# Enclosure 2 to PLA-7350

# Allegheny Electric Cooperative, Inc. Auditor's Report and Consolidated Financial Statements – December 31, 2014 and 2013

[redacted]

BKD LLP
CPAs & Advisors

# Allegheny Electric Cooperative, Inc.

Auditor's Report and Consolidated Financial Statements

December 31, 2014 and 2013

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# Allegheny Electric Cooperative, Inc.
## December 31, 2014 and 2013

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# Independent Auditor's Report

Board of Directors
Allegheny Electric Cooperative, Inc.
Harrisburg, Pennsylvania

We have audited the accompanying consolidated financial statements of Allegheny Electric Cooperative, Inc., which comprise the consolidated balance sheets as of December 31, 2014 and 2013, and the related consolidated statements of margin, comprehensive margin, members' equities and cash flows for the years then ended, and the related notes to the financial statements.

**Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor's Responsibility**

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Allegheny Electric Cooperative, Inc. as of December 31, 2014 and 2013, 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.

BKD, LLP

Decatur, Illinois
April 17, 2015

# Allegheny Electric Cooperative, Inc.
## Consolidated Balance Sheets
## December 31, 2014 and 2013
## (In Thousands)

### Assets

| | 2014 | 2013 |
|---|---|---|
| **Electric Utility Plant, at cost** | | |
| In service (see Note 2) | $ 982,828 | $ 960,601 |
| Less accumulated depreciation | (776,906) | (757,931) |
| | 205,922 | 202,670 |
| Construction work in progress | 13,992 | 11,061 |
| Nuclear fuel in process (see Notes 1 and 3) | 33,836 | 31,901 |
| Net electric utility plant (see Notes 1, 2 and 3) | 253,750 | 245,632 |
| **Investments and Other Assets** | | |
| Investments in associated organizations (see Note 4) | 16,442 | 26,844 |
| Nuclear Decommissioning Trust (NDT) (see Notes 1 and 5) | 113,849 | 104,286 |
| Non-utility property, at cost (net of accumulated depreciation of $7,244 in 2014 and $6,821 in 2013) | 7,796 | 6,710 |
| Assets of consolidated variable interest entity | | |
| Non-utility property, at cost (net of accumulated depreciation of $510 in 2014 and $569 in 2013) | 9 | 11 |
| Prepaid pension expense (see Notes 12 and 14) | 4,130 | 4,646 |
| Deferred tax assets, net (see Note 10) | 1,775 | 4,306 |
| Derivative investments (see Note 6) | 192 | 381 |
| Other noncurrent assets | 52 | 53 |
| | 144,245 | 147,237 |
| **Current Assets** | | |
| Cash and cash equivalents | 23,580 | 25,364 |
| Investments (see Note 1 and 4) | 40,278 | 32,954 |
| Derivative investments (see Note 6) | 1,102 | 1,544 |
| Accounts receivable, members (see Note 1) | 18,884 | 19,726 |
| Accounts receivable, affiliated organization | 96 | 63 |
| Other receivables | 16,176 | 12,562 |
| Inventories (see Note 1) | 11,060 | 10,324 |
| Other current assets | 1,702 | 1,643 |
| Assets of consolidated variable interest entity | | |
| Cash and cash equivalents | 613 | 599 |
| Accounts receivable, affiliated organization | 146 | 145 |
| Other receivables | - | 12 |
| Other current assets | 705 | 691 |
| Total current assets | 114,342 | 105,627 |
| **Deferred Charges (see Note 7)** | 15,525 | 7,823 |
| Total assets | $ 527,862 | $ 506,319 |

*See Notes to Consolidated Financial Statements*

## Members' Equities and Liabilities

| | 2014 | 2013 |
|---|---|---|
| **Members' Equities (see Note 1)** | | |
| Membership fees | $ 3 | $ 3 |
| Patronage capital | 76,613 | 72,169 |
| Donated capital | 38 | 38 |
| Unrestricted net assets | 100 | 100 |
| Retained earnings | 4,150 | 7,803 |
| Members' equities | 80,904 | 80,113 |
| Accumulated other comprehensive income | 36,033 | 30,131 |
| Total equities | 116,937 | 110,244 |
| **Asset Retirement Obligation (see Note 8)** | 166,539 | 160,132 |
| **Long-Term Debt (see Note 9)** | 194,093 | 170,214 |
| **Advance from Affiliated Organization (see Note 12)** | 615 | 692 |
| **Current Liabilities** | | |
| Notes payable (see Note 9) | 7,900 | 26,800 |
| Current installments of long-term debt | 5,611 | 4,555 |
| Financial transmission rights (see Note 6) | 1,102 | 1,544 |
| Accounts payable and accrued expenses | 25,129 | 25,668 |
| Liabilities of consolidated variable interest entity | | |
| Accounts payable and accrued expenses | 1,724 | 1,462 |
| Accrued postretirement benefit cost (see Note 13) | 209 | 233 |
| Accounts payable, affiliated organization | 88 | 88 |
| Total current liabilities | 41,763 | 60,350 |
| **Other Liabilities and Deferred Credits** | | |
| Financial transmission rights (see Note 6) | 192 | 381 |
| Deferred credits (see Note 16) | 7,723 | 4,306 |
| | 7,915 | 4,687 |
| Total liabilities and members' equities | $ 527,862 | $ 506,319 |

# Allegheny Electric Cooperative, Inc.
## Consolidated Statements of Margin
## Years Ended December 31, 2014 and 2013
## (In Thousands)

| | 2014 | 2013 |
|---|---|---|
| **Operating Revenues** | $ 215,812 | $ 224,127 |
| **Operating Expenses** | | |
| Operations | | |
| Purchased capacity and energy costs | 94,838 | 97,751 |
| Transmission | | |
| Operation | 31,876 | 33,027 |
| Maintenance | 434 | 440 |
| Production | | |
| Operation | 29,726 | 27,325 |
| Maintenance | 15,806 | 14,724 |
| Fuel | 15,974 | 15,371 |
| Depreciation | 8,322 | 8,367 |
| Accretion of asset retirement obligation | 700 | 600 |
| Administrative and general | 13,029 | 12,180 |
| Property and other taxes | 722 | 539 |
| **Total Operating Expenses Before Interest** | 211,427 | 210,324 |
| **Operating Margin Before Interest Expense** | 4,385 | 13,803 |
| **Interest Expense** | (10,277) | (10,534) |
| **Operating Margin (Loss)** | (5,892) | 3,269 |
| **Non-operating Margins** | | |
| Nonoperating rental income | 1,510 | 1,491 |
| Nonoperating rental expense | (1,728) | (1,542) |
| Interest income | 2,153 | 2,823 |
| Settlement proceeds | 7,135 | 1,165 |
| Capital credits and other income | 972 | 597 |
| | 10,042 | 4,534 |
| **Net Margin** | $ 4,150 | $ 7,803 |

# Allegheny Electric Cooperative, Inc.
## Consolidated Statements of Comprehensive Margin
## Years Ended December 31, 2014 and 2013
## (In Thousands)

| | 2014 | 2013 |
|---|---|---|
| **Net Margin** | $ 4,150 | $ 7,803 |
| **Other Comprehensive Margin** | | |
| Change in postretirement benefit plan | 22 | 21 |
| Unrealized appreciation in investments | 5,880 | 10,110 |
| | 5,902 | 10,131 |
| **Comprehensive Margin** | $ 10,052 | $ 17,934 |

