Owen Electric Cooperative, Inc.

Audited Financial Statements

December 31, 2013 and 2012

Owen Electric Cooperative, Inc.

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CPAs & Advisors

Independent Auditor's Report

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

We have audited the accompanying balance sheets of Owen Electric Cooperative, Inc. ("the Cooperative") as of December 31, 2013 and 2012 and the related statements of income and comprehensive (loss) income, changes in members' and patrons' equities and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Cooperative as of December 31, 2013 and 2012, and the respective changes in financial position and, where applicable, cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Independent Auditor's Report (Continued)

Other Reporting Required by Government Auditing Standards

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

Mountjoy Chilton Medley LLP

Louisville, Kentucky
April 14, 2014

Owen Electric Cooperative, Inc.
Balance Sheets
December 31, 2013 and 2012

	2013	2012
Assets		
Electric Plant in Service, net	$ 134,702,780	$ 135,358,965
Investments		
Investment in East Kentucky Power Cooperative	50,466,457	41,112,331
Investments in associated organizations	4,801,823	4,892,502
Other	(12,389)	(105)
Total Investments	55,255,891	46,004,728
Current Assets		
Cash and equivalents	8,846,890	4,783,977
Accounts receivable - customers (net of allowance for doubtful accounts of $134,458 in 2013 and $244,527 in 2012)	16,630,171	16,837,546
Materials and supplies	860,270	866,883
Current portion of pension prepayment	591,857	-
Prepayments and other	727,230	944,776
Total Current Assets	27,656,418	23,433,182
Long term portion of pension prepayment	4,981,465	-
Deferred debits	91,395	2,959,680
Total Assets	$ 222,687,949	$ 207,756,555
Members' and Patrons' Equities and Liabilities		
Members' and Patrons' Equities		
Memberships	$ 1,137,265	$ 1,122,475
Patronage capital	83,987,714	76,997,413
Accumulated other comprehensive loss	(652,245)	(842,765)
Other equities	3,038,381	2,899,731
Total Members' and Patrons' Equities	87,511,115	80,176,854
Long-term Debt and Other Liabilities		
Long-term debt, less current maturities	94,165,429	90,044,434
Accrued compensated absences	2,152,810	2,188,167
Postretirement benefits obligation	9,934,628	9,579,185
Total Long-term Debt and Other Liabilities	106,252,867	101,811,786
Current Liabilities		
Current portion of long-term debt	4,278,138	3,916,176
Lines-of-credit	5,155,701	4,796,980
Accounts payable	13,443,996	13,013,393
Accrued interest	128,838	74,667
Customer guaranty deposits	2,305,021	2,251,286
Other current liabilities	1,431,936	838,994
Total Current Liabilities	26,743,630	24,891,496
Deferred credits	2,180,337	876,419
Total Members' and Patrons' Equities and Liabilities	$ 222,687,949	$ 207,756,555

See accompanying notes.

Owen Electric Cooperative, Inc.
Statements of Income and Comprehensive Income (Loss)
Years Ended December 31, 2013 and 2012

