From: Michelle Carpenter
Sent: Wednesday, May 15, 2013 1:25 PM
To: PSC - Reports
Cc: Gwyn Willoughby; Patrick Woods
Subject: East Kentucky Power Cooperative, Inc. Audit Report

In accordance with 807 KAR 5:006, Section 4(3), please find an electronic copy of the Independent Auditors' Report and the Financial Statements of East Kentucky Power Cooperative, Inc. as of and for the years ended December 31, 2012 and 2011. If you have any questions or need additional information, please contact me.

Michelle

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EAST KENTUCKY POWER COOPERATIVE
A Touchstone Energy Cooperative

East Kentucky Power Cooperative, Inc.

Financial Statements as of and for the
Years Ended December 31, 2012 and 2011, and
Independent Auditors' Report

EAST KENTUCKY POWER COOPERATIVE, INC.

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
East Kentucky Power Cooperative, Inc.:

We have audited the accompanying financial statements of East Kentucky Power Cooperative, Inc. (the "Cooperative"), which comprise the balance sheets as of December 31, 2012 and 2011, and the related statements of revenue and expenses, 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 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.

Auditors' 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 of America 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 from 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 Cooperative'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 Company'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. as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated April 8, 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* in considering the Cooperative’s internal control over financial reporting and compliance.

Deloitte & Touche LLP

April 8, 2013

EAST KENTUCKY POWER COOPERATIVE, INC.

BALANCE SHEETS
AS OF DECEMBER 31, 2012 AND 2011
(Dollars in thousands)

	2012	2011
ASSETS		
ELECTRIC PLANT — At original cost:		
In-service	$3,694,486	$3,383,194
Construction in progress	42,761	251,173
	3,737,247	3,634,367
Less accumulated depreciation	1,050,272	976,855
Electric plant — net	2,686,975	2,657,512
LONG-TERM ACCOUNTS RECEIVABLE	726	1,086
INVESTMENT SECURITIES:		
Available for sale	42,781	42,584
Held to maturity	8,984	9,011
CURRENT ASSETS:		
Cash and cash equivalents	157,209	129,710
Deposit with RUS — restricted investment	8,424	45,128
Accounts receivable	92,103	87,067
Fuel	70,782	53,342
Materials and supplies	42,980	43,782
Regulatory asset		679
Emission allowances	1,266	1,973
Other current assets	4,065	5,035
Total current assets	376,829	366,716
REGULATORY ASSETS	153,005	154,878
DEFERRED CHARGES	2,494	3,879
OTHER NONCURRENT ASSETS	6,943	6,251
TOTAL	$3,278,737	$3,241,917
LIABILITIES AND MEMBERS' EQUITIES		
MEMBERS' EQUITIES:		
Patronage and donated capital	$ 352,151	$ 299,315
Memberships	2	2
Accumulated other comprehensive income	7,766	10,407
Total members' equities	359,919	309,724
LONG-TERM DEBT — Excluding current portion	2,656,514	2,624,168
CURRENT LIABILITIES:		
Current portion of long-term debt	94,009	90,236
Accounts payable	83,046	98,099
Accrued expenses	21,326	60,903
Regulatory liabilities	6,916	428
Total current liabilities	205,297	249,666
ACCRUED POSTRETIREMENT BENEFIT COST	53,533	48,946
EPA AND OTHER LIABILITIES	3,474	9,413
TOTAL	$3,278,737	$3,241,917

See notes to financial statements.

EAST KENTUCKY POWER COOPERATIVE, INC.

STATEMENTS OF REVENUE AND EXPENSES
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(Dollars in thousands)

	2012	2011
OPERATING REVENUE	$ 843,059	$ 877,604
OPERATING EXPENSES:		
Production:		
Fuel	310,642	364,444
Other	138,587	128,861
Purchased power	61,323	41,751
Transmission and distribution	41,996	41,055
Depreciation	86,003	78,055
General and administrative	40,224	42,451
	678,775	696,617
OPERATING MARGIN	164,284	180,987
NONOPERATING DEFICIT:		
Interest expense on long-term debt	(114,128)	(116,781)
Other interest and amortization of debt expense	(586)	(5,413)
Interest income	4,656	2,885
Consent decree settlements and other	(1,349)	(5,974)
Miscellaneous	(306)	58
	(111,713)	(125,225)
CAPITAL CREDITS AND PATRONAGE CAPITAL ALLOCATIONS	265	134
NET MARGIN	52,836	55,896
OTHER COMPREHENSIVE INCOME:		
Unrealized gain (loss) on investments available for sale	(39)	157
Postretirement benefit obligation gain (loss)	(2,602)	5,965
	(2,641)	6,122
COMPREHENSIVE INCOME	$ 50,195	$ 62,018

See notes to financial statements.

EAST KENTUCKY POWER COOPERATIVE, INC.

