Kentucky 20

Jackson Purchase Energy Corporation
Paducah, Kentucky

Audited Financial Statements
December 31, 2013 and 2012

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

CONTENTS

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
• AICPA DIVISION FOR FIRMS

Independent Auditor's Report

To the Board of Directors
Jackson Purchase Energy Corporation

Report on the Financial Statements

I have audited the accompanying financial statements of Jackson Purchase Energy Corporation, which comprise the balance sheets as of December 31, 2013 and 2012, and the related statements of revenue and comprehensive income, changes in 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

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 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 I 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 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, I express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made my management, as well as evaluating the overall presentation of the financial statements.

I believe the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

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, 2013 and 2012, and the results of their operations and 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*, I have also issued a report dated February 6, 2014, 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* in considering internal control over financial reporting and compliance.

Alan M. Zumstein

Alan M. Zumstein, CPA
February 6, 2014

Jackson Purchase Energy Corporation
Balance Sheets, December 31, 2013 and 2012

Assets	2013	2012
Electric Plant, at original cost:		
In service	$ 141,361,793	$ 138,177,537
Under construction	6,299,642	3,118,608
	147,661,435	141,296,145
Less accumulated depreciation	52,568,508	48,473,066
	95,092,927	92,823,079
Investments in Associated Organizations	3,045,316	2,979,110
Current Assets:		
Cash and cash equivalents	4,176,424	7,076,505
Accounts receivable, less allowance for 2013 of $117,216 and 2012 of $67,779	4,240,541	3,090,153
Other receivables	2,821,188	2,595,326
Accrued unbilled revenue	1,649,894	1,061,587
Material and supplies, at average cost	1,870,884	1,471,355
Other current assets	422,260	443,519
	15,181,191	15,738,445
Deferred mapping costs	-	99,325
Total	$ 113,319,434	$ 111,639,959

Members' Equities and Liabilities	2013	2012
Members' Equities:		
Memberships	$ 144,315	$ 151,210
Patronage capital	42,963,913	40,333,027
Accumulated other comprehensive income	(287,431)	(316,228)
	42,820,797	40,168,009
Long Term Debt	57,764,685	60,282,469
Accumulated Postretirement Benefits	1,993,042	1,842,386
Current Liabilities:		
Accounts payable	4,518,206	3,385,533
Consumer deposits	1,818,491	1,738,080
Current portion of long term debt	2,564,000	2,285,000
Accrued expenses	1,699,846	1,586,972
	10,600,543	8,995,585
Advances for Construction and others	140,367	351,510
Total	$ 113,319,434	$ 111,639,959

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

Statements of Revenue and Comprehensive Income
for the years ended December 31, 2013 and 2012

	2013	2012
Operating Revenues		
Sales of electricity	$ 52,796,547	$ 46,770,574
Other electric revenue	1,235,319	1,171,634
	54,031,866	47,942,208
Operating Expenses:		
Cost of power	34,245,007	29,783,789
Distribution - operations	2,657,385	2,693,580
Distribution - maintenance	3,478,749	3,739,739
Consumer accounts	1,204,030	1,043,716
Consumer service and information	96,540	80,595
Administrative and general	2,513,859	2,182,691
Depreciation, excluding $351,328 in 2013 and $318,425 in 2012 charged to clearing accounts	5,118,711	4,965,644
Taxes	56,909	52,720
Other deductions	2,074	1,109
	49,373,264	44,543,583
Operating Margins before Interest Charges	4,658,602	3,398,625
Interest Charges:		
Long-term debt	2,688,101	2,758,264
Other interest	38	54,294
	2,688,139	2,812,558
Operating Margins after Interest Charges	1,970,463	586,067
Nonoperating Margins		
Interest income	354,931	344,693
Other nonoperating income, net	59,242	(11,922)
	414,173	332,771
Patronage Capital from Associated Organizations	246,250	163,772
Net Margins	2,630,886	1,082,610
Accumulated comprehensive income:		
Accumulated postretirement benefits	28,797	28,797
Comprehensive Income	$ 2,659,683	$ 1,111,407