	2013	%	2012	%
Operating Revenue				
Sale of electric energy				
Residential	$ 79,439,125	46.50 %	$ 79,578,364	47.77 %
Commercial	86,785,881	50.80	82,555,637	49.55
Public authorities and outdoor lighting	2,540,259	1.49	2,494,973	1.50
Total Sale of Electric Energy	168,765,265	98.79	164,628,974	98.82
Other Revenue	2,078,589	1.21	1,974,259	1.19
Total Operating Revenue	170,843,854	100.00	166,603,233	100.01
Operating Expenses				
Cost of power	139,857,103	81.86	133,358,817	80.05
Distribution expense	8,658,571	5.07	8,814,535	5.29
Customer accounts expense	3,727,055	2.18	3,691,026	2.22
Customer services and information expense	647,921	0.38	705,596	0.42
Administrative and general expense	4,138,564	2.42	3,633,885	2.18
Depreciation	10,990,984	6.43	10,514,098	6.31
Taxes	8,741	0.01	146,131	0.09
Total Operating Expenses	168,028,939	98.35	160,864,088	96.56
Net Operating Income	2,814,915	1.65	5,739,145	3.45
Non-operating Income (Expense)				
Interest expense	(4,763,918)	(2.79)	(4,709,958)	(2.83)
Other margins	482,801	0.28	628,248	0.38
Patronage capital	9,410,848	5.51	7,189,294	4.32
Total Non-operating Income	5,129,731	3.00	3,107,584	1.87
Net Margins	7,944,646	4.65	8,846,729	5.32
Other Comprehensive Income (Loss)				
Change in post-retirement benefit obligation	190,520	0.11	(79,167)	(0.05)
	$ 8,135,166	4.76 %	$ 8,767,562	5.27 %

See accompanying notes.

Owen Electric Cooperative, Inc.
Statements of Changes in Members' and Patrons' Equities
Years Ended December 31, 2013 and 2012

		Patronage Capital					Other Equities			
	Memberships	Assignable	Assigned	Retired	Total	Accumulated Other Comprehensive Loss	Donated Capital	Retired Capital Credits Gains	Total	Total Members' and Patrons' Equities
Balance, January 1, 2012	$ 1,116,355	$ 7,941,820	$ 86,737,686	$ (25,594,994)	$69,084,512	$ (763,598)	$ 72,923	$ 2,702,771	$ 2,775,694	72,212,963
Unrealized gain on accumulated pension benefit obligations	-	-	-	-	-	(79,167)	-	-	-	(79,167)
Memberships issued, net of terminations	6,120	-	-	-	-	-	-	-	-	6,120
Retirements of patronage capital to estates of deceased members:										
Paid in cash	-	-	-	(174,059)	(174,059)	-	-	-	-	(174,059)
Applied to unpaid bills	-	-	-	(7,363)	(7,363)	-	-	-	-	(7,363)
General capital credit refund:										
Paid in cash	-	-	-	(294,793)	(294,793)	-	-	-	-	(294,793)
Applied to unpaid bills	-	-	-	(392,774)	(392,774)	-	-	-	-	(392,774)
Transferred to capital gains	-	-	-	(64,839)	(64,839)	-	-	124,047	124,047	59,208
Net margins	-	8,846,729	-	-	8,846,729	-	-	-	-	8,846,729
Assignment of patronage capital	-	(9,443,610)	9,443,610	-	-	-	-	-	-	-
Forfeiture of memberships	-	-	-	-	-	-	(10)	-	(10)	(10)
Balance, December 31, 2012	1,122,475	7,344,939	96,181,296	(26,528,822)	76,997,413	(842,765)	72,913	2,826,818	2,899,731	80,176,854
Unrealized loss on accumulated pension benefit obligations	-	-	-	-	-	190,520	-	-	-	190,520
Memberships issued, net of terminations	14,790	-	-	-	-	-	-	-	-	14,790
Retirements of patronage capital to estates of deceased members:										
Paid in cash	-	-	-	(196,146)	(196,146)	-	-	-	-	(196,146)
Applied to unpaid bills	-	-	-	(8,291)	(8,291)	-	-	-	-	(8,291)
General capital credit refund:										
Paid in cash	-	-	-	(296,967)	(296,967)	-	-	-	-	(296,967)
Applied to unpaid bills	-	-	-	(369,538)	(369,538)	-	-	-	-	(369,538)
Transferred to capital gains	-	-	-	(83,403)	(83,403)	-	-	138,646	138,646	55,243
Net margins	-	7,944,646	-	-	7,944,646	-	-	-	-	7,944,646
Assignment of patronage capital	-	(8,846,729)	8,846,729	-	-	-	-	-	-	-
Forfeiture of memberships	-	-	-	-	-	-	4	-	4	4
Balance, December 31, 2013	$ 1,137,265	$ 6,442,856	$ 105,028,025	$ (27,483,167)	$83,987,714	$ (652,245)	$ 72,917	$ 2,965,464	$ 3,038,381	$87,511,115

See accompanying notes.

