JACKSON ENERGY
COOPERATIVE
A Touchstone Energy Cooperative

115 Jackson Energy Lane
McKee, Kentucky 40447
Telephone (606) 364-1000 • Fax (606 364-1007

RECEIVED
JUN 4 2013
PUBLIC SERVICE
COMMISSION

May 30, 2013

Mr. Jeff D. Cline
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40601

Dear Mr. Cline:

Enclosed please find a copy of Jackson Energy Cooperative's audit report for the period through February 28, 2013. This audit report was prepared by an independent certified public accountant. If you have any questions concerning this audit, please contact Sharon Carson at (606) 364-9239 or sharoncarson@jacksonenergy.com.

Sincerely,

Sharon K. Carson

Sharon K. Carson
CFO

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JUN 4 2013

PUBLIC SERVICE
COMMISSION

Kentucky 3
Jackson Energy Cooperative
and Subsidiary
McKee, Kentucky

Audited Financial Statements
February 28, 2013 and 2012

ALAN M. ZUMSTEIN
Certified Public Accountant
1032 Chetford Drive
Lexington, Kentucky 40509

CONTENTS

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• KENTUCKY SOCIETY OF CPA'S
• INDIANA SOCIETY OF CPA'S
• AICPA DIVISION FOR FIRMS

Independent Auditor's Report

To the Board of Directors
Jackson Energy Cooperative
McKee, Kentucky

Report on the Financial Statements

I have audited the accompanying consolidated financial statements of Jackson Energy Cooperative and Subsidiary, which comprise the balance sheets as of February 28, 2013 and 2012, and the related statements of revenue and comprehensive income, changes in equities, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In my opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Jackson Energy Cooperative and Subsidiary as of February 28, 2013 and 2012, and the results of their operations and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, I have also issued a report dated May 16, 2013, on my consideration of Jackson Energy Cooperative's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering internal control over financial reporting and compliance.

Alan M. Zumstein

Alan M. Zumstein, CPA
May 16, 2013

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

To the Board of Directors
Jackson Energy Cooperative

I have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Jackson Energy Cooperative, which comprise the balance sheets as of February 28, 2013 and 2012, and the related statements of revenue and comprehensive income, members' equities and cash flows for the years then ended, and related notes to the financial statements, and have issued my report thereon dated May 16, 2013.

Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing my audit, I considered Jackson Energy's internal control over financial reporting as a basis for designing my auditing procedures for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Jackson Energy's internal control over financial reporting. Accordingly, I do no express an opinion on the effectiveness of Jackson Energy's internal control over financial reporting.

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

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

Compliance and Other Matters

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

Purpose of this Report

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

Alan M. Zumstein

Alan M. Zumstein, CPA
May 16, 2013

Jackson Energy Cooperative

Consolidated Balance Sheets, February 28, 2013 and 2012

	2013	2012
Assets		
Utility Plant, net	$ 164,125,545	$ 160,412,761
Investments and Other Assets:		
Associated organizations	39,400,307	34,155,050
Goodwill	262,177	262,177
	39,662,484	34,417,227
Current Assets:		
Cash and cash equivalents	2,204,248	6,639,792
Accounts receivable, less allowance for uncollectible accounts	17,589,637	15,616,073
Material and supplies	1,717,337	1,540,584
Prepayments	744,600	645,560
	22,255,822	24,442,009
Deferred Property Retirements	8,434,385	8,973,177
Total	$ 234,478,236	$ 228,245,174
Members' Equities and Liabilities		
Members' Equities:		
Memberships and capital	$ 1,297,560	$ 1,296,610
Patronage capital and retained earnings	70,939,930	69,691,007
Accumulated other comprehensive income	(1,381,211)	(1,582,811)
Other equities and minority interest	4,929,561	3,459,931
	75,785,840	72,864,737
Long Term Debt	130,268,692	128,781,278
Accumulated Postretirement Benefits	8,240,510	7,918,704
Current Liabilities:		
Accounts payable	8,647,193	7,852,171
Short term borrowings	1,710,282	754,328
Current portion of long term debt	5,345,000	5,095,000
Consumer deposits	1,037,175	1,628,346
Other current and accrued liabilities	3,115,333	3,047,763
	19,854,983	18,377,608
Consumer advances for construction	328,211	302,847
Total	$ 234,478,236	$ 228,245,174

The accompanying notes are an integral part of these statements.

