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Jackson Purchase Energy Corporation
Paducah, Kentucky

Audited Financial Statements
December 31, 2012 and 2011

ALAN ZUMSTEIN
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To the Board of Directors
Jackson Purchase Energy Corporation

I have audited the financial statements of Jackson Purchase Energy Corporation for the year ended December 31, 2012, and have issued my report thereon dated February 8, 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 Corporation 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 February 8, 2013, or summary of recommendations related to my audit have been furnished to management.
To the Board of Directors

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 Corporation's internal control over financial reporting and its operation that I consider to be a material weakness as previously defined with respect to:

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

Comments on Compliance with Specific RUS Loan and Security Instrument Provisions

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

- Procedures performed with respect to the requirement for a borrower to obtain written approval of the mortgagee to enter into any contract for the operation or maintenance of property, or for the use of mortgaged property by others for the year ended December 31, 2012, of the Corporation.
    1. The borrower 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 Financial and Operating Report Electric Distribution to RUS:
    1. Agreed amounts reported in Financial and Operating Report Electric Distribution to the Corporation's records as of December 31, 2012.

The results of my tests indicate that, with respect to the items tested, the Corporation 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 Corporation 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 Financial and Operating Report Electric Distribution to RUS and 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 borrower received no long term loan fund 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 Corporation, nothing came to my attention that caused me to believe that the Corporation 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 December 31, 2012, in the financial statements referenced in the first paragraph of this report addressed at 7 CFR Part 1773.33(f);
- The depreciation rates addressed at 7 CFR Part 1773.33(g);
- The detailed schedule of deferred debits and deferred credits; and
- The detailed schedule of investments, of which there were none.

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 mapping costs	$99,325

The deferred credits are as follows:

Consumer advances for construction	$127,048
Unlocated checks	224,462
Total	$351,510

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
February 8, 2013

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Jackson Purchase Energy Corporation
Paducah, Kentucky

Audited Financial Statements
December 31, 2012 and 2011

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Independent Auditor's Report

To the Board of Directors
Jackson Purchase Energy Corporation

I have audited the accompanying balance sheets of Jackson Purchase Energy Corporation, as of December 31, 2012 and 2011, and the related statements of revenues and comprehensive income, members' equities, and cash flows for the years then ended. These financial statements are the responsibility of Jackson Purchase Energy Corporation's management. My responsibility is to express an opinion on these financial statements based on my audits.

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

In my opinion, the financial statements referred to previously present fairly, in all material respects, the financial position of Jackson Purchase Energy Corporation as of December 31, 2012 and 2011, and the results of operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, I have also issued a report dated February 8, 2013, on my consideration of Jackson Purchase Energy Corporation's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements. 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 my audits.

Alan M. Zumstein
Alan M. Zumstein, CPA
February 8, 2013

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To the Board of Directors
Jackson Purchase Energy Corporation

I have audited the financial statements of Jackson Purchase Energy Corporation as of and for the years ended December 31, 2012 and 2011, and have issued my report thereon dated February 8, 2013. I conducted my audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

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 the Corporation'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 the Corporation's internal control over financial reporting. Accordingly, I do no express an opinion on the effectiveness of the Corporation'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 the Corporation's financial statements are free of material misstatement, I performed tests 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*.

This report is intended solely for the information and use of the board of directors, 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
February 8, 2013

Jackson Purchase Energy Corporation
Balance Sheets, December 31, 2012 and 2011

Assets	2012	2011
Electric Plant, at original cost:		
In service	$ 138,177,537	$ 134,624,348
Under construction	3,118,608	2,907,866
	141,296,145	137,532,214
Less accumulated depreciation	48,473,066	45,094,854
	92,823,079	92,437,360
Investments in Associated Organizations	2,979,110	2,961,606
Current Assets:		
Cash and cash equivalents	7,076,505	2,970,640
Accounts receivable, less allowance for 2012 of $67,779 and 2011 of $94,735	3,090,153	2,698,963
Other receivables	2,595,326	2,730,094
Accrued unbilled revenue	1,061,587	1,031,603
Material and supplies, at average cost	1,471,355	1,615,433
Other current assets	443,519	403,994
	15,738,445	11,450,727
Deferred mapping costs	99,325	297,973
Total	$ 111,639,959	$ 107,147,666

