# Financial Statements

East Kentucky Power Cooperative, Inc.
Years Ended December 31, 2016 and 2015
With Report of Independent Auditors

Ernst & Young LLP

Building a better
working world

East Kentucky Power Cooperative, Inc.

Financial Statements

Years Ended December 31, 2016 and 2015

## Contents

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# 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, 2016 and 2015, and the related statements of revenue 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.

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. at December 31, 2016 and 2015, 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 30, 2017 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 30, 2017

# East Kentucky Power Cooperative, Inc.

## Balance Sheets
*(Dollars in Thousands)*

| | December 31 2016 | December 31 2015 |
|---|---|---|
| **Assets** | | |
| Electric plant: | | |
| In-service | **$ 4,043,504** | $ 3,948,438 |
| Construction-in-progress | **34,114** | 50,876 |
| | **4,077,618** | 3,999,314 |
| Less accumulated depreciation | **1,319,126** | 1,217,768 |
| Electric plant – net | **2,758,492** | 2,781,546 |
| Long-term accounts receivable | **1,225** | 1,364 |
| Restricted cash and investments | **232,176** | 7,063 |
| Investment securities: | | |
| Available-for-sale | **33,735** | 35,271 |
| Held-to-maturity | **8,397** | 8,488 |
| Current assets: | | |
| Cash and cash equivalents | **124,116** | 51,473 |
| Restricted investment | **174,749** | 62,195 |
| Accounts receivable | **89,231** | 74,324 |
| Fuel | **47,392** | 71,527 |
| Materials and supplies | **61,112** | 57,209 |
| Regulatory assets | **863** | 2,529 |
| Other current assets | **6,563** | 6,840 |
| Total current assets | **504,026** | 326,097 |
| Regulatory assets | **168,958** | 162,262 |
| Deferred charges | **3,170** | 1,494 |
| Other noncurrent assets | **8,054** | 7,168 |
| Total assets | **$ 3,718,233** | $ 3,330,753 |
| **Members' equities and liabilities** | | |
| Members' equities: | | |
| Memberships | **$ 2** | $ 2 |
| Patronage and donated capital | **588,897** | 535,189 |
| Accumulated other comprehensive loss | **(13,074)** | (23,244) |
| Total members' equities | **575,825** | 511,947 |
| Long-term debt | **2,794,578** | 2,499,815 |
| Current liabilities: | | |
| Current portion of long-term debt | **89,650** | 91,661 |
| Accounts payable | **66,170** | 62,770 |
| Accrued expenses | **38,973** | 14,579 |
| Regulatory liabilities | **1,759** | 1,077 |
| Total current liabilities | **196,552** | 170,087 |
| Accrued postretirement benefit cost | **83,159** | 88,530 |
| Asset retirement obligations and other liabilities | **68,119** | 60,374 |
| Total members' equities and liabilities | **$ 3,718,233** | $ 3,330,753 |

*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 | |
|---|---|---|
| | **2016** | **2015** |
| Operating revenue | **$ 887,419** | $ 885,054 |
| Operating expenses: | | |
| Production: | | |
| Fuel | **247,040** | 228,372 |
| Other | **151,105** | 149,553 |
| Purchased power | **114,954** | 147,354 |
| Transmission and distribution | **55,866** | 53,395 |
| Regional market operations | **4,524** | 4,366 |
| Depreciation | **106,366** | 95,164 |
| General and administrative | **57,276** | 52,105 |
| Total operating expenses | **737,131** | 730,309 |
| Operating margin before fixed charges and other expenses | **150,288** | 154,745 |
| Fixed charges and other: | | |
| Interest expense on long-term debt | **113,042** | 113,259 |
| Amortization of debt expense | **458** | 440 |
| Accretion and other | **314** | (74) |
| Total fixed charges and other expenses | **113,814** | 113,625 |
| Operating margin | **36,474** | 41,120 |
| Nonoperating margin: | | |
| Interest income | **17,233** | 8,974 |
| Patronage capital allocations from other cooperatives | **194** | 230 |
| Regulatory settlements | **(20)** | – |
| Other | **(173)** | (1,034) |
| Total nonoperating margin | **17,234** | 8,170 |
| Net margin | **53,708** | 49,290 |
| Other comprehensive margin (loss): | | |
| Unrealized loss on available-for-sale securities | **(42)** | (72) |
| Postretirement benefit obligation gain (loss) | **10,212** | (19,824) |
| | **10,170** | (19,896) |
| Comprehensive margin | **$ 63,878** | $ 29,394 |

*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 Loss | Total Members' Equities |
|---|---|---|---|---|---|
| Balance – December 31, 2014 | $ 2 | $ 482,864 | $ 3,035 | $ (3,348) | $ 482,553 |
| Net margin | – | 49,290 | – | – | 49,290 |
| Unrealized loss on available for sale securities | – | – | – | (72) | (72) |
| Postretirement benefit obligation loss | – | – | – | (19,824) | (19,824) |
| Balance – December 31, 2015 | 2 | 532,154 | 3,035 | (23,244) | 511,947 |
| Net margin | **–** | **53,708** | **–** | **–** | **53,708** |
| Unrealized loss on available for sale securities | **–** | **–** | **–** | **(42)** | **(42)** |
| Postretirement benefit obligation gain | **–** | **–** | **–** | **10,212** | **10,212** |
| Balance – December 31, 2016 | **$ 2** | **$ 585,862** | **$ 3,035** | **$ (13,074)** | **$ 575,825** |