Owen Electric Cooperative, Inc.
Statements of Cash Flows
Years Ended December 31, 2013 and 2012

	2013	2012
Cash Flows from Operating Activities		
Net Margins	$ 7,944,646	$ 8,846,729
Non-cash expenses included in net margins		
Patronage capital assigned but not paid by associated organizations	(9,410,848)	(7,189,294)
Depreciation	10,990,984	10,514,098
Bad debt expense	136,988	121,378
(Gain) Loss on disposition of general plant	(17,004)	30,627
Charges for postretirement benefits obligation	355,443	558,792
Changes in current and non-current assets and liabilities:		
Accounts receivable	70,387	309,144
Materials and supplies	6,613	64,920
Prepayments and other	(5,355,776)	(79,602)
Accounts payable	430,603	(114,618)
Customer guaranty deposits	53,735	(614,159)
Accrued interest and other current liabilities	647,113	17,984
Accrued compensated absences	(35,357)	164,708
Net Cash Provided by Operating Activities	5,817,527	12,630,707
Cash Flows from Investing Activities		
Increase in deferred debits	2,868,285	(735,470)
Increase in deferred credits	1,303,918	36,020
Additions to electric plant in service	(8,403,019)	(10,672,202)
Removal cost	(1,914,776)	(1,301,893)
Patronage capital received from associated organizations	159,685	127,752
Net Cash Used in Investing Activities	(5,985,907)	(12,545,793)
Cash Flows from Financing Activities		
Proceeds from long-term notes payable	9,362,621	8,000,000
Payment of principal on long-term notes payable	(4,879,664)	(4,408,474)
Membership fees	14,790	6,120
Patronage capital paid out	(625,175)	(888,958)
Net activity on lines-of-credit	358,721	(1,015,958)
Net Cash Provided by Financing Activities	4,231,293	1,692,730
Increase in Cash and Equivalents During the Year	4,062,913	1,777,644
Cash and Equivalents, Beginning of Year	4,783,977	3,006,333
Cash and Equivalents, End of Year	$ 8,846,890	$ 4,783,977
Supplemental Disclosures of Cash Flow Information		
Interest paid	$ 4,709,747	$ 4,727,527

See accompanying notes.

Note A - Nature of Operations

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

Note B - Summary of Significant Accounting Policies

1. Basis of Accounting: The financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. The Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") is the sole source of authoritative accounting technical literature for nongovernmental entities. The significant accounting policies are described below to enhance the usefulness of the financial statements to the reader.

2. Cash and Equivalents: For purposes of the statement of cash flows, the Cooperative considers short-term investments having maturities of three months or less at time of purchase to be cash equivalents.

3. Accounts Receivable: Accounts receivable consists of amounts due for sales of electric energy, which were not received by the Cooperative at year-end. Based on management's evaluation of uncollected accounts receivable at the end of each year, bad debts are provided for on the allowance method.

4. Materials and Supplies: The Cooperative values materials and supplies at average cost.

5. Deferred Debits/Credits: Regulatory requirements authorized by the Kentucky Public Service Commission allow the electric supplier to impose a fuel adjustment surcharge upon the Cooperative. In turn, the Cooperative is required to pass on the fuel surcharge to the consumer. Due to the regulatory requirements in calculating the surcharge the Cooperative may experience an over or under recovery of the fuel adjustment surcharge.

