DUKE ENERGY®

RECEIVED

MAR 18 2016

PUBLIC SERVICE COMMISSION

Mailing Address
139 East Fourth Street
1303-Main / P.O. Box 960
Cincinnati, Ohio 45202

o: 513-287-4320
f: 513-287-4385

Rocco.O.D'Ascenzo@duke-energy.com
Rocco O. D'Ascenzo
Associate General Counsel

VIA OVERNIGHT DELIVERY

March 17, 2016

Mr. Jeff Cline
Public Service Commission
Commonwealth of Kentucky
211 Sower Boulevard
Frankfort, Kentucky 40602-0615

Re: In the Matter of an Adjustment of Gas Rates of The Union Light, Heat and Power Company, Case No. 2001-00092; and

In the Matter of the Joint Application of Duke Energy Corporation, Duke Energy Holding Corp., Deer Acquisition Corp., Cougar Acquisition Corp., Cinergy Corp., The Cincinnati Gas & Electric Company and The Union Light, Heat and Power Company for Approval of a Transfer and Acquisition of Control, Case No. 2005-00228.

Dear Mr. Cline:

I have enclosed Duke Energy Kentucky, Inc.'s Financial Statements as of December 31, 2015 and Auditors' Report per order by the Commission in the above-referenced cases.

Please file-stamp the extra copy of this letter and return to me in the enclosed return-addressed envelope.

If you have any questions regarding the financial statements, please contact Ms. Janet Smith, Lead Accounting Analyst, at (704) 382-8362.

Very truly yours,

Rocco O. D'Ascenzo
Associate General Counsel

Enclosure

cc: Janet Smith
Michael O'Keeffe

597748

Duke Energy Kentucky, Inc.
Financial Statements
and Independent Auditors' Report

December 31, 2015

TABLE OF CONTENTS

DUKE ENERGY KENTUCKY, INC.

December 31, 2015

Glossary of Terms

The following terms or acronyms used in this document are defined below:

Term or Acronym	Definition
AFUDC	Allowance for Funds Used During Construction
ALJ	FERC Administrative Law Judge
ARO	Asset Retirement Obligation
ASRP	Accelerated Natural Gas Service Line Replacement Program
CCR	Coal Combustion Residuals
Cinergy	Cinergy Corp.
CO2	Carbon Dioxide
CP	Capacity Performance
CPP	Clean Power Plan
CRC	Cinergy Receivables Company, LLC
DP&L	The Dayton Power and Light Company
Duke Energy	Duke Energy Corporation
Duke Energy Indiana	Duke Energy Indiana, Inc. (subsequently Duke Energy Indiana, LLC)
Duke Energy Kentucky	Duke Energy Kentucky, Inc.
Duke Energy Ohio	Duke Energy Ohio, Inc.
EPA	U.S. Environmental Protection Agency
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
GAAP	Generally Accepted Accounting Principles in the U.S.
KPSC	Kentucky Public Service Commission
Master Trust	Master Retirement Trust
MISO	Midcontinent Independent System Operator, Inc.
MTEP	MISO Transmission Expansion Planning
MVP	Multi Value Projects
PJM	PJM Interconnection, LLC
Rider ASRP	Rate rider requested to recover cost of the ASRP
RTO	Regional Transmission Organization
U.S.	United States
VIE	Variable Interest Entity

Deloitte.

Deloitte & Touche LLP

550 South Tryon Street
Suite 2500
Charlotte, North Carolina 28202
USA

Tel: +1 704 887 1500
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholder of
Duke Energy Kentucky, Inc.
Charlotte, North Carolina

We have audited the accompanying financial statements of Duke Energy Kentucky, Inc. (the "Company"), which comprise the balance sheets as of December 31, 2015 and 2014, and the related statements of operations, changes in common stockholder's equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Duke Energy Kentucky, Inc. as of December 31, 2015 and 2014, 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.

Emphasis of Matter

As discussed in Note 13 to the financial statements, Duke Energy Kentucky, Inc. adopted ASU 2015-17, *Income Taxes (Topic 740); Balance Sheet Classification of Deferred Taxes* effective December 31, 2015 on a prospective basis.

Deloitte & Touche LLP

March 16, 2016

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF OPERATIONS

(in thousands)	Years Ended December 31, 2015	2014
Operating Revenues		
Electric	$ 359,196	$ 368,894
Natural gas	102,354	124,403
Total operating revenues	461,550	493,297
Operating Expenses		
Fuel used in electric generation and purchased power	142,546	171,705
Cost of natural gas	41,610	59,826
Operation, maintenance and other	133,403	133,085
Depreciation and amortization	43,813	44,296
Property and other taxes	13,089	13,516
Total operating expenses	374,461	422,428
Gains on Sales of Assets, net	245	—
Operating Income	87,334	70,869
Other Income and Expenses, net	1,075	1,896
Interest Expense	14,172	16,345
Income Before Income Taxes	74,237	56,420
Income Tax Expense	28,061	21,118
Net Income	$ 46,176	$ 35,302

See Notes to Financial Statements

DUKE ENERGY KENTUCKY, INC.
BALANCE SHEETS

(in thousands, except share amounts)	December 31, 2015	December 31, 2014
ASSETS		
Current Assets		
Cash and cash equivalents	$ 9,141	$ 11,307
Receivables (net of allowance for doubtful accounts of $195 at December 31, 2015 and $187 at December 31, 2014)	5,488	2,248
Receivables from affiliated companies	11,499	25,567
Inventory	44,141	52,900
Regulatory assets	8,879	5,991
Collateral assets	13,749	11,701
Other	23,207	19,850
Total current assets	116,104	129,564
Other Assets	6,448	5,902
Property, Plant and Equipment		
Cost	2,079,761	1,711,836
Accumulated depreciation and amortization	(923,578)	(691,367)
Generation facilities to be retired, net	—	8,601
Net property, plant and equipment	1,156,183	1,029,070
Regulatory Assets and Deferred Debits		
Regulatory assets	61,411	47,694
Other	332	297
Total regulatory assets and deferred debits	61,743	47,991
Total Assets	$ 1,340,478	$ 1,212,527
LIABILITIES AND EQUITY		
Current Liabilities		
Accounts payable	$ 25,654	$ 22,578
Accounts payable to affiliated companies	14,426	13,263
Notes payable to affiliated companies	55,743	37,609
Taxes accrued	10,550	14,483
Interest accrued	3,343	3,346
Current maturities of long-term debt	101,519	1,615
Regulatory liabilities	2,668	985
Other	19,260	17,365
Total current liabilities	233,163	111,244
Long-Term Debt	192,508	294,171
Long-Term Debt Payable to Affiliated Companies	25,000	25,000
Deferred Credits and Other Liabilities		
Deferred income taxes	289,642	271,308
Investment tax credits	887	1,095
Accrued pension and other post-retirement benefit costs	11,649	9,469
Asset retirement obligations	103,500	8,122
Regulatory liabilities	52,986	52,730
Other	26,711	26,132
Total deferred credits and other liabilities	485,375	368,856
Commitments and Contingencies		
Equity		
Common Stock, $15.00 par value, 1,000,000 shares authorized and 585,333 shares outstanding at December 31, 2015 and December 31, 2014	8,780	8,780
Additional paid-in-capital	167,494	167,494
Retained earnings	228,158	236,982
Total equity	404,432	413,256
Total Liabilities and Equity	$ 1,340,478	$ 1,212,527

See Notes to Financial Statements

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF CASH FLOWS

(in thousands)	Years Ended December 31, 2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 46,176	$ 35,302
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	44,497	44,904
Gains on sales of assets, net	(245)	—
Deferred income taxes	23,462	14,128
Accrued pension and other post-retirement benefit costs	2,152	2,122
Contributions to qualified pension plans	(2,203)	—
Payments for asset retirement obligations	(3,858)	—
(Increase) decrease in		
Receivables	(7,071)	(8,936)
Receivables from affiliated companies	14,068	432
Inventory	9,017	(14,180)
Other current assets	(10,443)	(10,055)
Increase (decrease) in		
Accounts payable	(1,491)	(1,320)
Accounts payable to affiliated companies	1,163	(4,941)
Taxes accrued	2,645	3,496
Other current liabilities	1,743	(1,181)
Other assets	(10,207)	(9,661)
Other liabilities	527	(7,299)
Net cash provided by operating activities	109,932	42,811
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(69,234)	(56,001)
Acquisitions	—	(10,596)
Notes receivable from affiliated companies	—	1,267
Other	(4,173)	(5)
Net cash used in investing activities	(73,407)	(65,335)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments for the redemption of long-term debt	(1,615)	(41,724)
Notes payable to affiliated companies	18,134	62,609
Dividends to parent	(55,000)	—
Other	(210)	(92)
Net cash (used in) provided by financing activities	(38,691)	20,793
Net decrease in cash and cash equivalents	(2,166)	(1,731)
Cash and cash equivalents at beginning of period	11,307	13,038
Cash and cash equivalents at end of period	$ 9,141	$ 11,307
Supplemental Disclosures:		
Cash paid for interest, net of amount capitalized	$ 13,492	$ 15,850
Cash paid for income taxes	13,111	11,150
Significant non-cash transactions:		
Accrued capital expenditures	7,511	3,173

See Notes to Financial Statements

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF CHANGES IN EQUITY

(in thousands)	Common Stock	Additional Paid-in Capital	Retained Earnings	Total Equity
Balance at December 31, 2013	$ 8,780	$ 167,494	$ 201,680	$ 377,954
Net income	—	—	35,302	35,302
Balance at December 31, 2014	$ 8,780	$ 167,494	$ 236,982	$ 413,256
Net income	—	—	**46,176**	**46,176**
Dividends to parent	—	—	**(55,000)**	**(55,000)**
Balance at December 31, 2015	**$ 8,780**	**$ 167,494**	**$ 228,158**	**$ 404,432**

See Notes to Financial Statements

1. ORGANIZATION AND BASIS OF PRESENTATION

NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Duke Energy Kentucky, Inc. (Duke Energy Kentucky) is a combination electric and natural gas public utility company that provides service in northern Kentucky. Duke Energy Kentucky's principal lines of business include generation, transmission, distribution and sale of electricity, as well as the transportation and sale of natural gas. Duke Energy Kentucky is subject to the regulatory provisions of the Kentucky Public Service Commission (KPSC) and the Federal Energy Regulatory Commission (FERC). Duke Energy Kentucky's common stock is wholly owned by Duke Energy Ohio, Inc. (Duke Energy Ohio), an indirect wholly owned subsidiary of Duke Energy Corporation (Duke Energy).

Duke Energy Kentucky acquired The Dayton Power and Light Company's (DP&L) 31 percent interest in East Bend Station on December 30, 2014. Following the acquisition, Duke Energy Kentucky owns 100 percent of the East Bend Station. Duke Energy Kentucky's proportionate ownership share of the East Bend Station's results of operations and cash flows are included in the accompanying financial statements for the year ended December 31, 2014. See Note 2 for further discussion.

Certain prior year amounts have been reclassified to conform to the current year presentation.

