

**From:** Michelle Herrman  
**Sent:** Wednesday, May 22, 2013 10:03 AM  
**To:** PSC - Reports  
**Cc:** Ann Wood; Shawn West  
**Subject:** 2012 Audit PDF Owen Electric

Jeff,

Attached is an unprotected pdf of the 2012 audit report for Owen Electric Cooperative.  
Please let me know if you have any problems.

***Michelle D. Herrman, CPA***  
***Controller***



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**Owen Electric Cooperative, Inc.**

**Audited Financial Statements**

**December 31, 2012 and 2011**

**Owen Electric Cooperative, Inc.**

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December 31, 2012 and 2011

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## Independent Auditor's Report

To the Board of Directors  
**Owen Electric Cooperative, Inc.**  
Owenton, Kentucky

We have audited the accompanying balance sheets of Owen Electric Cooperative, Inc. ("the Cooperative") as of December 31, 2012 and 2011 and the related statements of income and comprehensive (loss) income, changes in members' and patrons' equities and cash flows for the years then ended, and the related notes to the financial statements.

### *Management's Responsibility for the Financial Statements*

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

### *Auditor's Responsibility*

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

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

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

### *Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Cooperative as of December 31, 2012 and 2011, and the respective changes in financial position and, where applicable, cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

## **Independent Auditor's Report (Continued)**

### ***Other-Reporting Required by Government Auditing Standards***

In accordance with Government Auditing Standards, we have also issued our reported dated April 24, 2013, on our consideration of the Cooperative's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

### **Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133**

We have audited the financial statements of the Cooperative as of and for the year ended December 31, 2012, and have issued our report thereon dated April 24, 2013, which contained an unmodified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditure of federal awards is fairly stated in all material respects in relation to the financial statements as a whole.



Louisville, Kentucky  
April 24, 2013

**Owen Electric Cooperative, Inc.**  
**Balance Sheets**  
**December 31, 2012 and 2011**

	<u>2012</u>	<u>2011</u>
<b>Assets</b>		
Electric Plant in Service, net	\$ 135,358,965	\$ 133,929,596
Investments		
Investments in associated organizations	4,892,502	4,842,573
Investment in East Kentucky Power Cooperative	41,112,331	34,098,129
Other	(105)	2,484
Total Investments	<u>46,004,728</u>	<u>38,943,186</u>
Current Assets		
Cash and equivalents	4,783,977	3,006,333
Accounts receivable - customers (net of allowance for doubtful accounts of \$244,527 in 2012 and \$239,508 in 2011)	16,837,546	17,268,068
Materials and supplies	866,883	931,803
Prepayments and other	944,776	865,174
Total Current Assets	<u>23,433,182</u>	<u>22,071,378</u>
Deferred debits	<u>2,959,680</u>	<u>2,224,210</u>
Total Assets	<u><u>\$ 207,756,555</u></u>	<u><u>\$ 197,168,370</u></u>
<b>Members' and Patrons' Equities and Liabilities</b>		
Members' and Patrons' Equities		
Memberships	\$ 1,122,475	\$ 1,116,355
Patronage capital	76,997,413	69,084,512
Accumulated other comprehensive loss	(842,765)	(763,598)
Other equities	2,899,731	2,775,694
Total Members' and Patrons' Equities	<u>80,176,854</u>	<u>72,212,963</u>
Long-term Debt and Other Liabilities		
Long-term debt, less current maturities	90,044,434	86,362,876
Accrued compensated absences	2,188,167	2,023,459
Postretirement benefits obligation	9,579,185	9,020,393
Total Long-term Debt and Other Liabilities	<u>101,811,786</u>	<u>97,406,728</u>
Current Liabilities		
Current portion of long-term debt	3,916,176	4,006,209
Lines-of-credit	4,796,980	5,812,938
Accounts payable	13,013,393	13,128,011
Accrued interest	74,667	92,236
Customer guaranty deposits	2,251,286	2,865,445
Other current liabilities	838,994	803,441
Total Current Liabilities	<u>24,891,496</u>	<u>26,708,280</u>
Deferred credits	<u>876,419</u>	<u>840,399</u>
Total Members' and Patrons' Equities and Liabilities	<u><u>\$ 207,756,555</u></u>	<u><u>\$ 197,168,370</u></u>

See accompanying notes.

**Owen Electric Cooperative, Inc.**  
**Statements of Income and Comprehensive (Loss) Income**  
**Years Ended December 31, 2012 and 2011**

