Financial Statements

East Kentucky Power Cooperative, Inc.
Years Ended December 31, 2014 and 2013
With Report of Independent Auditors

Ernst & Young LLP

Building a better
working world

East Kentucky Power Cooperative, Inc.

Financial Statements

Years Ended December 31, 2014 and 2013

Contents

Report of Independent Auditors....1

Financial Statements

Balance Sheets....3
Statements of Revenue and Expenses and Comprehensive Margin....4
Statements of Changes in Members' Equities....5
Statements of Cash Flows....6
Notes to Financial Statements....7

Ernst & Young LLP
Suite 2400
400 West Market Street
Louisville, KY 40202

Tel: +1 502 585 1400
Fax: +1 502 584 4221
ey.com

Report of Independent Auditors

The Board of Directors
East Kentucky Power Cooperative, Inc.

Report on the Financial Statements

We have audited the accompanying financial statements of East Kentucky Power Cooperative, Inc., which comprise the balance sheets as of December 31, 2014 and 2013, and the related statements of revenues and expenses and comprehensive margin, changes in members' 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 conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States 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 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.

A member firm of Ernst & Young Global Limited

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of East Kentucky Power Cooperative, Inc. as of December 31, 2014 and 2013, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we also have issued our report dated March 31, 2015 on our consideration of the East Kentucky Power Cooperatives, Inc.'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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering East Kentucky Power Cooperative, Inc.'s internal control over financial reporting and compliance.

Ernst + Young LLP

March 31, 2015

A member firm of Ernst & Young Global Limited

East Kentucky Power Cooperative, Inc.

Balance Sheets
(Dollars in Thousands)

	December 31	
	2014	**2013**
Assets		
Electric plant – at original cost:		
In-service	**$ 3,836,337**	$ 3,765,062
Construction-in-progress	**30,790**	39,602
	3,867,127	3,804,664
Less accumulated depreciation	**1,224,225**	1,133,823
Electric plant – net	**2,642,902**	2,670,841
Long-term accounts receivable	**–**	270
Debt service reserve	**1,063**	13,805
Investment securities:		
Available for sale	**33,662**	29,570
Held to maturity	**8,579**	8,670
Current assets:		
Cash and cash equivalents	**183,070**	201,008
Deposit with RUS – restricted investment	**154,313**	63,256
Accounts receivable	**85,812**	91,314
Fuel	**65,688**	76,891
Materials and supplies	**54,834**	47,116
Regulatory assets	**269**	70
Emission allowances	**762**	956
Other current assets	**6,097**	5,500
Total current assets	**550,845**	486,111
Regulatory assets	**153,587**	150,273
Deferred charges	**3,849**	3,115
Other noncurrent assets	**9,069**	7,400
Total assets	**$ 3,403,556**	$ 3,370,055
Members' equities and liabilities		
Members' equities:		
Memberships	**$ 2**	$ 2
Patronage and donated capital	**485,899**	421,054
Accumulated other comprehensive margin (loss)	**(3,348)**	7,686
Total members' equities	**482,553**	428,742
Long-term debt	**2,632,276**	2,680,289
Current liabilities:		
Current portion of long-term debt	**90,635**	97,556
Accounts payable	**63,808**	58,235
Accrued expenses	**13,950**	10,443
Regulatory liabilities	**14,319**	4,083
Total current liabilities	**182,712**	170,317
Accrued postretirement benefit cost	**68,918**	55,410
Asset retirement obligations and other liabilities	**37,097**	35,297
Total members' equities and liabilities	**$ 3,403,556**	$ 3,370,055

See notes to financial statements.

East Kentucky Power Cooperative, Inc.

Statements of Revenue and Expenses and Comprehensive Margin

(Dollars in Thousands)

	Year Ended December 31	
	2014	**2013**
Operating revenue	**$ 952,771**	$ 903,243
Operating expenses:		
Production:		
Fuel	**297,399**	292,918
Other	**147,125**	140,940
Purchased power	**150,337**	110,331
Transmission and distribution	**43,130**	43,790
Regional market operations	**4,427**	2,278
Depreciation	**96,689**	96,116
General and administrative	**43,720**	41,673
Total operating expenses	**782,827**	728,046
Operating margin before fixed charges	**169,944**	175,197
Fixed charges and other:		
Interest expense on long-term debt	**116,148**	112,306
Amortization of debt expense	**480**	470
Accretion and other	**348**	178
Total fixed charges and other expenses	**116,976**	112,954
Operating margin	**52,968**	62,243
Nonoperating margin:		
Interest income	**9,853**	5,268
Patronage capital allocations from other cooperatives	**372**	598
Regulatory settlements	**(12)**	(105)
Other	**1,664**	899
Total nonoperating margin	**11,877**	6,660
Net margin	**64,845**	68,903
Other comprehensive loss:		
Unrealized loss on available for sale securities	**(82)**	(102)
Postretirement benefit obligation gain (loss)	**(10,952)**	22
	(11,034)	(80)
Comprehensive margin	**$ 53,811**	$ 68,823

See notes to financial statements.

East Kentucky Power Cooperative, Inc.

Statements of Changes in Members' Equities
(Dollars in Thousands)

	Memberships	Patronage Capital	Donated Capital	Accumulated Other Comprehensive Margin (Loss)	Total Members' Equities
Balance – December 31, 2012	$ 2	$ 349,116	$ 3,035	$ 7,766	$ 359,919
Net margin	–	68,903	–	–	68,903
Unrealized loss on available for sale securities	–	–	–	(102)	(102)
Postretirement benefit obligation gain	–	–	–	22	22
Balance – December 31, 2013	2	418,019	3,035	7,686	428,742
Net margin	**–**	**64,845**	**–**	**–**	**64,845**
Unrealized loss on available for sale securities	**–**	**–**	**–**	**(82)**	**(82)**
Postretirement benefit obligation loss	**–**	**–**	**–**	**(10,952)**	**(10,952)**
Balance – December 31, 2014	**$ 2**	**$ 482,864**	**$ 3,035**	**$ (3,348)**	**$ 482,553**

See notes to financial statements.

East Kentucky Power Cooperative, Inc.