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

Statements of Members' Equities
for the years ended December 31, 2012 and 2013

	Memberships	Patronage Capital	Accumulated Other Comprehensive Income	Total Members' Equity
Balance - Beginning of year	$ 157,865	$ 39,250,417	$ (345,025)	$ 39,063,257
Comprehensive income:				
Net margins		1,082,610		1,082,610
Postretirement benefit obligation				
Amortization			28,797	
Adjustments			-	28,797
Total comprehensive income				1,111,407
Net change in memberships	(6,655)			(6,655)
Refunds of capital credits				-
Other equities				-
Balance - December 31, 2012	151,210	40,333,027	(316,228)	40,168,009
Comprehensive income:				
Net margins		2,630,886		2,630,886
Postretirement benefit obligation				
Amortization			28,797	
Adjustments			-	28,797
Total comprehensive income				2,659,683
Net change in memberships	(6,895)			(6,895)
Refunds of capital credits				-
Other equities				-
Balance - December 31, 2013	$ 144,315	$ 42,963,913	$ (287,431)	$ 42,820,797

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

Statements of Cash Flows
for the years ended December 31, 2013 and 2012

	2013	2012
Cash Flows from Operating Activities:		
Net margins	$ 2,630,886	$ 1,082,610
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation		
Charged to expense	5,118,711	4,965,644
Charged to clearing	351,328	318,425
Capital credits allocated	(246,250)	(163,772)
Accumulated postretirement benefits	179,453	170,390
Net change in current assets and liabilities:		
Receivables	(1,964,557)	(286,406)
Material and supplies	(399,529)	144,078
Other current assets	21,259	(39,525)
Deferred charges	99,325	198,648
Accounts payable	1,132,673	499,939
Consumer deposits	80,411	(21,807)
Accrued expenses	112,874	145,391
Consumer advances for construction	(211,143)	205,041
	6,905,441	7,218,656
Cash Flows from Investing Activities:		
Construction of plant	(7,281,408)	(4,967,358)
Plant removal costs	(507,588)	(851,764)
Salvage recovered from plant	49,109	149,334
Receipts from investments, net	180,044	146,268
	(7,559,843)	(5,523,520)
Net Cash Flows from Financing Activities:		
Net decrease in memberships	(6,895)	(6,655)
Additional long-term borrowings	-	5,000,000
Advance payments	408,258	(204,733)
Payments on long-term debt	(2,647,042)	(2,377,883)
	(2,245,679)	2,410,729
Net increase in cash balances	(2,900,081)	4,105,865
Cash and cash equivalents - beginning	7,076,505	2,970,640
Cash and cash equivalents - ending	$ 4,176,424	$ 7,076,505
Supplemental disclosures of cash flow information:		
Interest on long-term debt	$ 2,692,834	$ 2,402,989

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:

	2013	2012
Distribution plant	$132,346,695	$129,325,369
General plant	9,015,098	8,852,168
Total	$141,361,793	$138,177,537

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, 2013, 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.

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, 2013 or 2012. 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.

Note 1. Summary of Significant Accounting Policies, continued

Taxes The Corporation is required to collect, on behalf of the State of Kentucky, sales taxes based on 6 percent of gross sales from non-residential consumers, a 3 percent school tax from certain counties on most gross sales, and franchise fees in certain cities. The Corporation's policy is to exclude sales tax from revenue when collected and expenses when paid and instead, record collection and payment of sales taxes through a liability account.

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 Measurements The Fair Value Measurements and Disclosures Topic of the FASB ASC 820, *Fair Value Measurements and Disclosures,* defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal, or most advantageous, market for the asset or liability in an orderly transaction between market participants at the measurement date. The Fair Values Measurements Topic establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of observable inputs when possible. The three levels of inputs used to measure fair value are as follows:

> 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 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 due to their short maturity. Investments in associated organizations are not considered a financial instrument because they represent nontransferable interests in associated organizations. Other assets and liabilities are not considered financial instruments because they represent activities specifically related to the Corporation. Long term debt can not be traded in the market, and is specifically for electric cooperatives and, therefore, a value other than its outstanding principal cannot be determined.

The Corporation may, and also does, invest idle funds in local banks and in National Rural Utilities Cooperative Finance Corporation ("CFC") commercial paper. The inputs used to measure idle funds are Level 1 measurements, as these funds are exchange traded funds in an active market.

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.

Advertising The Corporation expenses advertising costs as incurred.