	<u>2012</u>	<u>%</u>	<u>2011</u>	<u>%</u>
Operating Revenue				
Sale of electric energy				
Residential	\$ 79,180,655	47.53 %	\$ 78,807,462	47.86 %
Commercial	82,555,637	49.55	81,071,624	49.24
Public authorities and outdoor lighting	<u>2,892,682</u>	<u>1.74</u>	<u>2,762,740</u>	<u>1.68</u>
Total Sale of Electric Energy	164,628,974	98.82	162,641,826	98.78
Other Revenue	<u>1,974,259</u>	<u>1.18</u>	<u>2,004,645</u>	<u>1.22</u>
Total Operating Revenue	166,603,233	100.00	164,646,471	100.00
Operating Expenses				
Cost of power	133,358,817	80.05	131,922,578	80.12
Distribution expense	8,814,535	5.29	8,665,811	5.26
Customer accounts expense	3,691,026	2.22	3,698,757	2.25
Customer services and information expense	705,596	0.42	635,126	0.39
Administrative and general expense	3,633,885	2.18	3,613,909	2.19
Depreciation	10,514,098	6.31	10,101,182	6.14
Taxes	<u>146,131</u>	<u>0.09</u>	<u>141,730</u>	<u>0.09</u>
Total Operating Expenses	<u>160,864,088</u>	<u>96.56</u>	<u>158,779,093</u>	<u>96.44</u>
Net Operating Income	5,739,145	3.44	5,867,378	3.56
Non-operating Income (Expense)				
Interest expense	(4,709,958)	(2.83)	(4,678,321)	(2.84)
Other margins	628,248	0.38	151,844	0.09
Patronage capital	<u>7,189,294</u>	<u>4.32</u>	<u>8,102,709</u>	<u>4.92</u>
Total Non-operating Income	<u>3,107,584</u>	<u>1.87</u>	<u>3,576,232</u>	<u>2.17</u>
Net Margins	8,846,729	5.31	9,443,610	5.73
Other Comprehensive (Loss) Income				
Change in post-retirement benefit obligation	<u>(79,167)</u>	<u>(0.05)</u>	<u>93,267</u>	<u>0.06</u>
	<u>\$ 8,767,562</u>	<u>5.26 %</u>	<u>\$ 9,536,877</u>	<u>5.79 %</u>

See accompanying notes.

**Owen Electric Cooperative, Inc.**  
**Statements of Changes in Members' and Patrons' Equities**  
**Years Ended December 31, 2012 and 2011**

	Memberships	Patronage Capital			Total	Accumulated Other Comprehensive Loss	Other Equities		Total Members' and Patrons' Equities	
		Assignable	Assigned	Retired			Donated Capital	Retired Capital Credits Gains		Total
Balance, January 1, 2011	\$ 1,107,355	\$ 5,626,630	\$ 79,609,266	\$ (24,588,361)	\$ 60,647,535	\$ (856,865)	\$ 69,909	\$ 2,566,649	\$ 2,636,558	63,534,583
Unrealized gain on accumulated pension benefit obligations	-	-	-	-	-	93,267	-	-	-	93,267
Memberships issued, net of terminations	9,000	-	-	-	-	-	-	-	-	9,000
Retirements of patronage capital to estates of deceased members:										
Paid in cash	-	-	-	(219,858)	(219,858)	-	-	-	-	(219,858)
Applied to unpaid bills	-	-	-	(12,769)	(12,769)	-	-	-	-	(12,769)
General capital credit refund:										
Paid in cash	-	-	-	(303,650)	(303,650)	-	-	-	-	(303,650)
Applied to unpaid bills	-	-	-	(414,654)	(414,654)	-	-	-	-	(414,654)
Transferred to capital gains	-	-	-	(55,702)	(55,702)	-	-	136,122	136,122	80,420
Net margins	-	9,443,610	-	-	9,443,610	-	-	-	-	9,443,610
Assignment of patronage capital	-	(7,128,420)	7,128,420	-	-	-	-	-	-	-
Forfeiture of memberships	-	-	-	-	-	-	3,014	-	3,014	3,014
Balance, December 31, 2011	1,116,355	7,941,820	86,737,686	(25,594,994)	69,084,512	(763,598)	72,923	2,702,771	2,775,694	72,212,963
Unrealized loss on accumulated pension benefit obligations	-	-	-	-	-	(79,167)	-	-	-	(79,167)
Memberships issued, net of terminations	6,120	-	-	-	-	-	-	-	-	6,120
Retirements of patronage capital to estates of deceased members:										
Paid in cash	-	-	-	(174,059)	(174,059)	-	-	-	-	(174,059)
Applied to unpaid bills	-	-	-	(7,363)	(7,363)	-	-	-	-	(7,363)
General capital credit refund:										
Paid in cash	-	-	-	(294,793)	(294,793)	-	-	-	-	(294,793)
Applied to unpaid bills	-	-	-	(392,774)	(392,774)	-	-	-	-	(392,774)
Transferred to capital gains	-	-	-	(64,839)	(64,839)	-	-	124,047	124,047	59,208
Net margins	-	8,846,729	-	-	8,846,729	-	-	-	-	8,846,729
Assignment of patronage capital	-	(9,443,610)	9,443,610	-	-	-	-	-	-	-
Forfeiture of memberships	-	-	-	-	-	-	(10)	-	(10)	(10)
Balance, December 31, 2012	\$ 1,122,475	\$ 7,344,939	\$ 96,181,296	\$ (26,528,822)	\$ 76,997,413	\$ (842,765)	\$ 72,913	\$ 2,826,818	\$ 2,899,731	\$ 80,176,854

See accompanying notes.