Consolidated Statements of Revenue and Comprehensive Income
for the years ended February 28, 2013 and 2012

	2013	2012
Operating Revenues	$ 104,878,212	$ 104,110,656
Operating Expenses:		
Cost of purchases	68,796,243	68,851,696
Distribution - operations and maintenance	11,618,857	11,450,289
Consumer accounts	3,377,936	3,766,458
Sales	844,850	791,734
Administrative and general	4,839,876	4,357,131
Depreciation, excluding $555,350 in 2013 and $487,908 in 2012 charged to clearing accounts	8,516,652	8,171,246
Amortization of deferred property retirements	470,772	470,772
Taxes	145,757	170,238
Other	73,532	97,059
	98,684,475	98,126,623
Operating Margins before Interest Charges	6,193,737	5,984,033
Interest Charges:		
Interest on long-term debt	5,416,882	5,631,224
Other interest	40,051	100,631
	5,456,933	5,731,855
Operating Margins after Interest Charges	736,804	252,178
Net Operating Margins	5,243,297	5,433,517
Nonoperating Margins		
Interest income	164,675	177,289
Subsidiary and others	(101,688)	(5,650)
	62,987	171,639
Patronage Capital assigned, associated organizations	4,506,493	5,181,339
Net Margins	5,306,284	5,605,156
Other Comprehensive Income:		
Postretirement benefits	201,600	201,600
Noncontrolling interest	(41,424)	(10,278)
Total Comprehensive income	$ 5,466,460	$ 5,796,478

The accompanying notes are an integral part of these statements.

Statements of Changes in Members' Equity
for the years ended February 28, 2012 and 2013

	Memberships and Capital	Patronage Capital	Other Equity	Accumulated Other Comprehensive Income	Total Members' Equity
Balance - Beginning of year	$ 1,294,805	$ 67,754,769	$ 1,905,754	$ (1,784,411)	$ 69,170,917
Comprehensive income:					
Net margins		5,605,156			5,605,156
Postretirement benefit obligation					
Amortization				201,600	
Adjustments				-	201,600
Minority interests		(10,278)			(10,278)
Total comprehensive income					5,796,478
Refunds of capital credits		(3,466,105)			(3,466,105)
Transfers to other equity and minority interests		(192,535)			(192,535)
Memberships, net	1,805				1,805
Other equities			1,554,177		1,554,177
Balance - February 28, 2012	1,296,610	69,691,007	3,459,931	(1,582,811)	72,864,737
Comprehensive income:					
Net margins		5,306,284			5,306,284
Postretirement benefit obligation					
Amortization				201,600	
Adjustments				-	201,600
Minority interests		(41,424)			(41,424)
Total comprehensive income					5,466,460
Refunds of capital credits		(3,933,090)			(3,933,090)
Transfers to other equity and minority interests		(82,847)			(82,847)
Memberships, net	950				950
Other equities			1,469,630		1,469,630
Balance - February 28, 2013	$ 1,297,560	$ 70,939,930	$ 4,929,561	$ (1,381,211)	$ 75,785,840

