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Clark Energy Cooperative

Winchester, Kentucky

Report on Audits of Financial Statements

for the years ended April 30, 2004 and 2003

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Independent Auditor's Report

I have audited the balance sheets of Clark Energy Cooperative, as of April 30, 2004 and 2003, and the related statements income and patronage capital and cash flows for the years then ended. These financial statements are the responsibility of Clark Energy Cooperative's management. My responsibility is to express an opinion on these financial statements based on my audits.

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

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Clark Energy Cooperative as of April 30, 2004 and 2003, and the results of operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, I have also issued a report dated June 15, 2004, on my consideration of Clark Energy Cooperative's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of my audit.

Alan Zumstein

Alan M. Zumstein
June 15, 2004

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I have audited the financial statements of Clark Energy Cooperative as of and for the years ended April 30, 2004 and 2003, and have issued my report thereon dated June 15, 2004. I conducted my audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

<u>Compliance</u>

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

<u>Internal Control Over Financial Reporting</u>

In planning and performing my audit, I considered Clark Energy Cooperative's internal control over financial reporting in order to determine my auditing procedures for the purpose of expressing my opinion on the financial statements and not to provide assurance on the internal control over financial reporting. My consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatement in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. I noted no matters involving the internal control over financial reporting and its operation that I consider to be material weaknesses.

This report is intended for the information of the audit committee, management, the Rural Utilities Service and supplemental lenders. However, this report is a matter of public record and its distribution is not limited.

Alan Zumstein

Alan M. Zumstein
June 15, 2004

Clark Energy Cooperative, Inc.

Balance Sheets, April 30, 2004 and 2003

Assets	2004	2003
Electric Plant, at original cost:		
In service	$77,367,369	$71,814,567
Under construction	289,933	859,163
	77,657,302	72,673,730
Less accumulated depreciation	10,004,761	9,008,152
	67,652,541	63,665,578
Investments in Associated Organizations	9,593,276	8,258,621
Current Assets:		
Cash and cash equivalents	278,262	1,488,906
Accounts receivable, less allowance for 2004 of $54,167 and 2003 of $79,794	1,494,318	1,723,107
Material and supplies, at average cost	605,510	395,521
Other current assets	159,089	217,237
	2,537,179	3,824,771
Past Service Pension Costs	-	35,146
Total	$79,782,996	$75,784,116
Members' Equities and Liabilities		
Members' Equities:		
Patronage capital	$27,654,307	$25,159,283
Other equities	470,325	470,325
	28,124,632	25,629,608
Long Term Debt	46,241,253	44,932,020
Accumulated Postretirement Benefits	781,285	782,700
Current Liabilities:		
Current portion of long term debt	1,550,000	1,325,000
Short term notes payable	100,000	-
Accounts payable	590,901	688,286
Consumer deposits	665,547	657,241
Accrued expenses	1,349,908	1,315,319
	4,256,356	3,985,846
Consumer Advances and Meter Installations	379,470	453,942
Total	$79,782,996	$75,784,116

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

Statements of Revenue and Patronage Capital
for the years ended April 30, 2004 and 2003

	2004	2003
Operating Revenues	$29,174,706	$28,579,800
Operating Expenses:		
Cost of power	17,267,078	16,864,073
Distribution - operations	1,282,556	1,159,098
Distribution - maintenance	1,923,937	2,008,506
Consumer accounts	1,016,985	1,018,783
Customer services	206,089	216,459
Sales	136,647	108,130
Administrative and general	2,080,020	1,384,254
Depreciation, excluding $307,823 in 2004 and $242,480 in 2003 charged to clearing accounts	2,419,762	2,228,193
Taxes	35,069	34,392
	26,368,143	25,021,888
Operating margins before interest charges	2,806,563	3,557,912
Interest Charges:		
Interest on long-term debt	1,622,999	1,736,950
Other interest expense	51,015	53,471
	1,674,014	1,790,421
Operating margins after interest charges	1,132,549	1,758,037
Patronage Capital Assigned by:		
East Kentucky Power Cooperative, Inc.	1,251,332	1,554,499
Other organizations	44,055	44,725
	1,295,387	1,599,224
Net Operating Margins	2,427,936	3,357,261
Nonoperating Margins:		
Interest income	50,503	81,157
Others	16,585	(119,613)
	67,088	(38,456)
Net Margins	2,495,024	3,328,259
Patronage Capital, beginning of year	25,159,283	21,831,024
Patronage Capital, end of year	$27,654,307	$25,159,283