Other Current Assets and Liabilities

The following table provides detail of certain amounts included in Other within Current Assets or Current Liabilities.

		December 31,	
(in thousands)	Location	2015	2014
Income taxes receivable	Current Assets	$ 13,410	$ 6,578
Other receivable and prepaid assets	Current Assets	6,883	9,433
Collateral liabilities	Current Liabilities	10,131	9,882

The current portion of deferred tax assets is included within Other in Current Assets at December 31, 2014. Due to the adoption of new accounting guidance issued by the Financial Accounting Standards Board (FASB) related to the balance sheet classification of deferred taxes, all deferred tax assets and liabilities are classified as noncurrent at December 31, 2015. See Note 13 for further information.

SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

In preparing financial statements that conform to generally accepted accounting principles (GAAP) in the United States (U.S.), Duke Energy Kentucky must make estimates and assumptions that affect the reported amounts of assets and liabilities, the reported amounts of revenues and expenses, and the disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

Regulatory Accounting

The majority of Duke Energy Kentucky's operations are subject to price regulation for the sale of electricity and natural gas by the KPSC or FERC. When prices are set on the basis of specific costs of the regulated operations and an effective franchise is in place such that sufficient natural gas or electric services can be sold to recover those costs, Duke Energy Kentucky applies regulatory accounting. Regulatory accounting changes the timing of the recognition of costs or revenues relative to a company that does not apply regulatory accounting. As a result, regulatory assets and regulatory liabilities are recognized on the Balance Sheets. Regulatory assets and liabilities are amortized consistent with the treatment of the related cost in the ratemaking process. See Note 2 for further information.

Regulated Fuel Costs and Purchased Power

Duke Energy Kentucky utilizes cost-tracking mechanisms, commonly referred to as fuel adjustment clauses. These clauses allow for the recovery of fuel and fuel-related costs and portions of purchased power costs through surcharges on customer rates. The difference between the costs incurred and the surcharge revenues is recorded as an adjustment to Fuel used in electric generation and purchased power and Cost of natural gas on the Statements of Operations with an off-setting impact on regulatory assets or liabilities.

Cash and Cash Equivalents

All highly liquid investments with maturities of three months or less at the date of acquisition are considered cash equivalents.

Inventory

Inventory is used for operations and is recorded primarily using the average cost method. Inventory related to regulated operations is valued at historical cost. Materials and supplies are recorded as inventory when purchased and subsequently charged to expense or capitalized to property, plant and equipment when installed. Reserves are established for excess and obsolete inventory. The components of inventory are presented in the table below.

(in thousands)	December 31, 2015	2014
Materials and supplies	$ 22,550	$ 26,048
Coal held for electric generation	16,282	20,342
Natural gas held in storage	5,309	6,510
Total inventory	$ 44,141	$ 52,900

Property, Plant and Equipment

Property, plant and equipment are stated at the lower of depreciated historical cost net of any disallowances or fair value, if impaired. Duke Energy Kentucky capitalizes all construction-related direct labor and material costs, as well as indirect construction costs such as general engineering, taxes and financing costs. Refer to Allowance for Funds Used During Construction (AFUDC) and Asset Retirement Obligations (ARO), respectively, for further information on capitalized financing costs and legal obligations associated with the retirement of property, plant and equipment. Costs of renewals and betterments that extend the useful life of property, plant and equipment are also capitalized. The cost of repairs, replacements and major maintenance projects, which do not extend the useful life or increase the expected output of the asset, is expensed as incurred. Depreciation is generally computed over the estimated useful life of the asset using the composite straight-line method. Depreciation studies are conducted periodically to update composite rates and are approved by the KPSC and/or the FERC when required. The composite weighted average depreciation rates were 2.4 percent and 2.6 percent for the years ended December 31, 2015 and 2014, respectively.

In general, when Duke Energy Kentucky retires its regulated property, plant and equipment, original cost plus the cost of retirement, less salvage value, is charged to accumulated depreciation. However, when it becomes probable a regulated asset will be retired substantially in advance of its original expected useful life or will be abandoned, the cost of the asset and the corresponding accumulated depreciation is recognized as a separate asset. If the asset is still in operation, the net amount is classified as Generation facilities to be retired, net on the Balance Sheets. If the asset is no longer operating, the net amount is classified in Regulatory assets on the Balance Sheets. The carrying value of the asset is based on historical cost if Duke Energy Kentucky is allowed to recover the remaining net book value and a return equal to at least the incremental borrowing rate. If not, an impairment is recognized to the extent the net book value of the asset exceeds the present value of future revenues discounted at the incremental borrowing rate.

When Duke Energy Kentucky sells entire regulated operating units, the original cost and accumulated depreciation and amortization balances are removed from Property, Plant and Equipment on the Balance Sheets. Any gain or loss is recorded in earnings, unless otherwise required by the applicable regulatory body.

See Note 6 for further information.

Allowance for Funds Used During Construction (AFUDC)

For regulated operations, the debt and equity costs of financing the construction of property, plant and equipment are reflected as AFUDC and capitalized as a component of the cost of property, plant and equipment. AFUDC equity is reported on the Statements of Operations as non-cash income in Other Income and Expenses, net. AFUDC debt is reported as a non-cash offset to Interest Expense. After construction is completed, Duke Energy Kentucky is permitted to recover these costs through their inclusion in rate base and the corresponding subsequent depreciation or amortization of those regulated assets.

AFUDC equity, a permanent difference for income taxes, reduces the effective tax rate when capitalized and increases the effective tax rate when depreciated or amortized.

Asset Retirement Obligations (ARO)

AROs are recognized for legal obligations associated with the retirement of property, plant and equipment. When recording an ARO, the present value of the projected liability is recognized in the period in which it is incurred, if a reasonable estimate of fair value can be made. The liability is accreted over time. For operating plants, the present value of the liability is added to the cost of the associated asset and depreciated over the remaining life of the asset. For retired plants, the present value of the liability is recorded as a regulatory asset.

The present value of the initial obligation and subsequent updates are based on discounted cash flows, which include estimates regarding timing of future cash flows, selection of discount rates and cost escalation rates, among other factors. These estimates are subject to change. Depreciation expense is adjusted prospectively for any changes to the carrying amount of the associated asset. Duke Energy Kentucky receives amounts to fund the cost of the ARO from regulated revenues. As a result, the net of amounts recovered in regulated revenues, accretion expense and depreciation of the associated asset is deferred as a regulatory asset or liability.

Obligations for closure of ash basins are based upon discounted cash flows of estimated costs for specific plans, if known, or probability weightings of the potential closure methods if the closure plans are under development and multiple closure options are being considered and evaluated on a site-by-site basis.

See Note 5 for further information.

Comprehensive Income

Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. Comprehensive income is the same as net income for all periods presented. Therefore, a separate statement of comprehensive income is not included in the accompanying financial statements.

Revenue Recognition and Unbilled Revenue

Revenues on sales of electricity and natural gas are recognized when service is provided or the product is delivered. Unbilled revenues are recognized by applying customer billing rates to the estimated volumes of energy delivered but not yet billed. Unbilled revenues can vary significantly from period to period as a result of seasonality, weather, customer usage patterns, customer mix, average price in effect for customer classes, timing of rendering customer bills and meter reading schedules.

Duke Energy Kentucky sells, on a revolving basis, nearly all of its retail accounts receivable, including receivables for unbilled revenues, to an affiliate, Cinergy Receivables Company, LLC (CRC). As discussed further in Note 11, Duke Energy Kentucky accounts for the transfers of receivables to CRC as sales. Accordingly, the receivables sold are not reflected on the Balance Sheets. Receivables for unbilled revenues related to retail accounts receivable included in the sales of accounts receivable to CRC at December 31, 2015 and 2014, were $16 million and $19 million, respectively.

Unbilled revenues, which are recorded as Receivables on the Balance Sheets and exclude receivables sold to CRC, primarily include wholesale related revenues and totaled $674 thousand at December 31, 2015 and were not a significant amount at December 31, 2014.

Derivatives and Hedging

Derivative and non-derivative instruments may be used in connection with commodity price, interest rate and foreign currency risk management activities, including swaps, futures, forwards and options. All derivative instruments, except those that qualify for the normal purchase/normal sale exception, are recorded on the Balance Sheets at fair value. For activity subject to regulatory accounting, gains and losses on derivative contracts are reflected as regulatory assets or liabilities and not as other comprehensive income or current period income. As a result, changes in fair value of these derivatives have no immediate earnings impact.

See Note 9 for further information.

Unamortized Debt Premium, Discount and Expense

Premiums, discounts and expenses incurred with the issuance of outstanding long-term debt are amortized over the term of the debt issue. Call premiums and unamortized expenses associated with refinancing higher-cost debt obligations used to finance regulated assets are amortized. Amortization expense is recorded as Interest Expense in the Statements of Operations and is reflected as Depreciation and amortization within Net cash provided by operating activities on the Statements of Cash Flows.

During 2015, Duke Energy retrospectively adopted revised accounting guidance related to the presentation of debt issuance costs. Unamortized debt issuance costs are presented as a reduction of the debt amount and included in Long-Term Debt on the Balance Sheets presented. Refer to the discussion of New Accounting Standards for further information.

Loss Contingencies and Environmental Liabilities

Contingent losses are recorded when it is probable a loss has occurred and can be reasonably estimated. When a range of the probable loss exists and no amount within the range is a better estimate than any other amount, the minimum amount in the range is recorded. Unless otherwise required by GAAP, legal fees are expensed as incurred.

Environmental liabilities are recorded on an undiscounted basis when environmental remediation or other liabilities become probable and can be reasonably estimated. Environmental expenditures related to past operations that do not generate current or future revenues are expensed. Environmental expenditures related to operations that generate current or future revenues are expensed or capitalized, as appropriate. Certain environmental expenditures receive regulatory accounting treatment and are recorded as regulatory assets.

See Notes 2 and 3 for further information.

Pension and Other Post-Retirement Benefit Plans

Duke Energy maintains qualified, non-qualified and other post-retirement benefit plans. Eligible employees of Duke Energy Kentucky participate in the respective qualified, non-qualified and other post-retirement benefit plans and Duke Energy Kentucky is allocated its proportionate share of benefit costs. See Note 12 for further information.

Income Taxes

Duke Energy and its subsidiaries file a consolidated federal income tax return and other state and foreign jurisdictional returns. Duke Energy Kentucky entered into a tax-sharing agreement with Duke Energy, and income taxes recorded represent amounts Duke Energy Kentucky would incur as a separate C-Corporation. Deferred income taxes have been provided for temporary differences between GAAP and tax bases of assets and liabilities because the differences create taxable or tax-deductible amounts for future periods. Investment tax credits associated with regulated operations are deferred and amortized as a reduction of income tax expense over the estimated useful lives of the related properties.