STATEMENTS OF CHANGES IN MEMBERS' EQUITIES
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(Dollars in thousands)

	Memberships	Patronage Capital	Donated Capital	Accumulated Other Comprehensive Income	Total Members' Equities
BALANCE — December 31, 2010	$ 2	$240,384	$3,035	$ 4,285	$247,706
Net margin		55,896			55,896
Unrealized gain on investments available for sale				157	157
Postretirement benefit obligation gain				5,965	5,965
BALANCE — December 31, 2011	2	296,280	3,035	10,407	309,724
Net margin		52,836			52,836
Unrealized loss on investments available for sale				(39)	(39)
Postretirement benefit obligation loss				(2,602)	(2,602)
BALANCE — December 31, 2012	$ 2	$349,116	$3,035	$ 7,766	$359,919

See notes to financial statements.

EAST KENTUCKY POWER COOPERATIVE, INC.

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(Dollars in thousands)

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net margin	$ 52,836	$ 55,896
Adjustments to reconcile net margin to net cash from operating activities:		
Depreciation	86,003	78,055
Amortization of loan costs	2,120	7,478
Changes in:		
Accounts receivable	(5,036)	9,341
Fuel	(17,440)	7,223
Materials and supplies	802	6,107
Regulatory asset/liability	9,040	8,093
Emission allowances	707	3,247
Accounts payable — trade	(17,636)	17,863
Accrued expenses	(39,577)	10,088
Accrued postretirement benefit cost	1,985	1,090
Other	(6,396)	(15,204)
Net cash provided by operating activities	67,408	189,277
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to electric plant	(112,883)	(171,899)
Maturities and calls of securities available for sale	77,185	149,637
Purchases of securities available for sale	(77,421)	(143,110)
Maturities of securities held to maturity	27	27
Purchases of securities held to maturity		(76)
Additional deposits with RUS restricted investment	(186,819)	(168,982)
Maturities of RUS restricted investment	223,523	172,968
Payments received on long-term accounts receivable	360	1,032
Net cash used in investing activities	(76,028)	(160,403)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from long-term debt	251,484	522,271
Principal payments on long-term debt	(215,365)	(470,376)
Net cash provided by financing activities	36,119	51,895
NET CHANGE IN CASH AND CASH EQUIVALENTS	27,499	80,769
CASH AND CASH EQUIVALENTS — Beginning of year	129,710	48,941
CASH AND CASH EQUIVALENTS — End of year	$ 157,209	$ 129,710

(Continued)

EAST KENTUCKY POWER COOPERATIVE, INC.

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(Dollars in thousands)

	2012	2011
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION — Cash paid for interest	$ 140,352	$ 117,702
NONCASH INVESTING TRANSACTION:		
Additions to electric plant included in accounts payable	$ 12,677	$ 15,260
Unrealized gain (loss) on securities available for sale	$ (39)	$ 157

See notes to financial statements.

(Concluded)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations — East Kentucky Power Cooperative (the "Cooperative") is a not-for-profit electric generation and transmission cooperative providing wholesale electric service to 16 distribution members mainly for residential consumers in central and eastern Kentucky.

The 2012 financial statements include only the accounts of East Kentucky Power Cooperative, Inc. Effective October 2012, Charleston Bottoms Rural Electric Cooperative Corporation (CBRECC), a wholly-owned subsidiary of East Kentucky Power Cooperative (EKPC), was dissolved and all assets were conveyed to EKPC. Therefore, at December 31, 2012, EKPC had no subsidiaries. The 2011 financial statements are presented on a consolidated basis and include the accounts of EKPC and CBRECC with all significant intercompany accounts and transactions eliminated from the presentation. The dissolution of CBRECC had no impact on the comparability of the 2012 financial statements to the 2011 consolidated financial statements.

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

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

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

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

Emission Allowances — Title IV of the Clean Air Act Amendments of 1990 provides for the issuance of allowances as a means to limit the emissions of certain airborne pollutants. Allowances are stated at cost. Issuances of allowances are recognized using a monthly weighted-average method of cost determination. Gains and losses are recorded upon the disposition of allowances.

Depreciation — Depreciation for the generating plants and transmission facilities is provided on the basis of estimated useful lives at straight-line composite rates. Rates applied to electric plant in service for both 2012 and 2011 are:

Production plant	Years 2019–2051
Transmission and distribution plant	0.71%–3.42%
General plant	2.00%–20.00%

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

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 not temporary.

Restricted Investment — The Cooperative has established a cushion of credit program administered by the RUS. Under the cushion of credit program, RUS borrowers may make voluntary irrevocable deposits into a special account. The account balance accrues interest at a rate of five percent per year. The amounts in the cushion of credit account (deposits and earned interest) can only be used to make scheduled payments on loans made or guaranteed by the RUS. At December 31, 2012 and 2011, the balance in the cushion of credit program was $8.4 million and $45.1 million, respectively.