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

Consolidated Statements of Cash Flows

for the years ended February 28, 2013 and 2012

	2013	2012
Cash Flows from Operating Activities:		
Net margins	$ 5,306,284	$ 5,605,156
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation and amortization		
Charged to expense	8,987,424	8,642,018
Charged to clearing accounts	555,350	487,908
Patronage capital allocated	(4,506,493)	(5,181,339)
Accumulated postretirement benefits	523,406	507,786
Change in assets and liabilities:		
Receivables	(1,973,226)	581,712
Material and supplies	(176,753)	2,803
Prepayments	(31,020)	(1,917,758)
Payables	795,008	412,871
Consumer deposits and advances	(565,807)	(213,494)
Accrued expenses	67,570	187,272
	8,981,743	9,114,935
Cash Flows from Investing Activities:		
Plant additions	(11,343,543)	(12,098,933)
Plant removal costs	(1,591,475)	(1,174,977)
Salvage recovered from plant retirements	150,232	89,049
Other investments, net	(697,340)	(523,990)
	(13,482,126)	(13,708,851)
Cash Flows from Financing Activities:		
Memberships, capital and other equities	1,299,884	1,516,886
Retirement of patronage capital	(3,928,413)	(3,466,105)
Additional long-term borrowings	6,967,000	6,740,000
Payments on long-term debt	(5,229,586)	(5,012,444)
Short term borrowings (repayments)	955,954	304,328
	64,839	82,665
Net increase in cash	(4,435,544)	(4,511,251)
Cash and cash equivalents - beginning of period	6,639,792	11,151,043
Cash and cash equivalents - end of period	$ 2,204,248	$ 6,639,792
Supplemental cash flows information:		
Interest paid on long-term debt	$ 5,421,595	$ 5,708,298
Income taxes paid	$ -	$ 42,997

The accompanying notes are an integral part of these statements.

Note 1. Summary of Significant Accounting Policies

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

Principles of Consolidation The accompanying consolidated financial statements include the accounts of Jackson Energy Cooperative, Jackson Energy Service Corporation ("Service Corporation") and Jackson Energy Propane Plus, LLC ("Propane Plus"). Jackson Energy owns 75% and East Kentucky Power Cooperative ("East Kentucky") owns 25% of Service Corporation's outstanding stock. The Service Corporation owns 100% of the outstanding stock of Propane Plus. All significant inter company accounts and transactions have been eliminated. Jackson Energy uses an audit date of February 28. The Subsidiary operates on a fiscal year ending December 31. The consolidated financial statements reflect the year end of February 28 for Jackson Energy and December 31 for the Subsidiary, respectively.

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

Propane Plus' fixed assets consist primarily of propane tanks located on customers' premises, bulk tanks, and trucks used in the delivery of propane.

Utility plant consists of:

	2013	2012
Electric Plant:		
Distribution plant	$196,271,410	$189,892,918
General plant	22,286,622	18,678,992
	218,558,032	208,571,910
Plant under construction	1,110,597	3,184,087
	219,668,629	211,755,997
Less accumulated depreciation	58,231,923	54,019,343
Net electric plant	161,436,706	157,736,654
Propane Plant:		
Propane tanks on customers' premises	1,830,101	1,711,692
Bulk tanks	599,229	513,239
Delivery and other trucks	847,522	847,522
Buildings and land	559,566	555,950
Office and other equipment	159,473	158,158
	3,995,891	3,786,561
Less accumulated depreciation	1,307,052	1,110,454
Net propane plant	2,688,839	2,676,107
Net utility plant	$164,125,545	$160,412,761

Note 1. Summary of Significant Accounting Policies, continued

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

Depreciation Provision has been made for depreciation on the basis of the estimated lives of assets, using the straight-line method. Depreciation rates range from 1.44% to 10.0%, with a composite rate of 4.1% for distribution plant. General plant rates range from 2.5% to 20%. Propane Plus's depreciation is computed using the straight-line method over the useful lives of its assets.

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

Off Balance Sheet Risk Jackson Energy has off-balance sheet risk in that they maintain cash deposits in financial institutions in excess of the amounts insured by the Federal Deposit Insurance Corporation (FDIC). At February 28, 2013, the financial institutions reported deposits in excess of the $250,000 FDIC insured limit several times during the audit period. These financial institutions have strong credit ratings and management believes that credit risk related to the accounts is minimal.

Estimates The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates used in the preparation of the financial statements.

Revenue Jackson Energy records revenue as billed to its consumers based on monthly meter-reading cycles. All consumers are required to pay a refundable deposit, however, it may be waived under certain circumstances. Jackson Energy's sales are concentrated in a fifteen (15) county area of southeastern Kentucky. Consumers must pay their bill within 20 days of billing, at which time a disconnect notice is sent with payment to be within 10 days. If not paid, then consumers are subject to disconnect. Accounts are written off when they are deemed to be uncollectible. The allowance for uncollectible accounts is based on the aging of receivables. The balance in the allowance account was $132,178 at 2013 and $172,451 at 2012. There were no individual account balances that exceeded 10% of outstanding accounts receivable at February 28, 2013 or 2012.