Statements of Cash Flows
(Dollars in Thousands)

	Year Ended December 31	
	2014	**2013**
Operating activities		
Net margin	**$ 64,845**	$ 68,903
Adjustments to reconcile net margin to net cash provided by operating activities:		
Depreciation	**96,689**	96,116
Amortization of loan costs	**1,513**	1,975
Changes in operating assets and liabilities:		
Accounts receivable	**5,502**	789
Fuel	**11,203**	(6,109)
Materials and supplies	**(7,718)**	(4,136)
Regulatory assets/liabilities	**10,196**	(171)
Emission allowances	**194**	310
Accounts payable	**(2,338)**	(18,168)
Accrued expenses	**3,507**	(6,007)
Accrued postretirement benefit cost	**2,556**	1,899
Other	**(2,844)**	(4,571)
Net cash provided by operating activities	**183,305**	130,830
Investing activities		
Additions to electric plant	**(64,364)**	(59,596)
Maturities of debt service reserve	**40,379**	13,766
Purchases of debt service reserve securities	**(27,637)**	(13,787)
Maturities of securities available for sale	**52,934**	52,309
Purchases of securities available for sale	**(57,108)**	(52,984)
Maturities of securities held to maturity	**91**	314
Additional deposits with RUS restricted investment	**(277,226)**	(238,297)
Maturities of RUS restricted investment	**186,169**	183,465
Payments received on long-term accounts receivable	**453**	456
Net cash used in investing activities	**(146,309)**	(114,354)
Financing activities		
Proceeds from long-term debt	**267,622**	121,708
Principal payments on long-term debt	**(322,556)**	(94,385)
Net cash provided by (used in) financing activities	**(54,934)**	27,323
Net change in cash and cash equivalents	**(17,938)**	43,799
Cash and cash equivalents – beginning of year	**201,008**	157,209
Cash and cash equivalents – end of year	**$ 183,070**	$ 201,008
Supplemental disclosure of cash flow		
Cash paid for interest	**$ 112,820**	$ 112,714
Noncash investing transactions:		
Additions to electric plant included in accounts payable	**$ 13,945**	$ 6,034
Unrealized loss on securities available for sale	**$ (82)**	$ (102)

See notes to financial statements.

1. Summary of Significant Accounting Policies

Nature of Operations

East Kentucky Power Cooperative (the Cooperative) is a not-for-profit electric generation and transmission cooperative incorporated in 1941 that provides wholesale electric service to 16 distribution members with territories that include parts of 87 counties in Kentucky. The majority of customers served by members are residential. Each of the members has entered into a wholesale power agreement with the Cooperative, which remains in effect until 2051. The rates charged to members are regulated by the Kentucky Public Service Commission (PSC or Commission).

The Cooperative owns and operates three coal-fired generation plants, nine combustion turbines and six landfill gas plants. In addition, the Cooperative has rights to 170 megawatts of hydroelectric power from the Southeastern Power Administration.

Basis of Accounting

The financial statements are prepared in accordance with policies prescribed or permitted by the Commission and the United States Department of Agriculture, Rural Utilities Service (RUS), which conform with accounting principles generally accepted in the United States of America (GAAP) in all material respects. As a rate-regulated entity, the Cooperative’s financial statements reflect actions of regulators that result in the recording of revenues and expenses in different time periods than enterprises that are not rate regulated in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 980-10, *Regulated Operations.*

Electric Plant and Maintenance

Electric plant is stated at original cost, which is the cost when first dedicated to public service, including applicable labor and overhead costs.

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 cost of units replaced or retired, including cost of removal, net of any salvage value, is charged to accumulated depreciation.

1. Summary of Significant Accounting Policies (continued)

Inventories

Inventories of fuel and materials and supplies are valued at the lower of average cost or market.

Emission Allowances

Title IV of the Clean Air Act Amendments of 1990 provides for the issuance of allowances as a means to limit the emissions of certain airborne pollutants. Allowances are stated at cost.

Issuances of allowances are recognized using a monthly weighted-average method of cost determination. Gains and losses are recorded upon the disposition of allowances.

Depreciation

Depreciation for the generating plants and transmission facilities is provided on the basis of estimated useful lives at straight-line composite rates. Rates applied to electric plant in service for both 2014 and 2013 are:

Transmission and distribution plant	0.71%–3.42%
General plant	2.00%–20.00%

The Production plant assets are depreciated on a straight line basis from the date of acquisition to the end of life of the respective plant, which ranges from 2019 to 2051.

Investment Securities

Investment securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Investment securities are classified as available for sale when they might be sold before maturity. Investment securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive margin (loss).

Interest income includes amortization of purchase premium or discount. Gains and losses on sales are based on the amortized cost of the security sold. Investment securities are written down to fair value when a decline in fair value is other than temporary.

1. Summary of Significant Accounting Policies (continued)

Restricted Investment

The Cooperative has established a cushion of credit program administered by the RUS. Under the cushion of credit program, RUS borrowers may make voluntary irrevocable deposits into a special account. The account balance accrues interest at a rate of five percent per year. The amounts in the cushion of credit account (deposits and earned interest) can only be used to make scheduled payments on loans made or guaranteed by the RUS. At December 31, 2014 and 2013, the balances in the cushion of credit program were $154.3 million and $63.3 million, respectively.

Fair Value of Financial Instruments

The carrying amount of cash, receivables and certain other current liabilities approximates fair value due to the short maturity of the instruments.

The Cooperative uses fair value to measure certain financial instruments. The fair value of a financial instrument is the amount 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 (the exit price). Observable inputs or unobservable inputs, defined by ASC Topic 820-10, *Fair Value Measurements and Disclosures*, may be used in the calculation of fair value. ASC Topic 820-10 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The three levels of the fair value hierarchy are described below:

- *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.

1. Summary of Significant Accounting Policies (continued)

The inputs used to measure cash equivalents are Level 1 measurements, as the money market funds are exchange traded funds in an active market. The inputs used to measure the available for sale, debt service reserve and restricted investments are Level 1 measurements, as the securities are based on quoted market prices for identical investments or securities. The inputs used to measure financial transmission rights (FTR) derivatives are Level 2 measurements, as the FTR derivatives are valued based upon recent auction data from the regional transmission organization. Estimated fair values of the Cooperative's financial instruments and methods of valuation as of December 31, 2014 and 2013, were as follows (dollars in thousands):

		Fair Value at Reporting Date Using		
	Fair Value December 31, 2014	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Cash equivalents	**$ 160,000**	**$ 160,000**	**$ –**	**$ –**
Available for sale securities	**33,662**	**33,662**	–	–
Debt service reserve	**1,063**	**1,063**	–	–
Deposit with RUS – restricted investment	**154,313**	**154,313**	–	–
FTR derivatives	**1,934**	–	**1,934**	–

		Fair Value at Reporting Date Using		
	Fair Value December 31, 2013	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Cash equivalents	$ 200,000	$ 200,000	$ –	$ –
Available for sale securities	29,570	29,570	–	–
Debt service reserve	13,805	13,805	–	–
Deposit with RUS – restricted investment	63,256	63,256	–	–
FTR derivatives	536	–	536	–

1. Summary of Significant Accounting Policies (continued)

The estimated fair values of the Cooperative's financial instruments carried at cost at December 31, 2014 and 2013, were as follows (in thousands):

	2014		2013	
	Carrying Amount	**Fair Value**	**Carrying Amount**	**Fair Value**
Held to maturity investments	**$ 8,579**	**$ 10,571**	$ 8,670	$ 8,507
Long-term debt	**2,722,911**	**3,201,962**	2,777,845	2,961,055

The inputs used to measure held to maturity investment securities are considered Level 2 and are based on third-party yield rates of similarly maturing instruments determined by recent market activity. The fair value of long-term debt, including current maturities and prepayment costs, is calculated using published interest rates for debt with similar terms and remaining maturities and is a Level 2 fair value measurement.