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

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

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

   The Cooperative's under-recovery in a 2012 case before the Commission totaled $2,417, 387. This large under- recovery resulted from the Cooperative's 2011 change to accrual accounting for its wholesale power billing, coupled with the length of the review period for the environmental cost recovery mechanism—an 18-month period versus the typical 6-month review period. The Commission issued an Order in this 2012 case in August 2013. While the Cooperative requested a 12-month amortization period for this under-recovery,

Note B - Summary of Significant Accounting Policies (Continued)

the Commission granted a 6-month amortization period. Because the over- and under- recoveries are calculated by comparing EKPC's environmental cost recovery billings to the Cooperative's environmental cost recovery billings, which for the Cooperative includes the impacts of the amortization in the 2012 case, the Cooperative is now experiencing a large over-recovery.

The amount recorded on the financial statements for the under/(over) recovery of the fuel adjustment surcharge at December 31, 2013 and 2012 was ($217,872) and $472,955, respectively. The amount of the under/(over) recovery of the environmental cost recovery mechanism at December 31, 2013 and 2012 was ($1,090,872) and $2,370,126, respectively.

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

Depreciation is provided using the straight-line method at rates which are designed to amortize the cost of depreciable plant, net of estimated salvage value, over its estimated useful life. The composite depreciation rate for distribution plant was approximately 4.5% for both 2013 and 2012. General plant is being depreciated using specific identification straight-line method over the following estimated useful lives:

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

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

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

	December 31, 2013	December 31, 2012
Distribution plant	$ 214,684,787	$ 205,472,959
General plant	25,473,205	25,592,514
Construction in progress	2,048,039	4,160,484
	242,206,031	235,225,957
Accumulated Depreciation	107,503,251	99,866,992
Electric Plant in Service, net	$ 134,702,780	$ 135,358,965

7. Revenue and Cost of Purchased Power: Revenue is recognized in the period used and the power costs are recognized in the period incurred.

Note B - Summary of Significant Accounting Policies (Continued)

8. Advertising Costs: The Cooperative records advertising expenses as they are incurred. Advertising expense amounted to $282,775 and $284,573 for the years ended December 31, 2013 and 2012, respectively.

9. Investments in Associated Organizations: The Cooperative follows the method of accounting as prescribed by the RUS Uniform System of Accounts in accounting for its investment in associated organizations. This accounting method results in the Cooperative recognizing in income its pro rata share of the associated organization's net margins in the year such margins are assigned. This accounting method does not provide for similar treatment for any losses of the associated organizations. Rather, such losses would not be assigned to member organizations and no additional margins are assigned until subsequent cumulative margins exceed prior cumulative losses.

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

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

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

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

    In June 2011, the FASB issued updated guidance to increase the prominence of items reported in other comprehensive income (loss) by eliminating the option of solely presenting components of comprehensive income (loss) as part of the statements of changes in members' and patrons' equities. The updated guidance became effective for the year ended December 31, 2012 and was applied retrospectively. The Cooperative has elected to present the required information on the accompanying statements of income and comprehensive (loss) income for the years ended December 31, 2013 and 2012.

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

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

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

15. Accounting Pronouncement: In September 2011, the FASB issued Accounting Standards Update (ASU) 2011-09, *Disclosures about an Employer's Participation in a Multiemployer Plan*, which amends FASB ASC 715-80, *Compensation – Retirement Benefits: Multiemployer Plans*, by requiring employers participating in multiemployer pension plans to provide additional quantitative and qualitative disclosures in order to provide

Note B - Summary of Significant Accounting Policies (Continued)

more detailed information about the employer's involvement in multiemployer pension plans. In addition, this amendment includes changes in the disclosures required for multiemployer plans that provide postretirement benefits other than pensions. This guidance is effective for non-public companies for the fiscal years ending after December 15, 2012. This guidance was adopted for the year ended December 31, 2012 and it had no impact on the Cooperative's financial position or results of operations.