Propane Plus recognizes revenue when earned, regardless of the period in which customers are billed. Propane sales are recognized when deliveries are made, tank rental each month, and sales of related accessories at the time of sale. Accounts are written off when they are deemed to be uncollectible. The allowance for uncollectible accounts is based on the aging of receivables. The balance in the allowance account was $9,000 for 2012 and $8,800 for 2011. There were no individual account balances that exceeded 10% of outstanding accounts receivable at December 31, 2012 or 2011.

The Companies are required to collect, on behalf of the Commonwealth of Kentucky, sales taxes based on 6 percent of gross sales from non-residential consumers, a 3 percent school tax from certain counties on most gross sales, and franchise fees in certain cities. The Company's policy is to exclude sales tax from revenue when collected and expenses when paid and instead, record collection and payment of sales taxes through a liability account.

Advertising Jackson Energy expenses advertising costs as incurred.

Note 1. Summary of Significant Accounting Policies, continued

Cost of Power Jackson Energy is one of sixteen (16) members of East Kentucky. Under a wholesale power agreement, Jackson Energy is committed to purchase its electric power and energy requirements from East Kentucky until 2051. The rates charged by East Kentucky are subject to approval of the PSC. The cost of purchased power is recorded monthly during the period in which the energy is consumed, based upon billings from East Kentucky.

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

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

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

> Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities
>
> Level 2: Quoted prices in markets that are not considered to be active or financial instruments for which all significant inputs are observable, either directly or indirectly.
>
> Level 3: Prices or valuations that require inputs that are both significant to the fair value measure and unobservable.

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

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

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

Goodwill Goodwill was recorded in connection with the purchase of one-half (1/2) interest from an unrelated party on June 30, 2000. The excess of the purchase price over the value of assets acquired has been recorded as goodwill. Goodwill was tested for impairment and it was determined that goodwill has not been impaired; therefore, there was no impairment of goodwill for 2012 or 2011.

Note 1. Summary of Significant Accounting Policies, continued

Deferred Property Retirement During 1994, Jackson Energy initiated a Geographic Information System ("GIS") project to establish detailed maps of its distribution electric system and provide a database containing detailed information on the facilities and quantities installed. A physical inventory was performed and the difference between the facilities reported on the GIS base map and the accounting records resulted in an adjustment to decrease plant by $14,535,593, and a reduction in accumulated depreciation of $2,530,647. This resulted in a net adjustment of $12,004,946. The PSC required this amount to be amortized over 25.5 years, which results in annual amortization of $470,782.

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

Environmental Contingency Jackson Energy, from time to time, is required to work with and handle PCB's, herbicides, automotive fluids, lubricants, and other hazardous materials in the normal course of business. As a result, there is a possibility that environmental conditions may arise which would require Jackson Energy to incur cleanup costs. The likelihood of such an event, or the amount of such costs, if any, cannot be determined at this time. However, management does not believe such costs, if any, would materially affect Jackson Energy's financial position or its future cash flows.

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

Effective January 1, 2008, Jackson Energy adopted the provisions of the *Income Taxes Topic* of the FASB ASC that pertains to accounting for uncertainty in income taxes. Jackson Energy had no prior unrecognized tax benefits as a result of the implementation. Management evaluates its potential exposures from tax positions taken that have or could be challenged by taxing authorities. These potential exposures result because taxing authorities may take positions that differ from those taken by management in the interpretation and application of statutes, regulations, and rules. There are no tax positions for which the ultimate deductibility is highly uncertain included in the accompanying financial statements. Jackson Energy recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. Jackson Energy did not recognize any interest or penalties during the years ended December 31, 2012 or 2011. Jackson Energy's income tax return is subject to possible examination by taxing authorities until the expiration of related statues of limitations on the return, which is generally three years.

Comprehensive Income Comprehensive income includes both net margin and other comprehensive income. Other comprehensive income represents the change in funded status of the accumulated postretirement benefit obligation.

Reclassifications Comparative data for the prior year have presented in certain sections of the accompanying financial statements in order to provide an understanding of changes in the financial position and operations.