Positions taken or expected to be taken on tax returns, including the decision to exclude certain income or transactions from a return, are recognized in the financial statements when it is more likely than not the tax position can be sustained based solely on the technical merits of the position. The largest amount of tax benefit that is greater than 50 percent likely of being effectively settled is recorded. Management considers a tax position effectively settled when: (i) the taxing authority has completed its examination procedures, including all appeals and administrative reviews; (ii) Duke Energy Kentucky does not intend to appeal or litigate the tax position included in the completed examination; and (iii) it is remote the taxing authority would examine or re-examine the tax position. The amount of a tax return position that is not recognized in the financial statements is disclosed as an unrecognized tax benefit. If these unrecognized tax benefits are later recognized, then there will be a decrease in income taxes payable, an income tax refund or a reclassification between deferred and current taxes payable. If the portion of tax benefits that has been recognized changes and those tax benefits are subsequently derecognized, then the previously recognized tax benefits may impact the financial statements through increasing income taxes payable, reducing income tax refunds receivable or changing deferred taxes. Changes in assumptions on tax benefits may also impact interest expense or interest income and may result in the recognition of tax penalties.

Tax-related interest and penalties are recorded in Interest Expense and Other Income and Expenses, net, in the Statements of Operations.

See Note 13 for further information.

NEW ACCOUNTING STANDARDS

The new accounting standards adopted for 2015 and 2014 had no material impact on the presentation or results of operations, cash flows or financial position of Duke Energy Kentucky. The following accounting standards were adopted by Duke Energy Kentucky during 2015.

Balance Sheet Classification of Deferred Taxes. In November 2015, the FASB issued revised accounting guidance for the Balance Sheet classification of deferred taxes. The core principle of this revised accounting guidance is that all deferred tax assets and liabilities should be classified as noncurrent. For Duke Energy Kentucky, this revised accounting guidance was adopted prospectively for December 31, 2015. The Balance Sheet as of December 31, 2014 does not reflect this reclassification of current deferred tax assets and liabilities. See Note 13 for further information on the impact from adoption of this accounting standard.

Balance Sheet Presentation of Debt Issuance Costs. In April and August 2015, the FASB issued revised accounting guidance for the presentation of debt issuance costs. The core principle of this revised accounting guidance is that debt issuance costs are not assets, but adjustments to the carrying cost of debt. For Duke Energy Kentucky, this revised accounting guidance was adopted retrospectively to December 31, 2014.

The implementation of this accounting standard resulted in a reduction of Other within Regulatory Assets and Deferred Debits and in Long-Term Debt of approximately $1 million and $2 million on the Balance Sheets as of December 31, 2015 and 2014, respectively.

The following new accounting standards were issued, but have not yet been adopted by Duke Energy Kentucky, as of December 31, 2015.

Revenue from Contracts with Customers. In May 2014, the FASB issued revised accounting guidance for revenue recognition from contracts with customers. The core principle of this guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The amendments in this update also require disclosure of sufficient information to allow users to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

For Duke Energy Kentucky, this guidance is effective for interim and annual periods beginning January 1, 2018, although it can be early adopted for annual periods beginning January 1, 2017. The guidance can be applied retroactively to all prior reporting periods presented or retrospectively with a cumulative effect as of the initial date of application. Duke Energy Kentucky is currently evaluating the requirements. The ultimate impact of the new standard has not yet been determined.

Leases. In February 2016, the FASB issued revised accounting guidance for leases. The core principle of this guidance is that a lessee should recognize the assets and liabilities that arise from leases on the balance sheet. For Duke Energy Kentucky, this guidance is effective for interim and annual periods beginning January 1, 2019, although it can be early adopted. The guidance is applied using a modified retrospective approach. Duke Energy Kentucky is currently evaluating the requirements. Other than an expected increase in assets and liabilities, the ultimate impact of the new standard has not yet been determined.

2. REGULATORY MATTERS

REGULATORY ASSETS AND LIABILITIES

Duke Energy Kentucky records assets and liabilities that result from the ratemaking process. See Note 1 for further information.

The following table represents the regulatory assets and liabilities on the Balance Sheets.

(in thousands)	December 31, 2015	December 31, 2014	Recovery/Refund Period Ends
Regulatory Assets[a]			
Accrued pension and other post-retirement benefits	$ 28,289	$ 24,806	(f)
East Bend deferrals	16,465	—	(b)
Demand side management/Energy efficiency costs	6,663	8,973	(b)(c)
Hedge costs and other deferrals	6,221	6,250	(d)
Storm cost deferrals	4,913	4,913	(b)
AROs – coal ash	4,425	—	(b)
Vacation accrual	1,440	1,591	2016
Deferred debt expense	1,721	1,988	2036
Natural gas purchase costs	579	1,921	2016
Carbon management research grant	1,400	1,200	(b)
Profit sharing mechanism	—	1,091	—
Net regulatory (liability) asset related to income taxes	(1,826)	952	(b)
Total regulatory assets	70,290	53,685	
Less: current portion	8,879	5,991	
Total noncurrent regulatory assets	$ 61,411	$ 47,694	
Regulatory Liabilities[a]			
Costs of removal	$ 48,032	$ 48,875	(e)
Accrued pension and other post-retirement benefits	4,937	3,835	(f)
Hedge costs and other deferrals	979	611	(d)
Deferred fuel	973	374	2016
Profit sharing mechanism	717	—	2016
Other	16	20	(b)
Total regulatory liabilities	55,654	53,715	
Less: current portion	2,668	985	
Total noncurrent regulatory liabilities	$ 52,986	$ 52,730	

(a) Regulatory assets and liabilities are excluded from rate base unless otherwise noted.
(b) The expected recovery or refund period varies for these amounts or has not been determined.
(c) Deferred costs are recovered through a rider mechanism.
(d) Recovery varies over the life of the associated instrument.
(e) Represents funds received from customers to cover future removal of property, plant and equipment from retired or abandoned sites as property is retired. Included in rate base and recovered over the life of associated assets.
(f) The regulatory asset or liability is amortized with the recognition of actuarial gains or losses and prior service cost and net periodic benefit costs for pension and OPEB plans. See Note 12 for further information.

RATE RELATED INFORMATION

The KPSC approves rates for retail electric and natural gas services within the Commonwealth of Kentucky. The FERC approves rates for electric sales to wholesale customers served under cost-based rates, as well as sales of transmission service.

Accelerated Natural Gas Service Line Replacement Program

On July 6, 2015, Duke Energy Kentucky filed an application for approval of an accelerated natural gas service line replacement program (ASRP). Under the ASRP, Duke Energy Kentucky proposed to replace certain natural gas service lines on an accelerated basis over a five year period. Through the ASRP, Duke Energy Kentucky also proposed to complete preliminary survey and investigation work related to natural gas service lines that are customer-owned and for which it does not have valid records and, further, to relocate interior natural gas meters to suitable exterior locations where such relocation can be accomplished. Duke Energy Kentucky estimates total capital and operations and maintenance expenditures under the ASRP to approximate $50 million. The filing also sought approval of a rider for ASRP expenditures to be recovered (Rider ASRP) which Duke Energy Kentucky would update on an annual basis.

Duke Energy Kentucky reached a settlement with the lone intervenor, the Kentucky Attorney General, which included the following key terms: (i) 9.7 percent return on equity; (ii) meter relocations only where code violations exist; (iii) one year rate stay-out, with exceptions; and, (iv) an annual $1.00 per month cap on Rider ASRP rate increases for residential customers. On February 2, 2016, the KPSC issued an order approving the settlement.

Regional Transmission Organization (RTO) Realignment

Duke Energy Ohio and Duke Energy Kentucky transferred control of their transmission assets to effect a RTO realignment from Midcontinent Independent System Operator, Inc. (MISO) to PJM Interconnection, LLC (PJM), effective December 31, 2011.

On December 22, 2010, the KPSC approved Duke Energy Kentucky's request to effect the RTO realignment, subject to a commitment not to seek double-recovery in a future rate case of the transmission expansion fees that may be charged by MISO and PJM in the same period or overlapping periods. Duke Energy Kentucky is not currently recovering PJM or MISO transmission expansion fees through current base rates.

Upon its exit from MISO on December 31, 2011, Duke Energy Kentucky recorded a liability and expense for its exit obligation and share of MISO Transmission Expansion Planning (MTEP) costs, excluding Multi Value Projects (MVP). This liability was recorded within Other in Current Liabilities and Other in Deferred Credits and Other Liabilities on the Balance Sheets.

The following table provides a reconciliation of the beginning and ending balance of recorded obligations related to the withdrawal from MISO.

(in thousands)	December 31, 2014	Provision / Adjustments	Cash Reductions	December 31, 2015
MISO withdrawal liability	$ 20,217	$ 724	$ (1,010)	$ 19,931

MVP

MISO approved 17 MVP proposals prior to Duke Energy Ohio and Duke Energy Kentucky's exit from MISO on December 31, 2011. Construction of these projects is expected to continue through 2020. Costs of these projects, including operating and maintenance costs, property and income taxes, depreciation and an allowed return, are allocated and billed to MISO transmission owners.

On December 29, 2011, MISO filed a tariff with the FERC providing for the allocation of MVP costs to a withdrawing owner based on monthly energy usage. The FERC set for hearing (i) whether MISO's proposed cost allocation methodology to transmission owners who withdrew from MISO prior to January 1, 2012 is consistent with the tariff at the time of their withdrawal from MISO and, (ii) if not, what the amount of and methodology for calculating any MVP cost responsibility should be. In 2012, MISO estimated Duke Energy Kentucky's MVP obligation over the period from 2012 to 2071 at $450 million, on an undiscounted basis. On July 16, 2013, a FERC Administrative Law Judge (ALJ) issued an initial decision. Under this initial decision, Duke Energy Ohio and Duke Energy Kentucky would be liable for MVP costs. Duke Energy Ohio and Duke Energy Kentucky filed exceptions to the initial decision, requesting FERC to overturn the ALJ's decision.

On October 29, 2015, the FERC issued an order reversing the ALJ's decision. The FERC ruled the cost allocation methodology is not consistent with the MISO tariff and that Duke Energy Ohio and Duke Energy Kentucky have no liability for MVP costs after withdrawal from MISO. On November 30, 2015, MISO filed with the FERC a request for rehearing. Duke Energy Kentucky cannot predict the outcome of this matter.

FERC Transmission Return on Equity and MTEP Cost Settlement

On October 14, 2011, Duke Energy Ohio and Duke Energy Kentucky submitted with the FERC proposed modifications to the PJM Interconnection Open Access Transmission Tariff pertaining to recovery of the transmission revenue requirement as PJM transmission owners. The filing was made in connection with Duke Energy Ohio's and Duke Energy Kentucky's move from MISO to PJM effective December 31, 2011. On April 24, 2012, the FERC issued an order accepting the proposed filing effective January 1, 2012, except that the order denied a request to recover certain costs associated with the move from MISO to PJM without prejudice to the right to submit another filing seeking such recovery and including certain additional evidence, and set the rate of return on equity of 12.38 percent for settlement and hearing. On April 16, 2015, the FERC approved a settlement agreement between Duke Energy Ohio, Duke Energy Kentucky and six PJM transmission customers with load in the Duke Energy Ohio and Duke Energy Kentucky zone. The principal terms of the settlement agreement are that, effective upon the date of FERC approval, (i) the return on equity for wholesale transmission service is reduced to 11.38 percent, (ii) the settling parties agreed not to seek a change in the return on equity that would be effective prior to June 1, 2017, and (iii) Duke Energy Ohio and Duke Energy Kentucky will recover 30 percent of the wholesale portion of costs arising from their obligation to pay any portion of the costs of projects included in any MTEP that was approved prior to the date of Duke Energy Ohio's and Duke Energy Kentucky's integration into PJM.