Note C - Investments

East Kentucky Power Cooperative:

The Cooperative's investment of $50,466,457 in EKPC, the sole supplier of power to the Cooperative, represents the Cooperative's equity ownership interest (approximately 12%) in EKPC. The Cooperative owed EKPC $12,837,448 and $11,780,678 at December 31, 2013 and 2012, respectively. These amounts are included in accounts payable on the balance sheets.

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

Associated Organizations:

Investments in associated organizations consisted of:

	December 31, 2013	December 31, 2012
United Utility Supply Cooperative	$ 929,830	$ 929,895
Kentucky Association of Electric Cooperatives, Inc.	116,453	116,974
National Rural Utilities Cooperative Finance Corporation	529,529	660,670
Capital Term Certificates of National Rural Utilities Cooperative Finance Corporation	2,409,387	2,409,387
Southeastern Data Cooperative, Inc.	228,500	147,175
Other	588,124	628,401
	$ 4,801,823	$ 4,892,502

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

United Utility Supply Cooperative (United) is a primary supplier of transformers and overhead line materials and supplies. The Cooperative's purchases from United amounted to $1,324,471 and $1,525,884 for the years ended December 31, 2013 and 2012, respectively. The Cooperative owed United $37,762 and $98,894 at December 31, 2013 and 2012, respectively. These amounts are included in accounts payable on the balance sheets.

Note C - Investments (Continued)

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

Southeastern Data Cooperative, Inc. (Southeastern) is a primary supplier of data processing services and computer hardware and software. The Cooperative's purchases from Southeastern were $833,716 and $784,262 for the years ended December 31, 2013 and 2012, respectively. There were no amounts owed to Southeastern at December 31, 2013 and 2012.

Note D - Income Tax Status

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

Note E - Line-of-credit

At December 31, 2013 and 2012, the Cooperative had an unsecured available line-of-credit of $22,800,000 from the NRUCFC. The interest rate for this line-of-credit was 2.90% at December 31, 2013 and 2012. The maturity date for the line-of-credit is December 31, 2049. The Cooperative had an outstanding balance under the line-of-credit of $5,155,701 and $4,796,980 at December 31, 2013 and 2012, respectively.

At December 31, 2013 and 2012, the Cooperative had a second unsecured available line-of-credit of $15,000,000 with CoBank. The interest rate for this line-of-credit at December 31, 2013 and 2012 was 2.93%, and the maturity date is September 21, 2041. There were no borrowings under this line-of-credit at December 31, 2013 and 2012.

Note F - Long-term Debt

Long-term debt consisted of the following:

	December 31, 2013	December 31, 2012
Mortgage notes payable to the Rural Utilities Services due in quarterly installments of varying amounts through 2043:		
2.500% first mortgage notes	$ 2,342,783	$ 2,481,819
2.521% first mortgage notes	5,874,950	6,000,000
2.806% first mortgage notes	4,296,731	4,386,920
2.809% first mortgage notes	6,772,171	3,675,565
3.894% first mortgage notes	3,613,082	
4.190% first mortgage notes	6,486,415	6,615,763
4.375% first mortgage notes	1,121,725	1,167,327
4.440% first mortgage notes	8,323,757	8,483,379
4.460% first mortgage notes	12,088,093	12,318,761
4.815% first mortgage notes	3,035,491	3,101,353
4.917% first mortgage notes	871,575	890,207
5.192% first mortgage notes	4,421,811	4,512,599
5.277% first mortgage notes	10,404,244	10,615,205
5.298% first mortgage notes	9,456,939	9,716,905
5.375% first mortgage notes	1,229,216	1,274,362
5.417% first mortgage notes	2,386,812	2,451,488
5.913% first mortgage notes	2,184,637	2,240,371
	84,910,435	79,932,023
Less: Unapplied Payments	8,948,626	8,512,147
	75,961,809	71,419,876
Notes payable to CoBank, interest at 2.01% and 3.90% due April 2028 and July 2014.	5,901,254	4,074,575
Mortgage notes payable to the NRUCFC due in quarterly installments of varying amounts through 2034:		
Variable rate first mortgage notes (1)	16,580,504	18,466,159
	98,443,567	93,960,610
Less Current Maturities	4,278,138	3,916,176
	$ 94,165,429	$ 90,044,434

(1) Interest rates on the variable rate notes vary monthly and are determined by the NRUCFC based on their cost of money plus adders for margins and administrative costs (2.90%-6.20% at December 31, 2013 and 2012, respectively).