# Allegheny Electric Cooperative, Inc.
## Consolidated Statements of Members' Equities
## Years Ended December 31, 2014 and 2013
## (In Thousands)

| | Membership Fees | Donated Capital | Patronage Capital |
|---|---|---|---|
| **Balance, January 1, 2013** | $ 3 | $ 38 | $ 71,395 |
| Patronage capital retirement | - | - | (3,437) |
| Patronage capital assignment | - | - | 2,510 |
| Patronage capital - NDT (earnings) losses | - | - | 1,701 |
| Net margin | - | - | - |
| Other comprehensive margin | - | - | - |
| **Balance, December 31, 2013** | 3 | 38 | 72,169 |
| Patronage capital retirement | - | - | (3,359) |
| Patronage capital assignment | - | - | 7,803 |
| Net margin | - | - | - |
| Other comprehensive margin | - | - | - |
| **Balance, December 31, 2014** | $ 3 | $ 38 | $ 76,613 |

*See Notes to Consolidated Financial Statements*

| Unrestricted Net Assets | Retained Earnings | Total Members' Equities | Accumulated Other Comprehensive Margin | Total Equities |
|---|---|---|---|---|
| $ 100 | $ 4,211 | $ 75,747 | $ 20,000 | $ 95,747 |
| - | - | (3,437) | - | (3,437) |
| - | (2,510) | - | - | - |
| - | (1,701) | - | - | - |
| - | 7,803 | 7,803 | - | 7,803 |
| - | - | - | 10,131 | 10,131 |
| 100 | 7,803 | 80,113 | 30,131 | 110,244 |
| - | - | (3,359) | - | (3,359) |
| - | (7,803) | - | - | - |
| - | 4,150 | 4,150 | - | 4,150 |
| - | - | - | 5,902 | 5,902 |
| $ 100 | $ 4,150 | $ 80,904 | $ 36,033 | $ 116,937 |

# Allegheny Electric Cooperative, Inc.

## Consolidated Statements of Cash Flows

## December 31, 2014 and 2013

## (In Thousands)

| | 2014 | 2013 |
|---|---|---|
| **Operating Activities** | | |
| Net margin | $ 4,150 | $ 7,803 |
| Items not requiring cash | | |
| Depreciation and fuel amortization | 22,963 | 22,348 |
| Accretion of asset retirement obligation | 6,407 | 6,159 |
| Deferred income taxes | 2,531 | 2,998 |
| Loss on disposal of equipment | (17) | - |
| Other than temporary losses | 42 | 567 |
| Change in | | |
| Investments in associated organizations | 10,402 | 128 |
| Accounts receivable, members | 842 | 575 |
| Other receivables | (3,602) | (10,324) |
| Inventories | (736) | (967) |
| Derivative investments | 631 | 1,017 |
| Prepaid pension expense | 516 | (253) |
| Other current and non-current assets | (72) | 2,423 |
| Accounts payable and accrued expenses | (277) | 9,115 |
| Accounts receivable/payable, affiliated organizations | (34) | (119) |
| Advance from affiliated organization | (77) | 692 |
| Financial transmission rights | (631) | (1,017) |
| Accrued postretirement benefit | (3) | 23 |
| Other liabilities and deferred credits | 871 | (15,310) |
| Net cash provided by operating activities | 43,906 | 25,858 |
| **Investing Activities** | | |
| Additions to electric utility plant and non-utility property, net | (32,148) | (27,969) |
| Proceeds from investments | (7,495) | 1,915 |
| Purchase of investments | (3,553) | (3,115) |
| Net cash used in investing activities | (43,196) | (29,169) |
| **Financing Activities** | | |
| Borrowings under line-of-credit agreement | 198,800 | 307,815 |
| Payments under ling-of-credit agreement | (217,700) | (301,515) |
| Principal payments on long-term debt | (5,065) | (4,743) |
| Proceeds from issuance of long-term debt | 30,000 | - |
| Patronage capital retirement | (3,359) | (3,437) |
| Increase in deferred charges | (5,156) | - |
| Net cash used in financing activities | (2,480) | (1,880) |
| **Net Decrease in Cash and Cash Equivalents** | (1,770) | (5,191) |
| **Cash and Cash Equivalents, Beginning of Year** | 25,963 | 31,154 |
| **Cash and Cash Equivalents, End of Year** | $ 24,193 | $ 25,963 |
| **Supplemental Cash Flows Information** | | |
| Interest paid | $ 9,779 | $ 10,406 |
| Prepaid pension expense purchased with long-term debt | - | 4,393 |

## Note 1: Nature of Operations and Summary of Significant Accounting Policies

### *Nature of Operations*

Allegheny Electric Cooperative, Inc. (Cooperative) is a rural electric cooperative corporation established under the laws of the Commonwealth of Pennsylvania. The Cooperative has entered into wholesale power contracts with each of its member cooperatives which extend through 2050. The Cooperative extends unsecured credit to its members, with credit extended to two members of 17% and 12% and 18% and 12% of the accounts receivable, members balance at December 31, 2014 and 2013, respectively. The Cooperative either finances or obtains approval for 100 percent of its outstanding debt with the National Rural Utilities Cooperative Finance Corporation (CFC).

The Cooperative is a generation and transmission cooperative. The member cooperatives' service areas are primarily rural areas throughout much of Pennsylvania and a portion of New Jersey. The Cooperative's primary operating asset is its 10 percent undivided interest in the Susquehanna Steam Electric Station (SSES), a 2,600-megawatt, two-unit nuclear power plant, co-owned by a subsidiary of PPL Corporation (PPL). In June 2014, PPL announced its intent to divest its competitive generation business within the PJM Interconnection, including SSES, into a new unaffiliated public company, Talen Energy Corporation. The transaction, which is subject to various regulatory approvals, is expected by PPL to close in the second quarter of 2015. The Cooperative will retain its ownership interest in SSES.

The Board of Directors of the Cooperative, elected by its members, has full authority to establish electric rates to its member cooperatives. Rates are established on a cost of service basis. The Cooperative's Board of Directors has established a deferred revenue account to offset future increases in power supply costs.

### *Principles of Consolidation*

The financial statements include the accounts of the Cooperative and a variable interest entity, Continental Electric Cooperative Services, Inc. (CCS), of which the Cooperative has determined it is the primary beneficiary. All significant intercompany accounts and transactions have been eliminated in consolidation.

### *Variable Interest Entity and Change in Accounting Principle*

A legal entity is referred to as a variable interest entity (VIE) if any of the following conditions exist: (1) the total equity investment at risk is insufficient to permit the legal entity to finance its activities without additional subordinated financial support from other parties, or (2) the entity has equity investors who cannot make significant decisions about the entity's operations or who do not absorb their proportionate share of the expected losses or receive the expected returns of the entity.

A VIE's primary beneficiary is the entity that has the power to direct the VIE's significant activities and has an obligation to absorb losses or the right to receive benefits that could be potentially significant to the VIE.

A VIE must be consolidated by the Cooperative if it is deemed to be the primary beneficiary of the VIE.

All facts and circumstances are taken into consideration when determining whether the Cooperative has variable interests that would deem it the primary beneficiary and, therefore, require consolidation of the related VIE or otherwise rise to the level where disclosure would provide useful information to the users of the Cooperative's financial statements. In many cases, it is qualitatively clear whether the Cooperative has the power to direct the activities significant to the VIE. In other cases, a more detailed qualitative analysis and possibly a quantitative analysis are required to make such a determination.