Subsequent Events Management has evaluated subsequent events through May 16, 2013, the date the financial statements were available to be issued. There were no significant subsequent events to report.

Note 2. Investments in Associated Organizations

Jackson Energy records patronage capital assigned by associated organizations in the year in which such assignments are received. The Capital Term Certificates ("CTCs") of CFC are recorded at cost. The CTCs were purchased from CFC as a condition of obtaining long-term financing. The CTCs bear interest at 0%, 3% and 5% and are scheduled to mature at varying times from 2020 to 2080. Member Capital Securities have a 7.5% fixed interest rate and mature 35 years from the issuance date. Interest is paid each Aprill and October 1.

Investments in associated organizations consist of:

	2013	2012
East Kentucky, patronage capital	$31,890,184	$27,531,845
CFC - CTC's	1,892,412	1,932,691
CFC - Member Capital Securities	980,000	980,000
Other associated organizations	2,594,157	2,524,314
Economic development loans	2,043,554	1,186,200
	$39,400,307	$34,155,050

Note 3. Patronage Capital

Under provisions of the long-term debt agreement, return to patrons of capital contributed by them is limited to amounts which would not allow the total equities and margins to be less than 30% of total assets, except that distributions may be made to estates of deceased patrons. The debt agreement provides, however, that should such distributions to estates not exceed 25% of the net margins for the next preceding year, Jackson Energy may distribute the difference between 25% and the payments made to such estates. The equity at February 28, 2013 was 32% of total assets. Included in other equities is $2,596,731 of losses from prior years' that is being carried forward to be offset with future years' non operating margins.

Patronage capital consists of:

	2013	2012
Assigned to date	$93,550,929	$89,041,661
Assignable	1,701,409	261,459
Prior year's deficits	(2,596,731)	(1,829,527)
Retired to date	(21,715,677)	(17,782,586)
	$70,939,930	$69,691,007

Note 4. Long Term Debt

All assets, except vehicles, are pledged as collateral on the long term debt to RUS, Federal Financing Bank ("FFB"), and CFC under a joint mortgage agreement. The Economic Development Loans are due to RUS and are secured by a portion of the assets pledged by Jackson Energy's consumers. The amounts due East Kentucky are for the Residential Marketing Loan Program for consumers.

The interest rates on the notes to CFC are subject to change every seven years from the repricing date for each individual note. The long term debt is due in quarterly and monthly installments of varying amounts through 2039. Jackson Energy has loan funds available from FFB in the amount of $8,000,000. RUS assess 12.5 basis points to administer the FFB loans.

During 2003, Jackson Energy refinanced $27,128,547 of RUS 5% notes with variable rate and term notes. These notes are due in 15 annual installments of $1,808,570 each.

Note 4. Long Term Debt, continued

On September 12, 2000, East Kentucky issued a "Commercial Note With Guaranty" in the amount of $817,852 to allow Service Corporation to purchase its one-half interest. The interest rate is variable, with the rate being the "*Index Rate*", as published in the Wall Street Journal, minus one-half percent. The rate at 2012 was 2.75% and 2011 was 2.75%.

Long term debt consists of:

	2013	2012
Notes due RUS, 4.125% to 5%	$29,571,608	$30,288,700
Notes due FFB, 0.122% to 5.353%	82,531,796	78,378,629
Economic Development, RUS, 0% interest	2,025,499	1,163,139
Notes due CFC:		
5.85% to 6.70%	11,274,680	11,935,510
Refinance RUS loans 5.30% to 6.05%	9,959,928	11,767,941
	135,363,511	133,533,919
Current portion	5,250,000	5,000,000
Long term portion for Jackson Energy	130,113,511	128,533,919
East Kentucky 2.75% (2.75% in 2010)	250,181	342,359
Current portion	95,000	95,000
Long term portion for Propane Plus	155,181	247,359
Total long term portion	$130,268,692	$128,781,278

As of February 28, 2013, the annual principal payments of Jackson Energy for the next five years are as follows: 2014 - $5,250,000; 2015 - $5,400,000; 2016 - $5,600,000; 2017 - $5,800,000; 2018 - $5,900,000.