Members' Equities and Liabilities	2012	2011
Members' Equities:		
Memberships	$ 151,210	$ 157,865
Patronage capital	40,333,027	39,250,417
Accumulated other comprehensive income	(316,228)	(345,025)
	40,168,009	39,063,257
Long Term Debt	60,282,469	57,775,085
Accumulated Postretirement Benefits	1,842,386	1,700,793
Current Liabilities:		
Accounts payable	3,385,533	2,885,594
Consumer deposits	1,738,080	1,759,887
Current portion of long term debt	2,285,000	2,375,000
Accrued expenses	1,586,972	1,441,581
	8,995,585	8,462,062
Advances for Construction and others	351,510	146,469
Total	$ 111,639,959	$ 107,147,666

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

Statements of Revenue and Comprehensive Income
for the years ended December 31, 2012 and 2011

	2012	2011
Operating Revenues	$ 47,942,208	$ 45,135,203
Operating Expenses:		
Cost of power	29,783,789	27,759,591
Distribution - operations	2,693,580	3,110,221
Distribution - maintenance	3,739,739	3,871,294
Consumer accounts	1,043,716	1,055,142
Consumer service and information	80,595	108,682
Administrative and general	2,182,691	2,138,367
Depreciation, excluding $318,425 in 2012 and $315,642 in 2011 charged to clearing accounts	4,965,644	4,695,048
Taxes	52,720	48,869
Other deductions	1,109	1,450
	44,543,583	42,788,664
Operating Margins before Interest Charges	3,398,625	2,346,539
Interest Charges:		
Long-term debt	2,758,264	2,867,944
Other interest	54,294	131,427
	2,812,558	2,999,371
Operating Margins after Interest Charges	586,067	(652,832)
Nonoperating Margins		
Interest income	344,693	330,626
Other nonoperating income, net	(11,922)	15,688
	332,771	346,314
Patronage Capital from Associated Organizations	163,772	419,241
Net Margins	1,082,610	112,723
Accumulated comprehensive income:		
Accumulated postretirement benefits	28,797	28,797
Comprehensive Income	$ 1,111,407	$ 141,520

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

Statements of Cash Flows
for the years ended December 31, 2012 and 2011

	2012	2011
Cash Flows from Operating Activities:		
Net margins	$ 1,082,610	$ 112,723
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation		
Charged to expense	4,965,644	4,695,048
Charged to clearing	318,425	315,642
Capital credits allocated	(163,772)	(419,241)
Accumulated postretirement benefits	170,390	153,511
Net change in current assets and liabilities:		
Receivables	(286,406)	4,178,213
Material and supplies	144,078	68,309
Other current assets	(39,525)	175,950
Deferred charges	198,648	198,648
Accounts payable	499,939	(379,835)
Consumer deposits	(21,807)	99,701
Accrued expenses	145,391	637,729
Consumer advances for construction	205,041	(8,205)
	7,218,656	9,828,193
Cash Flows from Investing Activities:		
Construction of plant	(4,967,358)	(5,659,505)
Plant removal costs	(851,764)	(768,669)
Salvage recovered from plant	149,334	490,611
Receipts from investments, net	146,268	229,421
	(5,523,520)	(5,708,142)
Net Cash Flows from Financing Activities:		
Net decrease in memberships	(6,655)	(8,895)
Refund capital credits	-	(1,589,135)
Notes payable	-	(5,500,000)
Additional long-term borrowings	5,000,000	8,000,000
Advance payments	(204,733)	(275,868)
Payments on long-term debt	(2,377,883)	(2,235,027)
	2,410,729	(1,608,925)
Net increase in cash balances	4,105,865	2,511,126
Cash and cash equivalents - beginning	2,970,640	459,514
Cash and cash equivalents - ending	$ 7,076,505	$ 2,970,640
Supplemental disclosures of cash flow information:		
Interest on long-term debt	$ 2,402,989	$ 2,872,907