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

The Cooperative uses fair value to measure certain financial instruments, with related unrealized gains or losses generally affecting future recoverable costs. The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (the exit price). Observable inputs or unobservable inputs, defined by ASC Topic 820-10*, Fair Value Measurements and Disclosures*, may be used in the calculation of fair value. ASC Topic 820-10 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The three levels of the fair value hierarchy are described below:

Level 1 — Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2 — Quoted prices in markets that are not considered to be active or financial instruments for which all significant inputs are observable, either directly or indirectly;

Level 3 — Prices or valuations that require inputs that are both significant to the fair value measure and unobservable.

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

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 restricted investments are Level 1 measurements, as the securities are based on quoted market prices for identical investments or securities. The inputs used to measure held to maturity investment securities and financial transmission rights (FTR) derivatives are considered Level 2 as defined above.

Estimated fair values of the Cooperative's assets and liabilities and methods of valuation as of December 31, 2012 and 2011 were as follows (dollars in thousands):

	Fair Value at Reporting Date Using:			
	Fair Value December 31, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash equivalents	$157,200	$157,200	$ -	$ -
Available for sale investments	42,781	42,781		
Restricted investments — deposits with RUS	8,424	8,424		
FTR derivatives	68		68	

	Fair Value at Reporting Date Using:			
	Fair Value December 31, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash equivalents	$129,700	$129,700	$ -	$ -
Restricted investments — deposits with RUS	45,128	45,128		
Available for sale investments	42,584	42,584		
FTR derivatives	611		611	

The estimated fair values of the Cooperative's financial instruments carried at cost at December 31, 2012 and 2011, are as follows (in thousands):

	2012		2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Held to maturity investments	$ 8,984	$ 11,351	$ 9,011	$ 11,296
Long-term debt	2,750,523	3,323,431	2,714,404	3,159,171

The inputs used to measure held to maturity investment securities are considered Level 2 as defined above. 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 using a Level 2 valuation methodology.

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

Rate Matters — Revenue is recorded monthly based on meter readings made at month-end.

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 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 being billed on a percentage of revenue basis in the month following the actual costs being incurred.

On January 14, 2011, the Commission issued an Order approving a settlement reached among the Cooperative and interveners in the Cooperative's rate case, which authorized a $43 million increase in annual base rate revenues. This rate increase was effective for service rendered on and after January 14, 2011. Additional provisions of the settlement include a provision to refund 2011 earnings in excess of a 1.50 times interest earned ratio (TIER) through the filing of an application with the Commission and an affirmation that the Cooperative has accepted and is implementing all of the recommendations made by the independent consultant that completed a Commission-ordered focused management and operations audit of the Cooperative in 2010. EKPC did not exceed a 1.50 TIER in 2011, and accordingly, no refund was due to EKPC members.

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 which amounted to approximately $832.8 million and $847.6 million for 2012 and 2011, respectively. Accounts receivable at December 31, 2012 and 2011, were primarily from billings to member cooperatives.

At December 31, 2012 and 2011, individual account receivable balances that exceeded 10% of total accounts receivable are as follows (dollars in thousands):

	2012	2011
Owen Electric Cooperative	$ 11,782	$ 12,000
South Kentucky RECC	9,367	9,042

Cash and Cash Equivalents — The Cooperative considers temporary investments having a maturity of three months or less when purchased to be cash equivalents. Cash equivalents at December 31, 2012 consisted primarily of money market mutual funds and investments in commercial paper.

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

Asset Impairment — Long-lived assets held and used by the Cooperative are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Specifically, the evaluation for impairment involves comparison of an asset's carrying value to the estimated undiscounted cash flows the asset is expected to generate over its remaining life. If this evaluation were to conclude that the carrying value of the asset is impaired, an impairment charge would be recorded as a charge to operations based on the difference between the asset's carrying amount and its fair value. No impairment has been recognized on long-term assets for the years ended December 31, 2012 or 2011.

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. In addition, any available capital credits will also be allocated to members on a contribution-to-gross margins basis.

A provision in the Cooperative's bylaws prohibits the return of capital contributed by patrons unless, after any proposed retirement, the total capital of the Cooperative equals or exceeds 40% of total assets. In addition, provisions of certain loan agreements prohibit the retirement of capital until stipulated requirements as to aggregate margins and equities are met. Accordingly, at December 31, 2012 and 2011, no patronage capital was available for refunds or retirement.

Comprehensive Income — Comprehensive income includes both net margin and other comprehensive income. Other comprehensive income represents the change in unrealized gains and losses on securities available for sale as well as the change in funded status of the accumulated postretirement benefit obligation.

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

Deferred Finance Charges — The Cooperative amortizes deferred financing charges using the effective interest method.