As of December 31, 2012, the annual principal payments of Propane Plus for the next five years are as follows: 2013 - $95,000; 2014 - $100,000; 2015 - $55,000; 2016 - none.

Note 5. Short Term Borrowings

At February 28, 2013, Jackson Energy had a short term line of credit of $10,000,000 available from CFC and $5,000,000 from National Bank for Cooperative ("CoBank"). At February, 2013 there was $1,000,000 advanced against the CFC line of credit with an interest rate of 2.90%.

Propane Plus has advanced funds from a related propane company to open facilities at a new location. $30,000 has been advanced from a related propane company for a period of 6 months, with renewal for another 6 months. The note is due upon 30 days notice by the propane company. The note bears interest at 3% per year. The remaining advances are from two (2) Line of Credit loans from Cumberland Valley National Bank in the amount of $400,000 and $350,000, respectively. These notes are for a period of one year, with renewal options. The interest rate on both line of credit advances is the minimum of 5%.

Note 6. Pension Plan

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

Jackson's contributions to the R&S Plan in 2013 and 2012 represent less than 5 percent of the total contributions made to the plan by all participating employers. Jackson made contributions to the plan of $2,442,964 in 2012 and $2,264,685 in 2012. There have been no significant changes that affect the comparability of 2013 and 2012. During 2013, Jackson Energy purchased Cost of Living Allowance ("COLA") benefits for participating employees at a cost of $2,040,627. This amount is being amortized over 30 years.

In the R&S Plan, a "zone status" determination is not required, and therefore not determined, under the Pension Protection Act ("PPA") of 2006. In addition, the accumulated benefit obligations and plan assets are not determined or allocated separately by individual employer. In total, the R&S Plan was between 65 percent and 80 percent funded at January 1, 2012 and 2011 based on the PPA funding target and PPA actuarial value of assets on those dates. Because the provisions of the PPA do not apply to the R&S Plan, funding improvement plans and surcharges are not applicable. Future contribution requirements are determined each year as part of the actuarial valuation of the plan and may change as a result of plan experience.

Propane Plus has a profit sharing plan of 10% of net profits, before the pension amount, where managers receive 5% of the plan amount and the remaining employees share the remaining 5%. The pension amount for 2012 was $10,779 and 2011 was $8,121.

Note 7. Postretirement Benefits

Jackson Energy sponsors a defined benefit plan that provides medical insurance coverage to retired employees, directors, and attorney and their dependents. The plan calls for benefits to be paid at retirement based primarily upon years of service with Jackson Energy. Participating retirees and dependents do not contribute to the projected cost of coverage. The following is a reconciliation of the postretirement obligation.

The funded status of the plan is as follows:

	2013	2012
Projected benefit obligation	($8,240,510)	($7,918,704)
Fair value of plan assets	-	-
Funded status	($8,240,510)	($7,918,704)

Note 7. Postretirement Benefits, continued

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

	2013	2012
Benefit obligation - beginning of period	$7,918,704	$7,612,518
Net periodic benefit cost:		
Service cost	298,664	322,463
Interest cost	484,776	465,937
Amortize gains/losses	-	-
Net period cost	783,440	788,400
Accumulated comprehensive income	-	-
Benefit payments to participants	(461,634)	(482,214)
Benefit obligation - end of period	$8,240,510	$7,918,704

Projected retiree benefit payments for the next five years are expected to be as follows: 2014 - $440,000; 2015 - $434,000; 2016 - $423,000; 2017 - $420,000; 2018 - $400,000.

The discount rate used in determining the APBO was 6.50% for 2013 and 2012. The health care cost trend rate used to compute the APBO in an 8% annual rate of increase for 2011, and decreasing gradually to 5.5%, then remain at that level thereafter.

Note 11. Related Party Transactions

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

Note 12. Commitments

Jackson Energy has various other agreements outstanding with local contractors. Under these agreements, the contractors will perform certain meter reading, construction, and maintenance work at specified hourly rates or unit cost, or on an as needed basis. The duration of these contracts are one to three years.

Note 13. Leases

Jackson Energy leases space for two (2) of its branch offices and a storage facility from unrelated parties. The leases are operating leases with monthly payments of $1,600, $200, and $55 per month, respectively. The lease terms vary, and can be renewed, or cancelled, by either party with advance notice.

