Owen Electric Cooperative, Inc.

Audited Financial Statements

December 31, 2016 and 2015

Owen Electric Cooperative, Inc.

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CPAs & ADVISORS

Independent Auditor's Report

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

We have audited the accompanying balance sheets of the Owen Electric Cooperative, Inc. ("the Cooperative") as of December 31, 2016 and 2015 and the related statements of income and comprehensive income (loss), changes in members' and patrons' equities and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our 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 of material misstatement.

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

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

Kentucky
Indiana
Ohio

Mountjoy Chilton Medley LLP
P 502.749.1900 | F 502.749.1930
2600 Meidinger Tower | 462 South Fourth Street | Louisville, KY 40202
www.mcmcpa.com | 888.587.1719
A Member of PrimeGlobal – An Association of Independent Accounting Firms

Independent Auditor's Report (Continued)

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Cooperative as of December 31, 2016 and 2015, 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 reported dated April 13, 2017, 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.

Mountjoy Chilton Medley LLP

Louisville, Kentucky
April 13, 2017

Owen Electric Cooperative, Inc.
Balance Sheets
December 31, 2016 and 2015

	2016	2015
Assets		
Electric Plant in Service, net	$ 138,722,252	$ 135,446,013
Investments		
Investment in East Kentucky Power Cooperative	72,183,727	65,140,644
Investments in associated organizations	5,600,301	5,566,698
Other	51,555	38,434
Total Investments	77,835,583	70,745,776
Current Assets		
Cash and equivalents	10,108,222	10,570,064
Accounts receivable - customers (net of allowance for doubtful accounts of $112,000 in 2016 and $100,016 in 2015)	16,266,488	14,855,851
Materials and supplies	869,833	803,794
Current portion of pension prepayment	591,857	591,857
Prepayments and other	363,689	403,194
Total Current Assets	28,200,089	27,224,760
Long term portion of pension prepayment	3,205,894	3,797,751
Deferred debits	489,820	121,551
Total Assets	$ 248,453,638	$ 237,335,851
Members' and Patrons' Equities and Liabilities		
Members' and Patrons' Equities		
Memberships	$ 1,189,060	$ 1,168,000
Patronage capital	117,660,669	107,690,553
Accumulated other comprehensive loss	(4,329,831)	(4,976,704)
Other equities	3,579,419	3,352,184
Total Members' and Patrons' Equities	118,099,317	107,234,033
Long-term Debt and Other Liabilities		
Long-term debt, less current maturities	80,443,456	84,782,690
Accrued compensated absences	2,057,937	1,952,355
Other long-term liabilities	112,724	124,544
Postretirement benefits obligation	14,988,468	14,873,226
Total Long-term Debt and Other Liabilities	97,602,585	101,732,815
Current Liabilities		
Current portion of long-term debt	4,181,243	4,131,541
Lines-of-credit	9,479,060	4,937,452
Accounts payable	13,016,884	11,844,935
Accrued interest	679,840	57,695
Customer guaranty deposits	2,317,533	2,369,875
Other current liabilities	1,064,059	758,631
Total Current Liabilities	30,738,619	24,100,129
Deferred credits	2,013,117	4,268,874
Total Members' and Patrons' Equities and Liabilities	$ 248,453,638	$ 237,335,851

See accompanying notes.

Owen Electric Cooperative, Inc.
Statements of Income and Comprehensive Income (Loss)
December 31, 2016 and 2015

	2016	%	2015	%
Operating Revenue				
Sale of electric energy				
Residential	$ 82,780,498	49.57 %	$ 83,000,218	50.92 %
Commercial	79,364,811	47.53	74,882,029	45.94
Public authorities and outdoor lighting	2,503,708	1.50	2,596,236	1.59
Total Sale of Electric Energy	164,649,017	98.60	160,478,483	98.45
Other Revenue	2,332,355	1.40	2,506,870	1.55
Total Operating Revenue	166,981,372	100.00	162,985,353	100.00
Operating Expenses				
Cost of power	128,136,426	76.74	124,320,035	76.28
Distribution expense	8,557,279	5.12	8,810,837	5.41
Power production expense	355,191	0.21	-	-
Customer accounts expense	3,899,714	2.34	3,887,882	2.39
Customer services and information expense	704,112	0.42	627,855	0.39
Administrative and general expense	5,097,979	3.05	4,638,389	2.85
Depreciation	12,014,642	7.20	11,614,014	7.13
Interest expense	4,312,402	2.58	4,441,780	2.73
Taxes	10	-	13,576	0.01
Total Operating Expenses	163,077,755	97.66	158,354,368	97.19
Net Operating Income	3,903,617	2.34	4,630,985	2.81
Non-operating Income				
Other margins	582,547	0.35	372,173	0.23
Patronage capital	7,245,779	4.34	6,940,099	4.26
Total Non-operating Income	7,828,326	4.69	7,312,272	4.49
Net Margins	11,731,943	7.03	11,943,257	7.30
Other Comprehensive Income (Loss)				
Change in postretirement benefit obligation	646,873	0.39	(3,890,193)	(2.39)
	$ 12,378,816	7.42 %	$ 8,053,064	4.91 %