OTHER REGULATORY MATTERS

PJM Capacity Performance Proposal

On June 9, 2015, the FERC ruled in favor of PJM on a revised Tariff and Reliability Assurance Agreement including implementation of a Capacity Performance (CP) proposal and to amend sections of the Operating Agreement related to generation non-performance. The CP proposal includes performance-based penalties for non-compliance. Duke Energy Kentucky is a Fixed Resource Requirement (FRR) entity, and therefore is subject to the compliance standards through its FRR plans. A partial CP obligation will apply to Duke Energy Kentucky in the delivery year beginning June 1, 2019, with full compliance beginning June 1, 2020.

Duke Energy Kentucky is evaluating potential strategies for compliance and required investment. The regulatory treatment of CP compliance costs and potential penalties has not been determined. The ruling could result in an adverse impact on Duke Energy Kentucky's future results of operations and cash flows. Duke Energy Kentucky cannot predict the outcome of this matter.

Regulatory Assets for Coal Combustion Residuals Cost

On June 10, 2015, Duke Energy Kentucky filed an application with the KPSC seeking approval to record ARO amounts and other compliance obligations related to the disposal of coal combustion residuals (CCR) at the East Bend Station as regulatory assets and to defer costs incurred, including carrying costs. The application was approved in December 2015. The approval imposed annual reporting requirements to provide ARO calculations that reflect any studies, reports or updated assumptions related to the ARO balance and a CCR Compliance Regulatory Asset report to include the annual spend and carrying costs incurred.

Refer to Note 5 for further information on the U.S. Environmental Protection Agency's (EPA) rule to regulate the disposal of CCR from electric utilities as solid waste.

East Bend Station

On December 30, 2014, Duke Energy Kentucky acquired The Dayton Power and Light Company's 31 percent interest in the jointly owned East Bend Station for approximately $12.4 million. Duke Energy Kentucky owns 100 percent of the East Bend Station as a result of the acquisition. The KPSC approved the deferral of incremental operations and maintenance costs related to the additional ownership interest above amounts currently reflected in base rates.

The purchase price, in accordance with FERC guidelines, was reflected with the net purchase amount as an increase to property, plant and equipment as of December 31, 2014, and subsequently with the DP&L's historical original cost as an increase to property, plant and equipment and accumulated depreciation as of December 31, 2015. On August 20, 2015, the KPSC approved Duke Energy Kentucky's application to use the purchase price as the value of the newly acquired interest in the East Bend Station for depreciation purposes and ratemaking and to create a regulatory asset for recovery.

3. COMMITMENTS AND CONTINGENCIES

GENERAL INSURANCE

Duke Energy Kentucky has insurance and/or reinsurance coverage either directly or through indemnification from Duke Energy's captive insurance company, Bison Insurance Company Limited, and its affiliates, consistent with companies engaged in similar commercial operations with similar type properties. Duke Energy Kentucky's coverage includes (i) commercial general liability coverage for liabilities arising to third parties for bodily injury and property damage; (ii) workers' compensation; (iii) automobile liability coverage; and (iv) property coverage for all real and personal property damage. Real and personal property damage coverage excludes electric transmission and distribution lines, but includes damages arising from boiler and machinery breakdowns, earthquakes, flood damage and extra expense, but not outage or replacement power coverage. All coverage is subject to certain deductibles or retentions, sublimits, exclusions, terms and conditions that are common for companies with similar types of operations. Duke Energy Kentucky self-insures its electric transmission and distribution lines against loss due to storm damage and other natural disasters.

The cost of Duke Energy Kentucky's coverage can fluctuate year to year reflecting claims history and conditions of the insurance and reinsurance markets.

In the event of a loss, terms and amounts of insurance and reinsurance available might not be adequate to cover claims and other expenses incurred. Uninsured losses and other expenses, to the extent not recovered by other sources, could have a material effect on Duke Energy Kentucky's results of operations, cash flows or financial position. Duke Energy Kentucky is responsible to the extent losses may exceed limits of the coverage available.

ENVIRONMENTAL

Duke Energy Kentucky is subject to federal, state, and local regulations regarding air and water quality, hazardous and solid waste disposal, and other environmental matters. These regulations can be changed from time to time, imposing new obligations on Duke Energy Kentucky.

Remediation Activities

In addition to the AROs discussed in Note 5, Duke Energy Kentucky is responsible for environmental remediation at various sites. These include some properties that are part of ongoing operations and sites formerly owned or used by Duke Energy Kentucky. These sites are in various stages of investigation, remediation and monitoring. Managed in conjunction with relevant federal, state and local agencies, remediation activities vary based upon site condition and location, remediation requirements, complexity and sharing of responsibility. If remediation activities involve joint and several liability provisions, strict liability, or cost recovery or contribution actions, Duke Energy Kentucky could potentially be held responsible for environmental impacts caused by other potentially responsible parties, and may also benefit from insurance policies or contractual indemnities that cover some or all cleanup costs. Liabilities are recorded when losses become probable and are reasonably estimable. The total costs that may be incurred cannot be estimated because the extent of environmental impact, allocation among potentially responsible parties, remediation alternatives and/or regulatory decisions have not yet been determined. Additional costs associated with remediation activities are likely to be incurred in the future and could be significant. Costs are typically expensed as Operation, maintenance and other in the Statements of Operations unless regulatory recovery of the costs is deemed probable.

Duke Energy Kentucky has accrued approximately $515 thousand for probable and estimable costs related to its various environmental sites. These amounts are recorded in Other within Deferred Credits and Other Liabilities on the Balance Sheets. Additional losses in excess of recorded reserves are expected to be immaterial for the stages of investigation, remediation and monitoring for the environmental sites that have been evaluated. The maximum amount of the range for all stages of Duke Energy Kentucky's environmental sites cannot be determined at this time.

Clean Power Plan

On October 23, 2015, the EPA published in the Federal Register the Clean Power Plan (CPP) rule for regulating carbon dioxide (CO_2) emissions from existing fossil fuel-fired electric generating units. The CPP establishes CO_2 emission rates and mass cap goals that apply to fossil fuel-fired generation. Under the CPP, states are required to develop and submit a final compliance plan, or an initial plan with an extension request, to the EPA by September 6, 2016, or no later than September 6, 2018, with an approved extension. These state plans are subject to EPA approval, with a federal plan applied to states that fail to submit a plan to the EPA or if a state plan is not approved. Legal challenges to the CPP have been filed by stakeholders and motions to stay the requirements of the rule pending the outcome of the litigation were granted by the U.S. Supreme Court in February 2016. Final resolution of these legal challenges could take several years. Compliance with CPP could cause the industry to replace coal generation with natural gas and renewables, especially in states that have significant CO_2 reduction targets under the rule. Costs to operate coal-fired generation plants continue to grow due to increasing environmental compliance requirements, including ash management costs unrelated to CPP, and this may result in the retirement of coal-fired generation plants earlier than the current useful lives. Duke Energy Kentucky continues to evaluate the need to retire generating facilities and plans to seek regulatory recovery, where appropriate, for amounts that have not been recovered upon asset retirements. However, recovery is subject to future regulatory approval, including the recovery of carrying costs on remaining book values, and therefore cannot be assured.

LITIGATION

Duke Energy Kentucky is involved in other legal, tax and regulatory proceedings arising in the ordinary course of business, some of which involve significant amounts. Duke Energy Kentucky believes the final disposition of these proceedings will not have a material effect on its results of operations, cash flows or financial position. Duke Energy Kentucky expenses legal costs related to the defense of loss contingencies as incurred.

OTHER COMMITMENTS AND CONTINGENCIES

General

As part of its normal business, Duke Energy Kentucky is party to various financial guarantees, performance guarantees and other contractual commitments to extend guarantees of credit and other assistance to various third parties. These guarantees involve elements of performance and credit risk which are not included on the Balance Sheets. The possibility of Duke Energy Kentucky having to honor its contingencies is largely dependent upon future operations of various third parties or the occurrence of certain future events.

Operating and Capital Lease Commitments

Duke Energy Kentucky leases vehicles, computer equipment and other property and equipment with various terms and expiration dates. Capitalized lease obligations are classified as Long-Term Debt on the Balance Sheets. Amortization of assets recorded under capital leases is included in Depreciation and amortization on the Statements of Operations.

Rental expense for operating leases, which is included in Operation, maintenance and other on the Statements of Operations, was $2 million for the years ended December 31, 2015 and 2014, respectively.

The following table presents future minimum lease payments under operating leases, which at inception had a non-cancelable term of more than one year, and capital leases as of December 31, 2015.

(in thousands)	Operating Leases	Capital Leases
2016	$ 2,250	$ 1,730
2017	1,912	853
2018	1,233	1,053
2019	483	499
2020	311	265
Thereafter	508	—
Minimum annual payments	6,697	4,400
Less: amount representing interest	—	(728)
Total	$ 6,697	$ 3,672

4. DEBT AND CREDIT FACILITIES

SUMMARY OF DEBT AND RELATED TERMS

The following table summarizes outstanding debt.

(in thousands)	Weighted Average Interest Rate	Year Due	December 31, 2015	December 31, 2014
Unsecured debt	5.37%	2016-2036	$ 215,000	$ 215,851
Capital leases	5.73%	2016-2020	3,672	5,287
Tax-exempt bonds[a][b]	0.73%	2027	76,720	76,720
Money pool borrowings[b][c]	0.76%		80,743	62,609
Unamortized debt discount and premium, net			(389)	(441)
Unamortized debt issuance costs			(976)	(1,631)
Total debt	3.44%		$ 374,770	$ 358,395
Short-term money pool borrowings			(55,743)	(37,609)
Current maturities of long-term debt			(101,519)	(1,615)
Total long-term debt			$ 217,508	$ 319,171

(a) Includes $27 million that is secured by a bilateral letter of credit agreement.
(b) Floating-rate debt. At December 31, 2014, the weighted average interest rate was 0.70% for tax-exempt bonds.
(c) Includes $25 million classified as Long-Term Debt Payable to Affiliated Companies on the Balance Sheets.

CURRENT MATURITIES OF LONG-TERM DEBT

At December 31, 2015, Duke Energy Kentucky had $50 million of senior unsecured notes with a 5.750% fixed interest rate due March 2016 classified as Current maturities of long-term debt on the Balance Sheets. Duke Energy Kentucky currently anticipates satisfying this obligation with additional borrowings and available cash.