Derivatives — The Cooperative's activities expose it to a variety of market risks including interest rates and commodity prices. Management has established risk management policies and strategies to reduce the potentially adverse effects that the volatility of the markets may have on its operating results. These policies and strategies include the use of derivative instruments and hedging activities. These derivative instruments generally qualify for hedge accounting or the normal purchase and normal sales exclusion under ASC Topic 815-10, *Derivatives and Hedging*. If hedge treatment is obtained, unrealized gains or losses resulting from these instruments are deferred as a component of accumulated other comprehensive income (loss) until the corresponding item being hedged is settled, at which time the gain or loss is recognized in earnings. Gains or losses for items not qualifying for hedge treatment are accounted for as derivative assets or liabilities and recorded on the balance sheet until such time that the asset or liability is settled, at which time the gain or loss is recognized in earnings. At December 31, 2012, the Cooperative had Financial Transmission Rights (FTRs) derivative assets of $0.07 million and $0.05 million in related liabilities. At December 31, 2011, the Cooperative had FTRs derivative assets of $0.6 million and $0.5 million in related liabilities.

Asset Retirement Obligations — ASC Topic 410-20, *Asset Retirement Obligations*, requires legal obligations associated with the retirement of long-lived assets to be recognized at fair value when incurred and capitalized as part of the related long-lived asset. ASC Topic 410-20 clarifies the term conditional asset retirement obligation where an obligation exists even though the method or timing of settlement may be conditional. The liability is accreted to its present value each period and the capitalized cost is depreciated over the useful life of the related asset. When the asset is retired, the entity settles the obligation for its recorded amount or incurs a gain or loss. The Cooperative's asset retirement obligations reflect the requirements related to asbestos abatement at its coal-fired plants. The Cooperative has no plans to retire any of its generating plants at this time but continues to evaluate the useful lives of its plants and costs of remediation. The following table represents the details of asset retirement obligation activity as reported on the balance sheet in accrued expenses (in thousands):

	2012	2011
Balance — beginning of year	$ 1,981	$ -
Liabilities incurred	2,815	1,905
Liabilities settled		
Accretion	79	76
Cash flows revisions		
Balance — end of year	$ 4,875	$ 1,981

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

2. ELECTRIC PLANT IN SERVICE

Electric plant in-service at December 31, 2012 and 2011, consisted of the following (dollars in thousands):

	2012	2011
Production plant	$2,583,617	$2,497,554
Transmission plant	686,082	671,794
General plant	92,590	88,312
Completed construction, not classified, and other	332,197	125,534
Electric plant in service	$3,694,486	$3,383,194

3. LONG-TERM ACCOUNTS RECEIVABLE

Long-term receivables included modifications to Spurlock Power Station in order to provide steam to a paper mill that recycles container board served by a member system. The paper mill reimbursed the cost of the modifications through a monthly facilities charge which concluded in September 2012. Long-term receivables currently include interest-bearing notes from joint ventures owned by the Cooperative and four of the Cooperative's member systems for the buyout of a propane company. The joint ventures of the member systems are making principal and interest (prime rate minus one-half of one percent, adjusted annually) payments. The notes are payable in full in 2015.

4. INVESTMENT SECURITIES

Amortized cost and estimated fair value of investment securities available for sale at December 31, 2012 and 2011, are as follows (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2012				
National Rural Utilities Cooperative Finance Corporation Promissory Note	$ 527	$ -	$ -	$ 527
U.S. Treasury Bill	37,811	6		37,817
Zero coupon bond	3,111	244		3,355
Other	1,061	21		1,082
	$42,510	$271	$ -	$42,781
2011				
U.S. Treasury Bill	$38,194	$ -	$ (5)	$38,189
Zero coupon bond	3,019	264		3,283
Other	1,061	51		1,112
	$42,274	$315	$ (5)	$42,584

Proceeds from maturities and calls of securities were $77.2 million and $149.6 million in 2012 and 2011, respectively. There were no realized gains or losses on those calls.

Amortized cost and estimated fair value of investment securities held to maturity at December 31, 2012 and 2011, are as follows (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2012				
National Rural Utilities Cooperative Finance Corporation:				
3%–5% capital term certificates	$ 7,656	$ 2,286	$ -	$ 9,942
6.5875% subordinated term certificate	345	167		512
0% subordinated term certificate	983		(86)	897
	$ 8,984	$ 2,453	$ (86)	$ 11,351
2011				
National Rural Utilities Cooperative Finance Corporation:				
3%–5% capital term certificates	$ 7,656	$ 2,220	$ -	$ 9,876
6.5875% subordinated term certificate	365	175		540
0% subordinated term certificate	990		(110)	880
	$ 9,011	$ 2,395	$ (110)	$ 11,296

All investment securities held to maturity with unrealized losses at December 31, 2012 and 2011, not recognized in net margin have maturities of 12 months or more.