See accompanying notes.

Owen Electric Cooperative, Inc.
Statements of Changes in Members' and Patrons' Equities
December 31, 2016 and 2015

		Patronage Capital				Accumulated Other Comprehensive Loss	Other Equities			Total Members' and Patrons' Equities
	Memberships	Assignable	Assigned	Retired	Total		Donated Capital	Retired Capital Credits Gains	Total	
Balance, January 1, 2015	$ 1,149,195	$ 11,372,571	$ 114,021,168	$ (28,441,161)	$ 96,952,578	$ (1,086,511)	$ 72,925	$ 3,083,468	$ 3,156,393	$ 100,171,655
Unrealized loss on accumulated pension benefit obligations	-	-	-	-	-	(3,890,193)	-	-	-	(3,890,193)
Memberships issued, net of terminations	18,805	-	-	-	-	-	-	-	-	18,805
Retirements of patronage capital to estates of deceased members:										
Paid in cash	-	-	-	(195,411)	(195,411)	-	-	-	-	(195,411)
Applied to unpaid bills	-	-	-	(9,352)	(9,352)	-	-	-	-	(9,352)
General capital credit refund:										
Paid in cash	-	-	-	(450,670)	(450,670)	-	-	-	-	(450,670)
Applied to unpaid bills	-	-	-	(435,574)	(435,574)	-	-	-	-	(435,574)
Transferred to capital gains	-	-	-	(114,270)	(114,270)	-	-	195,787	195,787	81,517
Net margins	-	11,943,257	-	-	11,943,257	-	-	-	-	11,943,257
Assignment of patronage capital	-	(12,874,361)	12,874,356	-	(5)	-	-	-	-	(5)
Forfeiture of memberships	-	-	-	-	-	-	4	-	4	4
Balance, December 31, 2015	1,168,000	10,441,467	126,895,524	(29,646,438)	107,690,553	(4,976,704)	72,929	3,279,255	3,352,184	107,234,033
Unrealized gain on accumulated pension benefit obligations	-	-	-	-	-	646,873	-	-	-	646,873
Memberships issued, net of terminations	21,060	-	-	-	-	-	-	-	-	21,060
Retirements of patronage capital to estates of deceased members:										
Paid in cash	-	-	-	(252,209)	(252,209)	-	-	-	-	(252,209)
Applied to unpaid bills	-	-	-	(8,349)	(8,349)	-	-	-	-	(8,349)
General capital credit refund:										
Paid in cash	-	-	-	(671,821)	(671,821)	-	-	-	-	(671,821)
Applied to unpaid bills	-	-	-	(673,254)	(673,254)	-	-	-	-	(673,254)
Transferred to capital gains	-	-	-	(156,194)	(156,194)	-	-	227,218	227,218	71,024
Net margins	-	11,731,943	-	-	11,731,943	-	-	-	-	11,731,943
Assignment of patronage capital	-	(11,943,257)	11,943,257	-	-	-	-	-	-	-
Forfeiture of memberships	-	-	-	-	-	-	17	-	17	17
Balance, December 31, 2016	$ 1,189,060	$ 10,230,153	$ 138,838,781	$ (31,408,265)	$ 117,660,669	$ (4,329,831)	$ 72,946	$ 3,506,473	$ 3,579,419	$ 118,099,317

See accompanying notes.

