comprehensive regulatory scheme for greenhouse gases will be in place.

NOTE 16 - CONCENTRATIONS OF CREDIT RISK

The Cooperative's financial instruments that are exposed to concentrations of credit risk consist primarily of cash equivalents and accounts receivable.

The Cooperative places its cash and cash equivalents on deposit with financial institutions in the United States. The Federal Deposit Insurance Corporation (FDIC) provides coverage to $250,000 for substantially all depository accounts. At various times during the year, cash balances may exceed insured limits. The Cooperative has not experienced any losses in such accounts.

The Cooperative's accounts receivable are subject to concentration of credit risk due to the Cooperative's customer base. Substantially all of the accounts receivable balance is due from the Cooperative's three Members. The Cooperative believes the risk of loss related to this credit risk is remote.

NOTE 17 - DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amount of the Cooperative's cash investments, investment securities, trade receivables and payables approximates their fair value because of the short maturities of these financial instruments.

Due to restrictions on repricing of the Cooperative's long-term debt and related assumptions, the fair value of these financial instruments is estimated by management to approximate the carrying value.

The fair value of derivative instruments are measured using Level 2 observable inputs other than quoted prices in active markets for identical assets and liabilities, as defined in fair value guidance. Inputs for interest rate derivatives include LIBOR interest rates and interest rate futures contracts. Interest rate derivatives are standard over-the-counter financial products valued using the market approach.

INDEPENDENT AUDITORS' 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*

The Board of Directors
East Texas Electric Cooperative, Inc.
Nacogdoches, Texas

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of East Texas Electric Cooperative, Inc. which comprise the balance sheets as of December 31, 2015 and 2014 and the related statements of revenue and expenses, comprehensive income, patronage capital and cash flows for the years then ended and the related notes to the financial statements and have issued our report thereon dated April 13, 2016.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Cooperative's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion of the effectiveness of the Cooperative's internal control. Accordingly, we do not express an opinion on the effectiveness of the Cooperative's internal control.

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

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

Compliance

As part of obtaining reasonable assurance about whether East Texas Electric Cooperative, Inc.'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*.

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Cooperative's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Cooperative's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Axley & Rode LLP
CERTIFIED PUBLIC ACCOUNTANTS

Lufkin, Texas
April 13, 2016

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

INDEPENDENT AUDITORS' REPORT

Board of Directors
East Texas Electric Cooperative, Inc.
Nacogdoches, Texas

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of East Texas Electric Cooperative, Inc. (the Cooperative), which comprise the balance sheet as of December 31, 2015 and the related statements of revenue and expenses, patronage capital and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated April 13, 2016. In accordance with *Government Auditing Standards*, we have also issued our report dated April 13, 2016, on our consideration of the Cooperative's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. No reports other than the reports referred to above and our schedule of findings and recommendation related to our audit have been furnished to management.

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

Maintain adequate and effective accounting procedures;

Utilize adequate and fair methods of accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expenses 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 materials 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.

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.

Axley & Rode LLP
CERTIFIED PUBLIC ACCOUNTANTS

Lufkin, Texas
April 13, 2016