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Jackson Purchase Energy Corporation
Paducah, Kentucky

Audited Financial Statements
December 31, 2011 and 2010

Alan M. Zumstein
Certified Public Accountant
1032 Chetford Drive
Lexington, Kentucky 40509

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ALAN M. ZUMSTEIN
CERTIFIED PUBLIC ACCOUNTANT

1032 CHETFORD DRIVE
LEXINGTON, KENTUCKY 40509
(859) 264-7147
zumstein@windstream.net

MEMBER
• AMERICAN INSTITUTE OF CPA'S
• KENTUCKY SOCIETY OF CPA'S
• INDIANA SOCIETY OF CPA'S
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Independent Auditor's Report

To the Board of Directors
Jackson Purchase Energy Corporation

I have audited the accompanying balance sheets of Jackson Purchase Energy Corporation, as of December 31, 2011 and 2010, and the related statements of income and patronage capital and cash flows for the years then ended. These financial statements are the responsibility of Jackson Purchase Energy Corporation's management. My responsibility is to express an opinion on these financial statements based on my audits.

I conducted my audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and 7 CFR Part 1773, Policy on Audits of Rural Utilities Service (RUS) Borrowers. Those standards require that I plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audits provide a reasonable basis for my opinion.

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Jackson Purchase Energy Corporation as of December 31, 2011 and 2010, and the results of operations and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, I have also issued a report dated February 8, 2012, on my consideration of Jackson Purchase Energy Corporation's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of my 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* and should be considered in assessing the results of my audits.

Alan M. Zumstein

Alan M. Zumstein, CPA
February 8, 2012

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To the Board of Directors
Jackson Purchase Energy Corporation

I have audited the financial statements of Jackson Purchase Energy Corporation as of and for the years ended December 31, 2011 and 2010, and have issued my report thereon dated February 8, 2012. I conducted my audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

A control deficiency exists when the design or operation of a control does not allow management employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more that a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

My consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. I did not identify any deficiencies in internal control over financial reporting that I consider to be material weaknesses, as defined above.

Compliance and Other Matters

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

This report is intended solely for the information and use of the board of directors, management, the Rural Utilities Service, and supplemental lenders, and is not intended to be and should not be used by anyone other than these specified parties.

Alan M. Zumstein

Alan M. Zumstein, CPA
February 8, 2012

Jackson Purchase Energy Corporation

Balance Sheets, December 31, 2011 and 2010

Assets	2011	2010
Electric Plant, at original cost:		
In service	$ 134,624,348	$ 127,273,009
Under construction	2,907,866	6,304,491
	137,532,214	133,577,500
Less accumulated depreciation	45,094,854	42,067,013
	92,437,360	91,510,487
Investments in Associated Organizations	2,961,606	2,771,786
Current Assets:		
Cash and cash equivalents	2,970,640	459,514
Accounts receivable, less allowance for 2011 of $94,735 and 2010 of $106,493	2,698,963	3,319,986
Other receivables	2,730,094	4,879,596
Accrued unbilled revenue	1,031,603	2,439,291
Material and supplies, at average cost	1,615,433	1,683,742
Other current assets	403,994	579,944
	11,450,727	13,362,073
Deferred mapping costs	297,973	496,621
Total	$ 107,147,666	$ 108,140,967

Members' Equities and Liabilities	2011	2010
Members' Equities:		
Memberships	$ 157,865	$ 166,760
Patronage capital	39,250,417	40,726,829
Accumulated other comprehensive income	(345,025)	(373,822)
	39,063,257	40,519,767
Long Term Debt	57,641,085	52,460,980
Accumulated Postretirement Benefits	1,700,793	1,576,079
Current Liabilities:		
Notes payable	-	5,500,000
Accounts payable	2,885,594	3,265,429
Consumer deposits	1,759,887	1,660,186
Current portion of long term debt	2,509,000	2,200,000
Accrued expenses	1,441,581	803,852
	8,596,062	13,429,467
Advances for Construction and others	146,469	154,674
Total	$ 107,147,666	$ 108,140,967