Owen Electric Cooperative, Inc.
Statements of Cash Flows
December 31, 2016 and 2015

	2016	2015
Cash Flows from Operating Activities		
Net Margins	$ 11,731,943	$ 11,943,257
Non-cash expenses included in net margins		
Patronage capital assigned but not paid by associated organizations	(7,245,779)	(6,940,099)
Depreciation	12,014,642	11,614,014
Bad debt expense	42,451	98,523
(Gain) Loss on disposition of general plant	(9,434)	79,425
Amortization of pension prepayment	591,857	591,857
Changes in current and non-current assets and liabilities:		
Accounts receivable	(1,453,088)	1,900,393
Materials and supplies	(66,039)	45,538
Prepayments and other	39,505	(13,683)
Accounts payable	1,171,949	(1,432,630)
Customer guaranty deposits	(52,342)	(24,688)
Deferred credits	(2,255,757)	430,563
Accrued interest and other current and long-term liabilities	915,753	(44,170)
Accrued compensated absences	105,582	68,782
Postretirement benefit obligation	762,115	56,474
Net Cash Provided by Operating Activities	16,293,358	18,373,556
Cash Flows from Investing Activities		
Increase in deferred debits	(368,269)	(42,596)
Additions to electric plant in service	(9,984,501)	(8,427,405)
Removal cost	(5,296,946)	(4,170,634)
Patronage capital received from associated organizations	155,972	164,673
Net Cash Used in Investing Activities	(15,493,744)	(12,475,962)
Cash Flows from Financing Activities		
Payment of principal on long-term notes payable	(3,786,253)	(4,131,649)
Change in cushion of credit	(503,279)	(1,549,452)
Membership fees	21,060	18,805
Patronage capital paid out	(1,534,592)	(1,009,491)
Net activity on lines-of-credit	4,541,608	(706,055)
Net Cash Used in Financing Activities	(1,261,456)	(7,377,842)
Decrease in Cash and Equivalents During the Year	(461,842)	(1,480,248)
Cash and Equivalents, Beginning of Year	10,570,064	12,050,312
Cash and Equivalents, End of Year	$ 10,108,222	$ 10,570,064
Supplemental Disclosures of Cash Flow Information		
Interest paid	$ 3,690,257	$ 4,454,122
Removal of metering system	-	3,590,324

See accompanying notes.

Owen Electric Cooperative, Inc.
Notes to Financial Statements
December 31, 2016 and 2015

Note A - Nature of Operations

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

Note B - Summary of Significant Accounting Policies

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

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

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

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

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

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

   The amount recorded on the financial statements for the over recovery of the fuel adjustment surcharge at December 31, 2016 and 2015 was $1,031,324 and $679,447, respectively. The amount of the over recovery of the environmental cost recovery mechanism at December 31, 2016 and 2015 was $31,310 and $2,755,914, respectively.

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

Note B - Summary of Significant Accounting Policies (Continued)

6. Electric Plant in Service (Continued): Depreciation is provided using the straight-line method at rates which are designed to amortize the cost of depreciable plant, net of estimated salvage value, over its estimated useful life. The composite depreciation rate for distribution plant was approximately 4.8% for 2016 and 2015. General plant is being depreciated using specific identification straight-line method over the following estimated useful lives:

Structures and improvements	5 - 50
Miscellaneous equipment	5 - 20
Office, stores and lab equipment	3 - 20
Communication equipment	12
Transportation equipment	4 - 10
Power-operated equipment	7

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

The Cooperative constructed a two megawatt natural gas distributed generation ("DG") unit, which was declared commercially operational in June 2016. The DG unit was constructed to displace a portion of the Cooperative's purchased power costs. The cost of the DG unit is reflected in production plant, and is being depreciated on a straight-line basis over 20 years.

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

	December 31, 2016	December 31, 2015
Distribution plant	$ 236,096,828	$ 227,220,758
General plant	24,909,180	26,350,574
Production plant	2,476,862	-
Construction in progress	1,859,215	1,786,248
	265,342,085	255,357,580
Accumulated Depreciation	126,619,833	119,911,567
Electric Plant in Service, net	$ 138,722,252	$ 135,446,013

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

8. Advertising Costs: The Cooperative records advertising expenses as they are incurred. Advertising expense amounted to $279,700 and $281,895 for the years ended December 31, 2016 and 2015, respectively.