At December 31, 2015, Duke Energy Kentucky had $50 million of tax-exempt bonds with a 1.120% floating interest rate and a maturity date of August 2027. However, the bonds have a mandatory put in December 2016 and are classified as Current maturities of long-term debt on the Balance Sheets.

MATURITIES AND CALL OPTIONS

The following table shows the annual maturities of long-term debt for the next five years and thereafter.

(in thousands)	December 31, 2015
2016	$ 101,519
2017	687
2018	887
2019	100,230
2020	25,180
Thereafter	90,524
Total long-term debt, including current maturities	$ 319,027

Duke Energy Kentucky has the ability under certain debt facilities to call and repay the obligation prior to its scheduled maturity. Therefore, the actual timing of future cash repayments could be materially different than as presented above.

SHORT-TERM OBLIGATIONS CLASSIFIED AS LONG-TERM DEBT

Tax-exempt bonds that may be put to Duke Energy Kentucky at the option of the holder and money pool borrowings, which are short-term obligations by nature, are classified as long-term due to Duke Energy Kentucky's intent and ability to utilize such borrowings as long-term financing. As Duke Energy's Master Credit Facility and Duke Energy Kentucky's other bilateral letter of credit agreements have non-cancelable terms in excess of one year as of the balance sheet date, Duke Energy Kentucky has the ability to refinance these short-term obligations on a long-term basis. See "Available Credit Facilities" below for additional information.

At December 31, 2015 and 2014, $27 million of tax-exempt bonds and $25 million of money pool borrowings were classified as Long-Term Debt and Long-Term Debt Payable to Affiliated Companies, respectively, on the Balance Sheets.

SIGNIFICANT DEBT ISSUANCES

In January 2016, Duke Energy Kentucky issued $95 million of unsecured debentures, of which $45 million carry a fixed interest rate of 3.42 percent and mature January 15, 2026, and $50 million carry a fixed interest rate of 4.45 percent and mature January 15, 2046. Proceeds will primarily be used to refinance existing debt, including money pool borrowings, capital expenditures and for general corporate purposes.

AVAILABLE CREDIT FACILITIES

Duke Energy has a Master Credit Facility with a capacity of $7.5 billion through January 2020. Duke Energy Kentucky has borrowing capacity under the Master Credit Facility up to a specified sublimit. Duke Energy has the unilateral ability at any time to increase or decrease Duke Energy Kentucky's borrowing sublimit, subject to a maximum sublimit. The amount available to Duke Energy Kentucky under the Master Credit Facility may be reduced to backstop issuances of commercial paper, certain letters of credit and variable-rate demand tax-exempt bonds that may be put to Duke Energy Kentucky at the option of the holder. At December 31, 2015, Duke Energy Kentucky had a borrowing sublimit of $125 million and available capacity of $51 million under the Master Credit Facility.

Duke Energy Kentucky and Duke Energy Indiana, Inc. (subsequently Duke Energy Indiana, LLC) (Duke Energy Indiana), a wholly owned subsidiary of Duke Energy, collectively have a $156 million bilateral letter of credit agreement expiring February 2019. Duke Energy Kentucky and Duke Energy Indiana may request the issuance of letters of credit up to $27 million and $129 million, respectively, on their behalf to support various series of tax-exempt bonds. This credit facility may not be used for any purpose other than to support the tax-exempt bonds.

OTHER DEBT MATTERS

Money Pool

Duke Energy Kentucky receives support for its short-term borrowing needs through participation with Duke Energy and certain of its subsidiaries in a money pool arrangement. Under this arrangement, those companies with short-term funds may provide short-term loans to affiliates participating under this arrangement. The money pool is structured such that Duke Energy Kentucky separately manages its cash needs and working capital requirements. Accordingly, there is no net settlement of receivables and payables related to the money pool between the money pool participants.

Money pool receivable balances are reflected within Notes receivable from affiliated companies in the Balance Sheets. The change in receivables is reflected within Investing Activities on the Statements of Cash Flows. Money pool payable balances are reflected within either Notes payable to affiliated companies or Long-Term Debt Payable to Affiliated Companies on the Balance Sheets. The change in payables are reflected within Financing Activities on the Statements of Cash Flows.

Restrictive Debt Covenants

Duke Energy Kentucky's debt and credit agreements contain various financial and other covenants. Failure to meet those covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. As of December 31, 2015, Duke Energy Kentucky was in compliance with all covenants related to its debt agreements. In addition, some credit agreements may allow for acceleration of payments or termination of the agreements due to nonpayment, or the acceleration of other significant indebtedness of the borrower or some of its subsidiaries. None of the debt or credit agreements contain material adverse change clauses.

5. ASSET RETIREMENT OBLIGATIONS

Duke Energy Kentucky records an ARO when it has a legal obligation to incur retirement costs associated with the retirement of a long-lived asset and the obligation can be reasonably estimated. Certain assets have an indeterminate life, and thus the fair value of the retirement obligation is not reasonably estimable. A liability for these AROs will be recorded when a fair value is determinable.

Duke Energy Kentucky's regulated electric and regulated natural gas operations accrue costs of removal for property that does not have an associated legal retirement obligation based on regulatory orders from the KPSC. These costs of removal are recorded as a regulatory liability in accordance with regulatory accounting treatment. See Note 2 for the estimated cost of removal for assets without an associated legal retirement obligation, which are included in Regulatory liabilities on the Balance Sheets as of December 31, 2015 and 2014.

On April 17, 2015, the EPA published in the Federal Register a rule to regulate the disposal of CCR from electric utilities as solid waste. The federal regulation classifies CCR as nonhazardous waste under Subtitle D of the Resource Conservation and Recovery Act and allows beneficial use of CCRs with some restrictions. The regulation applies to all new and existing landfills, new and existing surface impoundments receiving CCR and existing surface impoundments that are no longer receiving CCR but contain liquid located at stations currently generating electricity (regardless of fuel source). The rule establishes requirements regarding landfill design, structural integrity design and assessment criteria for surface impoundments, groundwater monitoring and protection procedures and other operational and reporting procedures to ensure the safe disposal and management of CCR. In addition to the requirements of the federal CCR regulation, CCR landfills and surface impoundments will continue to be independently regulated by most states.

During the second quarter of 2015, as a result of the EPA rule, Duke Energy Kentucky recorded additional ARO amounts for estimated ash basin closure costs at the East Bend Station. The ARO amount recorded represents the discounted cash flows for estimated closure costs of this ash basin. Actual costs to be incurred will be dependent upon site specific factors that include the method and time frame of closure. Closure methods considered include removing the water from the basins and capping the ash with a synthetic barrier, excavating and relocating the ash to a lined structural fill or lined landfill, or recycling the ash for concrete or some other beneficial use. The ultimate method and timetable for closure will be in compliance with standards set by the EPA rule and any state regulations. The ARO amount will be adjusted as additional information is gained through the closure process, including acceptance and approval of compliance approaches which may change management assumptions, and may result in a material change to the balance.

Asset retirement costs associated with the AROs for CCR at the East Bend Station are included within Property, Plant and Equipment on the Balance Sheets.

The following table presents the changes in the liability associated with AROs.

(in thousands)	Years Ended December 31, 2015	2014
Balance at beginning of period[a]	$ 8,122	$ 6,253
Acquisitions[b]	—	270
Accretion expense	3,391	430
Liabilities settled[c]	(4,443)	—
Liabilities incurred in the current year[d]	115,723	—
Revisions to estimates of cash flows[e]	(19,293)	1,169
Balance at end of period	$ 103,500	$ 8,122

(a) Primarily related to the retirement of natural gas mains, asbestos removal and closure of landfills at fossil generation facilities.
(b) Acquired as a result of the purchase of Dayton Power and Light Company's ownership interest in the East Bend Station.
(c) Settlement of liabilities related to ash basin closure costs at the East Bend Station.
(d) Incurred as a result of the EPA's rule for disposal of CCR as solid waste. See Note 2 for further discussion of the approval granted by the KPSC to defer costs related to ash basin closure at the East Bend Station.
(e) The 2015 amount primarily relates to ash basin closure costs.

Cost recovery related to ash basin closures will be pursued through the normal ratemaking process with the KPSC which permits recovery of necessary and prudently incurred costs associated with Duke Energy Kentucky's regulated operations.

6. PROPERTY, PLANT AND EQUIPMENT

The following table summarizes property, plant and equipment.

(in thousands)	Estimated Useful Life (Years)	December 31, 2015	2014
Land		$ 24,475	$ 22,452
Plant			
Electric generation, distribution and transmission[a]	8 – 100	1,509,240	1,182,985
Natural gas transmission and distribution[a]	12 – 50	438,055	428,082
Other buildings and improvements	15 – 100	11,674	11,914
Equipment	5 – 25	16,464	15,888
Construction in process		43,361	14,898
Other	5 – 20	36,492	35,617
Total property, plant and equipment		2,079,761	1,711,836
Accumulated depreciation and amortization[b]		(923,578)	(691,367)
Generation facilities to be retired, net		—	8,601
Net property, plant and equipment[c]		$ 1,156,183	$ 1,029,070

(a) Includes capitalized lease amounts of $32 million for each of the years ended December 31, 2015 and 2014.
(b) Includes accumulated amortization of capitalized leases of $7 million and $6 million at December 31, 2015 and 2014, respectively.
(c) The debt component of AFUDC totaled $225 thousand and $233 thousand at December 31, 2015 and 2014, respectively.

7. OTHER INCOME AND EXPENSES, NET

The components of Other Income and Expenses, net on the Statements of Operations are as follows.

(in thousands)	Years Ended December 31, 2015	2014
Income/(Expense):		
Interest income	$ 1,019	$ 1,168
AFUDC equity	620	498
Other	(564)	230
Other Income and Expense, net	$ 1,075	$ 1,896

8. RELATED PARTY TRANSACTIONS

Duke Energy Kentucky engages in related party transactions, which are generally performed at cost and in accordance with KPSC and FERC regulations. Material amounts related to transactions with related parties included in the Statements of Operations are presented in the following table.

	Years Ended December 31,	
(in thousands)	2015	2014
Corporate governance and shared service expenses[(a)]	$ 77,884	$ 69,606

(a) Duke Energy Kentucky is charged its proportionate share of costs, primarily related to human resources, employee benefits, legal and accounting fees, as well as other third party costs, from an unconsolidated affiliate that is a consolidated affiliate of Duke Energy. These amounts are recorded in Operation, maintenance and other within Operating Expenses on the Statements of Operations.

In addition to the amounts presented above, Duke Energy Kentucky records the impact on net income of other affiliate transactions, including rental of office space, participation in a money pool arrangement with Duke Energy and certain of its subsidiaries, other operational transactions and its proportionate share of certain charged expenses. The net impact of these transactions was not material for each of the years ended December 31, 2015 and 2014.

Certain trade receivables have been sold by Duke Energy Kentucky to CRC, an unconsolidated entity formed by a subsidiary of Duke Energy. The proceeds obtained from the sales of receivables are largely cash but do include a subordinated note from CRC for a portion of the purchase price. Refer to Notes 1 and 11 for further information related to the sales of these receivables.