*See notes to financial statements.*

# East Kentucky Power Cooperative, Inc.

## Statements of Cash Flows
*(Dollars in Thousands)*

| | Year Ended December 31 | |
|---|---|---|
| | **2016** | **2015** |
| **Operating activities** | | |
| Net margin | **$ 53,708** | $ 49,290 |
| Adjustments to reconcile net margin to net cash provided by operating activities: | | |
| Depreciation | **106,366** | 95,164 |
| Amortization of loan costs | **1,132** | 1,146 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | **(14,907)** | 11,488 |
| Fuel | **24,135** | (5,077) |
| Materials and supplies | **(3,903)** | (2,375) |
| Regulatory assets/liabilities | **1,869** | (15,852) |
| Accounts payable | **7,002** | (4,935) |
| Accrued expenses | **24,394** | 629 |
| Accrued postretirement benefit cost | **4,841** | (212) |
| Other | **(13,102)** | (5,268) |
| Net cash provided by operating activities | **191,535** | 123,998 |
| **Investing activities** | | |
| Additions to electric plant | **(74,634)** | (211,263) |
| Restricted deposits held in escrow | **–** | (6,000) |
| Maturities of debt service reserve securities | **4,246** | 4,248 |
| Purchases of debt service reserve securities | **(4,248)** | (4,248) |
| Maturities of available-for-sale securities | **60,531** | 53,431 |
| Purchases of available-for-securities | **(59,037)** | (55,112) |
| Maturities of held-to-maturity securities | **91** | 91 |
| Additional deposits with RUS restricted investment | **(474,225)** | (96,185) |
| Maturities of RUS restricted investment | **136,560** | 188,303 |
| Other | **136** | 1,124 |
| Net cash used in investing activities | **(410,580)** | (125,611) |
| **Financing activities** | | |
| Proceeds from long-term debt | **784,000** | 665 |
| Principal payments on long-term debt | **(491,167)** | (130,649) |
| Debt issuance costs | **(1,145)** | – |
| Net cash provided by (used in) financing activities | **291,688** | (129,984) |
| Net change in cash and cash equivalents | **72,643** | (131,597) |
| Cash and cash equivalents – beginning of year | **51,473** | 183,070 |
| Cash and cash equivalents – end of year | **$ 124,116** | $ 51,473 |
| **Supplemental disclosure of cash flow** | | |
| Cash paid for interest | **$ 88,631** | $ 113,324 |
| Noncash investing transactions: | | |
| Additions to electric plant included in accounts payable | **$ 14,240** | $ 17,842 |
| Unrealized loss on available-for-sale securities | **$ (42)** | $ (72) |

*See notes to financial statements.*

## 1. Summary of Significant Accounting Policies

### Nature of Operations

East Kentucky Power Cooperative (the Cooperative or EKPC) 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 two coal-fired generation plants, twelve combustion turbines and six landfill gas plants. In addition, the Cooperative has rights to 170 megawatts of hydroelectric power from the Southeastern Power Administration. One simple cycle natural gas unit is designated to serve a capacity purchase and tolling agreement through April 30, 2019. The capacity and energy from one landfill gas plant is designated to serve a member system through a ten-year purchase power agreement.

### 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, *Regulated Operations.*

### Use of Estimates

The preparation of financial statements in conformity with GAAP 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.

## 1. Summary of Significant Accounting Policies (continued)

### Electric Plant and Maintenance

Electric plant is stated at cost. The cost of assets constructed by the Cooperative includes material, labor, contractor 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.

### 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 2016 and 2015 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 ranged from 2030 to 2051 in 2016, and 2019 to 2051 in 2015.

Depreciation expense was $106.4 million and $95.2 million for 2016 and 2015, respectively. The Cooperative received PSC approval to charge depreciation associated with asset retirement obligations to regulatory assets. These regulatory assets are charged to depreciation expense as recovery occurs. Depreciation charged to regulatory assets was $10.5 million and $6.8 million in 2016 and 2015, respectively.

**1. Summary of Significant Accounting Policies (continued)**

**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-lived assets during the years ended December 31, 2016 or 2015.

**Restricted Cash and Investments**

Restricted cash and investments represent funds restricted by contractual stipulations or other legal requirements. Funds designated for the repayment of debt within one year are shown as current assets on the balance sheets. All other restricted cash and investments are shown as noncurrent on the balance sheets. Restricted cash and investment activity is classified as investing activities on the statements of cash flows.

The Cooperative participates in the 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 principal and interest payments on loans made or guaranteed by the RUS. At December 31, 2016 and 2015, the balances in the cushion of credit program were $399.9 million and $62.2 million, respectively.

On December 29, 2015, the Cooperative became the lessor in a capacity purchase and tolling agreement that is effective through April 30, 2019. As part of the agreement, the Cooperative was required to pledge cash collateral with a third party that will be refunded over the term of the contract.

## 1. Summary of Significant Accounting Policies (continued)

Restricted cash and investments at December 31, 2016 and 2015 consisted of the following (dollars in thousands):

| | 2016 | 2015 |
|---|---|---|
| Debt service reserve (Note 6) | **$ 1,065** | $ 1,063 |
| Funds restricted by tolling agreement | **6,000** | 6,000 |
| Noncurrent restricted investment – RUS cushion of credit | **225,111** | – |
| Restricted cash and investments – noncurrent | **232,176** | 7,063 |
| Current restricted investment – RUS cushion of credit | **174,749** | 62,195 |
| Total restricted cash and investments | **$ 406,925** | $ 69,258 |

### 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, 2016 and 2015, consisted primarily of money market mutual funds and investments in commercial paper.

### 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. Available-for-sale securities are carried at fair value, with unrealized holding gains and losses reported in other comprehensive margin (loss) on the statements of revenue and expenses and comprehensive margin.