Note F - Long-term Debt (Continued)

The aggregate principal maturities of long-term debt as of December 31, 2013 are as follows:

2014	$ 4,278,138
2015	4,020,254
2016	4,048,566
2017	4,126,574
2018 and thereafter	81,970,035
	$ 98,443,567

Substantially all utility plant is pledged as collateral for the above notes. Under the terms of the loan agreements, the Cooperative is required to meet certain financial performance covenants. The Cooperative is in compliance with these covenants at December 31, 2013 and 2012.

Note G - Members' and Patrons' Equities

Under terms of its long-term debt agreements, return of capital contributions or patronage capital to the Cooperative's members and patrons is restricted to amounts which would not allow total equity to be less than 30% of total assets, except that distributions may be made to estates of deceased members provided that such distributions do not exceed 25% of total patronage capital and margins received in the previous year. Total equity as a percentage of assets can fall below the 30% requirement if the Cooperative has obtained the appropriate waiver from the RUS. The Cooperative is in compliance with these requirements at December 31, 2013 and 2012.

Note H - Retirement Benefits

Effective January 1, 1988, the Cooperative entered into a multi-employer defined benefit pension plan sponsored by the National Rural Electric Cooperative Association (NRECA). The NRECA Retirement Security Plan (RS Plan) is a defined benefit pension plan qualified under Section 401 and tax-exempt under Section 501(a) of the Internal Revenue Code. It is a multiemployer plan under the accounting standards. The plan sponsor's Employer Identification Number is 53-0116145 and the Plan Number is 333.

A unique characteristic of a multiemployer plan compared to a single employer plan is that all plan assets are available to pay benefits of any plan participant. Separate asset accounts are not maintained for participating employers. This means that assets contributed by one employer may be used to provide benefits to employees of other participating employers.

The Cooperative contributions to the RS Plan in 2013 and in 2012 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 $1,843,232 and $2,006,184 in 2013 and 2012, respectively. There have been no significant changes that affect the comparability of 2013 and 2012 contributions.

In the RS Plan, a "zone status" determination is not required, and therefore not determined, under the Pension Protection Act (PPA) of 2006. In addition, the accumulated benefit obligations and plan assets are not determined or allocated separately by individual employer. In total, the Retirement Security Plan was between 65 percent and 80 percent funded at January 1, 2013 and January 1, 2012 based on the PPA funding target and PPA actuarial value of assets on those dates.

Note H - Retirement Benefits (Continued)

Because the provisions of the PPA do not apply to the RS Plan, funding improvement plans and surcharges are not applicable. Future contribution requirements are determined each year as part of the actuarial valuation of the Plan and may change as a result of plan experience.

At the December 2012 meeting of the I&FS Committee of the NRECA Board of Directors, the Committee approved an option to allow participating cooperatives in the RS Plan to make a contribution prepayment and reduce future required contributions. The prepayment amount is a cooperative's share, as of January 1, 2013, of future contributions required to fund the RS Plan's unfunded value of benefits earned to date using RS Plan actuarial valuation assumptions. The prepayment amount will typically equal approximately 2.5 times a cooperative's annual RS Plan required contribution as of January 1, 2013. After making the prepayment, for most cooperatives the billing rate is reduced by approximately 25%, retroactive to January 1, 2013. The 25% differential in billing rates is expected to continue for approximately 15 years. However changes in interest rates, asset returns and other plan experience different from expected, plan assumption changes and other factors may have an impact on the differential in billing rates and the 15 year period. At December 31, 2013, the Cooperative's prepayment as reflected on the balance sheet is $5,573,322.

