Kansas Gas and Electric Company

KG&E

1987 Annual Report

Letter to Our Stockholders

KG&E is at a turning point . . .

For two years my letter to you has focused on the steps we have taken to relieve the immediate financial stress created by the 1985 Wolf Creek rate order. In 1987, approval of a new rate stabilization plan effectively ended litigation of the rate order. And the $392 million sale and leaseback of our La Cygne 2 generating unit completed a strategy intended to regain a minimum level of financial strength without seeking further rate increases.

The good news is we have achieved that goal. For the second consecutive year, dividends were increased, our bond ratings improved, and our earnings from operations increased.

A major remaining question for the near term is whether we will be required to write down retained earnings by more than $90 million and to eliminate further accrual of deferred revenues. Both could be required by the new Statement of Financial Accounting Standards No. 92. This new standard conflicts with accounting practices approved by our regulators. We are working with the Federal Energy Regulatory Commission and the Securities and Exchange Commission to favorably resolve this question.

The results produced to date give us breathing room to solve fundamental problems and aggressively move to strengthen our financial position long-term. What we do in the next few years will determine 10 years from now if we can still tell a good story.

Our business is selling energy. Our progress in the last two years, however, has been primarily the product of cost cutting, creative financing, and deferred revenues. These have been effective short term fixes; but, in the long run, they are not a substitute for selling energy.

Our key objective in the next few years is to more fully utilize existing generating facilities. The fact is we can produce more electrical energy than is currently being generated and sold. For example, the annual system capacity factor for our base load units — the electricity these facilities actually

(Continued on next page)

La Cygne Steam Electric Station

produce as a percentage of what they would produce if operated at full capacity 100% of the time — over the last five years has been 49%, 58%, 51%, 52% and 57%. Of course, it is not possible to achieve 100%. For our facilities about 65% to 70% is achievable.

That we are making progress is obvious. Retail sales in 1987 increased 4% over 1986, while wholesale sales increased 8%, bringing the total sales increase to 5%. System base load capacity factor in 1987 was 57% compared to 52% in 1986. We have some of the pieces in place to maintain this progress.

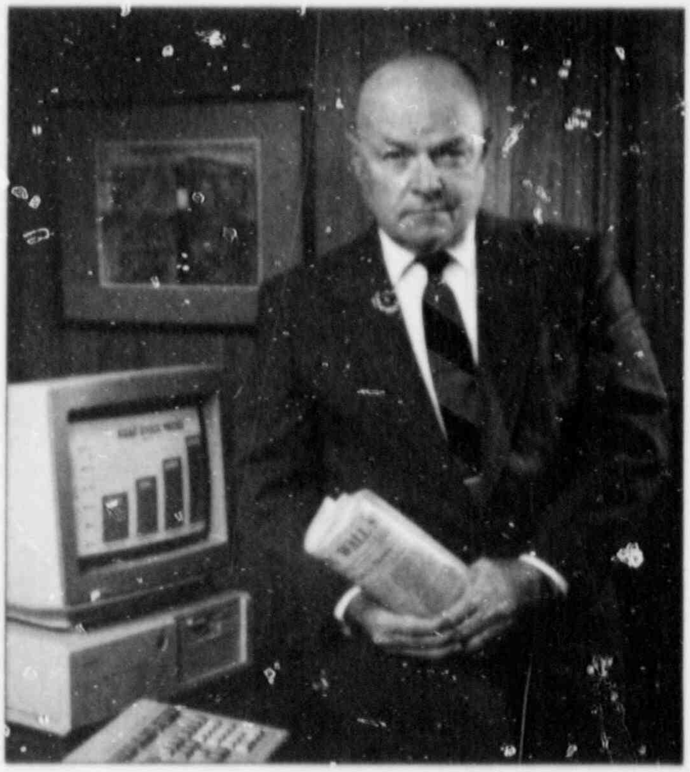
Through innovative rate contracts we have become partners with major customers in long range demand/capacity planning. But these contracts alone only maintain existing sales levels. We must go further, as we have with one major customer which purchased 76,625,000 additional kilowatthours in 1987 under a short term incremental sales contract.

We have increased our share of the residential space heating market and expect to continue doing so.

We very actively support economic development in our service territory. In part with the help of our economic development rate, during 1987 we connected 39,261 kilowatts of new load at 143 new or expanded industries accounting for 3,317 new jobs. As with other efforts to more fully use generating facilities, this one is also a good start. But it is only a start.

There should be no mistake about it. Our key objective is to more fully utilize our generating facilities. But, we have no intention of achieving that objective in a way which would require new base load units. Through encouragement of off peak use, load management, conservation, and, as necessary, cogeneration, we intend to avoid major construction projects at least for the rest of this century.