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)

### 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, *Fair Value Measurements and Disclosures*, may be used in the calculation of fair value. ASC Topic 820 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.

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 and debt service reserve 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.

## 1. Summary of Significant Accounting Policies (continued)

Estimated fair values of the Cooperative's financial instruments as of December 31, 2016 and 2015, were as follows (dollars in thousands):

| | | Fair Value at Reporting Date Using | | |
|---|---|---|---|---|
| | **Fair Value December 31, 2016** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
| Cash equivalents | **$ 100,000** | **$ 100,000** | **$ –** | **$ –** |
| Available-for-sale securities | **33,735** | **33,735** | **–** | **–** |
| Debt service reserve | **1,065** | **1,065** | **–** | **–** |
| FTR derivatives | **537** | **–** | **537** | **–** |

| | | Fair Value at Reporting Date Using | | |
|---|---|---|---|---|
| | **Fair Value December 31, 2015** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
| Cash equivalents | $ 30,000 | $ 30,000 | $ – | $ – |
| Available for sale securities | 35,271 | 35,271 | – | – |
| Debt service reserve | 1,063 | 1,063 | – | – |
| FTR derivatives | 473 | – | 473 | – |

## 1. Summary of Significant Accounting Policies (continued)

The estimated fair values of the Cooperative's financial instruments carried at cost at December 31, 2016 and 2015, were as follows (in thousands):

| | **2016** | | **2015** | |
|---|---|---|---|---|
| | **Carrying Amount** | **Fair Value** | **Carrying Amount** | **Fair Value** |
| Held-to-maturity investments | **$ 8,397** | **$ 9,868** | $ 8,488 | $ 9,558 |
| Long-term debt | **2,884,228** | **3,201,920** | 2,591,476 | 2,986,239 |

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.

### 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 $830.0 million and $848.7 million for 2016 and 2015, respectively. Accounts receivable at December 31, 2016 and 2015, were primarily from billings to member cooperatives.

At December 31, 2016 and 2015, individual accounts receivable balances that exceeded 10% of total accounts receivable are as follows (dollars in thousands):

| | **2016** | **2015** |
|---|---|---|
| Owen Electric Cooperative | **$ 12,272** | $ 11,039 |
| South Kentucky RECC | **9,698** | 7,716 |
| Blue Grass Energy Cooperative | **9,506** | 7,698 |

## 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. Upon removal from inventory for use, the average cost method is used.

### 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, *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, 2016, the Cooperative had FTR derivative assets of $0.5 million and $0.2 million in related liabilities. At December 31, 2015, the Cooperative had FTR derivative assets of $0.5 million and $0.4 million in related liabilities.

### Regulatory Assets and Liabilities

ASC Topic 980 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.

## 1. Summary of Significant Accounting Policies (continued)

### Debt Issuance Costs

The Cooperative adopted Accounting Standards Update (ASU) 2015-03, *Interest—Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance* Costs and ASU 2015-15, *Interest—Imputation of Interest Associated with Line-of-Credit Arrangements* in 2016 with full retrospective application, as required. Accordingly, the adoption of these amendments resulted in \$1.5 million and \$1.4 million of debt issuance costs previously reported as deferred charges being presented as a direct deduction from long-term debt at December 31, 2016 and 2015, respectively. Debt issuance costs associated with the credit facility revolver continue to be shown as part of deferred charges on the balance sheet.

Debt issuance costs are amortized to interest expense over the life of the respective debt using the effective interest rate method or the straight-line method when results approximate the effective interest rate method.

### Asset Retirement Obligations

ASC Topic 410, *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, including asset retirement obligations 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.

Fair value of each respective ARO, when incurred, is determined by discounting expected future cash outflows associated with required retirement activities using a credit adjusted risk-free rate. Cash outflows for retirement activities are based upon market information, historical information and management’s estimates and would be considered Level 3 under the fair value hierarchy.

The Cooperative’s asset retirement obligations (ARO) represent the requirements related to asbestos abatement and reclamation and capping of ash disposal sites at its coal-fired plants. Increases in ARO obligations in 2016 and 2015 are primarily related to changes in the estimated cost to settle ash disposal sites to comply with the closure and post-closure requirements contained in the EPA’s final rule regulating the management of coal combustion residuals (CCR). Settlement activities are associated with the reclamation and capping of ash disposal sites.

**1. Summary of Significant Accounting Policies (continued)**

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 accompanying Balance Sheets (in thousands):

| | 2016 | 2015 |
|---|---|---|
| Balance – beginning of year | **$ 56,408** | $ 33,263 |
| Liabilities incurred | **1,153** | – |
| Liabilities settled | **(12,934)** | (4,740) |
| Estimated cash flow revisions | **17,343** | 26,973 |
| Accretion | **1,464** | 912 |
| Balance – end of year | **$ 63,434** | $ 56,408 |

As discussed in Note 5, the PSC granted regulatory asset treatment of accretion and depreciation associated with AROs on EKPC's books by type and location beginning in January 2014. These regulatory assets will be charged to accretion expense and depreciation expense as recovery of settlement costs occurs. The Cooperative plans to seek similar regulatory asset treatment for accretion and depreciation associated with an ARO obligation incurred at a new location in 2016.

Accretion charged to regulatory assets in 2016 and 2015 was $1.5 million and $1.3 million, respectively. Accretion expense recognized in 2016 was $0.3 million which represented the recovery of settlement costs associated with the Dale Station ash transfer project. Accretion expense recognized in 2015 was $(0.07) million which represented the net impact of a PSC ordered credit for accretion expense recognized in 2014 and recovery of settlement costs associated with the Dale Station ash transfer project.