Regulatory Assets and Liabilities

ASC Topic 980-10 applies to regulated entities for which rates are designed to recover the costs of providing service. In accordance with this topic, certain items that would normally be reflected in the statements of revenue and expenses are deferred on the balance sheets. Regulatory assets represent probable future revenues associated with certain incurred costs, which will be recovered from customers through the rate-making process. Regulatory assets are charged to earnings as collection of the cost in rates is recognized or when future recovery is no longer probable. Conversely, regulatory liabilities represent future reductions in revenues associated with amounts that are to be credited to customers through the rate-making process.

Rate Matters

Operating revenues from sales to members consist primarily of electricity sales pursuant to long-term wholesale power contracts which are maintained with each of our members. These wholesale power contracts obligate each member to pay us for demand and energy furnished in accordance with rates established by the PSC. Electricity revenues are recognized when energy is provided. Energy provided is determined based on month-end meter readings.

1. Summary of Significant Accounting Policies (continued)

The base rates charged by the Cooperative are regulated by the PSC. Any change in base rates requires that EKPC file an application with the PSC and interested parties may seek intervention in the proceeding if they satisfy certain regulatory requirements. After reviewing all the documentation in the case, the Commission has ten months to complete its processing of the application and issue an order. EKPC's last base rate case was authorized by the PSC on January 14, 2011.

The PSC has adopted a uniform fuel adjustment clause for all electric utilities within its jurisdiction. Under this clause, fuel cost above or below a stated amount per kWh is charged or credited to the member cooperatives for all energy sales during the month following actual fuel costs being incurred. The regulatory asset or liability represents the amount has been under- or over-recovered due to timing or adjustments to the mechanism.

The PSC has an environmental cost recovery mechanism that allows utilities 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. This environmental surcharge is billed on a percentage of revenue basis, one month following the actual costs incurred. The regulatory asset or liability represents the amount that has been under- or over-recovered due to timing or adjustments to the mechanism.

Concentration of Credit Risk

Credit risk represents the risk of loss that would occur if suppliers or customers did not meet their contractual obligations to EKPC. Concentration of credit risk occurs when significant suppliers or customers possess similar characteristics that would cause their ability to meet contractual obligations to be affected by the same events.

The Cooperative's sales are primarily to its member cooperatives and totaled approximately $907.2 million and $882.1 million for 2014 and 2013, respectively. Accounts receivable at December 31, 2014 and 2013, were primarily from billings to member cooperatives.

1. Summary of Significant Accounting Policies (continued)

At December 31, 2014 and 2013, individual account receivable balances that exceeded 10% of total accounts receivable are as follows (dollars in thousands):

	2014	2013
Owen Electric Cooperative	**$ 12,323**	$ 12,838
South Kentucky RECC	**9,330**	10,006
Blue Grass Energy Cooperative	**9,036**	9,725

Cash and Cash Equivalents

The Cooperative considers temporary investments having an original maturity of three months or less when purchased to be cash equivalents. Cash equivalents at December 31, 2014 and 2013, consisted primarily of money market mutual funds and investments in commercial paper.

Use of Estimates

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

Asset Impairment

Long-lived assets held and used by the Cooperative are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Specifically, the evaluation for impairment involves comparison of an asset’s carrying value to the estimated undiscounted cash flows the asset is expected to generate over its remaining life. If this evaluation were to conclude that the carrying value of the asset is impaired, an impairment charge would be recorded as a charge to operations based on the difference between the asset’s carrying amount and its fair value. No impairment was recognized for long-term assets during the years ended December 31, 2014 or 2013.

1. Summary of Significant Accounting Policies (continued)

Members' Equities

Memberships represent contributions to the Cooperative made by members. Should the Cooperative cease business, these amounts, if available, will be returned to the members.

Patronage capital represents net margin allocated to the Cooperative's members on a contribution-to-gross margin basis pursuant to the provisions of its bylaws. The Cooperative's bylaws prohibit the retirement of capital contributed by or allocated to members unless, after any proposed retirement, the total capital of the Cooperative equals or exceeds 20% of total assets. In addition, provisions of certain financing documents prohibit the retirement of capital until stipulated requirements as to aggregate margins and equities are met. Accordingly, at December 31, 2014 and 2013, no patronage capital was available for refund or retirement.

Comprehensive Margin

Comprehensive margin includes both net margin and other comprehensive margin (loss). Other comprehensive deficit represents the change in unrealized gains and losses on available for sale securities as well as the change in the funded status of the accumulated postretirement benefit obligation. The Cooperative presents each item of other comprehensive deficit on a net basis, in the Statements of Revenue and Expenses and Comprehensive Margin. Reclassification adjustments are disclosed in Note 10 of the Notes to Financial Statements. For any item required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period, the affected line item(s) on the Statements of Revenue and Expenses and Comprehensive Margin are provided.

Income Taxes

The Cooperative is exempt under Section 501(c)(12) of the Internal Revenue Code from federal income tax for any year in which at least 85% of its gross income is derived from members but is responsible for income taxes on certain unrelated business income. ASC Topic 740-10, *Income Taxes*, clarifies the accounting for uncertainty in income taxes recognized in the financial statements. This interpretation requires financial statement recognition of the impact of a tax position if a position is more likely than not of being sustained on audit, based on the technical merits of the position. Additionally, ASC Topic 740-10 provides guidance on measurement, recognition, classification, accounting in interim periods, and disclosure requirements for uncertain tax positions. The Cooperative has determined that more than 85% of its gross income is derived from members and it meets the exemption status under the Section 501(c)(12).

1. Summary of Significant Accounting Policies (continued)

Deferred Finance Charges

The Cooperative amortizes all deferred financing charges using the effective interest method except for those charges associated with the private placement. The private placement amortizes on a straight-line basis, which approximates the effective interest method.