**Owen Electric Cooperative, Inc.**  
**Statements of Cash Flows**  
**Years Ended December 31, 2012 and 2011**

	<u>2012</u>	<u>2011</u>
Cash Flows from Operating Activities		
Net Margins	\$ 8,846,729	\$ 9,443,610
Non-cash expenses included in net margins		
Patronage capital assigned but not paid by associated organizations	(7,189,294)	(8,102,709)
Depreciation	10,514,098	10,101,182
Bad debt expense	121,378	137,496
Loss on disposition of general plant	30,627	2,329
Charges for postretirement benefits obligation	558,792	445,939
Changes in current and non-current assets and liabilities:		
Accounts receivable	309,144	(441,076)
Materials and supplies	64,920	(29,419)
Prepayments and other	(79,602)	(241,826)
Accounts payable	(114,618)	(631,454)
Customer guaranty deposits	(614,159)	124,051
Accrued interest and other current liabilities	17,984	1,448
Accrued compensated absences	164,708	99,012
	<u>12,630,707</u>	<u>10,908,583</u>
Net Cash Provided by Operating Activities		
Cash Flows from Investing Activities		
Increase in deferred debits	(735,470)	(2,138,696)
Increase in deferred credits	36,020	78,194
Additions to electric plant in service	(10,672,202)	(8,894,646)
Removal cost	(1,301,893)	(1,586,696)
Patronage capital received from associated organizations	127,752	132,755
	<u>(12,545,793)</u>	<u>(12,409,089)</u>
Net Cash Used in Investing Activities		
Cash Flows from Financing Activities		
Proceeds from long-term notes payable	8,000,000	4,250,000
Payment of principal on long-term notes payable	(4,408,474)	(4,903,104)
Membership fees	6,120	9,000
Patronage capital paid out	(888,958)	(774,230)
Net activity on lines-of-credit	(1,015,958)	4,035,327
	<u>1,692,730</u>	<u>2,616,993</u>
Net Cash Provided by Financing Activities		
Increase in Cash and Equivalents During the Year	1,777,644	1,116,487
Cash and Equivalents, Beginning of Year	<u>3,006,333</u>	<u>1,889,846</u>
Cash and Equivalents, End of Year	<u>\$ 4,783,977</u>	<u>\$ 3,006,333</u>
Supplemental Disclosures of Cash Flow Information		
Interest paid	\$ 4,727,527	\$ 4,698,761

See accompanying notes.

**Owen Electric Cooperative, Inc.**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

**Note A - Nature of Operations**

Owen Electric Cooperative, Inc. (the Cooperative) is engaged in distributing power to its member consumers throughout nine northern Kentucky counties. The audited financial statements are prepared in accordance with policies prescribed or permitted by the Kentucky Public Service Commission (KPSC) and the United States Department of Agriculture Rural Utilities Services (RUS), which conform with generally accepted accounting principles as applied to regulated enterprises. The more significant of these policies are as follows.

**Note B - Summary of Significant Accounting Policies**

1. Basis of Accounting: The financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. The Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") is the sole source of authoritative accounting technical literature for nongovernmental entities. The significant accounting policies are described below to enhance the usefulness of the financial statements to the reader.
2. Cash and Equivalents: For purposes of the statement of cash flows, the Cooperative considers short-term investments having maturities of three months or less at time of purchase to be cash equivalents.
3. Accounts Receivable: Accounts receivable consists of amounts due for sales of electric energy, which were not received by the Cooperative at year-end. Based on management's evaluation of uncollected accounts receivable at the end of each year, bad debts are provided for on the allowance method.
4. Materials and Supplies: The Cooperative values materials and supplies at the lower of cost or market.
5. Deferred Debits: Regulatory requirements authorized by the Kentucky Public Service Commission allow the electric supplier to impose a fuel adjustment surcharge upon the Cooperative. In turn, the Cooperative is required to pass on the fuel surcharge to the consumer. Due to the regulatory requirements in calculating the surcharge the Cooperative may experience an over or under recovery of the fuel adjustment surcharge.

Similarly, the Kentucky Public Service Commission has an environmental cost recovery mechanism that allows the electric supplier to recover certain costs incurred in complying with the Federal Clean Air Act as amended and those federal, state, and local environmental requirements which apply to coal combustion wastes and byproducts from facilities utilized for the production of energy from coal. In turn, the Cooperative is required to pass on this environmental cost recovery mechanism to the consumer.

In 2011, the Cooperative elected to begin recording the under or over recovery of the fuel adjustment surcharge on the financial statements as an asset in deferred debits or a liability in deferred credits, respectively. In 2012, the Cooperative also elected to record the under or over recovery of the environmental cost recovery mechanism in the same manner as the fuel adjustment surcharge.

The Cooperative has implemented the Accounting Standards Codification (ASC) No. 980, Accounting for the Effects of Certain Types of Regulation, in the recording of the described regulatory deferred debits. Similarly, in accordance with RUS Bulletin 1767B-1, section 1767.13(d)(3), the deferral of these regulatory items are recorded without the prior written approval of RUS.

The amount recorded on the financial statements for the under recovery of the fuel adjustment surcharge at December 31, 2012 and 2011 was \$472,955 and \$1,895,427, respectively. The amount of the under recovery of the environmental cost recovery mechanism at December 31, 2012 was \$2,370,126.

**Owen Electric Cooperative, Inc.**  
**Notes to Financial Statements (Continued)**  
**December 31, 2012 and 2011**

**Note B - Summary of Significant Accounting Policies (Continued)**

6. Electric Plant in Service: Utility plant is stated at original cost. Maintenance and repairs, including the cost of renewals of minor items of property, are charged to maintenance expense accounts. Replacements of property (exclusive of minor items) are charged to the utility plant accounts.

Depreciation is provided using the straight-line method at rates which are designed to amortize the cost of depreciable plant, net of estimated salvage value, over its estimated useful life. The composite depreciation rate for distribution plant was approximately 4.5% for both 2012 and 2011. General plant is being depreciated using specific identification straight-line method over the following estimated useful lives:

Structures and improvements	5 - 50
Miscellaneous equipment	5 - 20
Office, stores and lab equipment	5 - 20
Communication equipment	12
Transportation equipment	4 - 10
Power-operated equipment	7

When distribution plant is retired or otherwise disposed of in the normal course of business, an estimate of its cost, together with the cost of removal less salvage, is charged to the accumulated provision for depreciation. Gains and losses resulting from the sale or disposal of general plant are recognized in income currently.