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

Statements of Revenue and Patronage Capital

for the years ended December 31, 2011 and 2010

	2011	2010
Operating Revenues	$ 45,135,203	$ 46,534,070
Operating Expenses:		
Cost of power	27,759,591	26,856,527
Distribution - operations	3,110,221	2,610,154
Distribution - maintenance	3,871,294	3,198,253
Consumer accounts	1,055,142	1,147,639
Consumer service and information	108,682	132,314
Administrative and general	2,138,367	2,171,873
Depreciation, excluding $315,642 in 2011 and $393,959 in 2010 charged to clearing accounts	4,695,048	4,566,846
Taxes	48,869	46,300
Other deductions	1,450	4,800
	42,788,664	40,734,706
Operating Margins before Interest Charges	2,346,539	5,799,364
Interest Charges:		
Long-term debt	2,867,944	2,722,675
Other interest	131,427	200,518
	2,999,371	2,923,193
Operating Margins after Interest Charges	(652,832)	2,876,171
Nonoperating Margins		
Interest income	330,626	310,758
Other nonoperating income, net	15,688	19,403
	346,314	330,161
Patronage Capital from Associated Organizations	419,241	898,037
Net Margins	112,723	4,104,369
Patronage Capital - beginning of year	40,726,829	37,081,460
Refund of capital credits	(1,589,135)	-
Nonoperating margins to other equities	-	(459,000)
Patronage Capital - end of year	$ 39,250,417	$ 40,726,829

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

Statements of Cash Flows

for the years ended December 31, 2011 and 2010

	2011	2010
Cash Flows from Operating Activities:		
Net margins	$ 112,723	$ 4,104,369
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation		
Charged to expense	4,695,048	4,566,846
Charged to clearing	315,642	393,959
Capital credits allocated	(419,241)	(898,037)
Accumulated postretirement benefits	153,511	106,537
Net change in current assets and liabilities:		
Receivables	4,178,213	2,697,247
Material and supplies	68,309	107,071
Other current assets	175,950	(28,064)
Deferred charges	198,648	198,649
Accounts payable	(379,835)	(2,185,996)
Consumer deposits	99,701	189,899
Accrued expenses	537,729	(48,239)
Consumer advances for construction	(8,205)	(24,393)
	9,828,193	9,179,848
Cash Flows from Investing Activities:		
Construction of plant	(5,659,505)	(8,470,534)
Plant removal costs	(768,669)	(953,279)
Salvage recovered from plant	490,611	224,248
Receipts from investments, net	229,421	359,512
	(5,708,142)	(8,840,053)
Net Cash Flows from Financing Activities:		
Net decrease in memberships	(8,895)	(8,960)
Refund capital credits	(1,589,135)	-
Notes payable	(5,500,000)	2,100,000
Additional long-term borrowings	8,000,000	-
Advance payments	(275,868)	(262,172)
Payments on long-term debt	(2,235,027)	(2,198,902)
	(1,608,925)	(370,034)
Net increase in cash balances	2,511,126	(30,239)
Cash and cash equivalents - beginning	459,514	489,753
Cash and cash equivalents - ending	$ 2,970,640	$ 459,514
Supplemental disclosures of cash flow information:		
Interest on long-term debt	$ 2,872,907	$ 2,452,058

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

Note 1. Summary of Significant Accounting Policies

Jackson Purchase Energy Corporation ("the Corporation") maintains its records in accordance with the policies prescribed or permitted by the Kentucky Public Service Commission ("PSC") and the United States Department of Agriculture, Rural Utilities Service ("RUS"), which conform in all material respects with generally accepted accounting principles. The more significant of these policies are as follows:

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

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

	2011	2010
Distribution plant	$125,691,916	$118,950,665
General plant	8,932,432	8,322,344
Total	$134,624,348	$127,273,009

Depreciation Provision has been made for depreciation on the basis of the estimated lives of assets, using the straight-line method. Depreciation rates range from 1.48% to 12.09%, with a composite rate of 3.73% for distribution plant. General plant rates are as follows:

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

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

Off Balance Sheet Risk The Corporation has off-balance sheet risk in that they maintain cash deposits in financial institutions in excess of the amounts insured by the Federal Deposit Insurance Corporation (FDIC). At December 31, 2011, the financial institutions reported deposits in excess of the $250,000 FDIC insured limit on several of the accounts. Deposits and repurchase agreements in excess of the FDIC limits are 100% secured with collateral from each respective financial institution.

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

Advertising The Corporation expenses advertising costs as incurred.

Risk Management The Corporation is exposed to various forms of losses of assets associated with, but not limited to, fire, personal liability, theft, vehicular accidents, errors and omissions, fiduciary responsibility, workers compensation, etc. Each of these areas is covered through the purchase of commercial insurance.

Note 1. Summary of Significant Accounting Policies, continued

Revenue The Corporation records revenue as billed to its consumers based on monthly meter-reading cycles. All consumers are required to pay a refundable deposit that may be waived under certain circumstances. The Corporation's sales are concentrated in a six county area of western Kentucky. There were no consumers whose individual account balance exceeded 10% of outstanding accounts receivable at December 31, 2011 or 2010. Consumers must pay their bill within 20 days of billing, then are subject to disconnect after another 10 days. Accounts are written off when they are deemed to be uncollectible. The allowance for uncollectible accounts is based on the aging of receivables.