**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 the Cooperative's members. These wholesale power contracts obligate each member to pay EKPC 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 that 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.

**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 related to aggregate margins and equities are met. Accordingly, at December 31, 2016 and 2015, no patronage capital was available for refund or retirement.

## 1. Summary of Significant Accounting Policies (continued)

### Comprehensive Margin

Comprehensive margin includes both net margin and other comprehensive margin (loss). Other comprehensive margin (loss) 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 margin (loss) on a net basis in the Statements of Revenue and Expenses and Comprehensive Margin. Reclassification adjustments are disclosed in Note 8. 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, *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 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).

### Regional Transmission Organization

The Cooperative is a transmission-owning member of PJM Interconnection, LLC (PJM) and functional control of certain transmission facilities is maintained by PJM. 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.

## 1. Summary of Significant Accounting Policies (continued)

### Power Sales Arrangements

The Cooperative is the lessor under power sales arrangements that are required to be accounted for as operating leases due to the terms of the agreements. The details of those agreements are discussed in Note 10. The revenues from these arrangements are included in operating revenues on the Statements of Revenue and Expenses and Comprehensive Margin.

### New Accounting Guidance

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. In August 2015, the FASB issued Accounting Standards Update No. 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date* to provide a one year delay in the effective date of ASU 2014-09. ASU 2014-09 will be effective for the Cooperative beginning in 2019. Early adoption is permitted. The Company is currently assessing the impact of adopting this guidance, as well as the transition method it will use.

In August 2014, the FASB issued Accounting Standards Update 2014-15, *Presentation of Financial Statements – Going Concern (Subtopic 205-40): Disclosures of Uncertainties about an Entity's Ability to Continue as a Going Concern,* or ASU 2014-15. The amendment in this ASU requires management to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern. Substantial doubt exists when it is probable that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued. Disclosures are required if conditions or events give rise to substantial doubt. The Company adopted this update in 2016 and it did not have an impact on our disclosures.

## 1. Summary of Significant Accounting Policies (continued)

In February 2016, the FASB issued Accounting Standards Update 2016-02, *Leases (Topic 842)* or ASU 2016-02. The core principle of this revised accounting guidance requires that lessees recognize all leases (other than leases with a term of twelve months or less) on the balance sheet as lease liabilities, based upon the present value of the lease payments, with corresponding right of use assets. ASU 2016-02 also makes targeted changes to other aspects of the current guidance, including the lease classification criteria and the lessor accounting model. The amendments in ASU 2016-02 will be effective for the Cooperative beginning in 2020. Early adoption is permitted. The Company is currently assessing the impact of adopting this guidance.

In August 2016, the FASB issued Accounting Standards Update 2016-15, *Statement of Cash Flows (Topic 230) – Classification of Certain Cash Receipts and Payments*, or ASU 2016-15. This amendment provides specific guidance on certain cash flow presentation and classification issues in order to reduce diversity in practice on the statement of cash flows. This amendment will be effective for the Cooperative beginning in 2019. Early adoption is permitted. The guidance requires application using a retrospective transition method. The Company is currently assessing the impact that this amendment will have on our statements of cash flows.

In November 2016, the FASB issued Accounting Standards Update 2016-18, *Statement of Cash Flows (Topic 230) – Restricted Cash*, or ASU 2016-18. This amendment requires the statement of cash flows to explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Amounts described as restricted cash and restricted cash equivalents will be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. This amendment will be effective for the Cooperative beginning in 2019. Early adoption is permitted. The guidance is applied using a retrospective transition method to each period presented. The Company is currently assessing the impact that this amendment will have on our statements of cash flows.

## 2. Electric Plant in Service

Electric plant in service at December 31, 2016 and 2015, consisted of the following (in thousands):

| | 2016 | 2015 |
|---|---|---|
| Production plant | **$ 2,999,187** | $ 2,975,527 |
| Transmission plant | **796,311** | 785,443 |
| General plant | **118,789** | 113,246 |
| Completed construction, not classified, and other | **129,217** | 74,222 |
| Electric plant in service | **$ 4,043,504** | $ 3,948,438 |

On December 29, 2015, the Cooperative purchased three simple cycle combustion turbine units and related facilities near LaGrange, Kentucky with a total winter capacity of 594 megawatts. The purchase resulted in an additional $128.5 million included in plant in service at December 31, 2015.

As discussed in Note 5, the PSC granted regulatory asset treatment for the abandonment of Dale Station generating assets at December 31, 2015. Assets of $94.3 million and accumulated depreciation of $91.1 million, respectively, were removed from plant. Two regulatory assets comprising the remaining net book value of $3.2 million were established at December 31, 2015.

## 3. Long-Term Accounts Receivable

Long-term accounts receivable represents interest-bearing notes to three of the Cooperative's member systems for the buyout of EKPC's joint ownership of their propane companies. 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 2025.

## 4. Investment Securities

Amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2016 and 2015, were as follows (dollars in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **2016** | | | | |
| U.S. Treasury Bill | **$ 25,176** | **$ –** | **$ (23)** | **$ 25,153** |
| Zero coupon bond | **8,587** | **–** | **(5)** | **8,582** |
| | **$ 33,763** | **$ –** | **$ (28)** | **$ 33,735** |

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **2015** | | | | |
| U.S. Treasury Bill | $ 26,695 | $ – | $ (9) | $ 26,686 |
| Zero coupon bond | 8,562 | 28 | (5) | 8,585 |
| | $ 35,257 | $ 28 | $ (14) | $ 35,271 |

Proceeds from maturities of securities were $60.5 million and $53.4 million in 2016 and 2015, respectively.