The major classifications of electric plant in service were as follows:

	December 31,	
	2012	2011
Distribution plant	\$ 205,472,959	\$ 198,096,116
General plant	25,592,514	24,843,816
Construction in progress	4,160,484	2,787,879
	<u>235,225,957</u>	<u>225,727,811</u>
Accumulated Depreciation	<u>99,866,992</u>	<u>91,798,215</u>
Electric Plant in Service, net	<u>\$ 135,358,965</u>	<u>\$ 133,929,596</u>

7. Revenue and Cost of Purchased Power: Revenue is recognized in the period used and the power costs are recognized in the period incurred.
8. Advertising Costs: The Cooperative records advertising expenses as they are incurred. Advertising expense amounted to \$284,573 and \$289,905 for the years ended December 31, 2012 and 2011, respectively.
9. Investments in Associated Organizations: The Cooperative follows the method of accounting as prescribed by the RUS Uniform System of Accounts in accounting for its investment in associated organizations. This accounting method results in the Cooperative recognizing in income its pro rata share of the associated organization's net margins in the year such margins are assigned. This accounting method does not provide for similar treatment for any losses of the associated organizations. Rather, such losses would not be assigned to member organizations and no additional margins are assigned until subsequent cumulative margins exceed prior cumulative losses.

**Owen Electric Cooperative, Inc.**  
**Notes to Financial Statements (Continued)**  
**December 31, 2012 and 2011**

**Note B - Summary of Significant Accounting Policies (Continued)**

10. Accrued Compensated Absences: The Cooperative has a policy to pay available but untaken compensated absences to employees who leave service. The compensated absences are composed of sick and vacation leave.

Sick leave allows 100% of accrued sick leave for retiring employees, 100% of accrued sick leave for deceased employees (payment is made to deceased employees' beneficiary), 45% for employees taking early retirement, and 20% of annual base salary for employees who voluntarily leave service prior to reaching retirement age.

Vacation leave allows for the terminating employee, or their estate/beneficiary (in the case of death), to be paid for all earned and unused vacation days at the current rate of pay at termination.

11. Comprehensive Income (Loss): The Cooperative accounts for comprehensive income (loss) in accordance with the relative provisions of the ASC.

In June 2011, the FASB issued updated guidance to increase the prominence of items reported in other comprehensive income (loss) by eliminating the option of solely presenting components of comprehensive income (loss) as part of the statements of changes in members' and patrons' equities. The updated guidance became effective for the year ending December 31, 2012 and was applied retrospectively. The Cooperative has elected to present the required information on the accompanying statements of income and comprehensive (loss) income for the years ended December 31, 2012 and 2011.

12. Use of Estimates: Management uses estimates and assumptions in preparing these financial statements in accordance with accounting principles generally accepted in the United States of America. Those estimates and assumptions affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

13. Subsequent Events: Subsequent events for the Cooperative have been considered through the date of the Independent Auditor's Report which represents the date the financial statements were available to be issued.

14. Other: The Cooperative has a collective bargaining agreement with 60% of its employees which expires July 31, 2015.

15. New Accounting Pronouncement: In September 2011, the FASB issued Accounting Standards Update (ASU) 2011-09, *Disclosures about an Employer's Participation in a Multiemployer Plan*, which amends FASB ASC 715-80, *Compensation – Retirement Benefits: Multiemployer Plans*, by requiring employers participating in multiemployer pension plans to provide additional quantitative and qualitative disclosures in order to provide more detailed information about the employer's involvement in multiemployer pension plans. In addition, this amendment also includes changes in the disclosures required for multiemployer plans that provide postretirement benefits other than pensions. This guidance is effective for non-public companies for the fiscal years ending after December 15, 2012. This guidance was adopted for the year ended December 31, 2012 and it had no impact on the Cooperative's financial position or results of operations.

**Owen Electric Cooperative, Inc.**  
**Notes to Financial Statements (Continued)**  
**December 31, 2012 and 2011**

**Note C - Investments in Associated Organizations**

*East Kentucky Power Cooperative:*

The Cooperative's investment of \$41,112,331 in EKPC, the sole supplier of power to the Cooperative, represents the Cooperative's equity ownership interest (approximately 11%) in EKPC. The Cooperative owed EKPC \$11,780,678 and \$11,998,759 at December 31, 2012 and 2011, respectively. These amounts are included in accounts payable on the balance sheet.

The Cooperative was contingently liable for long-term obligations of EKPC related to Charleston Bottoms to RUS and the National Rural Utilities Cooperative Finance Corporation in the amount of \$333,000 at December 31, 2011. All amounts due under these obligations were paid in full during the year ended December 31, 2012.

*Other Associated Organizations:*

Investments in other associated organizations consisted of:

	December 31,	
	2012	2011
	<u>          </u>	<u>          </u>
United Utility Supply Cooperative	\$ 929,895	\$ 929,895
Kentucky Association of Electric Cooperatives, Inc.	116,974	116,974
National Rural Utilities Cooperative Finance Corporation	660,670	599,715
Capital Term Certificates of National Rural Utilities Cooperative Finance Corporation	2,409,387	2,409,387
Southeastern Data Cooperative, Inc.	147,175	160,947
Other	628,401	625,655
	<u>\$ 4,892,502</u>	<u>\$ 4,842,573</u>

Substantially all of such investments, which consist mainly of patronage capital in the associated organization and capital term certificates are restricted by the respective organization and are not currently available for distribution. The patronage capital will be available to the Cooperative if the Cooperative should terminate its investment in the associated organization. The capital term certificates are not available until the related debt is paid off, currently expected to be between the years 2020 and 2080.