Refer to the Balance Sheets for amounts due to or due from related parties.

Intercompany Income Taxes

Duke Energy and its subsidiaries file a consolidated federal income tax return and other state and jurisdictional returns. Duke Energy Kentucky has a tax sharing agreement with Duke Energy for the allocation of consolidated tax liabilities and benefits. Income taxes recorded represent amounts Duke Energy Kentucky would incur as a separate C-Corporation. For the years ended December 31, 2015 and 2014, Duke Energy Kentucky had intercompany tax receivable balances of $13 million and $5 million, respectively.

9. DERIVATIVES AND HEDGING

COMMODITY PRICE RISK

Duke Energy Kentucky has limited exposure to market price changes of fuel and emission allowance costs incurred for its retail customers due to the use of cost tracking and recovery mechanisms. Duke Energy Kentucky does have exposure to the impact of market fluctuations in the prices of electricity, fuel and emission allowances associated with its generation output not utilized to serve retail operations or committed load (off-system, wholesale power sales). Duke Energy Kentucky's outstanding commodity derivatives are primarily financial transmission rights.

See Note 10 for additional information on the fair value of commodity derivatives.

INTEREST RATE RISK

Duke Energy Kentucky is exposed to changes in interest rates as a result of its issuance or anticipated issuance of variable-rate and fixed-rate debt. Interest rate risk is managed by limiting variable-rate exposure to a percentage of total debt and by monitoring changes in interest rates. To manage risk associated with changes in interest rates, Duke Energy Kentucky may enter into financial contracts including interest rate swaps and U.S. Treasury lock agreements. The notional amount of interest rate swaps outstanding was $26.7 million at December 31, 2015 and December 31, 2014. Financial contracts entered into by Duke Energy Kentucky are not designated as a hedge because they are accounted for under regulatory accounting. With regulatory accounting, the mark-to-market gains or losses are deferred as regulatory assets or liabilities, respectively. Regulatory assets and liabilities are amortized consistent with the treatment of related costs in the ratemaking process. The accrual of interest on swaps is recorded as Interest Expense on the Statements of Operations.

See Note 10 for additional information on the fair value of interest rate derivatives.

CREDIT RISK

Duke Energy Kentucky analyzes the financial condition of counterparties prior to entering into agreements and establishes credit limits and monitors the appropriateness of those limits on an ongoing basis. Credit limits and collateral requirements for retail electric customers are established by the KPSC.

Duke Energy Kentucky's industry has historically operated under negotiated credit lines for physical delivery contracts. Duke Energy Kentucky may use master collateral agreements to mitigate certain credit exposures. The collateral agreements require certain counterparties to post cash or letters of credit for the amount of exposure in excess of an established threshold. The threshold amount represents an unsecured credit limit determined in accordance with the corporate credit policy. Collateral agreements also provide that the inability to post collateral is sufficient cause to terminate contracts and liquidate all positions.

Duke Energy Kentucky also obtains cash or letters of credit from customers to provide credit support outside of collateral agreements, where appropriate, based on its financial analysis of the customer and the regulatory or contractual terms and conditions applicable to each transaction.

10. FAIR VALUE MEASUREMENTS

Fair value is the exchange price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date. The fair value definition focuses on an exit price versus the acquisition cost. Fair value measurements use market data or assumptions market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, corroborated by market data or generally unobservable. Valuation techniques maximize the use of observable inputs and minimize the use of unobservable inputs. A midmarket pricing convention (the midpoint price between bid and ask prices) is permitted for use as a practical expedient.

Fair value measurements are classified in three levels based on the fair value hierarchy:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity can access at the measurement date. An active market is one in which transactions for an asset or liability occur with sufficient frequency and volume to provide ongoing pricing information.

Level 2 – A fair value measurement utilizing inputs other than quoted prices included in Level 1 that are observable, either directly or indirectly, for an asset or liability. Inputs include (i) quoted prices for similar assets or liabilities in active markets, (ii) quoted prices for identical or similar assets or liabilities in markets that are not active, (iii) and inputs other than quoted market prices that are observable for the asset or liability, such as interest rate curves and yield curves observable at commonly quoted intervals, volatilities, and credit spreads. A Level 2 measurement cannot have more than an insignificant portion of its valuation based on unobservable inputs. Instruments in this category include non-exchange-traded derivatives, such as over-the-counter forwards, swaps and options; certain marketable debt securities; and financial instruments traded in less than active markets.

Level 3 – Any fair value measurement which includes unobservable inputs for more than an insignificant portion of the valuation. These inputs may be used with internally developed methodologies that result in management's best estimate of fair value. Level 3 measurements may include longer-term instruments that extend into periods in which observable inputs are not available.

Fair value accounting guidance permits entities to elect to measure certain financial instruments that are not required to be accounted for at fair value, such as equity method investments or the company's own debt, at fair value. Duke Energy Kentucky has not elected to record any of these items at fair value.

Transfers between levels represent assets or liabilities that were previously (i) categorized at a higher level for which the inputs to the estimate became less observable or (ii) classified at a lower level for which the inputs became more observable during the period. Duke Energy Kentucky's policy is to recognize transfers between levels of the fair value hierarchy at the end of the period. There were no transfers between levels 1, 2 or 3 during the years ended December 31, 2015 and 2014.

Valuation methods of the primary fair value measurements disclosed below are as follows.

Interest rate derivatives

Most over-the-counter interest rate contract derivatives are valued using financial models which utilize observable inputs for similar instruments and are classified as Level 2. Inputs include forward interest rate curves, notional amounts, interest rates and credit quality of the counterparties.

QUANTITATIVE DISCLOSURES

The following tables provide recorded balances for assets and liabilities measured at fair value on a recurring basis on the Balance Sheets, the fair values presented below are shown gross. Derivative amounts in the table below exclude cash collateral.

	December 31, 2015			
(in thousands)	Total Fair Value	Level 1	Level 2	Level 3
Derivative assets[a]	$ 2,913	$ —	$ —	$ 2,913
Derivative liabilities[b]	(6,678)	(27)	(6,651)	—
Net (liabilities) assets	$ (3,765)	$ (27)	$ (6,651)	$ 2,913

	December 31, 2014			
(in thousands)	Total Fair Value	Level 1	Level 2	Level 3
Derivative assets[a]	$ 1,033	$ —	$ —	$ 1,033
Derivative liabilities[b]	(6,678)	—	(6,678)	—
Net (liabilities) assets	$ (5,645)	$ —	$ (6,678)	$ 1,033

(a) Relates to financial transmission rights included in Other within Current Assets on the Balance Sheets.
(b) Included in Other within Current Liabilities and Other within Deferred Credits and Other Liabilities on the Balance Sheets. The amounts classified as Level 2 are related to interest rate swaps.

The following table provides a reconciliation of beginning and ending balances of assets and liabilities measured at fair value on a recurring basis where the determination of fair value includes significant unobservable inputs (Level 3).

	Derivatives (net)	
	Years Ended December 31,	
(in thousands)	2015	2014
Balance at beginning of period	$ 1,033	$ 350
Total pretax realized or unrealized gains included in earnings:		
Operating Revenues	—	1,566
Purchases, sales, issuances and settlements:		
Purchases	4,611	1,060
Settlements	(3,113)	(2,542)
Total gains included on the Balance Sheets as regulatory assets or liabilities	382	599
Balance at end of period	$ 2,913	$ 1,033

OTHER FAIR VALUE DISCLOSURES

The fair value of long-term debt, including current maturities, is summarized in the following table. Judgment is required in interpreting market data to develop the estimates of fair value. Accordingly, the estimates determined are not necessarily indicative of the amounts Duke Energy Kentucky could have settled in current markets. The fair value of long-term debt is determined using Level 2 measurements.

	December 31, 2015		December 31, 2014	
(in thousands)	Book value	Fair value	Book value	Fair value
Long-Term debt, including current maturities	$ 319,027	$ 332,620	$ 320,786	$ 348,254

At both December 31, 2015 and December 31, 2014, the fair value of cash and cash equivalents, accounts and notes receivable, and accounts and notes payable are not materially different from their carrying amounts because of the short-term nature of these instruments and/or because the stated rates approximate market rates.

11. VARIABLE INTEREST ENTITIES

A variable interest entity (VIE) is an entity that is evaluated for consolidation using more than a simple analysis of voting control. The analysis to determine whether an entity is a VIE considers contracts with an entity, credit support for an entity, the adequacy of the equity investment of an entity, and the relationship of voting power to the amount of equity invested in an entity. This analysis is performed either upon the creation of a legal entity or upon the occurrence of an event requiring reevaluation, such as a significant change in an entity's assets or activities. A qualitative analysis of control determines the party that consolidates a VIE. This assessment is based on (i) what party has the power to direct the most significant activities of the VIE that impact its economic performance and (ii) what party has rights to receive benefits or is obligated to absorb losses that are significant to the VIE. The analysis of the party that consolidates a VIE is a continual reassessment.

Cinergy Receivables Company (CRC)

CRC is a bankruptcy remote, special purpose entity that is an affiliate of Duke Energy Kentucky. As discussed below, Duke Energy Kentucky does not consolidate CRC as it is not the primary beneficiary. On a revolving basis, CRC buys certain accounts receivable arising from the sale of electricity and/or related services from Duke Energy Kentucky. Receivables sold are securitized by CRC through a credit facility managed by two unrelated third parties. CRC's borrowing availability is limited to the amount of qualified receivables sold to CRC, which is expected to be in excess of the credit facility. The sole source of funds to satisfy CRC's related debt obligation is cash collections from the receivables. Depending on experience with collections, additional equity infusions to CRC may be required by Duke Energy to maintain a minimum equity balance of $3 million. There were no infusions to CRC during the years ended December 31, 2015 and 2014.

The proceeds Duke Energy Kentucky receives from the sale of receivables to CRC are typically 75 percent cash and 25 percent in the form of a subordinated note from CRC. The subordinated note is a retained interest in the receivables sold. Duke Energy Kentucky had receivables of $10.1 million and $21.6 million from CRC at December 31, 2015 and December 31, 2014, respectively. These balances are included in Receivables from affiliated companies on the Balance Sheets.

CRC is considered a VIE because (i) equity capitalization is insufficient to support its operations, (ii) power to direct the most significant activities that impact economic performance of the entity are not performed by the equity holder, Cinergy Corp. (Cinergy) and (iii) deficiencies in net worth of CRC are not funded by Cinergy, but by Duke Energy. The most significant activity of CRC relates to the decisions made with respect to the management of delinquent receivables. Duke Energy consolidates CRC as it makes these decisions. Duke Energy Kentucky does not consolidate CRC. No financial support was provided to this non-consolidated VIE during the years ended December 31, 2015 or 2014, or expected to be provided in the future, that was not previously contractually required.