The Cooperative monitors the consolidated VIE to determine if any reconsideration events have occurred that could cause it to no longer be a VIE. The Cooperative reconsiders whether it is the primary beneficiary of a VIE on an ongoing basis. A previously consolidated VIE is deconsolidated when the Cooperative ceases to be the primary beneficiary or the entity is no longer a VIE.

CCS is considered to be a variable interest entity and the Cooperative is determined to be the primary beneficiary of CCS. As such, the assets, liabilities, and results of operations have been consolidated into these financial statements.

### *Basis of Accounting*

The Cooperative substantially maintains its accounting records in accordance with the Federal Energy Regulatory Commission's (FERC) uniform system of accounts as modified and adopted by the U.S. Department of Agriculture, Rural Utilities Service (RUS).

In accordance with FERC guidelines, the Cooperative also maintains its accounts in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 980, *Regulated Operations.*

### *Deregulation*

Pennsylvania retail electric customers have the choice of selecting the power supplier, or generator, from which they buy electricity. The ability to choose alternative energy suppliers has not significantly affected the Cooperative's operations or ability to recover its costs through future rates charged to its members. As a result of legislative action effective January 1, 2015, Pennsylvania cooperatives are no longer subject to retail competition.

On a regular basis, the Cooperative reevaluates its application of FASB ASC Topic 980, *Regulated Operations*, and Topic 980-20, *Discontinuation of Rate Regulated Accounting*. The Cooperative has determined that regulatory assets and liabilities should continue to be accounted for under the provisions of Topic 980 because it is reasonable to assume that the Cooperative will continue to be able to charge and collect its cost of service-based rates.

### *Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial report, and the reported amounts of revenues and expenses during the years then ended. Actual results could differ from those estimates.

### *Electric Utility Plant*

Electric utility plant is carried at cost. Depreciation of electric utility plant is provided over the estimated useful lives of the respective assets on a straight-line basis, except for nuclear fuel, as follows:

| | |
|---|---|
| Nuclear Utility Plant | |
| Production | Unit #1 and Unit #2 Remaining License Life Extended to 2042 and 2044, respectively |
| Transmission | 2.75% - 6.7% |
| General plant | 3% - 12.5% |
| Nuclear fuel | Units of heat production |
| Non-Nuclear Utility Plant | 3% - 33% |
| Hydroelectric Production Plant | 5% |

Maintenance and repairs of property, and replacements and renewals of items determined to be less than units of property are charged to expense. Replacements and renewals of items considered to be units of property are charged to the property accounts. At the time properties are disposed of, the original cost, plus cost of removal less salvage of such property, is charged to accumulated depreciation.

### *Non-utility Property*

Non-utility property acquisitions are stated at cost less accumulated depreciation and amortization. Depreciation and amortization is charged to expense on a straight-line basis over the estimated useful life of each asset.

The estimated useful lives of non-utility property range from 3 to 50 years.

### *Nuclear Fuel*

Nuclear fuel is charged to fuel expense based on the quantity of heat produced for electric generation. Under the Nuclear Waste Policy Act of 1982, the U.S. Department of Energy (DOE) is responsible for the permanent storage and disposal of spent nuclear fuel removed from nuclear reactors. The Cooperative currently pays PPL for its portion of DOE fees for such future disposal services. During 2014 and 2013, the Cooperative recorded settlements related to the permanent storage and disposal of spent nuclear fuel as reported in non-operating margins in the consolidated statements of margins.

### *Investments*

Investments are classified as "available for sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

For debt securities with fair value below amortized cost when the Cooperative does not intend to sell a debt security, and it is more likely than not that the Cooperative will not have to sell the security before recovery of its cost basis, it recognizes the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income.

For available-for-sale debt securities that management has no intent to sell and believes that it more likely than not will not be required to sell prior to recovery, only the credit loss component of the impairment is recognized in earnings, while the noncredit loss is recognized in other comprehensive income. The credit loss component recognized in earnings is identified as the amount of principal cash flows not expected to be received over the remaining term of the security as projected based on cash flow projections.

For equity securities, when the Cooperative has decided to sell an impaired available-for-sale security and does not expect the fair value of the security to fully recover before the expected time of the sale, the security is deemed other-than-temporarily impaired in the period in which the decision to sell is made. The Cooperative recognizes an impairment loss when the impairment is deemed other than temporary even if a decision to sell has not been made.

### *Cash and Cash Equivalents*

Cash and cash equivalents consist of bank deposits in federally insured accounts, temporary investments and money market funds.

The Cooperative places its cash and temporary investments with high quality financial institutions. For purposes of the statements of cash flows, the Cooperative considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents. Cash equivalents are carried at cost.

At December 31, 2014, the Cooperative's cash accounts exceeded federally insured limits by approximately $20 million.

The Cooperative's cash and investments are in a variety of financial instruments. The related values as presented in the financial statements are subject to various market fluctuations, which include changes in the equity markets, interest rate environment and the general economic conditions. The Cooperative's credit losses have historically been minimal and within management's expectations.

### *Accounts Receivable*

Accounts receivable are stated at the amount billed to members. Accounts receivable are due in accordance with approved policies. An allowance for doubtful accounts has not been recorded because all accounts receivable are considered fully collectible.

### *Derivatives*

Derivatives are recognized as assets and liabilities on the consolidated balance sheet and measured at fair value. For exchange-traded contracts, fair value is based on quoted market prices. For nonexchange-traded contracts, fair value is based on dealer quotes, pricing models, discounted cash flow methodologies, or similar techniques for which the determination of fair value may require significant management judgment or estimation.

### *Inventories*

The Cooperative accounts for certain power plant spare parts using a deferred inventory method. Under this method, purchases of spare parts under inventory control are included in an inventory account and then charged to the appropriate capital or expense accounts when the parts are used or consumed. Inventories are carried at cost, with cost determined on the average cost method.

### *Patronage Capital*

Current and future margins (excluding earnings from the Nuclear Decommissioning Trust), will be assigned as patronage capital.

### *Income Taxes*

The Cooperative accounts for income taxes in accordance with income tax accounting guidance (ASC 740, *Income Taxes*). The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Cooperative determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur. Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

Tax positions are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more-likely-than-not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances and information available at the reporting date and is subject to management's judgment. At December 31, 2014 and 2013, no uncertain tax positions have been identified.

The Cooperative would recognize interest and penalties on income taxes, if any, as a component of income tax expense.

### *Revenue Recognition*

Revenue from the sale of electricity to members is recorded based on contracted power usage billed under the Cooperative's current rate schedule.

### *Comprehensive Margin*

Comprehensive margin consists of net margin and other comprehensive margin. Other comprehensive margin includes unrealized appreciation (depreciation) on available-for-sale securities and changes in the funded status of the postretirement plan.

### *Impairment of Long-Lived Assets*

The Cooperative evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate that carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimated future cash flows expected to result from the use and eventual disposition of the asset is less than the carrying amount of the asset, the asset cost is adjusted to fair value and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value. No asset impairment was recognized during the years ended December 31, 2014 and 2013.

### *Reclassifications*

Certain reclassifications have been made to the 2013 consolidated financial statements to conform to the 2014 consolidated financial statements presentation. These reclassifications had no effect on net margin.