The amortized cost and fair value of securities at December 31, 2012, 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	$ 38,738	$ 38,744
Due after one year through five years	2,711	2,955
Due after five through ten years	1,061	1,082
	$ 42,510	$ 42,781
Held to maturity:		
Due after five years through ten years	$ 724	$ 810
Due after ten years	8,260	10,541
	$ 8,984	$ 11,351

5. LONG-TERM DEBT

A Consolidated Mortgage, Security Agreement and Financing Statement (Existing RUS Mortgage) provides mortgage note holders with a pro-rated interest in substantially all owned assets. In order to provide additional financing alternatives, during 2012 the Cooperative took action to substitute an indenture of mortgage for its Existing RUS Mortgage. Consequently, 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. Pursuant to the Agreement Regarding Recording of Indenture, dated October 11, 2012, the Indenture was legally recorded and the security interest perfected as of January 4, 2013. The Existing RUS Mortgage will be released and cancelled upon execution of the release by the mortgagees. The Indenture provides secured note holders with a pro-rated interest in substantially all owned assets.

Long-term debt outstanding at December 31, 2012 and 2011, consisted of the following (dollars in thousands):

	2012	2011
First mortgage notes:		
2.302%–10.657%, payable quarterly to Federal Financing Bank (FFB) in varying amounts through 2044, weighted average 4.44%	$2,400,548	$2,239,570
5.13% payable quarterly to RUS in varying amounts through 2024	7,854	8,363
Variable rate, 4.00%, payable quarterly to CFC in varying amounts through 2024	7,465	7,958
Variable rate, 4% at December 31, 2012 and 2011, payable quarterly to CFC in varying amounts through 2019	2,928	5,159
Fixed rate loan, 7.7%, payable semi-annually in varying amounts to National Cooperative Services Corporation through 2012		1,500
Tax-exempt bonds:		
Pollution control revenue bonds, Series 1984B, variable rate bonds, due October 15, 2014, 0.36% and 0.70% at December 31, 2012 and 2011, respectively	25,850	37,750
Solid waste disposal revenue bonds, Series 1993B, variable rate bonds, due August 15, 2023, 0.65% and 1.00% at December 31, 2012 and 2011, respectively	6,500	6,900
Clean Renewable Energy Bonds, Fixed rate of 0.40% payable quarterly to CFC to December 1, 2023	5,922	6,460
Promissory notes:		
1.82% variable rate note payable to CFC	275,000	380,000
4.32% fixed rate notes payable to National Cooperative Services Corporation	18,456	20,744
	2,750,523	2,714,404
Less current portion of long-term debt	94,009	90,236
	$2,656,514	$2,624,168

In May 2005, the Cooperative submitted to RUS a loan application in the amount of $907 million for the construction of the Smith #1 Unit and the construction of five additional combustion turbines at the J.K. Smith site, including engineering services, preliminary structural design, and related transmission facilities. In June 2007, the Cooperative re-submitted this same loan application for the Smith #1 Unit, along with the construction of only two combustion turbines and related transmission facilities for a revised loan amount of $943.9 million. In May 2008, due to the institution by RUS of a moratorium on financing of base load generation facilities, the Cooperative once again revised this loan to only include the two combustion turbines and related transmission facilities for a revised loan amount of $276.3 million. This loan was approved by RUS in June 2008. Advances on this loan are subject to certain conditions outlined by RUS and the non-governmental portions of such loans are subject to authorization from the PSC. As of December 31, 2012, $57.8 million of these amounts remained to be advanced.

In August 2005, RUS approved a loan application in the amount of $64.2 million for the construction of various transmission projects. Advances on these loans are subject to certain conditions outlined by RUS and the non-governmental portions of such loans are subject to authorization from the PSC. As of December 31, 2012, no funds remained to be advanced.

In March 2006, RUS approved a loan application in the amount of $481.4 million for the construction of the Unit #4 at the Spurlock Power Station, including engineering services, preliminary structural design, and related transmission facilities. Advances on these loans are subject to certain conditions outlined by RUS and the non-governmental portions of such loans are subject to authorization from the PSC. As of December 31, 2012, no funds remained to be advanced.

In May 2007, the Cooperative submitted to RUS a loan application in the amount of $457.5 million for the engineering and construction of a new scrubber on the Spurlock Unit #1 and the replacement of the existing scrubber on the Spurlock Unit #2. This loan was approved by RUS in June 2008. Advances on this loan are subject to certain conditions outlined by RUS and the non-governmental portions of such loans are subject to authorization from the PSC. As of December 31, 2012, $58.9 million of these amounts remained to be advanced.