In addition to the above, the Cooperative maintains a 401(k) profit sharing plan. The Owen Electric Cooperative 401(k) Profit Sharing Plan, established April 1, 1986, is a defined contribution plan available to employees of the Cooperative upon completion of three months of service. The Cooperative makes annual matching contributions equal to 100% of all deferred salary reductions up to a 4% maximum employer contribution. The Cooperative's expense for 2013 and 2012 was approximately $346,600 and $362,000, respectively.

Note I - Postretirement Benefits

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

In accordance with the provision of "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans," the Cooperative has recorded an accrued benefit cost for the full benefit obligation as of December 31, 2013 and 2012.

Note I - Postretirement Benefits (Continued)

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

	December 31, 2013	December 31, 2012
Benefit obligation	$ 9,934,628	$ 9,579,185
Fair value of plan assets	-	-
Funded Status	$ (9,934,628)	$ (9,579,185)
Accrued benefit cost recognized in the balance sheets	$ (9,934,628)	$ (9,579,185)
Weighted-average assumptions		
Discounted rate	5.25%	5.50%

For measurement purposes, the health care cost trend rate is assumed to be 8.00% and 7.50% in 2013 and 2012, respectively. During 2013 and 2012, the rate was assumed to decrease by 0.5% per year to a minimum of 5.5%.

Other information, per the actuarial report regarding the Cooperative's benefit plans is as follows:

	December 31, 2013	December 31, 2012
Benefit cost	$ 939,201	$ 916,560
Benefits paid	393,238	436,935

Note J - Concentrations of Revenues, Receivables and Cash

All of the Cooperative's sales are made in portions of nine counties in north central Kentucky, which is primarily an agricultural region. However, a significant portion of the Cooperative's northern service territory has become increasingly developed with suburban residential and commercial activity. Accounts receivable and customer deposits at December 31, 2013 and 2012, were derived from the various classes of customers in approximately the same proportion as the revenues shown in the accompanying statements of income and other comprehensive income (loss).

On May 31, 2005, the Cooperative and EKPC entered into a five year electric service agreement with Gallatin Steel Company (Gallatin Steel) to provide electric power to Gallatin Steel's manufacturing facilities in Gallatin County, Kentucky, the first of which began operations June 1, 1995. On September 1, 2010, the Cooperative and EKPC entered into a five year electric service agreement with Gallatin Steel. This agreement expires December 1, 2015. Sales to Gallatin Steel in 2013 and 2012 totaled $48,708,017 and $46,356,994, respectively. Receivables from Gallatin Steel were $4,134,182 and $3,503,209 at December 31, 2013 and 2012, respectively.

Note J - Concentrations of Revenues, Receivables and Cash (Continued)

The Cooperative maintains its cash balances with banks throughout Kentucky. Effective July 21, 2010, the federal deposit insurance coverage provided by the Federal Deposit Insurance Corporation (FDIC) permanently increased from $100,000 to $250,000 per depositor. On November 9, 2010, the FDIC issued a final rule to implement Section 343 of the Dodd-Frank Wall Street Reform and Consumer Protection Act which provides temporary unlimited deposit insurance for non-interest bearing accounts at all FDIC insured depository institutions. This separate coverage for non-interest bearing transaction accounts became effective on December 31, 2010 and terminated on December 31, 2012. As of December 31, 2013, there were uninsured balances in the Cooperative's interest bearing accounts totaling approximately $7,925,000. At December 31, 2012, the Cooperative had uninsured balances totaling approximately $2,798,000.