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

Note B - Summary of Significant Accounting Policies (Continued)

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

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

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

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

    Comprehensive income (loss) is the change in equity of an enterprise during the year from transactions and other events and circumstances arising from non-operating sources. The Cooperative's total comprehensive income (loss) includes amounts associated with the change in the postretirement benefits obligation. (See Note I.)

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

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

14. Other: The Cooperative has a collective bargaining agreement with approximately 38% of its full-time employees. During 2015 the agreement was renegotiated, and is effective through July 31, 2020. There were no material modifications to the renegotiated agreement.

15. Reclassifications: Certain amounts for 2015 have been reclassified to conform to the 2016 presentation. The reclassifications had no effect on total assets, liabilities, or net income.

16. Recent Accounting Pronouncements: On May 28, 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*. The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. This standard also includes expanded disclosure requirements that result in an entity providing users of financial statement with comprehensive information about the nature, amount, timing, and uncertainty of revenue and cash flows arising from the entity's contracts with customers. This standard will be effective for the calendar year ending December 31, 2019.

Note B - Summary of Significant Accounting Policies (Continued)

16. Recent Accounting Pronouncements (Continued): In February 2016, the FASB issued ASU 2016-02, *Leases*. The standard requires all leases with lease terms over 12 months to be capitalized as a right-of-use asset and lease liability on the balance sheet at the date of lease commencement. Leases will be classified as either finance or operating. This distinction will be relevant for the pattern of expense recognition in the statement of income and comprehensive income (loss). This standard will be effective for the calendar year ending December 31, 2020.

    In June 2016, the FASB issued ASU 2016-13, *Financial Instruments-Credit Losses*. The standard requires a financial asset (including trade receivables) measured at amortized cost basis to be presented at the net amount expected to be collected. Thus, the statement of income and comprehensive income (loss) will reflect the measurement of credit losses for newly-recognized financial assets as well as the expected increases or decreases of expected credit losses that have taken place during the period. This standard will be effective for the calendar year ending December 31, 2021.

    The Cooperative is currently in the process of evaluating the impact of adoption of these ASUs on the financial statements.

Note C - Investments

East Kentucky Power Cooperative ("EKPC"):

The Cooperative's investment of $72,183,727 and $65,140,644 at December 31, 2016 and 2015, respectively, in EKPC, the sole supplier of power to the Cooperative, represents the Cooperative's equity ownership interest (approximately 12%) in EKPC. The Cooperative owed EKPC $12,243,492 and $11,038,906 for its power bill at December 31, 2016 and 2015, respectively. These amounts are included in accounts payable on the balance sheets.

Associated Organizations:

Investments in associated organizations consisted of:

	December 31, 2016	December 31, 2015
United Utility Supply Cooperative	$ 946,758	$ 940,633
Kentucky Association of Electric Cooperatives, Inc.	121,515	121,515
National Rural Utilities Cooperative Finance Corporation	930,548	900,952
Capital Term Certificates of National Rural Utilities Cooperative Finance Corporation	1,520,926	1,554,018
Southeastern Data Cooperative, Inc.	315,258	315,845
National Rural Telecommunications Cooperative	1,412,992	1,414,158
Other	352,304	319,577
	$ 5,600,301	$ 5,566,698

Note C - Investments (Continued)

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

United Utility Supply Cooperative ("United") is a primary supplier of transformers and overhead line materials and supplies. The Cooperative's purchases from United amounted to $1,626,168 and $1,741,502 for the years ended December 31, 2016 and 2015, respectively. The Cooperative owed United $30,276 and $24,281 at December 31, 2016 and 2015, respectively. These amounts are included in accounts payable on the balance sheets.

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

Southeastern Data Cooperative, Inc. ("Southeastern") is a primary supplier of data processing services and computer hardware and software. The Cooperative's purchases from Southeastern were $958,611 and $1,028,517 for the years ended December 31, 2016 and 2015, respectively. The Cooperative owed Southeastern $71,834 and $83,410 at December 31, 2016 and 2015, respectively. These amounts are included in accounts payable on the balance sheets.

Note D - Income Tax Status

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

Note E - Lines-of-credit

At December 31, 2016 and 2015, the Cooperative had an unsecured available line-of-credit of $22,800,000 from the NRUCFC. The interest rate for this line-of-credit was 2.50% and 2.90% at December 31, 2016 and 2015, respectively. The maturity date for the line-of-credit is December 31, 2049. The Cooperative had an outstanding balance under the line-of-credit of $9,479,060 and $4,937,452 at December 31, 2016 and 2015, respectively.