United Utility Supply Cooperative (United) is a primary supplier of transformers and overhead line materials and supplies. The Cooperative's purchases from United amounted to \$1,525,884 and \$1,671,500 for the years ended December 31, 2012 and 2011, respectively. The Cooperative owed United \$98,894 and \$23,259 at December 31, 2012 and 2011, respectively. These amounts are included in accounts payable on the balance sheet.

The Capital Term Certificates bear interest at varying rates between 0% and 5% per annum. These certificates are required to be maintained under the note agreement with the National Rural Utilities Cooperative Finance Corporation (NRUCFC) in an amount at least equal to 5% of the original debt issued or guaranteed by NRUCFC until maturity. These investments in associated organizations are similar to compensating bank balances and are necessary in order to maintain current financing arrangements. Accordingly, there is no market for these investments.

**Owen Electric Cooperative, Inc.**  
**Notes to Financial Statements (Continued)**  
**December 31, 2012 and 2011**

**Note C - Investments in Associated Organizations (Continued)**

Southeastern Data Cooperative, Inc. (Southeastern) is a primary supplier of data processing services and computer hardware and software. The Cooperative's purchases from Southeastern were \$784,262 and \$782,989 for the years ended December 31, 2012 and 2011, respectively. There were no amounts owed to Southeastern at December 31, 2012 and 2011.

**Note D - Income Tax Status**

The Cooperative is exempt from federal and state income taxes under §501(c)(12) of the Internal Revenue Code. The Cooperative recognizes uncertain income tax positions using the "more-likely-than-not" approach as defined in the ASC. No liability for uncertain tax positions has been recorded in the accompanying financial statements. The Cooperative's 2009 - 2012 tax years remain open and subject to examination.

**Note E - Line-of-credit**

At December 31, 2012 and 2011, the Cooperative had an unsecured available line-of-credit of \$22,800,000 from the NRUCFC. The interest rate for this line-of-credit was 2.90% and 3.20% at December 31, 2012 and 2011, respectively. The maturity date for the line-of-credit is December 31, 2049. The Cooperative had an outstanding balance under the line-of-credit of \$4,796,980 and \$5,812,938 at December 31, 2012 and 2011.

At December 31, 2012 and 2011, the Cooperative had a second unsecured available line-of-credit of \$15,000,000 with CoBank. The interest rate for this line-of-credit at December 31, 2012 and 2011 was 3.72%, and the maturity date is July 20, 2014. There were no borrowings under this line-of-credit at December 31, 2012 and 2011.

**Owen Electric Cooperative, Inc.**  
**Notes to Financial Statements (Continued)**  
**December 31, 2012 and 2011**

**Note F - Long-term Debt**

Long-term debt consisted of the following:

	December 31,	
	<u>2012</u>	<u>2011</u>
Mortgage notes payable to the Rural Utilities Services due in quarterly installments of varying amounts through 2043:		
2.500% first mortgage notes	\$ 2,481,819	\$ 2,620,397
2.521% first mortgage notes	6,000,000	-
2.806% first mortgage notes	4,386,920	4,475,626
3.894% first mortgage notes	3,675,565	3,736,829
4.190% first mortgage notes	6,615,763	6,739,795
4.375% first mortgage notes	1,167,327	1,210,976
4.440% first mortgage notes	8,483,379	8,636,057
4.460% first mortgage notes	12,318,761	12,539,350
4.815% first mortgage notes	3,101,353	3,165,340
4.917% first mortgage notes	890,207	908,302
5.192% first mortgage notes	4,512,599	4,600,706
5.277% first mortgage notes	10,615,205	10,819,890
5.298% first mortgage notes	9,716,905	9,967,694
5.375% first mortgage notes	1,274,362	1,317,144
5.417% first mortgage notes	2,451,488	2,513,846
5.913% first mortgage notes	2,240,370	2,293,990
	<u>79,932,023</u>	<u>75,545,942</u>
Less: Unapplied Payments	<u>8,512,147</u>	<u>8,099,433</u>
	71,419,876	67,446,509
Notes payable to CoBank, interest at 2.01% and due July 2014.	4,074,575	2,537,633
Mortgage notes payable to the NRUCFC due in quarterly installments of varying amounts through 2034:		
Variable rate first mortgage notes (1)	18,466,159	20,384,943
	<u>93,960,610</u>	<u>90,369,085</u>
Less Current Maturities	<u>3,916,176</u>	<u>4,006,209</u>
	<u>\$ 90,044,434</u>	<u>\$ 86,362,876</u>

(1) Interest rates on the variable rate notes vary monthly and are determined by the NRUCFC based on their cost of money plus adders for margins and administrative costs (2.90%-6.20% and 2.80%-6.20% at December 31, 2012 and 2011, respectively).

**Owen Electric Cooperative, Inc.**  
**Notes to Financial Statements (Continued)**  
**December 31, 2012 and 2011**

**Note F - Long-term Debt (Continued)**

The aggregate principal maturities of long-term debt as of December 31, 2012 are as follows:

2013	\$ 3,916,176
2014	4,031,619
2015	3,749,964
2016	3,731,776
2017 and thereafter	<u>78,531,075</u>
	<u>\$ 93,960,610</u>

Substantially all utility plant is pledged as collateral for the above notes. Under the terms of the loan agreements, the Cooperative is required to meet certain financial performance covenants. The Cooperative is in compliance with these covenants at December 31, 2012.