Derivatives

The Cooperative's activities expose it to a variety of market risks including interest rates and commodity prices. Management has established risk management policies and strategies to reduce the potentially adverse effects that the volatility of the markets may have on its operating results. These policies and strategies include the use of derivative instruments and hedging activities. These derivative instruments generally qualify for hedge accounting or the normal purchase and normal sales exclusion under ASC Topic 815-10, *Derivatives and Hedging*. The Company recognizes all of its derivative instruments as either assets or liabilities in the balance sheet at fair value. If hedge treatment is obtained, unrealized gains or losses resulting from these instruments are deferred as a component of accumulated other comprehensive margin (loss) until the corresponding item being hedged is settled, at which time the gain or loss is recognized in net margin. Gains or losses for items not qualifying for hedge treatment are recognized immediately in margin. At December 31, 2014, the Cooperative had Financial Transmission Rights (FTRs) derivative assets of $1.9 million and $0.6 million in related liabilities. At December 31, 2013, the Cooperative had FTRs derivative assets of $0.5 million and $0.7 million in related liabilities. FTRs are included in other current assets and current accrued liabilities on the balance sheet.

Asset Retirement Obligations

ASC Topic 410-20, *Asset Retirement Obligations*, requires legal obligations associated with the retirement of long-lived assets to be recognized at fair value when incurred and capitalized as part of the related long-lived asset. ASC Topic 410-20 clarifies the term conditional asset retirement obligation where an obligation exists even though the method or timing of settlement may be conditional. The liability is accreted to its present value each period and the capitalized cost is depreciated over the useful life of the related asset. When the asset is retired, the entity settles the obligation for its recorded amount or incurs a gain or loss. The Cooperative's asset retirement obligations (ARO) represent the requirements related to asbestos abatement and

1. Summary of Significant Accounting Policies (continued)

reclamation and capping of ash disposal sites at its coal-fired plants. During 2014, the liabilities incurred relate to an additional ash disposal site ARO at Spurlock Station. Cash flow revisions are related to changes in the estimated cost to settle the Dale Station ash disposal site ARO.

The Cooperative continues to evaluate the useful lives of its plants and costs of remediation required by law. The following table represents the details of asset retirement obligation activity as reported on the balance sheets (in thousands):

	2014	2013
Balance – beginning of year	**$ 32,238**	$ 4,875
Liabilities incurred	**1,313**	27,185
Cash flow revisions	**(1,365)**	–
Accretion	**1,077**	178
Balance – end of year	**$ 33,263**	$ 32,238

As discussed in Note 8, the PSC issued an order on March 6, 2015 granting regulatory asset treatment of ARO accretion and depreciation retroactive to January 1, 2014 for all AROs except for ash hauling associated with the Dale ash disposal site ARO. Regulatory assets for the applicable AROs were established at December 31, 2014, and accordingly, only $0.3 million accretion expense was recognized in 2014.

New Accounting Standards

In February 2013, the FASB issued Accounting Standards Update (ASU) 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income* (ASU 2013-02). ASU 2013-02 requires an entity to provide information in one location about amounts reclassified out of AOCI by component and their corresponding effect on net income if the amount reclassified is required under U.S. GAAP to be reconciled to net income in its entirety in the same reporting period. For other amounts not required to be reclassified to net income in their entirety, such as pension-related amounts, an entity is required to cross-reference to related footnote disclosures. The amendments in ASU 2013-02 were effective prospectively for non-public companies for the fiscal years beginning after December 15, 2013. The disclosures required by ASU 2013-02 have been included in Note 10 of the Notes to Financial Statements.

1. Summary of Significant Accounting Policies (continued)

Regional Transmission Organization

Effective June 1, 2013, the Cooperative became a transmission-owning member of PJM Interconnection, LLC (PJM) and functional control of certain transmission facilities was transferred to PJM at that time. Open access to the EKPC transmission system is managed by PJM pursuant to the FERC approved PJM Open Access Transmission Tariff and the Cooperative is an active participant in PJM's Regional Transmission Planning process, which develops a single approved transmission plan for the entire PJM footprint. Energy related purchases and sales transactions within PJM are recorded on an hourly basis with all transactions within each market netted to a single purchase or sale for each hour.

Reclassifications

A reclassification was made in the statement of cash flows for the year ended December 31, 2013, to correct for an error related to the identification of cash used for additions to plant. The change in classification increased net cash provided by operating activities and increased net cash used in investing activities by $13.3 million, respectively. The reclassification did not impact the net change in cash and cash equivalents for the year.

New Accounting Guidance Pending Adoption

On May 28, 2014, the FASB issued Accounting Standards Update 2014-09, "Revenue from Contracts with Customers (Topic 606)," or ASU 2014-09. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

ASU 2014-09 will supersede the revenue recognition requirements in the Revenue Recognition Topic 605 of the ASC and most industry-specific guidance, and creates the Revenue from Contracts with Customers Topic 606 of the ASC. ASU 2014-09 will be effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early adoption is not permitted. The Company is currently assessing the impact of adopting this guidance, as well as the transition method it will use.

2. Electric Plant in Service

Electric plant in-service at December 31, 2014 and 2013, consisted of the following (in thousands):

	2014	2013
Production plant	**$ 2,919,341**	$ 2,892,532
Transmission plant	**733,646**	729,968
General plant	**108,233**	101,737
Completed construction, not classified, and other	**75,117**	40,825
Electric plant in service	**$ 3,836,337**	$ 3,765,062

Electric plant in service at December 31, 2014 includes Dale Station generating assets, which were originally placed in service in 1954. Dale Station consists of four units and is accounted for as one asset with an original cost of approximately $94.6 million. Dale Station is not currently MATS compliant and EKPC has made no plans to invest in additional environmental compliance equipment at Dale Station. Therefore it is expected that Dale Station could retire before the end of its depreciable life of June 30, 2019. However, at the request of PJM, EKPC applied for a one year MATS extension to address reliability concerns. On January 6, 2015, the Kentucky Division of Air Quality granted a compliance extension for Dale Units 3 and 4 until April 15, 2016. The Board of Directors has authorized management to seek regulatory asset treatment for the remaining net book value of Dale Station when it ceases all coal generating operations, which is currently expected to be on April 15, 2016. The estimated net book value of Dale Station at April 15, 2016 is $2.9 million. Management believes it is probable that the PSC will allow the Cooperative to recover the full amount through rates.