At December 31, 2016 and 2015, the Cooperative had a second unsecured available line-of-credit of $15,000,000 with CoBank. There were no borrowings under this line-of-credit at December 31, 2016 and 2015.

Note F - Long-term Debt

Long-term debt consisted of the following:

	December 31, 2016	December 31, 2015
Mortgage notes payable to the Rural Utilities Services due in quarterly installments of varying amounts through 2043:		
0.500% first mortgage notes	$ 1,922,595	$ 2,062,336
2.521% first mortgage notes	5,501,171	5,605,819
2.806% first mortgage notes	4,035,131	4,108,591
2.809% first mortgage notes	6,360,049	6,475,782
3.894% first mortgage notes	3,428,021	3,480,591
4.190% first mortgage notes	6,064,278	6,210,910
4.375% first mortgage notes	972,342	1,024,325
4.440% first mortgage notes	7,800,180	7,982,489
4.460% first mortgage notes	11,331,170	11,594,780
4.815% first mortgage notes	2,837,020	2,893,893
4.917% first mortgage notes	815,320	831,458
5.192% first mortgage notes	4,146,236	4,225,512
5.277% first mortgage notes	9,762,857	9,947,531
5.298% first mortgage notes	8,666,518	8,893,980
5.375% first mortgage notes	1,078,304	1,131,327
5.417% first mortgage notes	2,189,718	2,246,505
5.913% first mortgage notes	2,013,177	2,062,826
	78,924,087	80,778,655
Less: Unapplied Payments	10,380,696	9,877,417
	68,543,391	70,901,238
Notes payable to CoBank, interest at 3.90% and 4.35% due April 2028 and July 2041, respectively	4,937,646	5,104,209
Mortgage notes payable to the NRUCFC due in quarterly installments of varying amounts through 2030:		
Variable and fixed rate first mortgage notes (1)	11,143,662	12,908,784
	84,624,699	88,914,231
Less Current Maturities	4,181,243	4,131,541
	$ 80,443,456	$ 84,782,690

(1) Interest rates on the variable rate notes vary monthly and are determined by the NRUCFC based on their cost of money plus adders for margins and administrative costs (2.50% and 2.90% at December 31, 2016 and 2015, respectively).

Note F - Long-term Debt (Continued)

The aggregate principal maturities of long-term debt as of December 31, 2016 are as follows:

2017	$ 4,181,243
2018	4,293,754
2019	4,367,715
2020	4,497,725
2021 and thereafter	67,284,262
	$ 84,624,699

Substantially all utility plant is pledged as collateral for the above notes. Under the terms of the loan agreements, the Cooperative is required to meet certain financial performance covenants. The Cooperative is in compliance with these covenants at December 31, 2016 and 2015.

The Cooperative has established a cushion of credit program administered by RUS. Under the cushion of credit program, RUS borrowers may make voluntary irrevocable deposits into a special account. The account balance accrued interest at a rate of 5 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 RUS. At December 31, 2016 and 2015, balances in the cushion of credit program were $10,380,696 and $9,877,417, respectively.

In January 2014, the Cooperative submitted to RUS a loan application in the amount of $30,000,000. This loan was approved by RUS in November 2014. No amounts have been advanced on this loan during 2016 and 2015.

Note G - Members' and Patrons' Equities

Under terms of its long-term debt agreements, return of capital contributions or patronage capital to the Cooperative's members and patrons is restricted to amounts which would not allow total equity to be less than 30% of total assets, except that distributions may be made to estates of deceased members provided that such distributions do not exceed 25% of total patronage capital and margins received in the previous year. Total equity as a percentage of assets can fall below the 30% requirement if the Cooperative has obtained the appropriate waiver from the RUS. The Cooperative is in compliance with these requirements at December 31, 2016 and 2015.

Note H - Retirement Benefits

Effective January 1, 1988, the Cooperative entered into a multi-employer defined benefit pension plan sponsored by the National Rural Electric Cooperative Association ("NRECA"). The NRECA Retirement Security Plan ("RS Plan") is a defined benefit pension plan qualified under Section 401 and tax-exempt under Section 501(a) of the Internal Revenue Code. It is a multi-employer 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 multi-employer 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.