Cost of Power The Corporation is one of three (3) members of Big Rivers Electric Corporation, Inc. ("Big Rivers"), a generation and transmission cooperative association. Under a wholesale power agreement, the Corporation is committed to purchase its electric power and energy requirements from Big Rivers until 2043. The rates charged by Big Rivers are subject to approval of the PSC. The cost of purchased power is recorded monthly during the period in which the energy is consumed, based upon billings from Big Rivers. There are certain surcharges, clauses, and credits that Big Rivers includes to the Corporation that are passed on to consumers using a methodology prescribed by the Commission.

Fair Value of Financial Instruments The carrying amounts of the Corporation's cash and cash equivalents, other receivables, investments, inventories, other assets, trade accounts payable, accrued expenses and liabilities, and other liabilities approximate fair value. The carrying value of long term debt approximates the fair value since interest rates approximate the current interest rates. Investments in associated organizations are not considered a financial instrument because they represent nontransferable interests in associated organizations.

The Corporation may, and also does, invest idle funds in local banks and in National Rural Utilities Cooperative Finance Corporation ("CFC") commercial paper. These investments are classified as held-to-maturity in accordance with provisions of the *Financial Instruments Topic* of the Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC"). Held-to-maturity securities are presented at amortized cost. The fair value of held-to-maturity securities approximates cost at 2011 and 2010.

The standard describes three levels of inputs that may be used to measure fair value:

> Level 1: Quoted prices (unadjusted) or identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
>
> Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices of similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.
>
> Level 3: Significant unobservable inputs that reflect an organization's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The only fair values of assets measured on a recurring basis are cash and cash equivalents, which are valued at Level 1 and are recorded at cost.

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

Note 1. Summary of Significant Accounting Policies, continued

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

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

Income Tax Status The Corporation is exempt from federal and state income taxes under section 501(c)(12) of the Internal Revenue Code and accordingly, the accompanying financial statements include no provision for such taxes. When applying the 85 percent test of IRC 501(c)(12), the Corporation excludes the Big Rivers non-cash allocations from "gross income".

Effective January 1, 2008, the Corporation adopted the provisions of the *Income Taxes Topic* of the FASB ASC that pertains to accounting for uncertainty in income taxes. The Corporation had no prior unrecognized tax benefits as a result of the implementation. Management evaluates its potential exposures from tax positions taken that have or could be challenged by taxing authorities. These potential exposures result because taxing authorities may take positions that differ from those taken by management in the interpretation and application of statures, regulations, and rules. There are no tax positions for which the ultimate deductibility is highly uncertain included in the accompanying financial statements. The Corporation recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. The Corporation did not recognize any interest or penalties during the years ended December 31, 2011 or 2010.

Subsequent Events Management has evaluated subsequent events through February 8, 2012, the date the financial statements were available to be issued. There were no significant subsequent events to report.

Note 2. Investments in Associated Organizations

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

Note 2. Investments in Associated Organizations, continued

Investments in associated organizations consist of:

	2011	2010
CFC, CTCs	$941,585	$942,703
CFC, patronage capital	43,969	42,362
CoBank, patronage capital	536,894	496,500
National Rural Telecommunications Cooperative	883,754	699,686
Others	555,404	590,535
Total	$2,961,606	$2,771,786

Note 3. Patronage Capital

Under provisions of the long-term debt agreement, return to patrons of capital contributed by them is limited to amounts which would not allow the total equities and margins to be less than 30% of total assets, except that distributions may be made to estates of deceased patrons. The debt agreement provides, however, that should such distributions to estates not exceed 25% of the net margins for the next preceding year, the Corporation may distribute the difference between 25% and the payments made to such estates. The equity at December 31, 2011 was 36% of total assets. The Corporation adopted a policy whereby it would refund capital credits to its members in any annual period that a Times Interest Earned Ratio ("TIER") of 2.0 is exceeded. There are none anticipated for 2011. Patronage capital consists of:

	2011	2010
Assigned to date	$40,726,829	$36,622,460
Assignable	$112,723	$4,104,369
Retired to date	(1,589,135)	-
Total	$39,250,417	$40,726,829

Note 4. Accumulated Other Comprehensive Income

The changes in accumulated other comprehensive income, which includes the effects of applying the provisions of accumulated postretirement benefits, follows:

	2011	2010
Balance, beginning of period	($373,822)	($402,619)
Current year amortization	28,797	28,797
Adjustments	-	-
Balance, end of period	($345,025)	($373,822)

Note 5. Long Term Debt

All assets, except vehicles, are pledged as collateral on the long term debt to RUS, Federal Financing Bank ("FFB"), CoBank, and CFC under a joint mortgage agreement. The long term debt is due in quarterly and monthly installments of varying amounts through 2039. The Corporation had a loan approved from FFB in the amount of $18,753,000 that will be used for future plant additions. RUS assesses 12.5 basis points to administer the FFB loans. During 2010 the Corporation refinanced $9,265,992 of RUS loans with funds advanced from CoBank. The Corporation refinanced another $9.4 million of RUS loans with CoBank during 2012.