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

Statements of Members' Equities
for the years ended December 31, 2011 and 2012

	Memberships	Patronage Capital	Other Equity	Accumulated Other Comprehensive Income	Total Members' Equity
Balance - Beginning of year	$ 166,760	$ 40,726,829	$ -	$ (373,822)	$ 40,519,767
Comprehensive income:					
Net margins		112,723			112,723
Postretirement benefit obligation					
Amortization				28,797	
Adjustments				-	28,797
Total comprehensive income					141,520
Net change in memberships	(8,895)				(8,895)
Refunds of capital credits		(1,589,135)			(1,589,135)
Other equities					-
Balance - December 31, 2011	157,865	39,250,417	-	(345,025)	39,063,257
Comprehensive income:					
Net margins		1,082,610			1,082,610
Postretirement benefit obligation					
Amortization				28,797	
Adjustments				-	28,797
Total comprehensive income					1,111,407
Net change in memberships	(6,655)				(6,655)
Refunds of capital credits					-
Other equities					-
Balance - December 31, 2012	$ 151,210	$ 40,333,027	$ -	$ (316,228)	$ 40,168,009

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

Note 1. Summary of Significant Accounting Policies

Jackson Purchase Energy Corporation ("the Corporation") 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:

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

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

	2012	2011
Distribution plant	$129,325,369	$125,691,916
General plant	8,852,168	8,932,432
Total	$138,177,537	$134,624,348

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 1.48% to 12.09%, with a composite rate of 3.73% for distribution plant. General plant rates are as follows:

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

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

Off Balance Sheet Risk The Corporation 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 December 31, 2012, the financial institutions reported deposits in excess of the $250,000 FDIC insured limit on several of the accounts. Deposits and repurchase agreements in excess of the FDIC limits are 100% secured with collateral from each respective financial institution.

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 The Corporation records revenue as billed to its consumers based on monthly meter-reading cycles. All consumers are required to pay a refundable deposit that may be waived under certain circumstances. The Corporation's sales are concentrated in a six county area of western Kentucky. There were no consumers whose individual account balance exceeded 10% of outstanding accounts receivable at December 31, 2012 or 2011. Consumers must pay their bill within 20 days of billing, then are subject to disconnect after another 10 days. Accounts are written off when they are deemed to be uncollectible. The allowance for uncollectible accounts is based on the aging of receivables.

Note 1. Summary of Significant Accounting Policies, continued

Taxes The Corporation is required to collect, on behalf of the State 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 Corporation'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.

Cost of Power The *Corporation is one of three (3) members of* Big Rivers Electric Corporation, Inc. ("Big Rivers"), a generation and transmission cooperative association. Under a wholesale power agreement, the Corporation is committed to purchase its electric power and energy requirements from Big Rivers until 2043. The rates charged by Big Rivers 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 Big Rivers. There are certain surcharges, clauses, and credits that Big Rivers includes to the Corporation that are passed on to consumers using a methodology prescribed by the Commission.

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 the Corporation's cash and cash equivalents, other receivables, investments, inventories, other assets, trade accounts payable, accrued expenses and liabilities, and other liabilities approximate fair value due to their short maturity. Investments in associated organizations are not considered a financial instrument because they represent nontransferable interests in associated organizations. Other assets and liabilities are not considered financial instruments because they represent activities specifically related to the Corporation. 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.

The Corporation 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.

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

Advertising The Corporation expenses advertising costs as incurred.

Note 1. Summary of Significant Accounting Policies, continued

Risk Management The Corporation 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.

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.