3. Long-Term Accounts Receivable

Long-term accounts receivable represents interest-bearing notes from joint ventures owned by the Cooperative and four of the Cooperative's member systems for the buyout of a propane company. The joint ventures of the member systems make principal and interest (prime rate minus one-half of one percent, adjusted annually) payments. The notes are payable in full in 2015. Accordingly, the outstanding balance at December 31, 2013, of $0.3 million was reclassified to other current assets at December 31, 2014.

4. Investment Securities

Amortized cost and estimated fair value of investment securities available for sale at December 31, 2014 and 2013, were as follows (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2014				
U.S. Treasury Bill	**$ 6,864**	**$ 86**	**$ –**	**$ 6,950**
Zero coupon bond	**26,712**	**–**	**–**	**26,712**
	$ 33,576	**$ 86**	**$ –**	**$ 33,662**

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2013				
U.S. Treasury Bill	$ 26,209	$ 1	$ –	$ 26,210
Zero coupon bond	3,193	167	–	3,360
	$ 29,402	$ 168	$ –	$ 29,570

Proceeds from maturities of securities were $52.9 million and $52.3 million in 2014 and 2013, respectively.

4. Investment Securities (continued)

Amortized cost and estimated fair value of investment securities held to maturity at December 31, 2014 and 2013, are as follows (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2014				
National Rural Utilities Cooperative Finance Corporation:				
3%–5% capital term certificates	**$ 7,656**	**$ 1,941**	**$ –**	**$ 9,597**
6.5875% subordinated term certificate	**300**	**107**	**–**	**407**
0% subordinated term certificate	**623**	**–**	**(56)**	**567**
	$ 8,579	**$ 2,048**	**$ (56)**	**$ 10,571**

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2013				
National Rural Utilities Cooperative Finance Corporation:				
3%–5% capital term certificates	$ 7,656	$ 24	$ (196)	$ 7,484
6.5875% subordinated term certificate	325	100	–	425
0% subordinated term certificate	689	–	(91)	598
	$ 8,670	$ 124	$ (287)	$ 8,507

4. Investment Securities (continued)

All investment securities held to maturity with unrealized losses at December 31, 2014 and 2013, have maturities of 12 months or more. The amortized cost and fair value of securities at December 31, 2014, by contractual maturity, are shown below (dollars in thousands). Expected maturities may differ from contractual maturities because certain borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Available for sale:		
Due in one year or less	$ 26,712	$ 26,712
Due after one year through five years	6,864	6,950
	$ 33,576	$ 33,662
Held to maturity:		
Due after one year through five years	$ 50	$ 49
Due after five years through ten years	1,531	1,621
Due after ten years	6,998	8,901
	$ 8,579	$ 10,571

5. Long-Term Debt

The Cooperative executed an Indenture of Mortgage, Security Agreement and Financing Statement, dated as of October 11, 2012 (Indenture) between the Cooperative, as Grantor, to U.S. Bank National Association, as Trustee. The Indenture provides secured note holders with a pro-rated interest in substantially all owned assets.

5. Long-Term Debt (continued)

Long-term debt outstanding at December 31, 2014 and 2013, consisted of the following (in thousands):

	2014	2013
First mortgage notes:		
2.30%–10.66%, payable quarterly to Federal Financing Bank (FFB) in varying amounts through 2044, weighted average 4.30%	**$ 2,407,968**	$ 2,445,661
5.13% payable quarterly to RUS in varying amounts through 2024	**6,753**	7,317
Variable rate, 3.30% at December 31, 2014 and 2013, payable quarterly to CFC in varying amounts through 2024	**6,384**	6,936
Variable rate, 3.30% at December 31, 2014 and 2013, payable quarterly to CFC in varying amounts through 2019	**2,095**	2,520
First Mortgage Bonds, Series 2014A, fixed rate of 4.61%, payable semi-annual, matures February 6, 2044	**200,000**	–
Tax-exempt bonds:		
Pollution control revenue bonds, Series 1984B, variable rate bonds, due October 15, 2014, 0.30% at December 31,2013	–	12,700
Solid waste disposal revenue bonds, Series 1993B, variable rate bonds, due August 15, 2023 0.50% and 0.65% at December 31, 2014 and 2013, respectively	**5,500**	6,000
Clean Renewable Energy Bonds, Fixed rate of 0.40% payable quarterly to CFC to December 1, 2023	**4,845**	5,383
Promissory notes:		
Variable rate note payable to CFC, 1.17% at December 31, 2014	**75,000**	275,000
4.68% fixed rate notes payable to National Cooperative Services Corporation	**14,366**	16,328
	2,722,911	2,777,845
Less current portion of long-term debt	**90,635**	97,556
	$ 2,632,276	$ 2,680,289

5. Long-Term Debt (continued)

First Mortgage Notes and Bonds

The Cooperative received loan funds in varying amounts through its first mortgage notes payable to the Federal Financing Bank. All such loans are subject to certain conditions outlined by RUS. Listed below are descriptions of those loan applications for which additional funds were advanced to the Cooperative during the year and the status of any remaining funds approved and available for advance at December 31, 2014.

In July 2008, the Cooperative submitted to RUS a loan application in the amount of $152.7 million for various transmission projects. This loan was revised in July 2008 to $140.7 million. This loan was approved by RUS in July 2009 and matures on December 31, 2040. The Cooperative received an advance on this loan of $21.0 million on December 19, 2014. As of December 31, 2014, $39.3 million of these amounts remained available for advance.

In March 2009, EKPC submitted to RUS a loan application for $341 million for construction of the Cooper Station Retrofit Air Pollution Project. This loan was approved by RUS in August 2009 with a maturity date of December 31, 2044. The Cooperative received an advance on this loan of $21.6 million on December 19, 2014. As of December 31, 2014, $116.1 million of these amounts remained available for advance.

In accordance with the Rural Electrification Act of 1936 (RE Act), as amended, the RUS established a cushion of credit program. Under this program, RUS borrowers may make voluntary deposits into a special cushion of credit account. This cushion of credit account balance accrues interest at a rate of 5% per annum. The amounts in the cushion of credit account (deposits and earned interest) can only be used to make scheduled payments on loans made or guaranteed under the RE Act. The Cooperative's cushion of credit account balance was $154.3 million and $63.3 million at December 31, 2014 and 2013, respectively. These balances were used to make scheduled debt payments to RUS in the subsequent year. Accordingly, these amounts were recorded as restricted current investments as of December 31, 2014 and 2013.

On December 11, 2013, the Cooperative entered into a Bond Purchase Agreement for $200 million 4.61% First Mortgage Bonds, Series 2014A due February 2044. The transaction closed and funded on February 6, 2014. The debt is secured on equal footing with the Cooperative's other secured debt under the Indenture.