What about sale of products other than electrical energy? We will consider diversification opportunities on a case-by-case basis. A first step has been taken with our purchase of a 50% interest



Wilson K. Cadman

in a small firm that sells a device which permits customers to carefully control their use of electricity and to pay in advance for service.

Finally, we remain committed to holding the line on rate increases and to restoring our common dividend to its pre-Wolf Creek rate order level of $2.36 per year. Progress to date has been good. We have kept rates within the levels established in our KCC approved rate stabilization plan. Dividends were increased 15% to $1.36 in 1986 and a further 9% to $1.48 in 1987. Both commitments depend upon our ability to achieve full utilization of our generating facilities.

We appreciate your support and welcome your questions and comments.

Wilson K Cadman

Wilson K. Cadman
Chairman of the Board and President

February 26, 1988

Financial Highlights, Five-Year Comparison

(Dollars in Thousands except per share data)

	1987	1986	1985	19[illegible]	1983
Operating Revenues	$ 512,126	$ 496,340	$ 410,786	$ 41[illegible],75[illegible]	$ 393,053
Net Income	$ 97,437	$ 14,856	$ 97,732	$ 121,858	$ 107,538
Earnings Applicable to Common Stock	$ 94,961	$ 5,669	$ 83,377	$ 106,4[illegible]5	$ 92,027
Average Shares of Common Stock Outstanding	40,522,801	40,752,852	39,118,105	3[illegible],[illegible]8,342	29,912,327
Common Stock Per Share Data					
Earnings	$ 2.34	$ 0.14	$ 2.13	$ 3.07	$ 3.08
Cash Dividends	$ 1.39	$ 1.225	$ 2.065	$ 2.36	$ 2.27
Indicated Year-End Dividend Rate	$ 1.43	$ 1.36	$ 1.18	$ [illegible].36	$ 2.36
Market Value Year-End	$ 19.25	$ 22.875	$ 14.125	$ 17.25	$ 17.25
Book Value (Moody's Net Tangible Assets) Year-End	$ 19.86	$ 18.87	$ [illegible]	$ 2[illegible].38	$ 20.31
Available Capacity (Megawatts)	2,399	2,435	2,0[illegible]7	2,099	2,160
System Peak Responsibility (Megawatts)	1,653	1,627	1,6[illegible]2	1,633	1,700
Reserve Capacity (Megawatts)	746	808	4[illegible]5	466	460
Average Use Per Residential Customer (Kilowatthours)	9,314	9,202	9,435	9,812	9,901
Average Price Per Residential Kilowatthour	9.02¢	8.93¢	7.13¢	6.98¢	6.77¢
Number of Customers at End of Year	249,970	247,726	246,017	242,666	238,591
Long-Term Debt	$ 1,016,[illegible]6	$ 1,063,464	$ 1,047,420	$ 991,004	$ 753,242
Redemption Required Preferred Stock	$ —	$ 18,000	$ 76,000	$ 78,[illegible]00	$ 95,[illegible]
Total Utility Plant (Net)	$ 1,926,536	$ 2,028,592	$ 2,217,478	$ 2,064,721	$ 1,657,203
Total Assets	$ 2,611,787	$ 2,282,860	$ 2,444,789	$ 2,226,256	$ 1,778,232

More than 38,000 persons visited The Moving Wall July 3-10 in Wichita. The half-scale replica of the Vietnam Veterans Memorial in Washington was sponsored in Kansas by KG&E and the Children's Museum of Wichita. The memorial was open 24-hours daily on the campus of The Wichita State University. More than 300 volunteers assisted, including 56 KG&E employees.

Management's Discussion and Analysis of Results of Operations and Financial Condition

Results of Operations

Sales and Customers

Total electric sales for 1987 were 5% higher than in 1986. Retail sales registered a 4% increase over 1986, while wholesale sales increased 8%. Wholesale sales were 16% of total electric sales.

Industrial sales registered the largest gain in the retail sales category with a 7% increase. The industrial gain is due primarily to a major chemical manufacturer increasing production. Residential and commercial sales increased in 1987 due primarily to an increased number of customers. Details of sales and customer statistics are presented in Table 1 and the Sales graph.

The increase in wholesale sales is due to the Company's success in selling uncommitted energy from its available capacity. Wholesale sales are expected to remain volatile due to the availability of generating capacity in the region and the competitive pricing it creates.