## Note 2: Electric Utility Plant in Service

| | 2014 | 2013 |
|---|---|---|
| | (In thousands) | |
| Production | $ 651,368 | $ 646,059 |
| Transmission | 42,213 | 42,162 |
| General plant | 5,583 | 5,448 |
| Nuclear fuel | 254,437 | 240,961 |
| Other | 29,227 | 25,971 |
| Total | $ 982,828 | $ 960,601 |

## Note 3: Susquehanna Steam Electric Station

The Cooperative owns a 10 percent undivided interest in SSES. PPL owns the remaining 90 percent. Both participants provide their own financing. The Cooperative's portion of SSES's gross assets, which includes electric utility plant in service, construction and nuclear fuel in progress, totaled $688 million and $664 million as of December 31, 2014 and 2013, respectively. The Cooperative's share of anticipated costs for ongoing construction and nuclear fuel for SSES is estimated to be approximately $120 million over the next five years. The Cooperative receives a portion of the total SSES output equal to its percentage ownership. SSES accounted for approximately 55% and 58% of the total kilowatt hours sold by the Cooperative during the years

ended December 31, 2014 and 2013, respectively. The balance sheets and statements of margins reflect the Cooperative's respective undivided share of assets, liabilities and operations associated with SSES.

During 2014, the Cooperative recorded settlement proceeds related to SSES on the consolidated statements of income.

## Note 4: Investments

### *Associated Organizations*

| | 2014 (In thousands) | 2013 (In thousands) |
|---|---|---|
| National Rural Utilities Cooperative Finance Corporation (CFC) Subordinated Term Certificates, bearing interest of 5.0% and 5.8%, maturing January 1, 2026 and October 31, 2044[1] | $ 12,926 | $ 13,750 |
| National Rural Utilities Cooperative Finance Corporation (CFC) Subordinated Term Certificates, bearing interest at 3%, maturing January 1, 2014[1] | - | 42 |
| National Rural Utilities Cooperative Finance Corporation (CFC) Member Capital Securities, bearing interest at 7.5%, maturing March 24, 2044[1][2] | - | 10,000 |
| Other | 3,516 | 3,052 |
| Total | $ 16,442 | $ 26,844 |

(1) The Cooperative is required to maintain these investments pursuant to certain loan and guarantee agreements. Such investments are carried at cost.

(2) On October 10, 2013, the Cooperative received notice from CFC of its intent to exercise its early redemption option on March 24, 2014. The Cooperative was presented the opportunity to reinvest in the program through a new member capital security with an interest rate of 5.00%, a new 30-year term and a non-call period of 10 years; however, the Cooperative elected to decline the opportunity and instead reinvest the redemption proceeds in its general investment portfolio.

### *Investments*

The Cooperative makes temporary investments of excess corporate funds in investment accounts managed by qualified registered investment advisors. The amortized cost, which includes any premiums or discounts at acquisition, and approximate fair values of these investments are as follows:

| 2014 | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Impairment Recognized | Fair Value |
|---|---|---|---|---|---|
| | (In thousands) | | | | |
| Investments | | | | | |
| U.S. Government agency securities | $ 1,223 | $ - | $ - | $ - | $ 1,223 |
| Corporate bonds | 36,222 | 1,200 | (123) | - | 37,299 |
| Auction rate security | 1,755 | - | - | - | 1,755 |
| Stocks | 1 | - | - | - | 1 |
| Total | $ 39,201 | $ 1,200 | $ (123) | - | $ 40,278 |

| 2013 | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Impairment Recognized | Fair Value |
|---|---|---|---|---|---|
| | (In thousands) | | | | |
| Investments | | | | | |
| U.S. Government agency securities | $ 3,557 | $ 1 | $ - | $ - | $ 3,558 |
| Corporate bonds | 20,695 | 1,774 | (31) | - | 22,438 |
| Auction rate security | 2,731 | - | - | (476) | 2,255 |
| Mutual funds | 4,800 | - | (97) | - | 4,703 |
| Total | $ 31,783 | $ 1,775 | $ (128) | $ (476) | $ 32,954 |

Maturities of investments at December 31, 2014:

| | Amortized Cost | Approximate Fair Value |
|---|---|---|
| | (In thousands) | |
| One year or less | $ 2,473 | $ 2,479 |
| After one through five years | 36,727 | 37,798 |
| Stocks | 1 | 1 |
| | $ 39,201 | $ 40,278 |

Corporate bonds in CFC comprise approximately $8 million and $11 million of the debt securities in 2014 and 2013, respectively.

Gross gains of $78,000 and $11,000 and gross losses of $91,000 and $0 resulting from sales of securities were realized for 2014 and 2013, respectively. These gains and losses are included in capital credits and other income on the consolidated statements of margin.

Certain investments in debt and equity securities are reported in the financial statements at an amount less than their historical cost. Total fair value of these investments at December 31, 2014 and 2013, was $11.2 million and $5.9 million, respectively. These declines primarily resulted from increases in market interest rates prior to the balance sheet date. The gross unrealized losses at December 31, 2014 and 2013 for a period of less than 12 months were $1,000 and $0, respectively, and for a period of greater than 12 months were $122,000 and $128,000, respectively.

In 2013, the Cooperative recorded other-than-temporary impairment on a corporate bond. The cost-basis of this investment has been adjusted to reflect recognition of this impairment. Total other-than-temporary impairment included in capital credits and other income on the statement of margins for 2013 was $476,000 for this temporary investment.

## Note 5: Nuclear Decommissioning Trust

The Nuclear Decommissioning Trust consists of the following as of December 31, 2014 and 2013:

| | 2014 | | | | |
|---|---|---|---|---|---|
| | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Impairment Recognized | Fair Value |
| | (In thousands) | | | | |
| Decommissioning Trust Fund | | | | | |
| Money market funds | $ 1,378 | $ - | $ - | $ - | $ 1,378 |
| U.S. Government securities | 24,506 | 465 | (66) | - | 24,905 |
| Corporate bonds | 18,215 | 442 | (196) | - | 18,461 |
| Other obligations | 1,812 | 34 | (14) | - | 1,832 |
| Common stocks | 36,324 | 31,829 | (838) | (42) | 67,273 |
| Total | $ 82,235 | $ 32,770 | $ (1,114) | $ (42) | $ 113,849 |

| | 2013 | | | | |
|---|---|---|---|---|---|
| | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Impairment Recognized | Fair Value |
| | (In thousands) | | | | |
| Decommissioning Trust Fund | | | | | |
| Money market funds | $ 1,044 | $ - | $ - | $ - | $ 1,044 |
| U.S. Government securities | 23,865 | 150 | (552) | (8) | 23,455 |
| Corporate bonds | 18,109 | 232 | (505) | - | 17,836 |
| Other obligations | 1,335 | 24 | (28) | (19) | 1,312 |
| Common stocks | 31,460 | 29,309 | (66) | (64) | 60,639 |
| Total | $ 75,813 | $ 29,715 | $ (1,151) | $ (91) | $ 104,286 |

Certain investments in debt and equity securities are reported in the financial statements at an amount less than their historical cost. Total fair value of these investments at December 31, 2014 and 2013, was $24 million and $28.1 million, respectively. These declines primarily resulted from increases in market interest rates prior to the balance sheet date and the failure of certain investments to meet projected earnings targets. The gross unrealized losses at December 31, 2014 and 2013 for a period of less than 12 months were $283,000 and $840,000, respectively, and for a period of greater than 12 months were $830,000 and $311,000, respectively.