Note H - Retirement Benefits (Continued)

The Cooperative contributions to the RS Plan in 2016 and in 2015 represented less than 5 percent of the total contributions made to the plan by all participating employers. The Cooperative made contributions to the Plan of $1,924,615 and $1,874,009 in 2016 and 2015, respectively. There have been no significant changes that affect the comparability of 2016 and 2015 contributions.

In the RS Plan, a "zone status" determination is not required, and therefore not determined, under the Pension Protection Act ("PPA") of 2006. In addition, the accumulated benefit obligations and plan assets are not determined or allocated separately by individual employer. In total, the Retirement Security Plan was over 80% funded at January 1, 2016 and January 1, 2015 based on the PPA funding target and PPA actuarial value of assets on those dates.

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

At the December 2012 meeting of the I&FS Committee of the NRECA Board of Directors, the Committee approved an option to allow participating cooperatives in the RS Plan to make a contribution prepayment and reduce future required contributions. The prepayment amount is a cooperative's share, as of January 1, 2013, of future contributions required to fund the RS Plan's unfunded value of benefits earned to date using RS Plan actuarial valuation assumptions. The prepayment amount will typically equal approximately 2.5 times a cooperative's annual RS Plan required contribution as of January 1, 2013. After making the prepayment, for most cooperatives the billing rate is reduced by approximately 25%, retroactive to January 1, 2013. The 25% differential in billing rates is expected to continue for approximately 15 years. However changes in interest rates, asset returns and other plan experience different from expected, plan assumption changes and other factors may have an impact on the differential in billing rates and the 15 year period. The Cooperative's pension prepayment, both current and long term, as reflected on the balance sheets was $3,797,751 and $4,389,608 as of December 31, 2016 and 2015, respectively.

During 2015 the Cooperative established a 457(b) plan with NRECA. The President and CEO of the Cooperative is eligible to participate in this plan and must agree to salary deferrals based on deferral limits established by the Internal Revenue Code. The participant becomes 100% vested and the account balance is paid when the participant reaches age 70 ½ or is no longer providing services to the Cooperative, whichever is later. The Cooperative owns the funds until they are distributed to the participant.

The Owen Electric Cooperative Employee Savings and Protection Plan, established April 1, 1986, is a defined contribution plan available to employees of the Cooperative upon completion of three months of service. The Cooperative makes annual matching contributions equal to 100% of all deferred salary reductions up to a 4% maximum employer contribution. The Cooperative's expense for 2016 and 2015 was $370,932 and $366,767, respectively.

Note I - Postretirement Benefits

The Cooperative provides postretirement medical benefits to its retired employees and their dependents. The Plan requires retiree contributions based on years of service at retirement. "Employers' Accounting for Postretirement Benefits Other Than Pensions," requires the accrual of the cost of providing certain postretirement benefits over the employees' years of service, rather than on a pay-as-you-go (cash) basis.

Note I - Postretirement Benefits (Continued)

In accordance with the provision of "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans," the Cooperative has recorded an accrued benefit cost for the full benefit obligation as of December 31, 2016 and 2015.

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

	December 31, 2016	December 31, 2015
Benefit obligation	$ 14,988,468	$ 14,873,226
Fair value of plan assets	-	-
Funded Status	$ (14,988,468)	$ (14,873,226)
Accrued benefit cost recognized in the balance sheets	$ (14,988,468)	$ (14,873,226)
Weighted-average assumptions		
Discounted rate	4.10%	4.30%

For measurement purposes, the health care cost trend rate is assumed to be 7.0% in 2016 and 7.5% in 2015. During 2016 and 2015, the rate was assumed to decrease by 0.5% per year to a minimum of 4.5% for 2016 and 2015.

Other information, per the actuarial report, as of December 31, 2016, regarding the Cooperative's benefit plans, is as follows:

	December 31, 2016	December 31, 2015
Benefit cost	$ 1,255,959	$ 967,305
Benefits paid	443,093	416,538

Note J - Concentrations of Revenues, Receivables and Cash

All of the Cooperative's sales are made in portions of nine counties in north central Kentucky, which is primarily an agricultural region. However, a significant portion of the Cooperative's Northern service territory has become increasingly developed with suburban residential and commercial activity. Accounts receivable and customer deposits at December 31, 2016 and 2015, were derived from the various classes of customers in approximately the same proportion as the revenues shown in the accompanying statements of income and other comprehensive income (loss).