In May 2008, the Cooperative submitted to RUS a loan application in the amount of $96.1 million for various generation projects. This loan amount was revised in July 2008 to $108.2 million. This loan was approved by RUS in August 2008. Advances on this loan are subject to certain conditions outlined by RUS and the non-governmental portions of such loans are subject to authorization from the PSC. As of December 31, 2012, $35.7 million of these amounts remained to be advanced.

In July 2008, the Cooperative submitted to RUS a loan application in the amount of $152.7 million for various transmission projects. This loan was revised in July 2008 to $140.7 million. This loan was approved by RUS in July 2009. Advances on this loan are subject to certain conditions outlined by RUS and the non-governmental portions of such loans are subject to authorization from the PSC. As of December 31, 2012, $71.6 million of these amounts remained to be advanced.

In March 2009, EKPC submitted to RUS a loan application for $341 million for construction of the Cooper Station Retrofit Air Pollution Project. This loan was approved by RUS in August 2009. Advances on this loan are subject to certain conditions outlined by RUS and the non-governmental portions of such loans are subject to authorization from the PSC. As of December 31, 2012, $151.5 million of these amounts remained to be advanced.

In accordance with the Rural Electrification Act of 1936 ("RE Act"), as amended, the RUS established a cushion of credit program. Under this program, RUS borrowers may make voluntary deposits into a special cushion of credit account. This cushion of credit account balance accrues interest at a rate of 5% per annum. The amounts in the cushion of credit account (deposits and earned interest) can only be used to make scheduled payments on loans made or guaranteed under the RE Act. The Cooperative's cushion of credit account balance was $8.4 million and $45.1 million at December 31, 2012 and 2011, respectively. These balances were used to make scheduled debt payments to RUS in the first quarter of the subsequent year. Accordingly, these amounts were recorded as restricted current investments as of December 31, 2012 and 2011.

On August 9, 2011, the Cooperative entered into an unsecured credit facility syndicate with the joint lead arrangers of CFC, KeyBank, and PNC Capital Markets. This loan was approved for a total of $450 million for general operating expenses and capital construction projects. As of December 31, 2012, $175 million of this amount remains to be advanced.

In December 2010, the Cooperative entered into a loan agreement with the National Cooperative Services Corporation (NCSC) for $23.8 million to refinance the corresponding outstanding principal balance of indebtedness to RUS.

The interest rate on the Series 1984B Pollution Control Bonds is subject to change weekly and the interest rate on the Series 1993B Solid Waste Disposal Revenue Bonds is subject to change semiannually. The interest rate adjustment period on any series of the above-mentioned 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 $25.9 million CFC guarantee secures payment of the Series 1984B bonds and has an expiration date of October 15, 2014. A $6.5 million CFC guarantee secures payment of the Series 1993B bonds and has an expiration date of August 15, 2023.

Long-term pollution control and solid waste disposal revenue bonds require that debt service reserve funds be on deposit with a trustee throughout the term of the bonds. Debt service reserve requirements are as follows: Series 1984B — $12.7 million and Series 1993B — $1.1 million. In addition, mandatory sinking fund payments are required for each series as follows: Series 1984B — payments range from $11.9 million in 2012 to $12.7 million in 2014; and Series 1993B — payments range from $0.4 million in 2012 to $0.7 million in 2023. Debt service reserve and construction funds are held by trustees and are invested primarily in U.S. Government securities and CFC promissory notes. These funds are included in investment securities available for sale and have a fair value of approximately $13.8 million at December 31, 2012.

Estimated annual maturities of long term debt for the five years subsequent to December 31, 2012, are as follows (dollars in thousands):

Years Ending December 31	
2013	$ 94,009
2014	94,517
2015	85,451
2016	82,435
2017	80,389
Thereafter	2,313,722
	$ 2,750,523

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, 2012.

As of December 31, 2012, 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, 2012, the Cooperative has pledged securities of $3.1 million with the United States Department of Labor for Federal Longshore Harbor Workers and the Commonwealth of Kentucky.

6. RETIREMENT BENEFITS

Pension Plan — Pension benefits for employees hired prior to January 1, 2007 are provided through participation in the National Rural Electric Cooperative Association (NRECA) Retirement and Security Plan (RS Plan). The plan is a defined benefit pension plan qualified under Section 401 and tax exempt under Section 501(a) of the Internal Revenue Code. It is a multiemployer plan under the accounting standards. The plan sponsor's Employer Identification Number is 53-0116145 and the Plan Number is 333.

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 2012 and 2011 represented less than 5 percent of the total contributions made to the plan by all participating employers. The Cooperative made contributions to the plan of $9.0 million and $9.4 million in 2012 and 2011, respectively. There have been no significant changes that affect the comparability of 2012 and 2011 contributions.