**Note G - Members' and Patrons' Equities**

Under terms of its long-term debt agreements, return of capital contributions or patronage capital to the Cooperative's members and patrons is restricted to amounts which would not allow total equity to be less than 30% of total assets, except that distributions may be made to estates of deceased members provided that such distributions do not exceed 25% of total patronage capital and margins received in the previous year. Total equity as a percentage of assets can fall below the 30% requirement if the Cooperative has obtained the appropriate waiver from the RUS. The Cooperative is in compliance with these requirements at December 31, 2012 and 2011.

**Note H - Retirement Benefits**

Effective January 1, 1988, the Cooperative entered into a multi-employer defined benefit pension plan sponsored by the National Rural Electric Cooperative Association (NRECA). The NRECA Retirement Security Plan (RS Plan) is 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 Employer 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 Cooperative contributions to the RS Plan in 2012 and in 2011 represented less than 5 percent of the total contributions made to the plan by all participating employers. The Cooperative made contributions to the plan of \$2,006,184 and \$1,925,969 in 2012 and 2011, respectively. There have been no significant changes that affect the comparability of 2012 and 2011 contributions.

In the RS 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 Retirement Security Plan was between 65 percent and 80 percent funded at January 1, 2012 and January 1, 2011 based on the PPA funding target and PPA actuarial value of assets on those dates.

**Owen Electric Cooperative, Inc.**  
**Notes to Financial Statements (Continued)**  
**December 31, 2012 and 2011**

**Note H - Retirement Benefits (Continued)**

Because the provisions of the PPA do not apply to the RS 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.

In addition to the above, the Cooperative maintains a 401(k) profit sharing plan. The Owen Electric Cooperative 401(k) Profit Sharing Plan, established April 1, 1986, is a defined contribution plan available to employees of the Cooperative upon completion of three months of service. The Cooperative makes annual matching contributions equal to 100% of all deferred salary reductions up to a 4% maximum employer contribution. The Cooperative's expense for 2012 and 2011 was approximately \$362,000 and \$342,000, respectively.

**Note I - Postretirement Benefits**

The Cooperative provides postretirement medical benefits to its retired employees and their dependents. The plan requires retiree contributions based on years of service at retirement. "Employers' Accounting for Postretirement Benefits Other Than Pensions," requires the accrual of the cost of providing certain postretirement benefits over the employees' years of service, rather than on a pay-as-you-go (cash) basis. The Cooperative elected to amortize the accumulated postretirement benefit obligation of \$3,178,700 over 20 years and records one-twentieth of this amount, \$158,935 each year.

In accordance with the provision of "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans," the Cooperative has recorded an accrued benefit cost for the full benefit obligation as of December 31, 2012 and 2011.

The following table sets forth the plan's benefit obligation and accrued liability:

	December 31,	
	<u>2012</u>	<u>2011</u>
Benefit obligation	\$ 9,579,185	\$ 9,020,393
Fair value of plan assets	<u>-</u>	<u>-</u>
Funded Status	<u>\$ (9,579,185)</u>	<u>\$ (9,020,393)</u>
Accrued benefit cost recognized in the statement of financial position	\$ (9,579,185)	\$ (9,020,393)
Weighted-average assumptions		
Discounted rate	5.50%	6.00%

For measurement purposes, the health care cost trend rate is assumed to be 7.50% and 8.00% in 2012 and 2011, respectively. During 2012 and 2011, the rate was assumed to decrease by 0.5% per year to 5.5%.

**Owen Electric Cooperative, Inc.**  
**Notes to Financial Statements (Continued)**  
**December 31, 2012 and 2011**

**Note I - Postretirement Benefits (Continued)**

Other information regarding the Cooperative's benefit plans is as follows:

	December 31,	
	2012	2011
Benefit cost	\$ 916,560	\$ 935,005
Benefits paid	436,935	395,799

**Note J - Concentrations of Revenues, Receivables and Cash**

All of the Cooperative's sales are made in portions of nine counties in north central Kentucky, which is primarily an agricultural region. However, a significant portion of the Cooperative's northern service territory has become increasingly developed with suburban residential and commercial activity. Accounts receivable and customer deposits at December 31, 2012 and 2011, were derived from the various classes of customers in approximately the same proportion as the revenues shown in the accompanying statements of revenues and expenses.

On May 31, 2005, the Cooperative and EKPC entered into a five year electric service agreement with Gallatin Steel Company (Gallatin Steel) to provide electric power to Gallatin Steel's manufacturing facilities in Gallatin County, Kentucky, the first of which began operations June 1, 1995. On September 1, 2010, the Cooperative and EKPC entered into a five year electric service agreement with Gallatin Steel. This agreement expires December 1, 2015. Sales to Gallatin Steel in 2012 and 2011 totaled \$46,356,994 and \$45,846,471, respectively. Receivables from Gallatin Steel were \$3,503,209 and \$4,181,817 at December 31, 2012 and 2011, respectively.

The Cooperative maintains its cash balances with banks throughout Kentucky. Effective July 21, 2010, the federal deposit insurance coverage provided by the Federal Deposit Insurance Corporation (FDIC) permanently increased from \$100,000 to \$250,000 per depositor. On November 9, 2010, the FDIC issued a final rule to implement Section 343 of the Dodd-Frank Wall Street Reform and Consumer Protection Act which provides temporary unlimited deposit insurance for non-interest bearing accounts at all FDIC insured depository institutions. This separate coverage for non-interest bearing transaction accounts became effective on December 31, 2010 and terminates on December 31, 2012. As of December 31, 2012, there were uninsured balances in the Cooperative's interest bearing accounts totaling approximately \$2,798,000. At December 31, 2011, the Cooperative had uninsured balances totaling approximately \$1,552,000.