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

Statements of Cash Flows

for the years ended April 30, 2004 and 2003

	2004	2003
Cash Flows from Operating Activities:		
Net margins	$2,495,024	$3,328,259
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation:		
Charged to expense	2,419,762	2,228,193
Charged to clearing accounts	307,823	242,480
Patronage capital credits assigned,	(1,295,387)	(1,599,224)
Accumulated postretirement benefits	(1,415)	11,781
Change in assets and liabilities:		
Receivables	228,789	(472,804)
Material and supplies	(209,989)	57,406
Other current assets	58,148	(39,484)
Past service pension costs	35,146	35,145
Payables	(97,385)	277,569
Consumer deposits	8,306	17,473
Accrued expenses	34,589	88,338
Consumer advances and others	(74,472)	(56,698)
	3,908,939	4,118,434
Cash Flows from Investing Activities:		
Plant additions	(6,753,012)	(7,325,733)
Salvage recovered from plant retirements	38,464	80,346
Additional investments, net	(39,267)	(86,244)
	(6,753,815)	(7,331,631)
Cash Flows from Financing Activities:		
Additional long-term borrowings	2,500,000	6,236,000
Payments on long-term debt	(1,468,473)	(1,287,510)
Payment for cushion of credit	502,705	(500,000)
Short-term borrowings	100,000	(350,000)
	1,634,232	4,098,490
Net increase in cash	(1,210,644)	885,293
Cash and cash equivalents, beginning of year	1,488,906	603,613
Cash and cash equivalents, end of year	$278,262	$1,488,906
Supplemental cash flows information:		
Interest paid on long-term debt	$1,625,782	$1,761,334

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

1. Summary of Significant Accounting Policies

Clark Energy maintains its records in accordance with 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, less contributions, which is the cost when first dedicated to public service. Such amount includes applicable supervisory and overhead costs. There was no interest capitalized on construction for 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 cost of units of property replaced or retired, including cost of removal net of any salvage value, is charged to accumulated depreciation for distribution plant. A gain or loss is recognized upon the retirement of general plant items.

The major classifications of electric plant in service consisted of:

	2004	2003
Distribution plant	$70,162,925	$66,162,400
General plant	7,204,444	5,652,167
Total	$77,367,369	$71,814,567

Depreciation

Provision has been made for depreciation on the basis of the estimated lives of assets, using the straight-line method. Clark Energy uses a composite depreciation rate of 3.0% per annum for distribution plant. General plant depreciation rates are as follows:

Structures and improvements	2%
Office furniture and fixtures	7%
Transportation equipment	15.6%
Other general plant	6% - 13%

Revenue

Revenue is recorded as billed to consumers, based on monthly meter reading cycles. Clark Energy's sales are concentrated in a portion of eleven eastern Kentucky counties. Certain consumers are required to pay a refundable deposit. There were no consumers whose individual account balance exceeded 10% of outstanding accounts receivable at April 30, 2004 or 2003.

Continued

1. Summary of Significant Accounting Policies, continued

Estimates

The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that effect the reported amounts of 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.

Purchase Power

Cost of power is recorded in the period in which the power bill is received, rather than the period of actual usage. Clark Energy does not accrue the liability for power purchased. The cost of power sold but not recorded at April 30, 2004 was $1,280,232 and 2003 was $1,082,757.

Fair Value of Financial Instruments

Financial instruments include cash, temporary investments and long-term debt. Investments in associated organizations are not considered a financial instrument because they represent non transferable interests in associated organizations.

The carrying value of cash and temporary investments approximates fair value because of the short maturity of those instruments. The fair value of long-term debt approximates the fair value because of the borrowing policies of Clark Energy.

Off Balance Sheet Risk

Clark Energy has off balance sheet risk in that at certain times of the month they have cash deposits in financial institutions in excess of the amounts insured by the Federal Deposit Insurance Corporation (FDIC).

Statement of Cash Flows

For purposes of the statement of cash flows, Clark Energy considers temporary investments having a maturity of three months or less to be cash equivalents.