For 2014 and 2013, the Cooperative recorded other-than-temporary impairments on equity securities in the amount of $42,000 and $91,000, respectively. The cost-basis of these investments has been adjusted to reflect the recognition of these impairments.

Under ASC Topic 980, *Regulated Operations*, the Cooperative has elected to defer these losses and pass them on to members through the future rate structure. As of December 31, 2014 and 2013, total deferred charges for the Nuclear Decommissioning Trust other-than-temporary impairment were $3.0 million and $3.3 million, respectively.

## Note 6: Derivatives and Hedging

The Cooperative does not engage in speculative derivative transactions, however, the Cooperative engages in hedging activities that are a natural part of power supply and transmission activities.

The Cooperative uses hedging instruments, including forwards, futures, financial transmission rights, and options, to manage power market price risks. In addition, substantial reliance on the purchase of energy from other power suppliers exposes the Cooperative to the risk that counterparties will default. Therefore, an assessment is performed on the creditworthiness of counterparties and other credit issues related to these purchases, which may require the counterparties to post collateral. Defaults, however, may still occur. If a default occurs, the Cooperative may be forced to enter into alternative contractual arrangements or purchase energy in the forward, short-term or spot markets at then-current market prices that could vary from the prices previously agreed upon with the defaulting counterparty. The Cooperative has never had a counterparty default or fail to perform, but past performance is no guarantee of future results.

### *Financial Transmission Rights*

The Cooperative is issued Financial Transmission Rights (FTRs) by the PJM Interconnection LLC, (PJM). These FTRs have been found to meet the FASB ASC Topic 815, *Derivatives and Hedging*, definition of a derivative, and therefore they must have special derivative accounting procedures applied to them.

The Cooperative receives an entitlement of FTRs. FTRs are defined from a "source" node to a "sink" node (path) for a specific amount of megawatts of electric power. The holder of an FTR is entitled to receive whole or partial offsets of transmission congestion charges that arise when that specific path is congested. The purpose of the FTR mechanism is to act as a hedge against volatile congestion charges.

Market values of FTRs are only observable based on the clearing prices of the FTRs in multi-year, annual, seasonal and monthly auctions. The expected value of FTRs fluctuates based on seasonal expectations of the supply and demand of energy for each specific path. Significant assumptions and modeling projections are necessary to value FTRs. The expected FTR values are considered in the rate-making process and therefore the fair value of FTRs are recognized on the balance sheet and recorded as deferred income under ASC Topic 980, *Regulated Operations.* The fair value of FTRs was $1.3 million and $1.9 million as of December 31, 2014 and 2013 for the remainder of the current PJM planning periods that end May 31, 2015 and 2014 and beyond.

| | 2014 | 2013 |
|---|---|---|
| | (In thousands) | |
| Fair value of FTRs | $ 1,294 | $ 1,925 |
| Balance sheet locations | Current assets | Current assets |
| | Current liabilities | Current liabilities |
| | Noncurrent assets | Noncurrent assets |
| | Noncurrent liabilities | Noncurrent liabilities |

## Note 7: Deferred Charges

Deferred charges consist of the following regulatory assets as of December 31, 2014 and 2013.

| | 2014 | 2013 |
|---|---|---|
| | (In thousands) | |
| Deferred asset plan - NDT investments (see Note 5) | $ 2,962 | $ 3,320 |
| Deferred decommissioning regulatory asset | 7,407 | 4,503 |
| Unamortized debt cost | 5,156 | - |
| | $ 15,525 | $ 7,823 |

The Cooperative has established a decommissioning regulatory account under ASC Topic 980, *Regulated Operations.* This account includes the excess (deficiency) of the annual accretion of the asset retirement obligation over (under) the annual cash contribution and realized earnings of the NDT. The Cooperative monitors this account periodically and will recognize amounts in the statements of margin and pass amounts through to its members as necessary to meet the funding requirements of the NDT. No such amounts were recognized for 2014 and 2013.

## Note 8: Asset Retirement Obligation

Amounts collected from the Cooperative's members for decommissioning, less applicable taxes, are deposited in external trust funds for investment and can only be used for future decommissioning costs. The fair value of the nuclear decommissioning trust was $113.8 million and $104.3 million for the years ended December 31, 2014 and 2013, respectively.

The changes in the carrying amounts of asset retirement obligations were as follows:

| | 2014 | 2013 |
|---|---|---|
| | (In thousands) | |
| Beginning balance | $ 160,132 | $ 153,973 |
| Accretion expense | 6,407 | 6,159 |
| Ending balance | $ 166,539 | $ 160,132 |

The amount of actual obligation could differ materially from the estimates reflected in these financial statements.

## Note 9: Long-Term Debt

| | 2014 | 2013 |
|---|---|---|
| | (In Thousands) | |
| CFC — Notes dated 2006 (A) | $ 78,300 | $ 78,300 |
| CFC — Note dated 2006 (B) | 10,349 | 10,955 |
| CFC — Notes dated 2006 (C) | 11,475 | 12,150 |
| CFC — Note dated 2006 (D) | 1,657 | 1,752 |
| CFC — Notes dated 2006 (E) | 34,125 | 35,625 |
| CFC — Note dated 2011 (F) | 56,843 | 27,971 |
| CoBank — Note dated 2012 (G) | 6,955 | 8,016 |
| Total long-term debt | 199,704 | 174,769 |
| Less current installments | 5,611 | 4,555 |
| Long-term debt, excluding current installments | $ 194,093 | $ 170,214 |

(A) Quarterly installments of varying amounts ranging from $325,000 to $5,037,500 through 2044. Annual interest rates range from 2.55% to 6.90% at December 31, 2014.
(B) Quarterly installments of varying amounts ranging from $30,000 to $189,000 through 2044. Annual interest rate of 6.25% at December 31, 2014.
(C) Quarterly installments of varying amounts ranging from $175,000 to $433,000 through 2026. Annual interest rates range from 2.55% to 6.90% at December 31, 2014.
(D) Quarterly installments of varying amounts ranging from $25,000 to $54,000 through 2025. Annual interest rate of 7.25% at December 31, 2014.
(E) Quarterly installments of varying amounts ranging from $375,000 to $1,050,000 through 2033. Annual interest rates range from 6.05% to 6.65% at December 31, 2014.
(F) Quarterly installments of varying amounts ranging from $440,000 to $1,060,000 through 2044. Annual interest rates range from 2.60% to 5.25% at December 31, 2014.
(G) Annual installments of varying amounts ranging from $1,121,000 to $2,190,000 through 2018. Annual interest rates range from 2.40% to 4.81% at December 31, 2014.

As of December 31, 2014, the Cooperative has an additional available borrowing balance with CFC beyond the operating line of credit below totaling $47.7 million.

In February 2014, the Cooperative converted certain notes with CFC totaling $45.9 million from a fixed interest rate of 7% to a one year variable rate, which is 2.55% through January 2015. The cost of this conversion was $5.8 million.

Also in February 2014, the Cooperative amended its notes with CFC to extend the date on which notes are due and payable through December 2044. The terms above and future maturities below have been adjusted to reflect these extended maturities.