In June of 2011, the Public Service Commission approved the reduction in the wholesale power supplier's base rates in recognition of reduced fuel expenses. In turn, this reduction in base rates was passed on to the Cooperative, then to the consumer. The roll-in of this rate reduction resulted in an under-collection from the Consumers. The Cooperative has sought remedy of this shortfall with the Public Service Commission with its pending rate review request. The receivable related to the under-collection is \$1,112,398 and has been included in the financial statements for the year ended December 31, 2012.

**Note K - Fair Value Measurements**

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date and establishes a framework for measuring fair value. The ASC establishes a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date.

**Owen Electric Cooperative, Inc.**  
**Notes to Financial Statements (Continued)**  
**December 31, 2012 and 2011**

**Note K - Fair Value Measurements (Continued)**

The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1: inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2: inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3: inputs to the valuation methodology are unobservable and significant to the fair value measurement.

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

At December 31, 2012 and 2011, financial instruments consisted of cash and equivalents whose carrying values approximate fair value due to the short-term nature of the instruments, all measured using the Level 1.

## **Supplementary Information**



**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  
**Owen Electric Cooperative, Inc.**  
Owenton, Kentucky

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in the Government Auditing Standards issued by the Comptroller General of the United States, the accompanying financial statements and related notes to the financial statements of Owen Electric Cooperative, Inc. (the Cooperative) as of and for the year ended December 31, 2012, and have issued our report thereon dated April 24, 2013.

**Internal Control Over Financial Reporting**

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

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

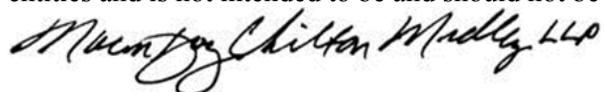
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not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

**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 (Continued)**

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Cooperative, Inc.'s financial statements are free of material misstatement, we 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 our audit and, accordingly, we do not express such an opinion. The results of our 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 audit committee, management, the Rural Utilities Service, supplemental lenders, others within the Cooperative, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



Louisville, Kentucky  
April 24, 2013

**Report on Compliance For Each Major Federal Program; Report on Internal Control Over Compliance; and Report on the Schedule of Expenditures of Federal Awards Required by OMB Circular A-133**

**Independent Auditor's Report**

**Report on Compliance for Each Major Federal Program**

We have audited Owen Electric Cooperative, Inc.'s (the Cooperative) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Cooperative's major federal programs for the year ended December 31, 2012. The Cooperative's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

***Management's Responsibility***

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

***Auditor's Responsibility***

Our responsibility is to express an opinion on compliance for each of the Cooperative's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance 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 OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Cooperative's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the Cooperative's compliance.

**Report on Compliance For Each Major Federal Program; Report on Internal Control Over Compliance; and Report on the Schedule of Expenditures of Federal Awards Required by OMB Circular A-133 (Continued)**

***Opinion on Each Major Federal Program***

In our opinion, the Cooperative complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2012.

**Report on Internal Control Over Compliance**

Management of the Cooperative is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Cooperative's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Cooperative's internal control over compliance.

*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

*A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance 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 compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

**Report on Compliance For Each Major Federal Program; Report on Internal Control Over Compliance; and Report on the Schedule of Expenditures of Federal Awards Required by OMB Circular A-133 (Continued)**

This report is intended solely for the information and use of the audit committee, management, the Rural Utilities Service, supplemental lenders, others within the Cooperative, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*Mauney Chilton Madley LLP*

Louisville, Kentucky  
April 24, 2013

**Owen Electric Cooperative, Inc.**  
**Schedule of Findings and Questioned Costs**  
**December 31, 2012**

**A. SUMMARY OF AUDIT RESULTS**

1. The auditor's report expresses an unqualified opinion on the financial statements of the Cooperative for the year ended December 31, 2012.
2. No material weaknesses relating to the audit of the financial statements are reported in the Independent Auditor's Report.
3. No instances of noncompliance material to the financial statements of the Cooperative were disclosed during the audit.
4. No significant deficiencies relating to the audit of the major federal awards programs are reported in the Independent Auditor's Report.
5. The auditor's report on compliance for the audit of the major federal awards programs for the Cooperative expresses an unqualified opinion.
6. There were no audit findings relative to the major federal awards programs for the Cooperative.
7. The programs tested as a major programs were: Electricity Delivery and Energy Reliability, Research, Development and Analysis (CFDA 81.122) and Disaster Recovery Grants (CFDA 97.036).
8. The threshold for distinguishing Type A and B programs was \$300,000.
9. The Cooperative was not determined to be a low-risk auditee.

**B. CURRENT YEAR FINDINGS– FINANCIAL STATEMENT AUDIT**

None

**C. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARDS PROGRAM AUDIT**

None

**D. SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS**

None

**Owen Electric Cooperative, Inc.**  
**Schedule of Expenditures of Federal Awards**  
**Other Supplementary Information**  
**December 31, 2012**

Federal Grantor CFDA #	Program Title	Pass-Through Grantor's Number	Expenditures
<b><u>U.S. Department of Energy</u></b>			
<i>Passed-Through National Rural Electric Cooperative</i>			
81.122	Electricity Delivery and Energy Reiliability, Research Development and Analysis	DE-OE0000222 **	\$ 688,705
<b>Total U.S. Department of Energy</b>			<b>\$ 688,705</b>
<b><u>U.S. Department of Homeland Security</u></b>			
<i>Passed-Through State Department of Homeland Security:</i>			
97.036	Disaster Recovery Grants	FEMA-DR-4057-KY **	\$ 491,121
<b>Total U.S. Department of Homeland Security</b>			<b>\$ 491,121</b>
Total Expenditures of Federal Awards			<b>\$ 1,179,826</b>

\*\*Tested as Major Program

## Independent Auditor's Letter to Management

To the Board of Directors  
**Owen Electric Cooperative, Inc.**  
Owenton, Kentucky

We have audited the financial statements of Owen Electric Cooperative, Inc. for the years ended December 31, 2012 and 2011, and have issued our report thereon dated April 24, 2013. We conducted our audits 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 Rural Utilities Service (RUS) Borrowers.