Subsidiary Activities

Clark Energy has a wholly-owned subsidiary corporation that provides non electric services to its consumers and others. Clark Energy is also a 75% owner of a subsidiary corporation that provides propane gas services to its consumers and others. The revenues, net income and investment in the subsidiaries are considered immaterial to the financial statements as a whole, therefore, consolidated financial statements are not filed.

Continued

2. Investments in Associated Organizations

Clark Energy records patronage capital assigned by associated organizations in the year in which such assignments are received.

The Capital Term Certificates (CTCs) of National Rural Utilities Cooperative Finance Corporation (NRUCFC) are recorded at cost. The CTCs were purchased from NRUCFC 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 and others consisted of:

	2004	2003
Associated organizations:		
East Kentucky Power Cooperative, Inc.	$7,209,391	$5,958,059
National Rural Utilities Cooperative Finance Corporation	1,107,292	1,117,237
Subsidiary	699,457	625,719
Other associated organizations	293,233	276,048
Others:		
Cash value of life insurance policy	283,903	281,558
Total	$9,593,276	$8,258,621

3. Patronage Capital

Patronage capital consisted of:

	2004	2003
Assigned to date	$26,905,660	$24,498,378
Assignable	748,647	660,905
Total	$27,654,307	$25,159,283

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 net margins for the next preceding year, Clark Energy may distribute the difference between 25% and the payments made to such estates. The equities and margins of Clark Energy represent 35% of the total assets at April 30, 2004.

Continued

3. Patronage Capital, continued

In connection with a rate increase effective April 26, 1993, Clark Energy agreed to make patronage capital distributions in the amount by which annual margins exceed a 2.0 Modified Times Interest Earned ratio. The period of measurement is a calendar year. There were no calculated minimum distributions. Clark Energy will record the estimated liability, if any, for patronage capital distributions at the end of each calendar year.

4. Long Term Debt

All assets, except vehicles, are pledged as collateral on the long-term debt to United States of America (RUS) Federal Financing Bank (FFB) and NRUCFC under a joint mortgage agreement. Long term debt consisted of:

	2004	2003
First mortgage notes due RUS:		
2%	$180,237	$247,665
1.125% to 6%	$20,798,770	$21,471,754
Advance payment	-	(502,705)
	20,979,007	21,216,714
First mortgage notes due FFB:		
0.942% to 5.086% (1.142% and 5.086% in 2003)	21,239,541	19,221,892
First mortgage notes due NRUCFC:		
7%	159,117	187,726
5.70% fixed	1,134,316	1,255,594
2.65% variable rate (3.35% in 2003)	4,279,272	4,375,094
	5,572,705	5,818,414
	47,791,253	46,257,020
Less current portion	1,550,000	1,325,000
Total long term debt	$46,241,253	$44,932,020

The interest rates on notes payable to NRUCFC at 5.70% are subject to change every seven years. The 2.65% interest rate notes to NRUCFC adjusts monthly and may be converted to fixed rate at any time upon Board approval by Clark Energy.

The long term debt payable to RUS, FFB and NRUCFC is due in monthly and quarterly installments of varying amounts through 2030. Clark Energy has unadvanced loan funds available at April 30, 2004 from FFB in the amount of $17,045,000. These funds will be used for plant expansion.

Continued

4. Long Term Debt, continued

As of April 30, 2004, the annual current portion of long term debt outstanding for the next five years are as follows: 2005 - $1,550,000; 2006 - $1,650,000; 2007 - $1,750,000; 2008 - $1,850,000; 2009 - $1,950,000.

5. Short Term Notes Payable

Clark Energy has executed a short-term line of credit agreement, including a note payable, with NRUCFC in the amounts of $4,000,000 and $2,300,000. Clark Energy had $100,000 advanced against this line of credit as of April 30, 2004 at an interest rate of 2.80%.

6. Employee Benefits

Pension Plan

All eligible employees of Clark Energy participate in the NRECA Retirement and Security Program, a defined benefit pension plan qualified under section 401 and tax-exempt under section 501(a) of the Internal Revenue Code. Clark Energy makes annual contributions to the Program equal to the amounts accrued for pension expense. Contributions were $415,119 for 2004 and $411,129 for 2003. In this multiemployer plan, which is available to all member cooperatives of NRECA, the accumulated benefits and plan assets are not determined or allocated separately by individual employer.