On September 1, 2010, the Cooperative and EKPC entered into a five year electric service extension agreement with Nucor Steel Gallatin. The Cooperative is to provide electric power to Nucor Steel Gallatin's manufacturing facilities in Gallatin County, Kentucky, the first of which began operations June 1, 1995. This agreement remains in effect at December 31, 2016. The agreement will remain in effect after the initial five-year term unless one of the parties gives twelve months advanced written notice to cancel the agreement. Sales to Nucor Steel Gallatin in 2016 and 2015 totaled $39,899,870 and $36,398,182, respectively. Receivables from Nucor Steel Gallatin were $3,601,283 and $3,695,108 at December 31, 2016 and 2015, respectively.

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

The Cooperative maintains its cash balances with banks throughout Kentucky. The Federal Deposit Insurance Corporation ("FDIC") provides federal deposit insurance coverage up to $250,000 per depositor. As of December 31, 2016 and 2015, there were uninsured balances in the Cooperative's interest and non-interest bearing accounts totaling approximately $8,302,000 and $9,098,000, respectively.

Note K - Fair Value Measurements

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

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

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

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

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

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

At December 31, 2016 and 2015, financial instruments consisted patronage capital whose carrying value is determined based on an allocation by a third party and are measured using Level 2.

Note L - Subsequent Event

On December 29, 2016, the Cooperative's Board of Directors approved the prepayment of RUS Qualified Notes. Additionally, the Board of Directors approved the application to CoBank for a loan up to $29,500,000 to be used to prepay the RUS Qualified Notes. The interest rates associated with the RUS Qualified Notes ranged from .50% to 5.375%, and the 2016 balance totaled $29,168,869. The RUS Qualified Notes are being refinanced with CoBank at a fixed interest rate of 3.63%. On March 28, 2017, the loan closing with CoBank was complete and resulted in a new loan in the amount of $28,965,674. The KPSC approved the borrowing from CoBank and prepayment to RUS.

Other Required Reports

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

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the accompanying financial statements and related notes to the financial statements of Owen Electric Cooperative, Inc. ("the Cooperative") as of and for the year ended December 31, 2016, and have issued our report thereon dated April 13, 2017.

Internal Control Over Financial Reporting

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

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

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

Mountjoy Chilton Medley LLP
P 502.749.1900 | F 502.749.1930
2600 Meidinger Tower | 462 South Fourth Street | Louisville, KY 40202
www.mcmcpa.com | 888.587.1719
A Member of PrimeGlobal – An Association of Independent Accounting Firms

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

Compliance and Other Matters

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

Purpose of this Report

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

Mountjoy Chilton Medley LLP

Louisville, Kentucky
April 13, 2017

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

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

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Owen Electric Cooperative, Inc., ("the Cooperative"), which comprise the balance sheet as of December 31, 2016, and the related statements of income and comprehensive income (loss), changes in members' and patrons' equities and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated April 13, 2017. In accordance with *Government Auditing Standards*, we have also issued our report dated April 13, 2017, on our consideration of Cooperative's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. No reports other than the reports referred to above have been furnished to management.

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

- Maintain adequate and effective accounting procedures;
- Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts;
- Reconcile continuing property records to the controlling general ledger plant accounts;
- Clear construction accounts and accrue depreciation on completed construction;
- Record and properly price the retirement of plant;

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P 502.749.1900 | F 502.749.1930
2600 Meidinger Tower | 462 South Fourth Street | Louisville, KY 40202
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Independent Auditor's Report on Compliance with Aspects of Contractual Agreements and Regulatory Requirements for Electric Borrowers (Continued)

- Seek approval of the sale, lease or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap;

- Maintain adequate control over materials and supplies;

- Prepare accurate and timely Financial and Operating Reports;

- Obtain written RUS approval to enter into any contract for the management, operation, or maintenance of the borrower's system if the contract covers all or substantially all of the electric system;

- Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles;

- Record depreciation in accordance with RUS requirements (See RUS Bulletin 183-1, Depreciation Rates and Procedures);

- Comply with the requirements for the detailed schedule of deferred debits and deferred credits; and

- Comply with the requirements for the detailed schedule of investments.

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

Mountjoy Chilton Medley LLP

Louisville, Kentucky
April 13, 2017