### Internal Control Over Financial Reporting

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

Our 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. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

## **Independent Auditor's Letter to Management (Continued)**

Section 1773.33 requires comments on specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and other additional matters. We have grouped our comments accordingly. In addition to obtaining reasonable assurance about whether the financial statements are free from material misstatements, at your request, we performed tests of specific aspects of the internal control over financial reporting, of compliance with specific RUS loan and security instrument provisions, and of additional matters. The specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and additional matters tested include, among other things, the accounting procedures and records, materials control, compliance with specific RUS loan and security instrument provisions set forth in 7 CFR 1773.33(e)(1), related party transactions, depreciation rates, and a schedule of deferred debits and credits upon which we express an opinion. In addition, our audit of the financial statements also included the procedures specified in §1773.38 - .45. Our objective was not to provide an opinion on these specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, or additional matters, and accordingly, we express no opinion thereon.

No reports other than our independent auditor's report, and our independent auditor's report on compliance and on internal control over financial reporting, all dated April 24, 2013 or summary of recommendations related to our audit have been furnished to management.

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

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

We noted no matters regarding Owen Electric Cooperative, Inc.'s internal control over financial reporting and its operations that we consider to be a material weakness as previously defined with respect to:

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

### Comments on Compliance with Specific RUS Loan and Security Instrument Provisions

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

- Procedures performed with respect to the requirement for a borrower to obtain written approval of the mortgagee to enter into any contract for the operation or maintenance of property, or for the use of mortgaged property by others for the year ended December 31, 2012:
  1. Obtained and read a borrower-prepared schedule of new written contracts entered into 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).
  2. Reviewed Board of Director minutes to ascertain whether board-approved written contracts are included in the borrower-prepared schedule.
  3. Noted the existence of written RUS (and other mortgagee) approval of each contract listed by the borrower.

## **Independent Auditor's Letter to Management (Continued)**

- Procedure performed with respect to the requirement to submit RUS Form 7 to the RUS:
  1. Agreed amounts reported in Form 7 to Owen Electric Cooperative, Inc.'s records.

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

- The borrower has obtained written approval of the RUS to enter into any contract for the operation or maintenance of property, or for the use of mortgaged property by others as defined in §1773.33(e)(1)(i); and
- The borrower has submitted its Form 7 to the RUS and the Form 7, Financial and Statistical Report, as of December 31, 2012, represented by the borrower as having been submitted to the RUS is in agreement with the Owen Electric Cooperative, Inc.'s audited records in all material respects, appears reasonable based upon the audit procedures performed.

### Comments on Other Additional Matters

In connection with our audit of the financial statements of Owen Electric Cooperative, Inc. as of and for the year ended December 31, 2012, nothing came to our attention that caused us to believe that Owen Electric Cooperative, Inc. failed to comply with respect to:

- The reconciliation of continuing property records to the controlling general ledger plant accounts addressed at 7 CFR 1773.33(c)(1);
- The clearing of the construction accounts and the accrual of depreciation on completed construction addressed at 7 CFR 1773.33(c)(2);
- The retirement of plant addressed at 7 CFR 1773.33(c)(3) and (4);
- Approval of the sale, lease or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap addressed at 7 CFR 1773.33(c)(5);
- There were no related party transactions, in accordance with Accounting Standards Codification, 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 1773.33(f);
- The depreciation rates addressed at 7 CFR 1773.33(g);
- The detailed schedule of deferred debits and deferred credits addressed at 7 CFR 1773.33(h) ; and
- The detailed schedule of all investments in subsidiary and affiliated companies addressed at 7 CFR 1773.33(i).

## Independent Auditor's Letter to Management (Continued)

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The detailed schedule of deferred debits and deferred credits required by 7 CFR 1773.33(h) and provided below is presented for purposes of additional analysis and is not a required part of the basic financial statements. The Cooperative has implemented the Accounting Standards Codification (ASC) No. 980, Accounting for the Effects of Certain Types of Regulation, in the recording of the described regulatory deferred debits. Similarly, in accordance with RUS Bulletin 1767B-1, section 1767.13(d)(3), the deferral of these regulatory items are recorded without the prior written approval of RUS. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements taken as a whole.

Owen Electric Cooperative, Inc.  
Detailed Schedule of Deferred Debits  
December 31, 2012

<u>Description</u>	<u>Amount</u>
Fuel surcharge	\$ 472,955
Environmental surcharge	2,370,126
Miscellaneous	116,599
	<u>\$ 2,959,680</u>

Owen Electric Cooperative, Inc.  
Detailed Schedule of Deferred Credits  
December 31, 2012

<u>Description</u>	<u>Amount</u>
Customer advances for construction	\$ 726,361
Other	120,352
Consumers' maintenance prepayment	29,706
	<u>\$ 876,419</u>

This report is intended solely for the information and use of the board of directors, management, others within the Cooperative, and 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.



Louisville, Kentucky  
April 24, 2013