Savings Plan

Clark Energy has a Retirement Savings Plan for all employees who are eligible to participate in Clark Energy's benefit programs. The plan allows participants to make contributions by salary reduction, pursuant to Section 401(k) of the Internal Revenue Code. Clark Energy will match 50% of the contributions of each participant up to 4% of the participant's base compensation. If the employee does not participate, Clark Energy will contribute one-half (1/2%) percent of base compensation. Clark Energy contributed $71,581 in 2004 and $67,293 in 2003. Participants vest immediately in their contributions and the contributions of Clark Energy.

7. Accumulated Postretirement Benefits

Clark Energy sponsors a defined benefit plan that provides medical coverage to retirees and their dependents. Participating retirees and dependents contribute 75 percent of the cost of coverage. For purposes of the liability estimates, the substantive plan is assumed to be the same as the extant written plan. Postretirement benefits are not funded.

Continued

7. Accumulated Postretirement Benefits, continued

The following is a reconciliation of the postretirement benefit obligation for 2004 and 2003:

	2004	2003
Postretirement Benefit Obligation:		
Balance, beginning of period	$782,700	$770,919
Recognition of components of net periodic postretirement benefit cost:		
Service cost	24,400	22,600
Interest cost	45,000	42,000
Amortization of gains or losses	(5,000)	(5,000)
	64,400	59,600
Benefits paid to participants	(65,815)	(47,819)
Net change	(1,415)	11,781
Balance, end of period	$781,285	$782,700

At April 30, 2004 and 2003, the funded status of the plan was as follows:

	2004	2003
Accumulated postretirement benefit obligation	$667,503	$663,918
Plan assets at fair value	-	-
Funded status	667,503	663,918
Unrecognized net gain from changes in assumptions	113,782	118,782
Accrued postretirement benefit cost	$781,285	$782,700

For measurement purposes, a 8% annual rate of increase, decreasing by 0.5% until 5.5%, in the per capita cost of covered health care benefits was assumed. The discount rate used in determining the accumulated postretirement benefit obligation was 7% for 2004 and 2003.

8. Related Party Transactions

Several of the Board of Directors, the President and CEO and another employee of Clark Energy are on the Board of Directors of associated organizations.

Clark Energy conducts business with its wholly-owned subsidiary. Clark Energy provides office space and facilities. The wholly-owned subsidiary pays a monthly rental fee of $325 per month. The lease is an operating lease and can be canceled with advance notice by either party.

Continued

9. Income Tax Status

Clark Energy is exempt from federal and state income taxes under provisions of Section 501(c)(12). Accordingly, the financial statements include no provision for income taxes.

10. Contingencies and Commitments

Electric power sold by Clark Energy is purchased from East Kentucky. The membership of East Kentucky is comprised of Clark Energy and 15 other distribution cooperatives.

Under its wholesale power agreement, Clark Energy is committed to purchase its electrical power and energy requirements from East Kentucky until 2025. The rates are subject to approval by the PSC.

Clark Energy is contingently liable as guarantor for approximately $549,000 of long term debt of East Kentucky to RUS, NRUCFC and institutional investors. Substantially all assets of Clark Energy are pledged as collateral for this guarantee, in addition to the pledge in the mortgage agreement referred to in Note 4. This contingent liability was part of an overall financing plan for the construction of a generating facility near Maysville, Kentucky.

Clark Energy 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, on an as needed basis. The duration of these contracts are either one or two years.

11. Risk Management

Clark Energy is exposed to various risks of loss to torts, theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters.

Clark Energy carries commercial insurance for all risks of loss, including workers' compensation, general liability and property loss insurance. As is customary in the utility industry, utility plant is not insured. Settled claims resulting from these risks have not exceeded commercial insurance coverage in 2003 or 2002.

12. Deferred Meter Installations

Starting in 2002, Clark Energy is purchasing and installing automated meter reading devices (AMR). In conjunction with the AMR devices, Clark Energy purchased additional meters that are compatible with the AMR devices. These meters will be installed in the future during the normal course of business. Since the meters were purchased in bulk, the estimated installation cost has been recorded as a deferred credit until the meters are actually installed. As of April 30, 2004, there was $155,175 of estimated installation costs recorded as a deferred credit.

13. Advertising

Clark Energy expenses advertising as incurred. Advertising expense for 2004 was $5,933 and for 2003 was $13,246.