Future maturities of all long-term debt are as follows (in thousands):

| | | |
|---|---|---|
| 2015 | $ | 5,611 |
| 2016 | | 6,772 |
| 2017 | | 6,118 |
| 2018 | | 6,585 |
| 2019 | | 4,489 |
| Thereafter | | 170,129 |
| | $ | 199,704 |

The Cooperative has a $50,000,000 operating line of credit with CFC that expires on March 31, 2016. There were borrowings of $7,900,000 and $26,800,000 against this line as of December 31, 2014 and 2013, respectively. The interest rate on the line of credit fluctuates as established by CFC and was 2.90% as of December 31, 2014.

Additionally, the Cooperative had a commitment from CFC to provide unsecured letters of credit of up to $25,000,000 which was replaced in September 2013 with an unsecured $25,000,000 line of credit commitment from CFC set to expire in 2018. Under this commitment, the Cooperative has unsecured letter of credit facilities totaling $7,150,000 and $9,850,000 at December 31, 2014 and 2013, respectively. These letters of credit are set to expire at various dates throughout 2015. As of December 31, 2014 and 2013, no funds have been drawn against this facility.

The maximum amount outstanding under the above two credit facilities was $58.0 million and $37.5 million during 2014 and 2013, respectively.

Substantially all assets of the Cooperative are pledged to secure the notes payable. The Cooperative is required to maintain certain covenants including an annual debt service coverage ratio. The Cooperative was in compliance with the applicable covenant as of December 31, 2014 and 2013, respectively.

During 2014 and 2013, the Cooperative incurred interest costs of $10,277,000 and $10,534,000, respectively.

## Note 10: Income Taxes

As of December 31, 2014 and 2013, the Cooperative had available nonmember net operating loss carryforwards of approximately $9 million and $8 million, respectively for tax reporting purposes expiring in 2015 through 2020, and alternative minimum tax credit carryforwards of approximately $1,269,000 and $1,280,000 respectively, which carry forward indefinitely.

There was no provision for federal income taxes at December 31, 2014 and 2013. The Cooperative is not subject to state income taxes. The Cooperative is no longer subject to federal income tax examinations by tax authorities for years before 2011.

Temporary differences that give rise to deferred tax balances are principally attributable to fixed asset basis, safe harbor lease treatment, and financial statement accruals. Deferred tax assets also include the effect of net operating loss carryforwards. The temporary differences and the carryforward items produce a deferred tax asset at December 31, 2014 and 2013, of approximately $1.8 and $4.3 million, respectively. Realization of the net deferred tax asset is contingent upon the Cooperative's future earnings. A valuation allowance had not been established against this asset because it had been determined that the deferred tax asset more likely than not would be realized. The Cooperative will include the utilization of the net deferred tax asset of approximately $1.8 million and $4.3 million at December 31, 2014 and 2013, respectively, in future rates charged to members. Therefore, a deferred credit has been recorded equal to the net deferred tax asset under FASB ASC Topic 980, *Regulated Operations.*

## Note 11: Affiliated Organization Transaction

A related organization, the Pennsylvania Rural Electric Association (PREA) has provided the Cooperative with certain management, general, and administrative services on a cost reimbursement basis. The costs for services provided by PREA were $971,000 and $875,000 for the years ended December 31, 2014 and 2013, respectively.

## Note 12: Consolidated Variable Interest Entity

As the primary beneficiary, the Cooperative consolidates CCS. The general creditors of CCS have no recourse against the general credit of the Cooperative.

The following table summarizes the carrying amount of the assets and liabilities of CCS included in the Cooperative's consolidated balance sheets at December 31, 2014 and 2013:

| | 2014 | 2013 |
|---|---|---|
| | (In thousands) | |
| Current assets | | |
| Cash and cash equivalents | $ 613 | $ 599 |
| Accounts receivable, affiliated organization | 146 | 145 |
| Other receivables | - | 12 |
| Other current assets | 705 | 691 |
| Non-utility property | 9 | 11 |
| Prepaid pension expense | 4,130 | 4,646 |
| Total assets | $ 5,603 | $ 6,104 |
| Current liabilities | | |
| Accounts payable and accrued expenses | $ 1,724 | $ 1,462 |
| Accrued postretirement benefit cost | 209 | 233 |
| Accounts payable, affiliated organization | 88 | 88 |
| Advance from affiliated organization | 615 | 692 |
| Total liabilities | $ 2,636 | $ 2,475 |

## Note 13: Postretirement Benefits

As of November 1, 1995 (the effective date), postretirement medical benefits are only offered to grandfathered employees. There are two different levels of benefits for those grandfathered retirees. For each retiree over the age of 62 on the effective date, CCS pays the full premium for the appropriate medical insurance for the covered participant. For those that were over the age of 55 but younger than 62 on the effective date, CCS pays a maximum premium for medical insurance equal to the policy premium on November 1, 1995. In this second group, the participant is responsible for any increases above this amount. On December 31, 2014 and 2013, there were eight individuals covered under this plan. CCS expects to contribute $17,000 to the plan in 2015. This amount will be allocated to the Cooperative and PREA based on historical payroll allocations of the retirees covered under the plan.

CCS uses a December 31 measurement date for the plan. Information about the plan's funded status follows:

| | 2014 | 2013 |
|---|---|---|
| | (In Thousands) | |
| Benefit obligation, projected | $ 209 | $ 233 |
| Fair value of plan assets | - | - |
| Funded status | $ (209) | $ (233) |

Amounts recognized in the statements of financial position:

| | 2014 | 2013 |
|---|---|---|
| | (In Thousands) | |
| Accrued postretirement benefit cost liability | $ 209 | $ 233 |

Amounts recognized in accumulated other comprehensive income not yet recognized as components of net periodic benefit cost consist of:

| | 2014 | 2013 |
|---|---|---|
| | (In Thousands) | |
| Net loss | $ 51 | $ 71 |
| Transition obligation | - | 10 |
| | $ 51 | $ 81 |

The accumulated benefit obligation for the plan was $158,000 and $152,000 at December 31, 2014 and 2013, respectively.

Other significant balances and costs are:

| | 2014 | 2013 |
|---|---|---|
| | (In Thousands) | |
| Employer contributions | $ 16 | $ 6 |
| Benefits paid | 16 | 6 |
| Benefit cost | 34 | 48 |

The following amounts have been recognized in the consolidated statement of margins for the year ended December 31, 2014:

| | 2014 | 2013 |
|---|---|---|
| | (In Thousands) | |
| Amounts arising during the period: | | |
| Net gain | $ 4 | $ (17) |
| Net transition obligation | (10) | 4 |

The estimated net gain for the plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year is $4,000.

The discount rate used to determine the benefit obligation was 3.65% for 2014 and 2013.

For measurement purposes, a 6% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2014 and should remain at that level.

As of December 31, 2014, the expected future payments, which reflect expected future service, are as follows:

| | |
|---|---|
| 2015 | $ 17 |
| 2016 | 18 |
| 2017 | 18 |
| 2018 | 19 |
| 2019 | 19 |
| 2020 and thereafter | 118 |
| | $ 209 |

## Note 14: Employee Benefit Plans

All employment relationships are through CCS, the consolidated variable interest entity of the Cooperative. CCS's leave policies provide for payment of unused leave after the end of each calendar year for 2014 and 2013. A provision has been recorded for this liability.

### *Multiemployer Pension Plan*

Substantially all of the employees of CCS participate in the National Rural Electric Cooperative Association (NRECA) Retirement Security Plan (RS Plan). The RS Plan is a defined benefit pension plan qualified under Section 401 and tax exempt under Section 501(a) of the Internal Revenue Code. It is a multi-employer plan under the accounting standards. The plan sponsor's Employer Identification Number is 53-0116145 and the Plan Number is 333.