Note 5. Long Term Debt, continued

First mortgage notes are due as follows:

	2011	2010
First mortgage notes due RUS:		
2.50% to 5.53%	$30,546,318	$31,196,291
Advance payment	(5,684,539)	(5,408,671)
	24,861,779	25,787,620
First mortgage notes due FFB:		
2.332% to 5.158%	22,539,835	15,145,661
First mortgage notes due CoBank:		
3.05% to 4.90%	12,174,727	13,094,883
First mortgage notes due CFC		
5.05%	573,744	632,816
	60,150,085	54,660,980
Current portion	2,509,000	2,200,000
Long term portion	$57,641,085	$52,460,980

As of December 31, 2011, the annual principal portion of long term debt outstanding for the next five years are as follows: 2012 - $2,509,000; 2013 - $2,500,000; 2014 - $2,650,000; 2015 - $2,800,000; 2016 - $2,975,000.

Note 6. Short Term Borrowings

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

Note 7. Pension Plans

All eligible employees of the Corporation participate in the NRECA Retirement and Security Program, a defined benefit pension plan qualified under section 401 and tax-exempt under section 501(a) of the Internal Revenue Code. Eligible employees include employees hired prior to January 1, 2006. Non-eligible employees are those hired after January 1, 2006. The Corporation makes annual contributions to the Program equal to the amounts accrued for pension expense. Contributions to this plan were $723,428 for 2011 and $796,638 for 2010. In this multiemployer plan, which is available to all member cooperatives of NRECA, the accumulated benefits and plan assets are not determined or allocated separately by individual employer.

All eligible union employees participate in the International Brotherhood of Electrical Workers ("IBEW") Savings Plan. The Corporation contributes 10% of base wages to the plan. The Corporation contributions to the plan totaled $203,464 in 2011 and $197,219 in 2010.

Note 8. Retirement Savings Plans

Eligible non-union employees are eligible to participate in the NRECA 401(k) Plan. The Corporation contributes 4% of annual wages to the plan. Non-eligible employees, as defined above, participate in the savings plan, with the Corporation contributing 14% for non-union employees and 10% for union employees. Contributions for these plans totaled $202,256 for 2011 and $194,610 for 2010.

Note 9. Postretirement Benefits

The Corporation sponsors a defined benefit plan that provides medical insurance coverage to retirees. The premiums are paid for a maximum of ten years or until age 65, whichever comes first. For measurement purposes, an annual rate of increase of 8% in 2010, then decreasing by 0.5% per year until 5% per year, in the per capita cost of covered health care benefit was assumed. The discount rate used in determining the accumulated postretirement benefit obligation was 5.75%.

The funded status of the plan is as follows:

	2011	2010
Projected benefit obligation	($1,700,793)	($1,576,079)
Plan assets at fair value	-	-
Funded status	($1,700,793)	($1,576,079)

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

	2011	2010
Benefit obligation at beginning of year	$1,576,079	$1,498,339
Net periodic benefit cost:		
Service cost	110,882	108,902
Interest cost	98,306	88,147
	209,188	197,049
Benefits paid	(84,474)	(119,309)
Actuarial gain/loss	-	-
Benefit obligation at end of year	$1,700,793	$1,576,079

Projected retiree benefit payments for the next five years are expected to be as follows: 2012 - $86,000; 2013 - $84,000; 2014 - $8,000; 2015 - $80,000; 2016 - $75,000.

Note 10. Related Party Transactions

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

Note 11. Labor Force

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

Note 12. Environmental Contingency

The Corporation from time to time is required to work with and handle PCBs, herbicides, automotive fluids, lubricants, and other hazardous materials in the normal course of business. As a result, there is the possibility that environmental conditions may arise which would require the Corporation to incur cleanup costs. The likelihood of such an event, or the amount of such costs, if any, cannot be determined at this time. However, management does not believe such costs, if any, would materially affect the Corporation's financial position or its future cash flows.

Note 13. Contingencies

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

* * * * * *