In the RS Plan, a "zone status" determination is not required and therefore, not determined, under the Pension Protection Act (PPA) of 2006. In addition, the accumulated benefit obligations and plan assets are not determined or allocated separately by individual employer. In total, the RS Plan was between 65 percent and 80 percent funded at January 1, 2012 and January 1, 2011 based on the PPA funding target and PPA actuarial value of assets on those dates. Because the provisions of the PPA do not apply to the RS Plan, funding improvement plans and surcharges are not applicable. Future contribution requirements are determined each year as part of the actuarial valuation of the plan and may change as a result of plan experience.

Retirement Savings Plan — The Cooperative has a Retirement Savings Plan for all employees who are eligible to participate in the Cooperative's benefit programs. The plan allows participants to make contributions by salary reduction, pursuant to Section 401(k) of the Internal Revenue Code. For employees hired prior to January 1, 2007, the Cooperative makes matching contributions to the account of each participant up to 2.0% of the participant's compensation. For employees hired on or after January 1, 2007, the Cooperative will automatically contribute 6.0% of base wages and match the employee contribution up to 4.0%. The Cooperative contributed approximately $1.9 million and $1.7 million to the plan in 2012 and 2011, respectively. Employees vest immediately in their contributions and the contributions of the Cooperative.

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 cause participants to forfeit 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.

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, 2012 and 2011 (dollars in thousands):

	2012	2011
Change in benefit obligation:		
Accumulated postretirement benefit obligation — beginning of year	$ 50,213	$ 55,267
Service cost	1,320	982
Interest cost	2,268	2,133
Plan participants' contributions	949	899
Benefits paid	(2,137)	(2,074)
Actuarial (gain) loss	2,395	(6,994)
Accumulated postretirement benefit obligation — end of year	$ 55,008	$ 50,213
Change in plan assets:		
Fair value of plan assets — beginning of year	$ -	$ -
Employer contributions	1,188	1,175
Participant contributions	949	899
Benefits paid	(2,137)	(2,074)
Fair value of plan assets — end of year	$ -	$ -
Funded status — end of year	$ (55,008)	$ (50,213)
Amounts recognized in balance sheet consists of:		
Current liabilities	$ 1,475	$ 1,267
Noncurrent liabilities	53,533	48,946
Total amount recognized in balance sheet	$ 55,008	$ 50,213
Amounts included in accumulated other comprehensive income — unrecognized actuarial gain	$ 7,497	$ 10,099
Net periodic benefit cost:		
Service cost	$ 1,320	$ 982
Interest cost	2,268	2,133
Amortization of net actuarial gain	(206)	(1,029)
Net periodic benefit cost	$ 3,382	$ 2,086
Net amount recognized in other comprehensive income	$ (2,602)	$ 5,965
Amounts expected to be realized in 2013 — amortization of net gain	$ (144)	$ (369)

The discount rate used in determining the accumulated postretirement benefit obligation was 4.34% and 4.40% for 2012 and 2011, respectively.

The Cooperative expects to contribute approximately $1.5 million to the plan in 2013.

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

Years Ending December 31	
2013	$ 1,475
2014	1,616
2015	1,715
2016	1,890
2017	2,074
2018–2022	12,561
Total	$ 21,331

For measurement purposes, a 7.5% annual rate of increase in the per capita cost of covered health care benefits was used for the year ended December 31, 2012. The rate is assumed to decline to 4.5% after 15 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 $0.8 million and increase the postretirement benefit obligation by $10.8 million. A 1% decrease in the health care trend rate would decrease total service and interest costs by $0.6 million and decrease the postretirement benefit obligation by $8.6 million.

7. COMMITMENTS AND CONTINGENCIES

The Cooperative has entered into long-term power purchase agreements having minimum payment obligations as follows (dollars in thousands):

Years Ending December 31	
2013	$ 16,819
2014	16,819

The Cooperative is committed to purchase coal for its generating plants under long-term contracts having minimum purchase obligations as follows (dollars in thousands):

Years Ending December 31	
2013	$ 213,153
2014	178,055
2015	146,772
2016	107,290
2017	76,356

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 re-openers.

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.

The Cooperative and 15 of its owner-members have been named in a complaint filed by another East Kentucky Power Cooperative owner-member (plaintiff). The plaintiff claims, among other things, that it owned a portion of Charleston Bottoms Rural Electric Cooperative Corporation (Note 1), which was dissolved with all assets conveyed to EKPC, and thereby, is entitled to its share of the fair market value of the assets at the time of dissolution. EKPC is vigorously contesting the complaint and has filed motions accordingly.

On January 17, 2006, the Cooperative received a Notice of Violation (NOV) from the EPA alleging violations of the Federal Clean Air Act's Acid Rain Program and NOx SIP Call Allowance Trading Program at Dale Units #1 and #2. At issue was the EPA's allegation that the Cooperative incorrectly reported the turbine, rather than the generator, nameplate ratings, thus placing the Units under the Acid Rain Program. On February 10, 2006, the Cooperative received an NOV from the Kentucky Environmental and Public Protection Cabinet regarding the same matter. The NOVs covered the years 2000 through 2004. The parties executed a Consent Decree (Acid Rain Consent Decree), which the United States Department of Justice lodged on September 20, 2007 and subsequently entered after the 30-day public comment period on November 30, 2007.