A unique characteristic of a multiemployer plan compared to a single employer plan is that all plan assets are available to pay benefits of any plan participant. Separate asset accounts are not maintained for participating employers. This means that assets contributed by one employer may be used to provide benefits to employees of other participating employers.

The Cooperative's contributions, through CCS, to the RS Plan in 2014 and in 2013 represented less than 5 percent of the total contributions made to the plan by all participating employers. The Cooperative, through CCS, made contributions to the plan of $1,542,000 in 2014 and $1,726,000 in 2013.

For the RS Plan, a "zone status" determination is not required, and therefore not determined, under the Pension Protection Act (PPA) of 2006. In addition, the accumulated benefit obligations and plan assets are not determined or allocated separately by individual employer. In total, the RS Plan was over 80 percent funded at January 1, 2014 and 2013 based on the PPA funding target and PPA actuarial value of assets on those dates.

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

### *RS Plan Prepayment*

At the December 2012 meeting of the I&FS Committee of the NRECA Board of Directors, the Committee approved an option to allow participating cooperatives in the RS Plan to make a prepayment and reduce future required contributions. The prepayment amount was a cooperative's share, as of January 1, 2013, of future contributions required to fund the RS Plan's unfunded value of benefits earned to date using Plan actuarial valuation assumptions. The prepayment amount will typically equal approximately 2.5 times a cooperative's annual RS Plan required contribution as of January 1, 2013. After making the prepayment, for most cooperatives the billing rate is reduced by approximately 25%, retroactive to January 1, 2013. The 25% differential in billing rates is expected to continue for approximately 15 years. However changes in interest rates, asset returns

and other plan experience different from that expected, plan assumption changes, and other factors may have an impact on the differential in billing rates and the 15 year period.

Two prepayment options were available to participating cooperatives:

1. Use current assets to make the prepayment over a period of not more than 4 years
2. Borrow funds sufficient to make the prepayment in a lump sum, with the repayment of the borrowed amount determined by the loan's amortization schedule

On March 27, 2013, the Cooperative made a prepayment of $5,162,000 to the NRECA RS Plan. This prepayment was funded with long-term debt through CFC of $4,393,000 from the Cooperative and cash of $769,000 from PREA. The Cooperative recorded a prepayment of $5,162,000 on the 2013 balance sheet as a prepaid pension expense. The Cooperative has also recorded PREA's portion of $769,000 on the 2013 balance sheet as an advance from affiliated organization. The Cooperative is amortizing these amounts over ten years. During 2014 and 2013, $516,000 of the prepaid pension expense and $77,000 of the advance from affiliated organization were amortized and are included in administrative and general expense on the consolidated statement of margin.

### *Defined Contribution Plan*

The Cooperative, through CCS, has a 401(k) defined-contribution program covering substantially all employees, which allows for both employee and Cooperative contributions. Contributions to the plan were approximately $445,000 and $413,000 for 2014 and 2013, respectively.

### *Deferred Compensation Agreements*

The Cooperative, through CCS, has an employment agreement with its President & CEO and retention arrangements with deferred compensation provisions.

## Note 15: Commitments and Contingencies

### *Power Supply and Transmission Agreements*

The Cooperative has entered into power supply and transmission agreements with various service providers. A significant number of these agreements are umbrella type agreements and do not bind the Cooperative to enter into any type of transaction.

Since June 2007, the Cooperative has issued periodic Requests for Proposal (RFP) for energy and/or capacity products for varying quantities and terms.

As of December 31, 2014, there were several significant capacity and energy transactions under these umbrella agreements with some energy deliveries extending through 2015.

The Cooperative also purchased capacity through May 2018, in a series of transactions. These transactions contained specific quantities of capacity, all of which were or will be needed to serve the Cooperative's load.

A summary of the power supply agreements are as follows:

**New York Power Authority**

This contract meets a portion of the Cooperative's base load and peaking requirements and its delivered cost to the Cooperative's members is below market. The current contract terminates in 2025 for the Niagara Project. The current contract for the St. Lawrence Project expires in 2017.

**Other Power Supply**

As the result of a competitive request for proposals, the Cooperative entered into an agreement in May 2013 to provide the Cooperative's remaining unmet load requirements beginning in January 2014. The agreement provides for the Cooperative to purchase energy at a fixed monthly price. The seller assumed all quantity and operating risks during the term of the agreement. The agreement expired on December 31, 2014.

Using the RFP process, the Cooperative entered into power purchase agreements in 2009 with various counterparties for around-the-clock energy products that when combined with Allegheny's generation assets, would meet approximately 80 percent of its projected energy requirements in 2014. The Cooperative entered into an agreement in May 2014 to provide the Cooperative's remaining current load requirements beginning in January 2015. The agreement expires in December 2015.

Various purchased power agreements require the Cooperative to post collateral deposits for exposure exceeding specified thresholds. As of December 31, 2014, collateral deposits totaled $24,000. Other agreements allow the Cooperative to provide additional credit support in the form of irrevocable standby letters of credit. The Cooperative had such letters issued as of December 31, 2014 in the amount of $7,150,000. These letters of credit were provided by CFC and are valid through December 31, 2015.

**SSES Replacement Power Insurance Policy**

The Cooperative mitigated a portion of the economic risk of an outage at SSES by purchasing a Replacement Power Insurance Policy from Ariel Syndicate 1910. Under the terms of the policy, if SSES had a forced outage event, the Cooperative would have been reimbursed for the cost of replacement power for the insured quantity of up to 250 MW. The policy stipulates that the outage limit for each such forced outage is 90 consecutive days, and the aggregate coverage limit is $10 million. For this coverage, the Cooperative purchased a two-year policy terminating December 31, 2014.

For 2015, the Cooperative mitigated a portion of the economic risk of an outage at SSES during the peak winter and summer months by purchasing a Replacement Power Insurance Policy from Ariel Syndicate 1910. Under the terms of the policy, if SSES has a forced outage event during the coverage period, the Cooperative will be reimbursed for the cost of replacement power for the insured quantity up to 250 MW. The policy stipulates that the outage limit for each such forced outage is 90 consecutive days, and the aggregate coverage limit is $10 million. This insurance policy terminates on August 31, 2015.

**Transmission Service**

Transmission service for the Cooperative's load is provided through a hybrid arrangement consisting of the PJM Open Access Transmission Tariff (OATT) and the pre-existing Wheeling and Supplemental Power Agreement with Pennsylvania Electric Company.

A separate irrevocable standby letter of credit is related to obligations existing under the OATT. This letter of credit was issued in the amount of $7,000,000 to the benefit of PJM Settlement, Inc. The letter of credit was provided by CFC and is valid through December 31, 2014.

### *Insurance*

PPL, as the 90 percent owner and sole operator of SSES, and the Cooperative, as owner of a 10 percent undivided interest in SSES, participate in certain insurance programs which provide coverage for the SSES nuclear generation plant.

The Price-Anderson Act, as amended (the Act), is a United States Federal Law governing liability-related issues and ensures the availability of funds for public liability claims arising from an incident at any U.S.-licensed nuclear facility. It also seeks to limit the liability of nuclear reactor owners for such claims from any single incident. At December 31, 2014, the liability per incident is $13.6 billion for such claims which is funded by insurance coverage from American Nuclear Insurers and an industry assessment program. Under the industry assessment program, in the event of a nuclear incident at any of the reactors covered by the Act, PPL and the Cooperative could be assessed up to $255 million per incident, payable at $38 million per year.