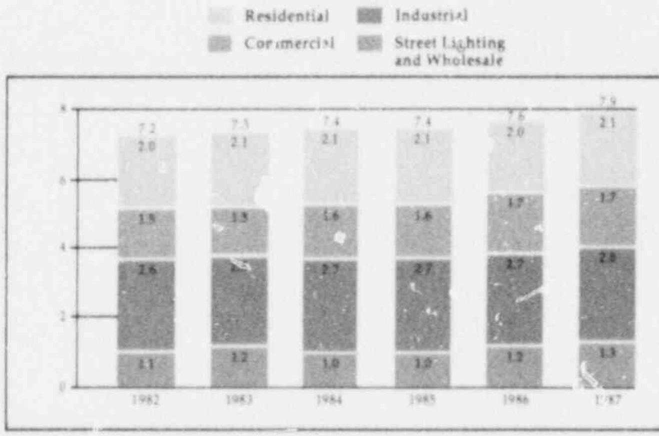
Table 1

Electric Sales (M kWh)	1987 Electric Sales	1987 Percent Change	1986 Electric Sales	1986 Percent Change
	Sales and Customer Statistics			
Residential	2,076,150	2.1%	2,034,158	(1.4)%
Commercial	1,681,847	1.4	1,658,665	1.8
Industrial	2,862,695	7.2	2,671,181	(0.9)
Public Street & Highway Lighting	53,022	(3.2)	54,792	(3.6)
Retail Sales	6,673,714	4.0	6,418,796	(0.4)
Wholesale Sales	1,253,644	8.3	1,157,888	17.7
Total Sales	7,927,358	4.6%	7,576,684	2.0%

Customers (End of Year)	1987 Customers	1987 Percent Change	1986 Customers	1986 Percent Change
Residential	224,162	0.8%	222,283	0.8%
Commercial	20,619	1.6	20,286	0.4
Industrial	4,365	0.2	4,356	(4.1)
Public Street & Highway Lighting	785	3.0	762	6.6
Retail Customers	249,931	0.9	247,687	0.7
Wholesale Customers	39	—	39	2.6
Total Customers	249,970	0.9%	247,726	0.7%

In 1986, retail sales were lower than in 1985. Residential sales were down due to milder temperatures. Industrial sales declined due to reduced demand for chemical and cement products, and discontinuance of construction energy sales to Wolf Creek Generating Station (Wolf Creek). Wholesale sales for 1986 were 18% higher than in 1985 due to the availability of Wolf Creek.

Sales
(Billions of kWh)



Operating Revenues

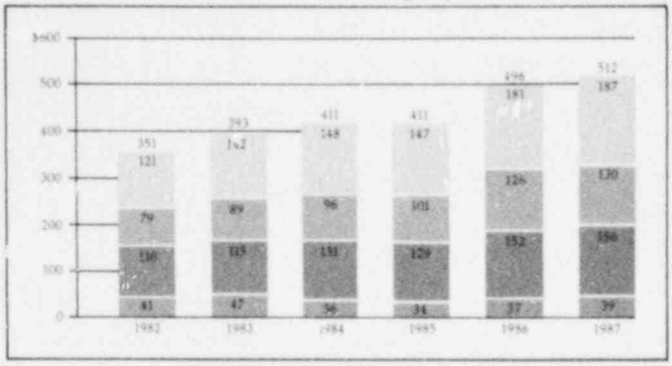
Total operating revenues for 1987 were $512 million. Operating revenues for 1987 and 1986 increased 3% and 21%, respectively. These increases reflect rate increases as well as decreases due to lower fuel and purchased power costs which flow through the fuel adjustment clause. The components of the changes in revenues are provided in Table 2 and the Electric Operating Revenues graph.

Table 2

	Operating Revenues — Revenue Increase or (Decrease) From Prior Year (Thousands of Dollars) 1987	1986
Retail		
Rate Increases	$15,675	$109,073
Fuel	(11,177)	(25,052)
Electric Sales	8,540	(819)
Other	334	106
Total Retail	13,372	83,308
Wholesale	1,627	855
Other Operating Revenues	787	1,391
Total Revenue	$15,786	$ 85,554

Electric Operating Revenues
(Millions of Dollars)

Residential · Industrial · Commercial · Wholesale, Street Lighting and Other



Operating Expenses

Total fuel and purchased power expense in 1987 decreased 6% from 1986. Fuel and purchased power expense is the combination of fossil fuel expense, nuclear fuel expense and purchased power expense. An increase in fossil fuel expense of 5% over 1986 was offset by decreases in nuclear fuel and purchased power expenses of 26% and 60%, respectively.

The fall 1987 refueling and maintenance outage at Wolf Creek extended longer than a similar outage in the fall of 1986. The longer outage resulted in a 7% decrease in nuclear fuel generation and contributed to a 15% increase in fossil generation compared to 1986. Increased availability of the Company's generating facilities decreased purchased power expense.