5. Long-Term Debt (continued)

Promissory Note–Unsecured Credit Facility

On August 9, 2011, the Cooperative entered into an unsecured credit facility syndicate with the joint lead arrangers of CFC, KeyBank, and PNC Capital Markets. This loan was approved for a total of $450 million for general operating expenses and capital construction projects. On October 3, 2013, this agreement was amended and extended to $500 million to expire on October 3, 2018. As of December 31, 2014, $425 million of this amount remained to be advanced.

Tax Exempt Bonds

The Cooperative's Series 1984B Pollution Control Bonds matured on October 15, 2014 and were paid in full. A $12.7 million CFC guarantee secured payment of the Series 1984B bonds expired on October 15, 2014 at the maturity of the debt. In addition, the Cooperative maintained a $12.7 million debt service reserve fund with a trustee throughout the term of the bonds; the requirement for the debt service reserve fund expired at October 15, 2014.

The interest rate on the Series 1993B Solid Waste Disposal Revenue Bonds is subject to change semiannually. The interest rate adjustment period on the variable rate bonds may be converted to a weekly, semiannual, annual or three-year basis, or to a fixed-rate basis, at the option of the Cooperative. A $6.0 million CFC guarantee secures payment of the Series 1993B bonds and has an expiration date of August 15, 2023. The 1993B solid waste disposal revenue bonds require that debt service reserve funds be on deposit with a trustee throughout the term of the bonds in the amount of $1.1 million. In addition, mandatory sinking fund payments are required ranging from $0.5 million in 2014 to $0.7 million in 2023. Debt service reserve and construction funds are held by a trustee and are invested primarily in U.S. Government securities and CFC promissory notes. These funds are included in debt service on the accompanying balance sheets and have a fair value of approximately $1.1 million at December 31, 2014 and 2013.

5. Long-Term Debt (continued)

Estimated annual maturities of long term debt for the five years subsequent to December 31, 2014, are as follows (dollars in thousands):

Years ending December 31	
2015	$ 90,635
2016	91,732
2017	89,853
2018	90,722
2019	92,234
Thereafter	2,267,735
	$ 2,722,911

The Indenture and certain other debt agreements contain provisions which, among other restrictions, require the Cooperative to maintain certain financial ratios. The Cooperative was in compliance with these financial ratios at December 31, 2014 and 2013, respectively.

As of December 31, 2014, the Cooperative has $3.3 million outstanding in a letter of credit with the Commonwealth of Kentucky for Worker's Compensation.

As of December 31, 2014, the Cooperative has pledged securities of $6.7 million with the United States Department of Labor for Federal Longshore Harbor Workers and the Commonwealth of Kentucky.

6. Retirement Benefits

Pension Plan

Pension benefits for employees hired prior to January 1, 2007, are provided through participation in the National Rural Electric Cooperative Association (NRECA) Retirement and Security Plan (RS Plan). The 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.

6. Retirement Benefits (continued)

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's contributions to the RS Plan in 2014 and 2013, 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 $8.5 million and $9.7 million in 2014 and 2013, respectively. There have been no significant changes that affect the comparability of 2014 and 2013 contributions.

For 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 RS Plan was over 80 percent funded on January 1, 2014 and over 80 percent funded on January 1, 2013, 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 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.

Retirement Savings Plan

The Cooperative has a Retirement Savings Plan for all employees who are eligible to participate in the Cooperative's benefit programs. The plan allows participants to make contributions by salary reduction, pursuant to Section 401(k) of the Internal Revenue Code. For employees hired prior to January 1, 2007, the Cooperative makes matching contributions to the account of each participant up to 2.0% of the participant's compensation. For employees hired on or after January 1, 2007, the Cooperative will automatically contribute 6.0% of base wages and match the employee contribution up to 4.0%. The Cooperative contributed approximately $2.3 million and $2.1 million to the plan for the years ended December 31, 2014 and 2013, respectively. Employees vest immediately in their contributions and the contributions of the Cooperative.

6. Retirement Benefits (continued)

Supplemental Executive Retirement Plan

The Cooperative provides a 457(f) Supplemental Executive Retirement Plan to executives of the organization. The plan is considered a defined contribution plan whereby annual contributions are made based upon a percentage of base salary. Participants become 100% vested and the account balance paid out upon attaining age 62 or if separation occurs due to involuntary termination without cause, disability, or death. Separation for any other reason before age 62 will result in participants forfeiting their benefits.

Supplemental Death Benefit Plan

The Cooperative provides a Supplemental Death Benefit Plan to all employees eligible to participate in the pension plan. The supplemental death benefit is payable to a deceased employee's beneficiary if the lump sum value of a 100% survivor benefit under the pension plan exceeds the pension plan benefits plus the Cooperative's group life insurance proceeds. Management believes that any liability related to this plan will not have a material effect on the financial statements.

Postretirement Medical Benefits

The Cooperative sponsors a defined benefit plan that provides medical and life insurance coverage to retirees and their dependents. Participating retirees and dependents contribute 50% of the projected cost of coverage. For purposes of the liability estimates, the substantive plan is assumed to be the same as the written plan. The plan is not funded.

6. Retirement Benefits (continued)

The following sets forth the accumulated postretirement benefit obligation, the change in plan assets, and the components of accrued postretirement benefit cost and net periodic benefit cost as of December 31, 2014 and 2013 (dollars in thousands):

	2014	**2013**
Change in benefit obligation:		
Accumulated postretirement benefit obligation – beginning of year	**$ 57,626**	$ 55,008
Service cost	**1,223**	1,399
Interest cost	**2,871**	2,355
Plan participants’ contributions	**1,220**	964
Benefits paid	**(2,569)**	(1,934)
Actuarial (gain) loss	**10,835**	(166)
Accumulated postretirement benefit obligation – end of year	**$ 71,206**	$ 57,626
Change in plan assets:		
Fair value of plan assets – beginning of year	**$ –**	$ –
Employer contributions	**1,349**	970
Participant contributions	**1,220**	964
Benefits paid	**(2,569)**	(1,934)
Fair value of plan assets – end of year	**–**	–
Funded status – end of year	**$ (71,206)**	$ (57,626)
Amounts recognized in balance sheet consists of:		
Current liabilities	**$ 2,288**	$ 2,216
Noncurrent liabilities	**68,918**	55,410
Total amount recognized in balance sheet	**$ 71,206**	$ 57,626
Amounts included in accumulated other comprehensive margin – unrecognized actuarial gain (loss)	**$ (3,434)**	$ 7,518
Net periodic benefit cost:		
Service cost	**$ 1,223**	$ 1,399
Interest cost	**2,871**	2,355
Amortization of net actuarial gain	**(117)**	(145)
Net periodic benefit cost	**$ 3,977**	$ 3,609
`		
Net gain (loss) recognized in other comprehensive margin	**$ (10,952)**	$ 22
Amounts expected to be realized in next fiscal year – amortization of net gain	**$ –**	$ (117)

6. Retirement Benefits (continued)

The discount rate used to determine the accumulated postretirement benefit obligation was 4.28% and 5.08% for 2014 and 2013, respectively. This decrease in the discount rate of eighty basis points resulted in $8.7 million of the $10.8 million actuarial loss for the year ended December 31, 2014.