## 4. Investment Securities (continued)

Amortized cost and estimated fair value of held-to-maturity investment securities at December 31, 2016 and 2015, are as follows (dollars in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **2016** | | | | |
| National Rural Utilities Cooperative Finance Corporation: | | | | |
| 3%–5% capital term certificates | **$ 7,656** | **$ 1,438** | **$ –** | **$ 9,094** |
| 6.5875% subordinated term certificate | **250** | **69** | **–** | **319** |
| 0% subordinated term certificate | **491** | **–** | **(36)** | **455** |
| | **$ 8,397** | **$ 1,507** | **$ (36)** | **$ 9,868** |

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **2015** | | | | |
| National Rural Utilities Cooperative Finance Corporation: | | | | |
| 3%–5% capital term certificates | $ 7,656 | $ 1,025 | $ – | $ 8,681 |
| 6.5875% subordinated term certificate | 275 | 89 | – | 364 |
| 0% subordinated term certificate | 557 | – | (44) | 513 |
| | $ 8,488 | $ 1,114 | $ (44) | $ 9,558 |

**4. Investment Securities (continued)**

All investment securities held to maturity with unrealized losses at December 31, 2016 and 2015, have maturities of 12 months or more. The amortized cost and fair value of securities at December 31, 2016, 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 | $ 33,763 | $ 33,735 |
| | $ 33,763 | $ 33,735 |
| Held-to-maturity: | | |
| Due after one year through five years | $ 691 | $ 721 |
| Due after five years through ten years | 708 | 742 |
| Due after ten years | 6,998 | 8,405 |
| | $ 8,397 | $ 9,868 |

**5. 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 further reduced by an additional $1.8 million for parts used by another EKPC generating unit for maintenance to bring the regulatory asset balance to $148.8 million at December 31, 2016. Effective January 1, 2017, the PSC approved a Stipulation and Recommendation Agreement between EKPC and intervenors which enabled EKPC to begin amortizing the regulatory asset balance, net of estimated mitigation and salvage efforts, over a

**5. Regulatory Assets and Liabilities (continued)**

period of ten years. PJM capacity market revenues through delivery year 2018 will be used to offset the expense until EKPC's next base rate case. The amortization associated with the remaining balance of the regulatory asset will be included for recovery in EKPC's next general base rate case.

In 2015, the PSC approved EKPC's request to recognize depreciation and accretion expenses related to its asbestos abatement and ash disposal AROs in existence at December 31, 2014 as regulatory assets for 2014 and all subsequent years. Also, in a separate proceeding, 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 is being 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.

On February 11, 2016, the PSC authorized the Cooperative to establish two regulatory assets for the abandonment of Dale Station at December 31, 2015, representing its net book value of $3.2 million. One regulatory asset was established in the amount of $2.4 million with a forty-two month amortization, which is consistent with the remaining depreciable life of the asset included in current rates. The balance of this regulatory asset was $1.6 million at December 31, 2016. A separate regulatory asset of $0.8 million, which represents the balance of capital projects remaining to be recovered in the environmental surcharge at December 31, 2015, will be considered for recovery, along with an associated return, during EKPC's next rate case.

**5. Regulatory Assets and Liabilities (continued)**

Regulatory assets (liabilities) were comprised of the following as of December 31, 2016 and 2015 (dollars in thousands):

| | 2016 | 2015 |
|---|---|---|
| Plant abandonment – Smith Unit 1 | **$ 148,834** | $ 148,750 |
| Plant abandonment – Dale Station | **2,414** | 3,169 |
| ARO-related depreciation and accretion expenses | **17,710** | 10,343 |
| Environmental cost recovery | **–** | 2,529 |
| Fuel adjustment clause | **863** | – |
| | **$ 169,821** | $ 164,791 |
| | | |
| Environmental cost recovery | **$ (1,759)** | $ – |
| Fuel adjustment clause | **–** | (1,077) |
| | **$ (1,759)** | $ (1,077) |

**6. 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 first mortgage note holders and tax-exempt bond holders with a pro-rated interest in substantially all owned assets.

**6. Long-Term Debt (continued)**

Long-term debt outstanding at December 31, 2016 and 2015, consisted of the following (in thousands):

| | 2016 | 2015 |
|---|---|---|
| First mortgage notes: | | |
| 2.30%–7.99%, payable quarterly to Federal Financing Bank (FFB) in varying amounts through 2044, weighted average 4.26% | **$ 2,261,098** | $ 2,323,192 |
| 5.13% payable quarterly to RUS in varying amounts through 2024 | **5,534** | 6,159 |
| Variable rate, 3.30% at December 31, 2016 and 2015, payable quarterly to CFC in varying amounts through 2024 | **6,425** | 7,469 |
| First Mortgage Bonds, Series 2014A, fixed rate of 4.61%, payable semi-annual, matures February 6, 2044 | **194,000** | 199,000 |
| Tax-exempt bonds: | | |
| Solid Waste Disposal Revenue Bonds, Series 1993B, variable rate bonds, due August 15, 2023 0.95% and 0.65% at December 31, 2016 and 2015, respectively | **4,500** | 5,000 |
| Clean Renewable Energy Bonds, fixed rate of 0.40% payable quarterly to CFC to December 1, 2023 | **3,109** | 4,306 |
| Promissory notes: | | |
| Variable rate notes payable to CFC, 1.63% at December 31, 2016 | **400,000** | 35,000 |
| 4.05%-5.50% fixed rate notes payable to National Cooperative Services Corporation, weighted average 4.92% | **11,094** | 12,801 |
| Total debt | **2,885,760** | 2,592,927 |
| Less debt issuance costs | **(1,532)** | (1,451) |
| Total debt adjusted for debt issuance costs | **2,884,228** | 2,591,476 |
| Less current maturities | **(89,650)** | (91,661) |
| Total long-term debt | **$ 2,794,578** | $ 2,499,815 |

## 6. Long-Term Debt (continued)

### First Mortgage Notes and Bonds

The Cooperative received loan funds in varying amounts through its first mortgage notes payable to RUS and 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, 2016. The amounts outstanding under these notes are $2.3 billion and $5.5 million at December 31, 2016.