The subordinated note held by Duke Energy Kentucky is stated at fair value. Carrying values of retained interests are determined by allocating carrying value of the receivables between assets sold and interests retained based on relative fair value. The allocated basis of the subordinated notes are not materially different than their face value because (i) the receivables generally turnover in less than two months, (ii) credit losses are reasonably predictable due to the broad customer base and lack of significant concentration and (iii) the equity in CRC is subordinate to all retained interests and thus would absorb losses first. The hypothetical effect on fair value of the retained interests assuming both a 10 percent and a 20 percent unfavorable variation in credit losses or discount rates is not material due to the short turnover of receivables and historically low credit loss history. Interest accrues to Duke Energy Kentucky on the retained interests using the acceptable yield method. This method generally approximates the stated rate on the notes since the allocated basis and the face value are nearly equivalent. An impairment charge is recorded against the carrying value of both retained interests and purchased beneficial interest whenever it is determined that an other-than-temporary impairment has occurred. Duke Energy Kentucky's maximum exposure to loss does not exceed the carrying value.

Key assumptions used in estimating fair value in 2015 and 2014 are detailed in the following table.

	2015	2014
Anticipated credit loss ratio	0.5%	0.5%
Discount rate	1.2%	1.2%
Receivables turnover rate	11.4%	11.4%

The following table presents gross and net receivables sold.

(in thousands)	December 31, 2015	December 31, 2014
Receivables sold	$ 46,253	$ 62,242
Less: Retained interests	10,137	21,560
Net receivables sold	$ 36,116	$ 40,682

The following table presents sales and cash flows related to receivables sold.

	Years Ended December 31,	
(in thousands)	2015	2014
Sales		
Receivables sold	$ 440,339	$ 527,149
Loss recognized on sale	1,553	1,979
Cash flows		
Cash proceeds from receivables sold	$ 450,208	$ 528,143
Collection fees received	220	264
Return received on retained interests	670	952

Cash flows from the sale of receivables are reflected within Operating Activities on the Statements of Cash Flows.

Collection fees received in connection with the servicing of transferred accounts receivable are included in Operation, maintenance, and other on the Statements of Operations. The loss recognized on the sale of receivables is calculated monthly by multiplying the receivables sold during the month by the required discount which is derived monthly utilizing a three-year weighted average formula that considers charge-off history, late charge history and turnover history on the sold receivables, as well as a component for the time value of money. The discount rate, or component for the time value of money, is calculated monthly by summing the prior month-end London Interbank Offered Rate (LIBOR) plus a fixed rate of 1.00 percent.

12. EMPLOYEE BENEFIT PLANS

DEFINED BENEFIT RETIREMENT PLANS

Duke Energy Kentucky participates in qualified and non-qualified defined benefit retirement plans and other post-retirement benefit plans sponsored by Duke Energy. Duke Energy allocates pension and other post-retirement obligations and costs related to these plans to Duke Energy Kentucky. The plans cover most employees using a cash balance formula. Under a cash balance formula, a plan participant accumulates a retirement benefit consisting of pay credits based upon a percentage of current eligible earnings based on age and/or years of service and interest credits. Certain employees are covered under plans that use a final average earnings formula. Under these average earnings formulas, a plan participant accumulates a retirement benefit equal to the sum of percentages of their (i) highest three-year or four-year average earnings, (ii) highest three-year or four-year average earnings in excess of covered compensation per year of participation (maximum of 35 years), and/or (iii) highest three-year average earnings times years of participation in excess of 35 years. Duke Energy also maintains, and Duke Energy Kentucky participates in, non-qualified, non-contributory defined benefit retirement plans which cover certain executives. As of January 1, 2014, the qualified and non-qualified non-contributory defined benefit plans are closed to new and rehired non-union and certain unionized employees.

Duke Energy uses a December 31 measurement date for its defined benefit retirement plan assets and obligations.

Duke Energy's policy is to fund amounts on an actuarial basis to provide assets sufficient to meet benefit payments to be paid to plan participants. Actual contributions for Duke Energy Kentucky were $2,203 thousand for the year-ended December 31, 2015. No contributions were made by Duke Energy Kentucky during 2014. Anticipated contributions for 2016 for Duke Energy Kentucky are $1,258 thousand.

Net periodic benefit costs disclosed in the tables below represent the cost of the respective plan for the periods presented. However, portions of the net periodic benefit cost disclosed in the tables have been capitalized as a component of property, plant and equipment. Amounts presented in the tables below represent the amounts of pension and other post-retirement benefit cost allocated by Duke Energy for employees of Duke Energy Kentucky. Additionally, Duke Energy Kentucky is allocated its proportionate share of pension and other post-retirement benefit cost for employees of Duke Energy's shared services affiliate that provides support to Duke Energy Kentucky. These allocated amounts are included in the governance and shared services costs discussed in Note 8.

QUALIFIED PENSION PLANS

Components of Net Periodic Pension Costs

	Years Ended December 31,	
(in thousands)	**2015**	**2014**
Service cost	**$ 1,471**	$ 1,387
Interest cost on projected benefit obligation	**3,857**	4,099
Expected return on plan assets	**(5,732)**	(5,654)
Amortization of prior service cost	**52**	104
Amortization of loss	**2,108**	1,594
Other	**80**	76
Net periodic pension costs	**$ 1,836**	$ 1,606

Amounts Recognized in Regulatory Assets

	December 31,	
(in thousands)	**2015**	**2014**
Regulatory assets, net increase	**$ 3,827**	$ 2,583

Reconciliation of Funded Status to Net Amount Recognized

	Years Ended December 31,	
(in thousands)	**2015**	**2014**
Change in Projected Benefit Obligation		
Obligation at prior measurement date	**$ 97,507**	$ 88,958
Service cost	**1,471**	1,387
Interest cost	**3,857**	4,099
Actuarial (gains) losses	**(1,211)**	7,840
Transfers	**6,452**	—
Plan amendments	**(79)**	(180)
Benefits paid	**(7,168)**	(4,597)
Obligation at measurement date	**$ 100,829**	$ 97,507
Accumulated Benefit Obligation	**$ 97,632**	$ 94,303
Change in Fair Value of Plan Assets		
Plan assets at prior measurement date	**$ 95,391**	$ 91,031
Actual return on plan assets	**(505)**	8,957
Benefits paid	**(7,168)**	(4,597)
Employer contributions	**2,203**	—
Transfers	**6,452**	—
Plan assets at measurement date	**$ 96,373**	$ 95,391

Amounts Recognized in the Balance Sheets

(in thousands)	December 31, 2015	December 31, 2014
Prefunded pension[a]	$ 1,121	$ 477
Noncurrent pension liability[b]	5,577	2,593
Net liability recognized	$ (4,456)	$ (2,116)
Regulatory assets	$ 25,323	$ 21,496
Amounts to be reported in net periodic pension expense in the next year		
Unrecognized net actuarial loss	$ 1,614	
Unrecognized prior service credit	34	

(a) Included in Other within Investments and Other Assets on the Balance Sheets.
(b) Included in Accrued pension and other post-retirement benefit costs on the Balance Sheets.

Information for Plans with Accumulated Benefit Obligation in Excess of Plan Assets

(in thousands)	December 31, 2015
Projected benefit obligation	$ 87,665
Accumulated benefit obligation	84,801
Fair Value of plan assets	82,088

As of December 31, 2014, no qualified pension plans had an accumulated benefit obligation in excess of plan assets.

Assumptions Used for Pension Benefits Accounting

	December 31, 2015	December 31, 2014
Benefit Obligations		
Discount rate	4.40%	4.10%
Salary increase	4.40%	4.40%
Net Periodic Benefit Cost		
Discount rate	4.10%	4.70%
Salary increase	4.40%	4.40%
Expected long-term rate of return on plan assets	6.50%	6.75%

The discount rate used to determine the current year pension obligation and following year's pension expense is based on a bond selection-settlement portfolio approach. This approach develops a discount rate by selecting a portfolio of high quality corporate bonds that generate sufficient cash flow to provide for the projected benefit payments of the plan. The selected bond portfolio is derived from a universe of non-callable corporate bonds rated Aa quality or higher. After the bond portfolio is selected, a single interest rate is determined that equates the present value of the plan's projected benefit payments discounted at this rate with the market value of the bonds selected.

NON-QUALIFIED PENSION PLANS

Components of Net Periodic Pension Costs

(in thousands)	Years Ended December 31, 2015	Years Ended December 31, 2014
Interest cost on projected benefit obligation	$ 6	$ 6
Amortization of actuarial loss	9	12
Net periodic pension costs	$ 15	$ 18

Amounts Recognized in Regulatory Assets

(in thousands)	December 31, 2015	December 31, 2014
Regulatory assets, net (decrease) increase	$ (13)	$ 6

Reconciliation of Funded Status to Net Amount Recognized

(in thousands)	Years Ended December 31, 2015	2014
Change in Projected Benefit Obligation		
Obligation at prior measurement date	$ 148	$ 135
Interest cost	6	6
Actuarial (gains) losses	(2)	18
Benefits paid	(11)	(11)
Obligation at measurement date	$ 141	$ 148
Accumulated Benefit Obligation	$ 141	$ 148
Change in Fair Value of Plan Assets		
Plan assets at prior measurement date	$ —	$ —
Benefits paid	(11)	(11)
Employer contributions	11	11
Plan assets at measurement date	$ —	$ —

Amounts Recognized in the Balance Sheets

(in thousands)	December 31, 2015	2014
Current pension liability[(a)]	$ 10	$ 10
Noncurrent pension liability[(b)]	131	138
Total accrued pension liability	$ 141	$ 148
Regulatory assets	$ 51	$ 64
Amounts to be recognized in net periodic pension expense in the next year		
Unrecognized net actuarial loss	$ 9	

(a) Included in Other within Current Liabilities on the Balance Sheets.
(b) Included in Accrued pension and other post-retirement benefit costs on the Balance Sheets.

Information for Plans with Accumulated Benefit Obligation in Excess of Plan Assets

(in thousands)	December 31, 2015	2014
Projected benefit obligation	$ 141	$ 148
Accumulated benefit obligation	141	148

Assumptions Used for Pension Benefits Accounting

	December 31, 2015	2014
Benefit Obligations		
Discount rate	4.40%	4.10%
Salary increase	4.40%	4.40%
Net Periodic Benefit Cost		
Discount rate	4.10%	4.70%
Salary increase	4.40%	4.40%

The discount rate used to determine the current year pension obligation and following year's pension expense is based on a bond selection-settlement portfolio approach. This approach develops a discount rate by selecting a portfolio of high quality corporate bonds that generate sufficient cash flow to provide for the projected benefit payments of the plan. The selected bond portfolio is derived from a universe of non-callable corporate bonds rated Aa quality or higher. After the bond portfolio is selected, a single interest rate is determined that equates the present value of the plan's projected benefit payments discounted at this rate with the market value of the bonds selected.

OTHER POST-RETIREMENT BENEFIT PLANS

Duke Energy provides, and Duke Energy Kentucky participates in, some health care and life insurance benefits for retired employees on a contributory and non-contributory basis. Employees are eligible for these benefits if they have met age and service requirements at retirement, as defined in the plans. The health care benefits include medical, dental, and prescription drug coverage and are subject to certain limitations, such as deductibles and co-payments.