The Cooperative expects to contribute approximately $2.3 million to the plan in 2015.

The following expected benefit payments from the plan, which reflect anticipated future service, are (dollars in thousands):

Years ending December 31:	
2015	$ 2,288
2016	2,421
2017	2,535
2018	2,656
2019	2,786
2020–2024	15,632
Total	$ 28,318

For measurement purposes, a 7.1% annual rate of increase in the per capita cost of covered health care benefits was used for the year ended December 31, 2014. The rate is assumed to decline to 4.5% after 13 years. The health care cost trend rate assumption has a significant effect on the amounts reported. For example, a 1% increase in the health care trend rate would increase the service and interest costs $1.0 million and increase the postretirement benefit obligation by $13.9 million. A 1% decrease in the health care trend rate would decrease total service and interest costs by $0.8 million and decrease the postretirement benefit obligation by $11.0 million.

7. Commitments and Contingencies

The Cooperative has entered into long-term agreements for the purchase of power, with the final agreement expiring in 2016. Payments made under the contracts for 2014 and 2013 were $19.7 million and $16.8 million, respectively, and total minimum payment obligations are as follows (dollars in thousands):

Years ending December 31:	
2015	$ 40,844
2016	5,643

The Cooperative is committed to purchase coal for its generating plants under long-term contracts that extend through 2021. Coal payments under contracts for 2014 and 2013 were $141.6 million and $188.2 million, respectively. Total minimum purchase obligations for the next five years are as follows (dollars in thousands):

Years ending December 31:	
2015	$ 170,115
2016	168,075
2017	59,457
2018	4,079
2019	1,484

The minimum cost of the coal purchases, based on the latest contractual prices, is subject to escalation clauses that are generally based on government-published indices and market price.

The supply agreements are not accounted for as derivatives based upon the Normal Purchases Normal Sales exception as permitted by ASC Topic 815-10, Derivatives and Hedging.

There are pending civil claims in litigation against the Cooperative. Under the Cooperative's general liability insurance program, it is responsible for a deductible amount up to $1 million for each occurrence. Neither the probable outcome nor ultimate liability resulting from any claims and litigation can be readily determined at this time. Accruals have been made when appropriate and management believes that any liability for such matters will, in any case, not have a material effect on the financial statements.

7. Commitments and Contingencies (continued)

The Cooperative and 15 of its owner-members have been named in a complaint filed by another East Kentucky Power Cooperative owner-member (plaintiff). The plaintiff claims, among other things, that it owned a portion of Charleston Bottoms Rural Electric Cooperative Corporation, which was dissolved in 2012 with all assets conveyed to EKPC, and thereby, is entitled to its share of the fair market value of the assets at the time of dissolution. EKPC is vigorously contesting the complaint and has filed motions accordingly.

8. Regulatory Assets and Liabilities

In 2010, the Cooperative recorded a regulatory asset of $157.1 million for construction costs expended on the cancelled Smith Unit 1 plant based on the guidance for abandonment of plant costs for regulated entities and management's assertion that full return on investment was probable. On February 28, 2011, the PSC approved the Cooperative's request to surrender the Certificate of Public Convenience and Necessity (CPCN) for Smith Unit 1 and in a separate order, authorized the establishment of a regulatory asset for the construction costs incurred and the Cooperative's estimate of the costs to unwind vendor contracts. During 2011, the Cooperative negotiated final settlement of the Smith Unit 1 contracts, resulting in a reduction of the regulatory asset balance to $150.8 million at December 31, 2011. Additional minimal costs have been incurred each year to maintain the assets. The balance of the regulatory asset was reduced by a $1 million non-refundable exclusivity payment from a prospective buyer in 2013. The balance was reduced by an additional $0.9 million in 2014 for parts used by another EKPC generating unit for maintenance to bring the regulatory asset balance to $149.4 million at December 31, 2014. While the Cooperative has not yet requested rate recovery, management believes that it is probable that the PSC will allow the Cooperative to recover through rates the full amount of the regulatory asset, along with a return on the investment, net of cash inflows from cost mitigation efforts.

On March 6, 2015, the PSC approved EKPC's request to recognize deprecation and accretion expenses related to its asbestos abatement and ash disposal AROs as regulatory assets for 2014 and all subsequent years with the exception of a portion of one ARO associated with ash transfer costs at Dale Station. EKPC has requested a rehearing to address the component of the ARO excluded from regulatory asset treatment and to gain clarity on other requirements outlined in the order. Also, in a separate proceeding, the Cooperative requested and the PSC approved recovery of the costs that will settle the Dale Station ash disposal ARO through the environmental surcharge mechanism. The associated regulatory asset will be expensed as recovery occurs. While the Cooperative has not yet requested recovery of the other ARO related regulatory assets, management believes it is probable that the PSC will allow the Cooperative to recover the full amount through rates or other mechanisms.

8. Regulatory Assets and Liabilities (continued)

In 2008, the Cooperative recorded a regulatory asset of $12.3 million related to unrecorded forced outage replacement power costs incurred during 2008. The PSC approved a three-year amortization period beginning in April 2009. In conjunction with the rate case approved by the PSC on January 14, 2011, the Cooperative was permitted to extend the amortization of forced outage costs an additional three years until January 14, 2014. Accordingly, this regulatory asset, along with deferred management audit costs, was classified as a current regulatory asset at December 31, 2013.

On January 30, 2015, the PSC issued an order disallowing purchased power costs included in the fuel adjustment clause recovery mechanism (FAC) of $8.5 million that were in excess of EKPC's own highest-cost generating unit available to be dispatched to serve native load from November 1, 2013 through April 30, 2014. The PSC directed EKPC to refund this amount through the FAC over four consecutive months in 2015. Accordingly, this amount, along with an additional $1.3 million estimated by EKPC for the months of May 2014 through December 2014 was included in the FAC regulatory liability at year-end. EKPC requested a rehearing on this matter and the PSC approved the request for rehearing on March 6, 2015.