In May 2015, the Cooperative submitted to RUS a loan application in the amount of $90.6 million for various transmission projects. The loan was approved by RUS in July 2015. No funds were advanced as of December 31, 2016. The loan documents were subsequently executed in January 2017 with a maturity date of December 31, 2049; $31.5 million was advanced in February 2017.

In June 2015, the Cooperative submitted to RUS a loan application in the amount of $238.9 million for various generation projects. The loan was revised to $221.8 million and approved by RUS in September 2015. The loan documents were subsequently executed in January 2017 with a maturity date of December 31, 2049; $23.2 million was advanced in February 2017.

In August 2015, a loan application was submitted for the acquisition of the assets of Bluegrass Generation Company, LLC in the amount of $131.8 million. The loan was approved by RUS in February 2016. The loan documents were executed in January 2017 with a maturity date of December 31, 2035; $128.8 million was advanced in February 2017.

In 1984, 1995 and 1998, EKPC entered into secured loans with CFC that initially totaled $20.5 million. As of December 31, 2016, the amount outstanding under these notes is $6.4 million.

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. The amount outstanding under these notes is $194 million at December 31, 2016.

## 6. Long-Term Debt (continued)

### Tax-Exempt Bonds

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 $5 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 2016 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 restricted cash and investments on the accompanying Balance Sheets and have a fair value of approximately $1.1 million at December 31, 2016 and 2015.

In January 2008, EKPC was approved to receive up to $8.6 million to finance certain qualified renewable energy projects with Clean Renewable Energy Bonds. The loan was fully advanced in July 2009. The amount outstanding at December 31, 2016 is $3.1 million.

In September 2016, EKPC was authorized by the IRS to issue $19.8 million in New Clean Renewable Energy Bonds to finance a planned community solar facility. In February 2017, EKPC issued an $18 million note to CFC, which has been designated as a New Clean Renewable Energy Bond. The remainder of the authorization expired on March 14, 2017.

### Promissory Notes

On July 6, 2016, the Cooperative entered into a new $600 million unsecured credit facility with CFC as the lead arranger, replacing its previously existing $500 million unsecured revolving credit facility. The new facility consists of a $500 million revolving tranche and a $100 million term loan tranche. This new facility matures on July 6, 2021 and is to be utilized for general corporate purposes including capital construction projects. The agreement allows the Cooperative to request two one-year maturity extensions and/or an increase in revolving commitments of up to $200 million. The Cooperative used proceeds from the new facility to repay the remaining $340 million of outstanding borrowings on the previously existing credit facility. As of December 31, 2016, the Cooperative had outstanding borrowings of $400 million (including the $100 million unsecured term loan). As of December 31, 2016, the availability under the credit facility was $200 million.

**6. Long-Term Debt (continued)**

In December 2010, the Cooperative entered into an unsecured loan agreement with the National Cooperative Services Corporation for $23.8 million to refinance indebtedness to RUS. As of December 31, 2016, the amount outstanding under these notes is $11.1 million.

Estimated annual maturities of long-term debt adjusted for debt issuance costs for the five years subsequent to December 31, 2016, are as follows (dollars in thousands):

| | |
|---|---|
| Years ending December 31 | |
| 2017 | $ 89,650 |
| 2018 | 90,520 |
| 2019 | 92,032 |
| 2020 | 94,398 |
| 2021 | 97,287 |
| Thereafter | 2,420,341 |
| | $ 2,884,228 |

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, 2016 and 2015.

As of December 31, 2016, 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, 2016, the Cooperative has pledged securities of $8.4 million with the United States Department of Labor for Federal Longshore Harbor Workers and the Commonwealth of Kentucky.

**7. 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 considered a multiemployer plan under the accounting standards. The plan sponsor's Employer Identification Number is 53-0116145 and the Plan Number is 333.

## 7. 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 2016 and 2015 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 $8.3 million and $8.2 million in 2016 and 2015, respectively. There have been no significant changes that affect the comparability of 2016 and 2015 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, 2016 and January 1, 2015, 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 offers 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 $3.1 million and $2.6 million to the plan for the years ended December 31, 2016 and 2015, respectively. Employees vest immediately in their contributions and the contributions of the Cooperative.