Additionally, SSES is covered by insurance programs provided by NEIL, an industry mutual insurance company. At December 31, 2014, the SSES plant is insured by the NEIL coverage against property damage losses up to $2 billion. Under the NEIL coverage, SSES is also insured against the cost of replacement power during prolonged outages of the nuclear units caused by certain specified conditions. Under the NEIL property and replacement power insurance programs, PPL and the Cooperative could be assessed retrospective premiums in the event of the insurers' adverse loss experience. This maximum assessment is $46 million.

### *Litigation*

The Cooperative may be subject to claims and lawsuits that arise primarily in the ordinary course of business. At December 31, 2014, no such claims or lawsuits existed.

## Note 16: Deferred Credits

### *Deferred Revenue Plan*

The Board has established a Deferred Revenue Plan, which seeks to stabilize members' rates for 2014 to mitigate the effects of expected increases in rates. The deferral of revenue for 2014 was determined as any amount above $4,150,000 of assignable margins. Deferred revenue additions and deletions are recorded in operating revenues in the consolidated statements of margin. No revenue deferral was made during 2013. At December 31, 2014, deferred revenues associated with the Deferred Revenue Plan were $5,948,000 The changes in deferred revenues in 2014 and 2013 were as follows:

| | 2014 | 2013 |
|---|---|---|
| | (In thousands) | |
| Beginning balance | $ - | $ 9,148 |
| Additions | 5,948 | - |
| Deletions | - | (9,148) |
| Ending balance | $ 5,948 | $ - |

### *Deferred Credit*

With the establishment of a deferred tax asset to record the effect of the temporary differences related to net operating loss carryforwards, fixed asset basis, safe harbor lease treatment, and financial statement accruals, the Cooperative established a deferred credit of $1.8 and $4.3 million for 2014 and 2013, respectively, under FASB ASC Topic 980, *Regulated Operations*. The value of the deferred tax asset is considered in the rate making process as required by Topic 980.

## Note 17: Disclosures About Fair Value of Assets and Liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

**Level 1** Quoted prices in active markets for identical assets or liabilities

**Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in active markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities

**Level 3** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

### *Recurring Measurements*

The following table presents the fair value measurements of assets and liabilities recognized in the accompanying consolidated balance sheet measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2014 and 2013:

| | | Fair Value Measurements Using | | |
|---|---|---|---|---|
| | Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| | | (In thousands) | | |
| December 31, 2014 | | | | |
| Available-for-sale securities | | | | |
| Nuclear Decommissioning Trust | $ 113,849 | $ 92,983 | $ 20,866 | $ - |
| Investments | 40,278 | 725 | 37,798 | 1,755 |
| Derivative investments | 1,294 | - | 1,294 | - |
| Financial transmission rights | (1,294) | - | (1,294) | - |
| December 31, 2013 | | | | |
| Available-for-sale securities | | | | |
| Nuclear Decommissioning Trust | $ 104,286 | $ 84,037 | $ 20,249 | $ - |
| Investments | 32,954 | 5,154 | 25,545 | 2,255 |
| Derivative investments | 1,925 | - | 1,925 | - |
| Financial transmission rights | (1,925) | - | (1,925) | - |

Following is a description of the valuation methodologies and inputs used for instruments measured at fair value on a recurring basis and recognized in the accompanying balance sheets, as well as the general classification of such instruments pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during the year ended December 31, 2014. For assets classified within Level 3 of the fair value hierarchy, the process used to develop the reported fair value is reported below.

### *Nuclear Decommissioning Trust and Investments (Available-for-sale Securities)*

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid government bonds and exchange-traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. For these investments, the inputs used by the pricing service to determine fair value may include one, or a combination of: observable inputs such as benchmark yields, reported trades, broker/dealer quotes, benchmark securities, bids, offers, and reference data market research publications and are classified within Level 2 of the valuation hierarchy. Level 2 securities include certain collateralized mortgage and debt obligations and certain municipal securities. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy and include an auction rate security. Inputs include quoted market prices, benchmark securities, bids, offers and broker/dealer quotes.

### *Derivatives*

The fair value is estimated using inputs that are observable or that can be corroborated by observable market data and, therefore, are classified within Level 2 of the valuation hierarchy. For financial transmission rights, inputs include clearing prices of the FTRs at multi-year, annual, seasonal and monthly auctions adjusted for seasonal expectations of the supply and demand of energy.

### Level 3 Reconciliation

The following is a reconciliation of the beginning and ending balances of recurring fair value measurements recognized in the accompanying consolidated balance sheet using significant unobservable (Level 3) inputs:

| | Auction Rate Security (In thousands) |
|---|---|
| Balance, January 1, 2013 | $ 2,831 |
| Total realized and unrealized gains and losses | |
| Included in net margin | (476) |
| Included in other comprehensive margin | - |
| Settlements | (100) |
| Balance, December 31, 2013 | 2,255 |
| Total realized and unrealized gains and losses | |
| Included in net margin | - |
| Included in other comprehensive margin | - |
| Settlements | (500) |
| Balance, December 31, 2014 | $ 1,755 |

During 2014, there were no realized gains or losses for the item reflected in the table above included in net margin in the accompanying consolidated statements of margin. During 2013, realized losses of $476,000 for the item reflected in the table above is included in net margin in the accompanying consolidated statements of margin.

### *Unobservable (Level 3) Inputs*

The following table presents quantitative information about unobservable inputs used in recurring Level 3 fair value measurements.

| | 2014 | | | |
|---|---|---|---|---|
| | Fair Value | Valuation Technique | Unobservable Inputs | |
| Auction rate security | $ 1,755 | Discounted cash flow | Discount rate | 5.10% |
| | | | Estimated maturity | 2029 |
| | | | Estimated cash flow | Historical retirements |

### *Fair Value of Other Financial Instruments*

The estimated fair values of the Cooperative's other financial instruments at December 31, 2014 and 2013 are as follows (in thousands):

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Cash and cash equivalents | $ 24,193 | $ 24,193 | $ 25,963 | $ 25,963 |
| Investment in associated organizations | 16,442 | 16,442 | 26,844 | 26,844 |
| Long-term debt | 199,704 | 199,704 | 174,769 | 174,769 |

The following methods were used to estimate the fair value of all other financial instruments not recognized in the accompanying balance sheet.

### *Cash and Cash Equivalents*

The carrying amount approximates fair value.

### *Investments in Associated Organizations*

Management was not able to estimate the fair value of investments that represent the Cooperative's investment in memberships and other associated organizations and they remain at their carrying value.

### *Long-term Debt*

Due to the current market interest rates and/or short-term maturities of the Cooperative's debt, carrying amounts approximate fair value.

## Note 18: Realty Taxes

The Cooperative's portion of local real estate taxes related to SSES are billed by and paid to PPL. The Cooperative is billed and pays directly to various local tax jurisdictions local real estate taxes on other property that is exclusively owned by the Cooperative.

## Note 19: Subsequent Events

Subsequent events have been evaluated through the date of the Independent Auditor's Report, which is the date the consolidated financial statements were available to be issued.

BKD LLP

CPAs & Advisors