Duke Energy did not make any pre-funding contributions to its other post-retirement benefit plans during the years ended December 31, 2015 and 2014.

Components of Net Periodic Other Post-Retirement Benefit Costs

	Years Ended December 31,	
(in thousands)	2015	2014
Service cost	$ 112	$ 131
Interest cost on projected benefit obligation	305	379
Expected return on plan assets	(51)	(64)
Amortization of prior service (credit) cost	(70)	2
Amortization of loss	5	50
Net periodic pension costs	$ 301	$ 498

Amounts Recognized in Regulatory Assets and Regulatory Liabilities

	December 31,	
(in thousands)	2015	2014
Regulatory assets, net decrease	$ (331)	$ (360)
Regulatory liabilities, net increase	1,103	408

Reconciliation of Funded Status to Accrued Other Post-Retirement Benefit Costs

	Years Ended December 31,	
(in thousands)	2015	2014
Change in Projected Benefit Obligation		
Accumulated post-retirement benefit obligation at prior measurement date	$ 7,751	$ 8,335
Service cost	112	131
Interest cost	305	379
Plan participants' contributions	215	74
Actuarial gains	(996)	(128)
Transfers	414	—
Plan amendments	(396)	(557)
Benefits paid	(560)	(483)
Accumulated post-retirement benefit obligation at measurement date	$ 6,845	$ 7,751
Change in Fair Value of Plan Assets		
Plan assets at prior measurement date	$ 1,180	$ 966
Actual return on plan assets	(23)	95
Plan participants' contributions	215	74
Benefits paid	(560)	(483)
Transfers	143	—
Employer contributions	243	528
Plan assets at measurement date	$ 1,198	$ 1,180

Amounts Recognized in the Balance Sheets

(in thousands)	December 31, 2015	2014
Current post-retirement liability[(a)]	$ 169	$ 158
Noncurrent post-retirement liability[(b)]	5,478	6,413
Total accrued post-retirement liability	$ 5,647	$ 6,571
Regulatory assets	$ 2,915	$ 3,246
Regulatory liabilities	$ 4,938	$ 3,835

(a) Included in Other within Current Liabilities on the Balance Sheets.
(b) Included in Accrued pension and other post-retirement benefit costs on the Balance Sheets.

Assumptions Used for Other Post-Retirement Benefits Accounting

	December 31, 2015	2014
Benefit Obligations		
Discount rate	**4.40%**	4.10%
Net Periodic Benefit Cost		
Discount rate	**4.10%**	4.70%
Expected long-term rate of return on plan assets	**6.50%**	6.75%

The discount rate used to determine the current year other post-retirement benefits obligation and following year's other postretirement benefits expense is based on a bond selection-settlement portfolio approach. This approach develops a discount rate by selecting a portfolio of high quality corporate bonds that generate sufficient cash flow to provide for the projected benefit payments of the plan. The selected bond portfolio is derived from a universe of non-callable corporate bonds rated Aa quality or higher. After the bond portfolio is selected, a single interest rate is determined that equates the present value of the plan's projected benefit payments discounted at this rate with the market value of the bonds selected.

Assumed Health Care Cost Trend Rate

	December 31, 2015	2014
Health care cost trend rate assumed for next year	**7.50%**	6.75%
Rate to which the cost trend is assumed to decline (the ultimate trend rate)	**4.75%**	4.75%
Year that the rate reaches the ultimate trend rate	**2023**	2023

Expected Benefit Payments

The following table presents Duke Energy's expected benefit payments to participants on behalf of Duke Energy Kentucky in its qualified, non-qualified and other post-retirement benefit plans over the next 10 years. These benefit payments reflect expected future service, as appropriate.

(in thousands)	Qualified Plans	Non-Qualified Plans	Other Post-Retirement Plans	Total
Years ending December 31,				
2016	$ 6,113	$ 11	$ 777	$ 6,901
2017	6,195	11	742	6,948
2018	6,594	11	703	7,308
2019	7,201	11	636	7,848
2020	7,319	10	632	7,961
2021–2025	39,999	51	2,844	42,894

MASTER RETIREMENT TRUST

The assets for the Duke Energy Kentucky plans discussed above are derived from the Master Retirement Trust (Master Trust) that is held by Duke Energy and, as such, Duke Energy Kentucky is allocated its proportionate share of assets discussed below. Assets for both the qualified pension and other post-retirement benefits are maintained in the Master Trust. Duke Energy assumes pension and other post-retirement plan assets will generate a long-term rate of return of 6.50 percent. The expected long-term rate of return was developed using a weighted average calculation of expected returns based primarily on future expected returns across asset classes considering the use of active asset managers, where applicable. The asset allocation targets were set after considering the investment objective and the risk profile. Equity securities are held for their high expected return. Debt securities are primarily held to hedge the qualified pension plan liability. Hedge funds, real estate and other global securities are held for diversification. Investments within asset classes are diversified to achieve broad market participation and reduce the impact of individual managers or investments.

Duke Energy has a de-risking investment strategy for the Duke Energy Master Retirement Trust. As the funded status of the pension plans increase, the targeted allocation to return seeking assets will be reduced and the targeted allocation to fixed-income assets will be increased to better manage Duke Energy's pension liability and reduce funded status volatility. Duke Energy regularly reviews its actual asset allocation and periodically rebalances its investments to the targeted allocation when considered appropriate.

The following table presents target and actual asset allocations for the Master Trust at December 31, 2015 and 2014.

		Actual Allocation at December 31,	
Asset Category	Target Allocation	2015	2014
U.S. equity securities	10%	11%	10%
Non-U.S. equity securities	8%	8%	8%
Global equity securities	10%	10%	10%
Global private equity securities	3%	2%	3%
Debt securities	63%	63%	63%
Hedge funds	2%	2%	3%
Real estate and cash	2%	2%	1%
Other global securities	2%	2%	2%
Total	100%	100%	100%

EMPLOYEE SAVINGS PLAN

Duke Energy Kentucky also participates in employee savings plans sponsored by Duke Energy. Most employees participate in a matching contribution formula where Duke Energy provides a matching contribution generally equal to 100 percent of employee before-tax and Roth 401(k) contributions and, as applicable, after-tax contributions of up to 6 percent of eligible pay per period.

As of January 1, 2014, for new and rehired non-union and certain unionized employees who are not eligible to participate in Duke Energy's defined benefit plans, an additional employer contribution of 4 percent of eligible pay per pay period, which is subject to a three-year vesting schedule, is provided to the employee's savings plan account.

Duke Energy Kentucky's expense related to its proportionate share of pretax employer contributions and the additional 4 percent employer contribution was $888 thousand and $775 thousand for the years ended December 31, 2015 and 2014, respectively.

13. INCOME TAXES

INCOME TAX EXPENSE

Components of Income Tax Expense

	Years Ended December 31,	
(in thousands)	2015	2014
Current income taxes		
Federal	$ 4,844	$ 4,372
State	(245)	2,618
Total current income taxes	4,599	6,990
Deferred income taxes		
Federal	19,825	13,801
State	3,810	500
Total deferred income taxes	23,635	14,301
Investment tax credit amortization	(173)	(173)
Total income tax expense presented in Statements of Operations	$ 28,061	$ 21,118

Statutory Rate Reconciliation

The following table presents a reconciliation of income tax expense at the U.S. federal statutory tax rate to actual tax expense.

	Years Ended December 31,	
(in thousands)	**2015**	**2014**
Income tax expense, computed at the statutory rate of 35 percent	**$ 25,983**	$ 19,747
State income tax, net of federal income tax effect	**2,317**	2,027
Federal true-up	**341**	(264)
Manufacturing deduction	**—**	(290)
Other items, net	**(580)**	(102)
Total income tax expense	**$ 28,061**	$ 21,118
Effective tax rates	**37.8%**	37.4%

DEFERRED TAXES

Net Deferred Income Tax Liability Components

	Years Ended December 31,	
(in thousands)	**2015**	**2014**
Deferred credits and other liabilities	**$ 495**	$ 945
Tax credits and net operating loss carryforwards	**375**	220
Pension, postretirement and other employee benefits	**5,461**	4,626
Other	**2,077**	1,985
Investments and other liabilities	**2,331**	—
Total deferred income tax assets	**10,739**	7,776
Investments and other assets	**—**	(3,245)
Accelerated depreciation rates	**(278,603)**	(261,377)
Regulatory assets and deferred debits, net	**(21,778)**	(11,665)
Total deferred income tax liabilities	**(300,381)**	(276,287)
Net deferred income tax liabilities	**$ (289,642)**	$ (268,511)

Classification of Deferred Tax Assets (Liabilities) in the Balance Sheets

As discussed in Note 1, the FASB issued revised accounting guidance for the balance sheet classification of deferred taxes. As shown in the table below, all deferred tax assets and liabilities are presented as noncurrent as of December 31, 2015. However, for December 31, 2014, the revised guidance was not applied. As a result, a portion of deferred tax assets and liabilities is shown as current at December 31, 2014.

	Years Ended December 31,	
(in thousands)	**2015**	**2014**
Current Assets: Other	**$ —**	$ 2,797
Deferred Credits and Other Liabilities: Deferred income taxes	**(289,642)**	(271,308)
Net deferred income tax liabilities	**$ (289,642)**	$ (268,511)

UNRECOGNIZED TAX BENEFITS

The following table presents changes to unrecognized tax benefits.

	Years Ended December 31,	
(in thousands)	**2015**	**2014**
Unrecognized tax benefits – January 1	**$ 52**	$ 47
Unrecognized tax benefits increases (decreases)		
Gross increases – tax positions in prior periods	**—**	5
Unrecognized tax benefits – December 31	**$ 52**	$ 52

The following table includes information regarding unrecognized tax benefits. Duke Energy Kentucky does not anticipate a material increase or decrease in unrecognized tax benefits within the next 12 months.

(in thousands)	**December 31, 2015**
Amount that if recognized, would affect the effective tax rate or regulatory liability[(a)]	**$ 52**

(a) Duke Energy Kentucky is unable to estimate the specific amounts that would affect the effective tax rate versus the regulatory liability.

OTHER TAX MATTERS

The following table includes interest recognized in the Statements of Operations and the Balance Sheets.

(in thousands)	As of December 31, 2015	2014
Net interest income recognized related to income taxes	$ 18	$ 61
Interest receivable related to income taxes	224	206

Duke Energy Kentucky is no longer subject to U.S. federal examination for years before 2008. The years 2008 through 2011 are in appeals. The IRS is currently auditing the federal income tax returns for years 2012, 2013 and 2014. With few exceptions, Duke Energy Kentucky is no longer subject to state, local or non-U.S. income tax examinations by tax authorities for years before 2006.

14. SUBSEQUENT EVENTS

For information on subsequent events related to summary of significant accounting policies, regulatory matters, commitments and contingencies, and debt and credit facilities, see Notes 1, 2, 3, and 4, respectively. Management has evaluated these Financial Statements and Notes for subsequent events up through March 16, 2015, the date the financial statements were available to be issued.