In June of 2011, the Public Service Commission approved the reduction in the wholesale power supplier's base rates in recognition of reduced fuel expenses. In turn, this reduction in base rates was passed on to the Cooperative, then to the consumer. The roll-in of this rate reduction resulted in an under-collection from the Consumers. While the Cooperative sought remedy of this shortfall with the Public Service Commission during its 2013 rate application, the Cooperative withdrew the request for recovery and wrote off the receivable. The receivable related to the under-collection was $1,112,398 for the year ended December 31, 2012.

Note K - Fair Value Measurements

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

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

- Level 1: inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

- Level 2: inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

- Level 3: inputs to the valuation methodology are unobservable and significant to the fair value measurement.

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

At December 31, 2013 and 2012, financial instruments consisted of cash and equivalents whose carrying values approximate fair value due to the short-term nature of the instruments, all measured using the Level 1.

Note L – Adjustment of Rates

On March 25, 2013, the Kentucky Public Service Commission ("Commission") accepted the Cooperative's Application for an Adjustment of Rates. The Kentucky Attorney General's Office of Rate Intervention ("AG") was an intervenor in this proceeding. After several rounds of discovery, the Cooperative and the AG reached a settlement. On August 30, 2013, the Commission entered an Order approving the settlement agreement which granted the Cooperative a $4 million increase in annual revenue for service rendered on and after September 1, 2013.

Supplementary Information

MCM
CPAs & Advisors

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in the *Government Auditing Standards* issued by the Comptroller General of the United States, the accompanying financial statements and related notes to the financial statements of Owen Electric Cooperative, Inc. ("the Cooperative") as of and for the year ended December 31, 2013, and have issued our report thereon dated April 14, 2014

Internal Control Over Financial Reporting

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

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

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

Independent Auditor'sReport on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards (Continued)*

Compliance and Other Matters

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

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the organization's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the organization's internal control and compliance. Accordingly, this communication is not suitable for any other purposes.

Mountjoy Chilton Medley LLP

Louisville, Kentucky
April 14, 2014

Independent Auditor's Report on Compliance with Aspects of Contractual Agreements and Regulatory Requirements for Electric Borrowers

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

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Owen Electric Cooperative, Inc., ("the Cooperative"), which comprise the balance sheet as of December 31, 2013, and the related statements of revenue and patronage capital, changes in cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated April 14, 2014. In accordance with *Government Auditing Standards*, we have also issued our report dated April 14, 2014, on our consideration of Cooperative's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. No reports other than the reports referred to above have been furnished to management.

In connection with our audit, nothing came to our attention that caused us to believe that the Cooperative failed to comply with the terms, covenants, provisions, or conditions of their loan, grant, and security instruments as set forth in 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers*, §1773.33 and clarified in the RUS policy memorandum dated February 7, 2014, insofar as they relate to accounting matters as enumerated below. However, our audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding the Cooperative's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters. In connection with our audit, we noted no matters regarding the Cooperative's accounting and records to indicate that the Cooperative did not:

- Maintain adequate and effective accounting procedures;
- Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts;
- Reconcile continuing property records to the controlling general ledger plant accounts;
- Clear construction accounts and accrue depreciation on completed construction;
- Record and properly price the retirement of plant;
- Seek approval of the sale, lease or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap;
- Maintain adequate control over materials and supplies;
- Prepare accurate and timely Financial and Operating Reports;

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Independent Auditor's Report on Compliance with Aspects of Contractual Agreements and Regulatory Requirements for Electric Borrowers (Continued)

- Obtain written RUS approval to enter into any contract for the management, operation, or maintenance of the borrower's system if the contract covers all or substantially all of the electric system;
- Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles;
- Record depreciation in accordance with RUS requirements (See RUS Bulletin 183-1, Depreciation Rates and Procedures);
- Comply with the requirements for the detailed schedule of deferred debits and deferred credits; and
- Comply with the requirements for the detailed schedule of investments.

This report is intended solely for the information and use of the board of directors, management, and the RUS and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Mountjoy Chilton Medley LLP

Louisville, Kentucky
April 14, 2014