Generation and Transmission Corporation As discussed in the preceding footnotes, the Corporation purchases electric power from Big Rivers, a generation and transmission cooperative association. The membership of Big Rivers is comprised of the Corporation and two other distribution cooperatives.

On July 16, 2009, Big Rivers consummated an "unwind" transaction with E.ON US under which Big Rivers will assume from E.ON US full responsibility for operating its three generation facilities and the obligation to serve two aluminum smelters through Kenergy Corporation. E.ON US provided cash payments, asset transfers and other benefits to Big Rivers, which resulted in Big Rivers booking extraordinary income of $537,978,000 in 2009. These economic benefits allowed Big Rivers to pay down approximately $140,000,000 of debt, provide $253,000,000 of rate stabilization funds, and increase its equity to a positive $379,391,000 from a deficit of ($154,602,000) at December 31, 2009. After consideration of all relevant facts and information the Corporation has elected to continue valuing the non-cash allocations received from Big Rivers at zero for financial accounting purposes, a practice it has followed since Big Rivers emerged from bankruptcy in 1998 during which all previous booked non-cash allocations were reduced to zero. The Corporation will continue to make memorandum entries in its patronage subsidiary ledger of the face amount of the allocations received from Big Rivers. Refer to the subsequent footnote for the income tax treatment of these non-cash allocations.

Income Tax Status The Corporation is exempt from federal and state income taxes under provisions of Section 501(c)(12). Accordingly, the financial statements for The Corporation include no provision for income taxes. When applying the 85 percent test of IRC 501(c)(12), the Corporation excludes the Big Rivers non-cash allocations from "gross income". The Corporation's accounting policy provides that a tax expense/benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits. Management believes The Corporation has no uncertain tax positions resulting in an accrual of tax expense or benefit. The Corporation recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. The Corporation did not recognize any interest or penalties during the years ended August 31, 2012 and 2011. The Corporation'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.

Subsequent Events Management has evaluated subsequent events through February 7, 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, continued

The Corporation records patronage capital assigned by associated organizations in the year in which such assignments are received. The Capital Term Certificates ("CTCs") of CFC are recorded at cost. The CTCs were purchased from CFC as a condition of obtaining long-term financing. The CTCs bear interest at 0%, 3% and 5% and are scheduled to mature at varying times from 2020 to 2080.

Note 2. Investments in Associated Organizations, continued

Investments in associated organizations consist of:

	2012	2011
CFC, CTCs	$940,404	$941,585
CFC, patronage capital	45,157	43,969
CoBank, patronage capital	584,204	536,894
National Rural Telecommunications Cooperative	843,824	883,754
Others	565,521	555,404
Total	$2,979,110	$2,961,606

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, the Corporation may distribute the difference between 25% and the payments made to such estates. The equity at December 31, 2012 was 36% of total assets. The Corporation adopted a policy whereby it would refund capital credits to its members in any annual period that a Times Interest Earned Ratio ("TIER") of 2.0 is exceeded. There are none anticipated for 2012. Patronage capital consists of:

	2012	2011
Assigned to date	$40,839,552	$40,726,829
Assignable	1,082,610	112,723
Retired to date	(1,589,135)	(1,589,135)
Total	$40,333,027	$39,250,417

Note 4. Long Term Debt

All assets, except vehicles, are pledged as collateral on the long term debt to RUS, Federal Financing Bank ("FFB"), CoBank, and CFC under a joint mortgage agreement. The long term debt is due in quarterly and monthly installments of varying amounts through 2039. The Corporation had a loan approved from FFB in the amount of $13,753,000 that will be used for future plant additions. RUS assesses 12.5 basis points to administer the FFB loans. During 2012 the Corporation refinanced $9,403,475 of RUS loans with funds advanced from CoBank.