Regulatory assets (liabilities) were comprised of the following as of December 31, 2014 and 2013 (dollars in thousands):

	2014	**2013**
Plant abandonment – Smith Unit 1	**$ 149,384**	$ 150,273
ARO-related depreciation and accretion expenses	**4,203**	–
Environmental cost recovery	**269**	–
Deferred outage costs	**–**	60
Deferred management audit costs	–	10
	$ 153,856	$ 150,343
Fuel adjustment clause	**$ (14,319)**	$ (1,089)
Environmental cost recovery	**–**	(2,994)
	$ (14,319)	$ (4,083)

9. Environmental Matters

In June 2014, EPA proposed new rules under Section 111(d) of the Clean Air Act to regulate greenhouse gas emissions from existing power utilities. EKPC provided detailed comments on this rule. EPA anticipates finalizing all rules regarding carbon dioxide emissions from the power sector in 2015. Although EPA has proposed that interim carbon dioxide emission goals must be met between 2020 and 2029 and that final carbon dioxide emission goals must be achieved by 2030, compliance requirements and deadlines will not be certain until the rule is finalized.

Existing coal and oil fired electric utility steam generating units must comply with Mercury and Air Toxics Standards (MATS) rules to reduce emissions of air toxins by April 15, 2015. A one year extension until April 15, 2016 may be granted under certain circumstances. EKPC's Cooper and Dale Stations have received a one-year compliance extension, until April 15, 2016. The extension for Dale was granted because the units are expected to be needed to be available to operate during the upcoming year to ensure reliability of the power grid, as requested by PJM. Cooper obtained the extension to provide EKPC with additional time to complete installation of the necessary environmental controls. Unit 4 at Spurlock Station is already in compliance with MATS per an Agreed Consent Order with the Commonwealth of Kentucky. Units 1, 2 and 3 at Spurlock Station will begin MATS compliance on April 15, 2015.

On December 30, 2012, the DC Court of Appeals stayed the Cross-State Air Pollution Rule (CSAPR) to limit S02 and NOx emissions pending judicial review. In April of 2014, the Supreme Court reversed the DC Court of Appeals, reinstating CSAPR. This decision prompted the DC Court of Appeals to lift the stay on October 23, 2014. Phase 1 of CSAPR began on January 1, 2015 and Phase 2 will begin on January 1, 2017.

In August 2014, EPA published its final rule under Section 316(b) of the Clean Water Act, regulating the location, design, construction, and capacity of cooling water intake systems. The rule became effective on October 14, 2014. The rule requires facilities that withdraw 2 million gallons per day and use 25% of the withdrawn water exclusively for cooling purposes to ensure that the cooling water intake structures implement the best technology available (BTA) to minimize impingement and entrainment of fish and other aquatic organisms. EPA does not dictate what technology must be used, but provides seven BTA options. Kentucky is responsible for establishing a compliance schedule for the 316(b) rule in connection with the renewal of the Cooperative's existing permits.

9. Environmental Matters (continued)

In December 2014, EPA released its rule regulating management of coal combustion residuals (CCR) under the Resource Conservation and Recovery Act. To date, the final rule has not been published in the Federal Register. The rule is expected to be effective 180 days after its publication in the Federal Register. The final rule applies to owners and operators of landfills and surface impoundments and establishes minimum national criteria for the safe disposal of solid waste CCR. The criteria address a wide spectrum of activities related to CCR solid waste disposal. Areas addressed include location restrictions, structural integrity requirements, liner design criteria, operations, groundwater monitoring, closure and postclosure requirements. Also, the closure and postclosure requirements may result in additional asset retirement obligations in the period it becomes a legal obligation.

The Cooperative is evaluating the impact of these rules on its current fleet of coal-fired units.

10. Changes in Accumulated Other Comprehensive Margin (Loss) by Component

The following table represents the details of accumulated other comprehensive margin activity by component (in thousands):

	Postretirement Benefit Obligation	Unrealized Gain (Loss) on Investments Available for Sale	Accumulated Other Comprehensive Margin (Loss)
Balance – December 31, 2013	$ 7,518	$ 168	$ 7,686
Other comprehensive loss before reclassifications	(10,835)	(82)	(10,917)
Amounts reclassified from accumulated other comprehensive margin	(117)	–	(117)
Net current period other comprehensive loss	(10,952)	(82)	(11,034)
Balance – December 31, 2014	$ (3,434)	$ 86	$ (3,348)

The postretirement benefit obligation reclassification noted above represents the amortization of actuarial gain that is included in the computation of net periodic postretirement benefit cost. See Note 6 – Retirement Benefits for additional details.

11. Related-Party Transactions

The Cooperative is a member of the National Rural Utilities Cooperative Finance Corporation (CFC), which provides a portion of the Cooperative's financing and is also a joint lead arranger and a 16% participant in the Cooperative's $500 million unsecured credit facility. Investments held to maturity included CFC capital term certificates of $8.6 million and $8.7 million at December 31, 2014 and 2013, respectively. CFC Patronage capital assigned to EKPC was $1.3 million and $1.2 million at December 31, 2014 and 2013, respectively.

The Cooperative is also a member of CoBank, which is a 13.4% participant in the Cooperative's $500 million unsecured credit facility. The balance of CoBank patronage capital assigned to EKPC at December 31, 2014 and 2013, was $0.3 million and $0.2 million, respectively.

EKPC is a member of ACES LLC (ACES), which provides various energy marketing, settlement and risk management related services to its members and clients. EKPC's Chairman of the Board is the Treasurer on ACES Board of Managers. EKPC's CEO is also an ACES Board Member. EKPC accounts for its investment in ACES on the cost basis of accounting. At December 31, 2014 and 2013, the balance of EKPC's investment in ACES was approximately $0.6 million. Payments to ACES were $2.2 million in 2014 and $2.1 million in 2013.

12. Subsequent Events

On March 6, 2015, the PSC granted EKPC a Certificate of Public Convenience and Necessity (CPCN) to construct the Smith Landfill to receive coal ash removed from the Dale ash ponds. The total project is for $27 million and also includes reclamation of the Dale ash pond site and transfer of the ash from Dale to the Smith location. The PSC also approved EKPC's request to recover the costs of the project, with the exception of ash transfer costs, through the environmental surcharge over a 10 year period. The order requires ash transfer costs to be recovered through the environmental surcharge as incurred.

Management has evaluated subsequent events through March 31, 2015, which is the date these financial statements were available to be issued.

EY | Assurance | Tax | Transactions | Advisory

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization and may refer to one or more of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

© 2015 Ernst & Young LLP.
All Rights Reserved.

ey.com