Note 1. Summary of Significant Accounting Policies, continued

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.

Comprehensive Income Comprehensive income includes both net margin and other comprehensive income. Other comprehensive income represents the change in funded status of the accumulated postretirement benefit obligation.

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.

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 provisions of Section 501(c)(12). Accordingly, the financial statements for the Corporation include no provision for income taxes. When applying the 85 percent test of IRC 501(c)(12), the Corporation excludes the Big Rivers non-cash allocations from "gross income". The Corporation's accounting policy provides that a tax expense/benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits. Management believes the Corporation has no uncertain tax positions resulting in an accrual of tax expense or benefit. 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, 2013 and 2012. The Corporation's income tax return is subject to possible examination by taxing authorities until the expiration of related statues of limitations on the return, which is generally three years.

Subsequent Events Management has evaluated subsequent events through February 6, 2014, 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%, 3% and 5% and are scheduled to mature at varying times from 2020 to 2080. Investments in associated organizations consist of:

	2013	2012
CFC, CTCs	$939,162	$940,404
CFC, patronage capital	46,383	45,157
CoBank, patronage capital	635,968	584,204
National Rural Telecommunications Coop.	843,824	843,824
Others	579,979	565,521
Total	$3,045,316	$2,979,110

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, 2013 was 38% 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 2014. Patronage capital consists of:

	2013	2012
Assigned to date	$41,922,162	$40,839,552
Assignable	2,630,886	1,082,610
Retired to date	(1,589,135)	(1,589,135)
Total	$42,963,913	$40,333,027

Note 4. 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 $13,753,000 that will be used for future plant additions. RUS assesses 12.5 basis points to administer the FFB loans. During 2012 the Corporation refinanced $9,403,475 of RUS loans with funds advanced from CoBank. First mortgage notes are due as follows:

	2013	2012
RUS: 2.50% to 5.53%	$20,277,925	$20,718,972
Advance payment @ 5%	(5,481,013)	(5,889,272)
	14,796,912	14,829,700
FFB: 0.733% to 5.158%	25,802,701	26,810,931
CoBank: 2.93% to 4.90%	19,282,748	20,415,205
CFC: 5.05%	446,324	511,633
	60,328,685	62,567,469
Current portion	2,564,000	2,285,000
Long term portion	$57,764,685	$60,282,469

As of December 31, 2013, the annual principal portion of long term debt outstanding for the next five years are as follows: 2014 - $2,564,000; 2015 - $2,700,000; 2016 - $2,800,000; 2017 - $2,900,000; 2018 - $2,950,000.

Note 5. 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 6. Pension Plans

All eligible non-union employees of the Corporation participate in the NRECA Retirement and Security Plan ("R&S Plan"), 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 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 Corporation's contributions to the R&S Plan in 2013 and 2012 represent less than 5 percent of the total contributions made to the plan by all participating employers. The Corporation made contributions to the plan of $850,466 in 2013 and $822,872 in 2012. There have been no significant changes that affect the comparability of 2013 and 2012.

In the R&S 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 R&S Plan was between 65 percent and 80 percent funded at January 1, 2013 and 2012 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 R&S 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.

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 $185,604 in 2013 and $193,751 in 2012.

Note 7. 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 $216,559 for 2013 and $208,699 for 2012.

Note 8. 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 2013, 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 5.0%.

The funded status of the plan is as follows:

	2013	2012
Projected benefit obligation	($1,993,042)	($1,842,386)
Plan assets at fair value	-	-
Funded status	($1,993,042)	($1,842,386)

Note 8. Postretirement Benefits, continued

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

	2013	2012
Benefit obligation at beginning of year	$1,842,386	$1,700,793
Net periodic benefit cost:		
Service cost	117,558	125,595
Interest cost	105,474	97,437
	223,032	223,032
Benefits paid	(72,376)	(81,439)
Actuarial gain/loss	-	-
Benefit obligation at end of year	$1,993,042	$1,842,386

Projected retiree benefit payments for the next five years are expected to be as follows: 2014 - $74,000; 2015 - $74,000; 2016 - $68,000; 2017 - $66,000; 2018 - $65,000.

Note 9. 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 10. 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 11. 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 12. Contingencies

The Corporation, on occasion, 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.

* * * * * *