## 7. 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.

**7. 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, 2016 and 2015 (dollars in thousands):

| | 2016 | 2015 |
|---|---|---|
| Change in benefit obligation: | | |
| Accumulated postretirement benefit obligation – beginning of year | **$ 92,546** | $ 71,206 |
| Service cost | **1,690** | 1,485 |
| Interest cost | **4,201** | 2,999 |
| Participants' contributions | **1,301** | 1,176 |
| Benefits paid | **(3,575)** | (4,144) |
| Actuarial (gain) loss | **(9,294)** | 19,824 |
| Accumulated postretirement benefit obligation – end of year | **$ 86,869** | $ 92,546 |
| | | |
| Change in plan assets: | | |
| Fair value of plan assets – beginning of year | **$ –** | $ – |
| Employer contributions | **2,274** | 2,968 |
| Participant contributions | **1,301** | 1,176 |
| Benefits paid | **(3,575)** | (4,144) |
| Fair value of plan assets – end of year | **–** | – |
| Funded status – end of year | **$ (86,869)** | $ (92,546) |
| | | |
| Amounts recognized in balance sheet consists of: | | |
| Current liabilities | **$ 3,710** | $ 4,016 |
| Noncurrent liabilities | **83,159** | 88,530 |
| Total amount recognized in balance sheet | **$ 86,869** | $ 92,546 |
| | | |
| Amounts included in accumulated other comprehensive margin – unrecognized actuarial loss | **$ (13,046)** | $ (23,258) |
| | | |
| Net periodic benefit cost: | | |
| Service cost | **$ 1,690** | $ 1,485 |
| Interest cost | **4,201** | 2,999 |
| Amortization of net actuarial gain | **918** | – |
| Net periodic benefit cost | **$ 6,809** | $ 4,484 |
| | | |
| Net gain (loss) recognized in other comprehensive margin | **$ 10,212** | $ (19,824) |
| Amounts expected to be realized in next fiscal year – amortization of net gain (loss) | **$ (286)** | $ 918 |

**7. Retirement Benefits (continued)**

The per capita claim cost assumptions for the postretirement benefit plan is based upon the Cooperative's own retiree-specific medical and prescription drug claim experience. Improved experience over 2015 resulted in a decrease in the December 31, 2016 obligation of $10.3 million which was offset by an increase in the obligation of $1 million due to changes in the discount rate and mortality assumptions.

The discount rate used to determine the accumulated postretirement benefit obligation was 4.48% and 4.64% for 2016 and 2015, respectively.

The Cooperative expects to contribute approximately $3.7 million to the plan in 2017. The expected benefit payments from the plan, which reflect anticipated future service, are (dollars in thousands):

| | | |
|---|---|---|
| Years ending December 31: | | |
| 2017 | $ | 3,711 |
| 2018 | | 3,836 |
| 2019 | | 3,902 |
| 2020 | | 3,700 |
| 2021 | | 3,853 |
| 2022 – 2026 | | 22,256 |

For measurement purposes, a 6.7% annual rate of increase in the per capita cost of covered health care benefits was used for the year ended December 31, 2016. The rate is assumed to decline to 4.5% after 20 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 by $1.1 million and increase the postretirement benefit obligation by $13.8 million. A 1% decrease in the health care trend rate would decrease total service and interest costs by $0.9 million and decrease the postretirement benefit obligation by $11.2 million.

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

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

| | Postretirement Benefit Obligation | Unrealized Gain (Loss) on Investments Available for Sale | Accumulated Other Comprehensive Margin (Loss) |
|---|---|---|---|
| Balance – December 31, 2014 | $ (3,434) | $ 86 | $ (3,348) |
| Other comprehensive loss before reclassifications | (19,824) | (72) | (19,896) |
| Amounts reclassified from accumulated other comprehensive margin | – | – | – |
| Net current period other comprehensive loss | (19,824) | (72) | (19,896) |
| Balance – December 31, 2015 | (23,258) | 14 | (23,244) |
| Other comprehensive gain (loss) before reclassifications | **9,294** | **(42)** | **9,252** |
| Amounts reclassified from accumulated other comprehensive margin | **918** | **–** | **918** |
| Net current period other comprehensive gain (loss) | **10,212** | **(42)** | **10,170** |
| Balance – December 31, 2016 | **$ (13,046)** | **$ (28)** | **$ (13,074)** |

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 7 – Retirement Benefits for additional details.

## 9. Commitments and Contingencies

The Cooperative periodically enters into long-term agreements for the purchase of power. Payments made under long-term power contracts in 2016 and 2015 were $11.4 million and $47.0 million, respectively. One long-term agreement remained in effect at December 31, 2016 and will continue until either party gives a three year notice of termination. Total minimum payment obligations related to this contract are as follows (dollars in thousands):

| | |
|---|---|
| Years ending December 31: | |
| 2017 | $ 3,892 |
| 2018 | 3,892 |
| 2019 | 3,892 |

**9. Commitments and Contingencies (continued)**

The Cooperative is committed to purchase coal for its generating plants under long-term contracts that extend through 2019. Coal payments under contracts for 2016 and 2015 were $170.9 million and $135.2 million, respectively. Total minimum purchase obligations for the next three years are as follows (dollars in thousands):

| | |
|---|---|
| Years ending December 31: | |
| 2017 | $ 101,873 |
| 2018 | 53,234 |
| 2019 | 7,907 |

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 Cooperative is also committed to purchase limestone and lime for its coal-fired generating plants under all requirements contracts that extend through 2018. These contracts set forth pricing and quantity maximums for each product but do not require minimum purchases. Given that annual quantities purchased will vary according to the generation produced at each plant, minimum purchase obligations for the next two years cannot be determined.

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

On June 30, 2016, the Cooperative entered into a $16.4 million contract for the design, procurement, construction, and installation of an 8.5 megawatt community solar facility at the Cooperative's headquarter facilities, subject to PSC approval of the Cooperative's application for a CPCN. The PSC granted the CPCN on November 22, 2016 and also approved the Cooperative's request to assume indebtedness in the form of New Clean Renewable Bonds to finance the project. The project is expected to be completed in 2017 at a total cost of approximately $18.0 million.

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.