Under the terms of the Acid Rain Consent Decree, the Cooperative was required to make six annual payments of $1.9 million (Fixed Penalty Payment), totaling $11.4 million. The Cooperative made the sixth and final installment of this fixed penalty payment in December 2012. In addition to the Fixed Penalty Payment, the Cooperative was also subject to a Contingent Penalty Payment for a period of five years if certain financial ratios were achieved, based on audited financial statements for the years 2008 through 2012. The Cooperative reserved $7.6 million in 2012 for the final Contingency Penalty Payment, which is classified as current accrued expenses on the balance sheet. Total fixed and contingency penalties accrued at December 31, 2011 were $16.3 million, with $10.0 million classified as current accrued expenses on the balance sheet and $6.3 million included in EPA and other liabilities on the balance sheet.

8. REGULATORY ASSETS AND LIABILITIES

In 2010, the Cooperative recorded a regulatory asset of $157.1 million for construction costs expended on the cancelled Smith Unit 1 plant based on the guidance for abandonment of plant costs for regulated entities and management's assertion that full return on investment was probable. On February 28, 2011, the PSC approved the Cooperative's request to surrender the Certificate of Public Convenience and Necessity (CPCN) for Smith Unit 1 and in a separate order, authorized the establishment of a regulatory asset for the construction costs incurred and the Cooperative's estimate of the costs to unwind vendor contracts. During 2011, the Cooperative negotiated final settlement of the Smith Unit 1 contracts, resulting in a reduction of the regulatory asset balance to $150.8 million at December 31, 2011. Additional minimal costs were incurred to maintain the assets in 2012, resulting in an increase of the regulatory asset balance to $150.9 million at December 31, 2012. While the Cooperative has not yet requested rate recovery, management believes that it is probable that the PSC will allow the Cooperative to recover through rates the full amount of the regulatory asset, along with a return on the investment, net of cash inflows from cost mitigation efforts.

During 2008, the Cooperative recorded a regulatory asset of $12.3 million related to unrecorded forced outage replacement power costs incurred during 2008 that are included in their 2009 rate case. The PSC approved a three-year amortization period beginning in April 2009. In conjunction with the rate case approved by the PSC on January 14, 2011, the Cooperative was permitted to extend the amortization of forced outage costs an additional three years.

Regulatory assets (liabilities) were comprised of the following as of December 31, 2012 and 2011 (dollars in thousands):

	2012	2011
Plant abandonment — Smith Unit 1	$ 150,945	$ 150,827
Deferred outage costs	1,768	3,477
Deferred management audit costs	292	574
	$ 153,005	$ 154,878
Fuel adjustment clause	$ (4,382)	$ 679
Environmental cost recovery	(2,534)	(428)
	$ (6,916)	$ 251

9. ENVIRONMENTAL MATTERS

The EPA finalized the Mercury and Air Toxics Standards (MATS) rules on December 16, 2011, to reduce emissions of air toxins from new and existing coal and oil fired electric utility steam generating units. Existing units will be required to comply with these rules by April 16, 2015. The EPA's delegated permit authority (State Air Agency) will consider granting extensions to April 16, 2016, for transmission reliability critical units; states can also grant one year extensions for retrofits. In July 2011, the EPA issued the Cross-State Air Pollution Rule (CSAPR) to limit SO2 and NOx emissions. This rule replaced the EPA's Clean Air Interstate Rule (CAIR) and was to become effective on January 1, 2012. Numerous legal challenges were filed by a variety of companies and states. On December 30, 2011, the DC Court of Appeals stayed the CSAPR pending judicial review. The Court noted that the EPA is expected to continue the CAIR program pending Supreme Court resolution. The Cooperative continues to monitor other air rules pending final authorization as well as the EPA's new water and Resource Conservation and Recovery Act (RCRA) coal combustion rules expected to be issued in 2013 and 2014, respectively.

The Cooperative is evaluating the impact of these rules on its current fleet of coal-fired units and developing appropriate cost effective compliance strategies. Neither EKPC's management nor Board of Directors has approved any retirements of generating capacity based upon the anticipated impact of these rules.

10. SUBSEQUENT EVENTS

On December 20, 2012, the Kentucky Public Service Commission approved, with certain conditions, the Cooperative's request to transfer functional control of certain transmission facilities to the PJM Interconnection, LLC (PJM). On February 12, 2013, EKPC's Board of Directors granted final approval for EKPC's integration into PJM effective June 1, 2013.

The Cooperative's financial statements are available for issuance as of April 8, 2013. Any subsequent events have been evaluated through this date.

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