First mortgage notes are due as follows:

	2012	2011
First mortgage notes due RUS:		
2.50% to 5.53%	$20,718,972	$30,546,318
Advance payment	(5,889,272)	(5,684,539)
	14,829,700	24,861,779
First mortgage notes due FFB:		
0.733% to 5.158%	26,810,931	22,539,835

First mortgage notes due CoBank:		
3.05% to 4.90%	20,415,205	12,174,727
First mortgage notes due CFC		
5.05%	511,633	573,744
	62,567,469	60,150,085
Current portion	2,285,000	2,375,000
Long term portion	$60,282,469	$57,775,085

As of December 31, 2012, the annual principal portion of long term debt outstanding for the next five years are as follows: 2013 - $2,285,000; 2014 - $2,500,000; 2015 - $2,560,000; 2016 - $2,625,000; 2017 - $2,690,000.

Note 5. Short Term Borrowings

The Corporation has a line of credit available from CoBank in the amount of $10,000,000. All advances were repaid during the audit period. The Corporation also has a short term line of credit of $5,000,000 available from CFC. There were no advances against the CFC line of credit during the audit period.

Note 6. Pension Plans

All eligible non-union employees of the Corporation 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.

The Corporation's contributions to the R&S Plan in 2012 and 2011 represent less than 5 percent of the total contributions made to the plan by all participating employers. The Corporation made contributions to the plan of $822,872 in 2012 and $818,570 in 2011. There have been no significant changes that affect the comparability of 2012 and 2011.

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.

All eligible union employees participate in the International Brotherhood of Electrical Workers ("IBEW") Savings Plan. The Corporation contributes 10% of base wages to the plan. The Corporation contributions to the plan totaled $193,751 in 2012 and $203,464 in 2011.

Note 7. Retirement Savings Plans

Eligible non-union employees are eligible to participate in the NRECA 401(k) Plan. The Corporation contributes 4% of annual wages to the plan. Non-eligible employees, as defined above, participate in the savings plan, with the Corporation contributing 14% for non-union employees and 10% for union employees. Contributions for these plans totaled $208,699 for 2012 and $202,256 for 2011.

Note 8. Postretirement Benefits

The Corporation sponsors a defined benefit plan that provides medical insurance coverage to retirees. The premiums are paid for a maximum of ten years or until age 65, whichever comes first. For measurement purposes, an annual rate of increase of 8% in 2011, then decreasing by 0.5% per year until 5% per year, in the per capita cost of covered health care benefit was assumed. The discount rate used in determining the accumulated postretirement benefit obligation was 5.75%.

The funded status of the plan is as follows:

	2012	2011
Projected benefit obligation	($1,842,386)	($1,700,793)
Plan assets at fair value	-	-
Funded status	($1,842,386)	($1,700,793)

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

	2012	2011
Benefit obligation at beginning of year	$1,700,793	$1,576,079
Net periodic benefit cost:		
Service cost	125,595	110,882
Interest cost	97,437	98,306
	223,032	209,188
Benefits paid	(81,439)	(84,474)
Actuarial gain/loss	-	-
Benefit obligation at end of year	$1,842,386	$1,700,793

Projected retiree benefit payments for the next five years are expected to be as follows: 2013 - $86,000; 2014 - $84,000; 2015 - $8,000; 2016 - $80,000; 2017 - $75,000.

Note 9. Related Party Transactions

Several of the Directors of the Corporation and its President & CEO are on the Boards of Directors of various associated organizations.

Note 10. Labor Force

Approximately 45% of the Corporation's labor force is subject to a collective bargaining agreement. An eight (8) year agreement was negotiated and approved for the period starting November, 2005 between the Corporation and the IBEW.

Note 11. Environmental Contingency

The Corporation from time to time is required to work with and handle PCBs, herbicides, automotive fluids, lubricants, and other hazardous materials in the normal course of business. As a result, there is the possibility that environmental conditions may arise which would require the Corporation 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 the Corporation's financial position or its future cash flows.

Note 12. Contingencies

The Corporation is involved in litigation arising in the normal course of business. While the results of such litigation cannot be predicted with certainty, management, based upon advice of counsel, believes that the final outcome will not have a material adverse effect on the financial statements.

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