## 10. Power Sales Arrangements

In December 2015, the Cooperative became the lessor under two power sales arrangements that are required to be accounted for as operating leases due to the specific terms of the agreements. One arrangement is a capacity purchase and tolling agreement that entitles a third party to 165 MW of firm generation and capacity from Bluegrass Generation Station Unit 3 through April 30, 2019. The third party is responsible for the delivery of natural gas and also for securing electric transmission service in their balancing area. The other arrangement is an agreement to sell the capacity and energy from the Glasgow landfill gas plant to a member system for a period of ten years. The generating units used in these arrangements have asset values and accumulated depreciation of $34.3 million and $1.5 million, respectively, at December 31, 2016 and $33.5 million and $0.1 million, respectively, at December 31, 2015. The revenue associated with these arrangements for 2016 and 2015 was $9.0 million and $0.08 million, respectively, and is included in operating revenue on the Statements of Revenue and Expenses and Comprehensive Margin for the years ended December 31, 2016 and 2015. The minimum future revenues under these arrangements are as follows (dollars in thousands):

| | | |
|---|---|---|
| Years ending December 31: | | |
| 2017 | $ | 10,143 |
| 2018 | | 10,162 |
| 2019 | | 3,708 |
| 2020 | | 460 |
| 2021 | | 460 |

## 11. Environmental Matters

Existing coal and oil fired electric utility steam generating units were required to comply with Mercury and Air Toxics Standards (MATS) rules to reduce emissions of air toxins by April 15, 2015. However, a one-year extension until April 15, 2016 was available under certain circumstances. EKPC's Cooper and Dale Stations received one-year compliance extensions, until April 15, 2016. Cooper Station completed the installation of MATS controls and timely complied with MATS requirements. Units 3 and 4 of Dale Station were made available to operate to ensure reliability of the power grid, as requested by PJM, and officially ceased operations on April 15, 2016. As discussed in Note 5, given it was probable that Dale Station would be abandoned, EKPC requested, and the PSC approved, regulatory asset treatment of the net book value of Dale Station at December 31, 2015.

**11. Environmental Matters (continued)**

On April 17, 2015, the EPA published its final rule regulating management of CCR under the Resource Conservation and Recovery Act and it became effective on October 14, 2015. 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 post-closure requirements. Also, the closure and post-closure requirements resulted in the Cooperative revising its asset retirement obligations.

On October 23, 2015, the EPA published the Clean Power Plan (CPP) rule which established emission guidelines for states to follow in developing plans to reduce 2005 carbon emissions levels from existing fossil fuel-fired power plants thirty-two percent by 2030. On February 9, 2016, the Supreme Court stayed implementation of the CPP pending judicial review. Oral argument was held before eight judges of the D.C. Circuit on September 27, 2016. The court has not yet issued a decision. EKPC and two other cooperatives filed a joint administrative petition with the EPA for reconsideration of the CPP. On January 17, 2017, EPA denied all pending administrative petitions. On March 6, 2017, thirteen petitions for review of EPA’s denial, including a joint petition filed by EKPC and two other cooperatives, were filed. The court consolidated the petitions into a single case and ordered docketing statements and statements of issues due April 5, 2017.

The EPA published the Effluent Limitations Guidelines (ELG) final rule on November 3, 2015, which governs the quality of the wastewater that can be discharged from power plants. ELG phases in more stringent effluent limits for arsenic, mercury, selenium, and nitrogen discharged from wet scrubber systems and zero discharge of pollutants in ash transport water. Power plants must comply between 2018 and 2023, depending upon when new Clean Water Act permits are required for each respective plant.

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

## 11. Environmental Matters (continued)

On March 2, 2015, the EPA signed a Court-Ordered Consent Decree to re-examine violations of the 1-Hour National Ambient Air Quality Standard (NAAQS) under new triggers and criteria. Sixty-eight facilities were alleged to be in violation, including EKPC's Cooper Station. The facilities are working to demonstrate attainment of the standard. The EPA and the States are working with the sixty-eight facilities across the country to work through up to four rounds of attainment demonstrations by December 31, 2020. EKPC filed a modeling protocol and modeling information with the state and federal EPA for both Spurlock and Cooper Stations. Kentucky Division of Air Quality (KDAQ) agreed with EKPC's assessment of attainment and provided the attainment demonstration to EPA. KDAQ issued the final Cooper Station Title V air permit on June 17, 2016. On January 6, 2017, the Kentucky Cabinet issued a letter to EPA that Spurlock Station and several other units in the Commonwealth were in attainment of the new standard.

## 12. Related Party Transactions

The Cooperative is a member of CFC, which provides a portion of the Cooperative's financing and is also a joint lead arranger and an 18.3% participant in the Cooperative's $600 million unsecured credit facility. Held-to-maturity investments included CFC capital term certificates of $8.4 million and $8.5 million at December 31, 2016 and 2015, respectively. CFC Patronage capital assigned to EKPC was $1.3 million at December 31, 2016 and 2015.

The Cooperative is also a member of CoBank, which is a 15% participant in the Cooperative's $600 million unsecured credit facility. The balance of CoBank patronage capital assigned to EKPC at December 31, 2016 and 2015, was $0.3 million.

EKPC is a member of ACES LLC (ACES), which provides various energy marketing, settlement and risk management related services to its members and clients. An EKPC director 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, 2016 and 2015, the balance of EKPC's investment in ACES was approximately $0.6 million. Payments to ACES were $2.2 million in 2016 and $2.1 million in 2015.

**13. Subsequent Events**

As discussed in Note 6, the Cooperative executed loan documents associated with three approved RUS loans of $444.2 million in January 2017. Approximately $183.5 million was advanced to the Cooperative on these loans in February 2017. Also, In February 2017, EKPC issued an $18 million note to CFC, which has been designated as a New Clean Renewable Energy Bond, to finance the Cooperative's community solar project.

Management has evaluated subsequent events through March 30, 2017, which is the date these financial statements were available to be issued.

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