Note 14. Rate Matters

East Kentucky increased its base rates to Jackson Energy during August 2007, by 2%, in April 2008, by another 7%, and in January, 2012 by another 5%. Jackson Energy passed each of East Kentucky's increases on to its customers using the methodology prescribed by the PSC.

* * * * * *

Independent Auditor's Report

To the Board of Directors
Jackson Energy Cooperative

My report on the audits of the consolidated financial statements of Jackson Energy Cooperative and Subsidiary as of February 28, 2013 and 2012 and for the years then ended appears on page 1. My audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The consolidating information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual companies. The supplementary consolidating information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and, in my opinion is fairly stated in all material respects, in relation to the basic financial statements taken as a whole.

Alan M. Zumstein

Alan M. Zumstein, CPA
May 16, 2013

Jackson Energy Cooperative and Subsidiary

Consolidating Balance Sheet, February 28, 2013

Assets	Energy	Services	Propane	Eliminations	Consolidated
Net Utility Plant	$161,436,706		$2,688,839		$164,125,545
Investments and Other Assets:					
Associated organizations	39,400,307				39,400,307
Goodwill, net of amortization			262,177		262,177
Subsidiary	1,767,412	2,355,635		(4,123,047)	0
	41,167,719	2,355,635	262,177	(4,123,047)	39,662,484
Current Assets:					
Cash and cash equivalents	2,037,118	1,070	166,060		2,204,248
Accounts receivable, less allowance for uncollectible accounts	17,412,387		177,406	(156)	17,589,637
Material and supplies, at average cost	1,485,856		231,481		1,717,337
Prepayments	701,428		43,172		744,600
	21,636,789	1,070	618,119	(156)	22,255,822
Deferred charges	8,434,385				8,434,385
Total	$232,675,599	$2,356,705	$3,569,135	($4,123,203)	$234,478,236
Members' Equities and Liabilities					
Members' and Stockholder's Equities:					
Memberships and capital	$1,297,560	$1,344,000	$1,217,680	($2,561,680)	$1,297,560
Patronage capital and retained earnings	70,939,930	423,412	1,142,376	(1,565,788)	70,939,930
Accum other comprehensive income	(1,381,211)				(1,381,211)
Minority interests and other equities	4,336,003	589,137		4,421	4,929,561
	75,192,282	2,356,549	2,360,056	(4,123,047)	75,785,840
Long Term Debt	130,113,511		155,181		130,268,692
Accumulated Postretirement Benefits	8,240,510				8,240,510
Current Liabilities:					
Accounts payable	8,398,577	156	248,616	(156)	8,647,193
Short term borrowings	1,000,000		710,282		1,710,282
Current portion of long term debt	5,250,000		95,000		5,345,000
Consumer deposits	1,037,175				1,037,175
Accrued expenses	3,115,333				3,115,333
	18,801,085	156	1,053,898	(156)	19,854,983
Consumer Advances for Construction	328,211				328,211
Total	$232,675,599	$2,356,705	$3,569,135	($4,123,203)	$234,478,236

The accompanying notes are an integral part of these statements.

Consolidating Statement of Revenue and Comprehensive Income

for the year ended February 28, 2013

	Energy	Services	Propane	Eliminations	Consolidated
Operating Revenues	$101,322,190		$3,584,778	($28,756)	$104,878,212
Operating Expenses:					
Cost of purchases	66,944,575		1,851,668		68,796,243
Distribution - operations and maintenance	10,717,512		901,345		11,618,857
Consumer accounts	3,170,163		207,773		3,377,936
Customer service and information	778,187		66,663		844,850
Administrative and general	4,741,453	4,778	122,401	(28,756)	4,839,876
Depreciation, excluding $555,350 charged to clearing accounts	8,319,035		197,617		8,516,652
Amortization of deferred property retirements	470,772				470,772
Taxes	120,557		25,200		145,757
Other	73,532				73,532
	95,335,786	4,778	3,372,667	(28,756)	98,684,475
Operating Margins before Interest Charges	5,986,404	(4,778)	212,111		6,193,737
Interest Charges:					
Interest on long term debt	5,371,193		45,689		5,416,882
Other interest	40,051				40,051
	5,411,244		45,689		5,456,933
Operating Margins after Interest Charges	575,160	(4,778)	166,422		736,804
Nonoperating Margins:					
Interest income	164,477		198		164,675
Subsidiary and others	60,154	170,473	3,853	(336,168)	(101,688)
	224,631	170,473	4,051	(336,168)	62,987
Patronage Capital, associated organizations	4,506,493				4,506,493
Net Margins	5,306,284	165,695	170,473	(336,168)	5,306,284
Other Comprehensive Income:					
Postretirement benefits	201,600				201,600
Noncontrolling interests		(41,424)			(41,424)
Total Comprehensive Income	$5,507,884	$124,271	$170,473	($336,168)	$5,466,460

The accompanying notes are an integral part of these statements.

ALAN M. ZUMSTEIN
CERTIFIED PUBLIC ACCOUNTANT

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MEMBER
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- KENTUCKY SOCIETY OF CPA'S
- INDIANA SOCIETY OF CPA'S
- AICPA DIVISION FOR FIRMS

To the Board of Directors
Jackson Energy Cooperative

I have audited the financial statements of Jackson Energy Cooperative for the year ended February 28, 2013, and have issued my report thereon dated May 16, 2013. I conducted my audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and 7 CFR Part 1773, Policy on audits of the Rural Utilities Service (RUS) Borrowers. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing my audit of the financial statements of the Cooperative for the year ended December 31, 2012, I considered its internal control over financial reporting in order to determine my auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control over financial reporting.

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

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

No reports, other than my independent auditor's report, and my independent auditor's report on internal control over financial reporting and compliance and other matters, all dated May 16, 2013, or summary of recommendations related to my audit have been furnished to management.

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

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

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

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

Comments on Compliance with Specific RUS Loan and Security Instrument Provisions

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

- Procedures performed with respect to the requirement for a borrower to obtain written approval of the mortgagee to enter into any contract for the operation or maintenance of property, or for the use of mortgaged property by others for the year ended February 28, 2013, of the Cooperative.
  1. The Cooperative has not entered into any contract during the year for the operation or maintenance of its property, or for the use of its property by others as defined in 1773.33(e)(1)(i).
- Procedures performed with respect to the requirement to submit RUS Financial and Operating Report, Electric Distribution to RUS:
  1. Agreed amounts reported in RUS Financial and Operating Report, Electric Distribution to the Cooperative's records as of December 31, 2012.

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

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

Comments on Other Additional Matters

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

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

- The clearing of the construction accounts and the accrual of depreciation on completed construction addressed at 7 CFR Part 1773.33(c)(2);
- The retirement of plant addressed at 7 CFR 1773.33(c)(3) and (4);
- Approval of the sale, lease, or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap addressed at 7 CFR Part 1773.33(c)(5);
- The disclosure of material related party transactions, in accordance with Statement of Financial Accounting Standard No. 57, Related party Transactions, for the year ended February 28, 2013, in the financial statements referenced in the first paragraph of this report addressed at 7 CFR Part 1773.33(f);
- The depreciation rates addressed at 7 CFR Part 1773.33(g);
- The detailed schedule of deferred debits and deferred credits; and
- The detailed schedule of investments.

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

The deferred debits are as follows:

Deferred property retirements	$6,473,115
Past service pension benefits	1,961,270
	$8,434,385

The deferred credits are as follows:

Consumer advances for construction	$328,211

Jackson Energy is a 75% owner of Jackson Energy Services Corporation, which owns 100% of the stock of Jackson Energy Propane Plus, LLC. Jackson Propane distributes propane to residential and commercial customers in and around areas where Jackson Energy Cooperative provides electric service. Jackson Energy Cooperative's initial investment was $9,000. The investment and profits (losses) are as follows:

	Investment	Profits
Beginning balance	$1,344,000	$299,141
Activity for 2013		124,271
Ending balance	$1,344,000	$423,412

This report is intended solely for the information and use of the Board of Directors, management, RUS, and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties.

Alan M. Zumstein

Alan M. Zumstein, CPA
May 16, 2013