Fossil fuel and purchased power expense in 1986 decreased from 1985 by 24% and 77%, respectively, reflecting the increased availability and use of nuclear fueled generation from Wolf Creek. Information on the cost of fuel and energy sources is provided in the Average Fuel Cost Data and Sources of Energy graphs.

Other operation and maintenance expenses in 1987 combined for an 11% increase over 1986. The lease expense from the sale and leaseback of the Company's interest in the La Cygne 2 coal-fired generating unit (La Cygne 2) accounted for 53% of the increase. The sale and leaseback of La Cygne 2 is discussed under Capital Requirements and Resources. The remainder of the other operation and maintenance expense increase is due primarily to inflation.

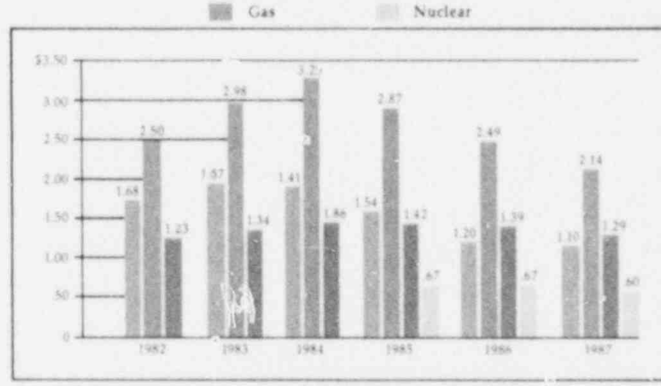
Depreciation expense decreased $12.5 million, 15% below the 1986 level. The decrease is primarily due to increasing Wolf Creek's depreciable life from 30 to 40 years and removing La Cygne 2 from plant-in-service as a result of its sale.

Completion of Wolf Creek had a major effect on 1986 operating expenses, phase-in revenues and Allowance for Funds Used During Construction (AFC). With commercial operation of Wolf Creek, the majority of costs previously capitalized is now expensed.

The Company's income tax expense for operations increased by approximately $1.6 million in 1987. This increase results principally from the

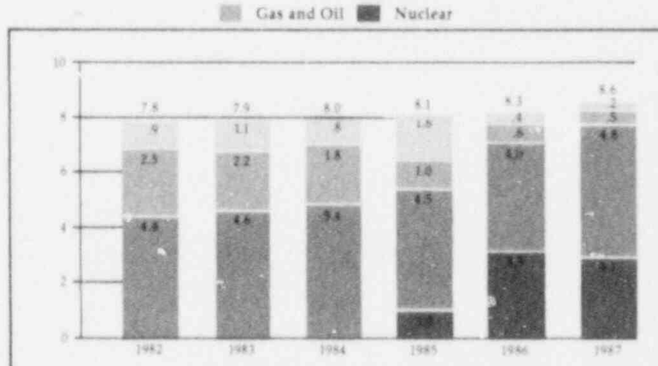
Average Fuel Cost Data
(Dollars per Million BTU)

KG&E System · Coal · Gas · Nuclear



Sources of Energy
(Billions of kWh)

Purchased · Coal · Gas and Oil · Nuclear



Management's Discussion and Analysis of Results of Operations and Financial Condition (continued)

increase of approximately $15 million in operating income net of the effect of the reduction in federal income tax rates from 46% to 40%. See Other Matters - Accounting Standards Changes and Note 1 of the Notes to Financial Statements for the effects of adopting Statement of Financial Accounting Standards No. 96 (SFAS 96), *Accounting for Income Taxes*, and the 1987, 1986 and 1985 financial statements.

Other Income and Other Non-Operating Items

Phase-in revenues in 1987 increased $20.4 million over 1986 phase-in revenues net of related deferred taxes. The rate stabilization plan, approved by the Kansas Corporation Commission (KCC) in March 1987, authorized the Company to record phase-in revenues on a gross basis, and to cease accruing deferred tax expense on phase-in revenues. Deferred taxes were provided on most phase-in revenues accrued during 1986 and 1985. The deferred carrying charge allowed on certain Wolf Creek capacity also increased as a result of the revised rate base valuation of Wolf Creek to $2,376 per kW from $1,290 per kW. Phase-in revenues are discussed further in Note 2 of the Notes to Financial Statements.

Net income in 1987 of $97 million increased by $83 million over 1986. The increase is due to the effects on 1986 net income of the accounting changes made with respect to accruing unbilled revenues and adopting Statement of Financial Accounting Standards No. 90 (SFAS 90), *Regulated Enterprises - Accounting for Abandonments and Disallowances of Plant Costs*. See the Statement of Income for 1986 and related Notes to Financial Statements for further discussion.

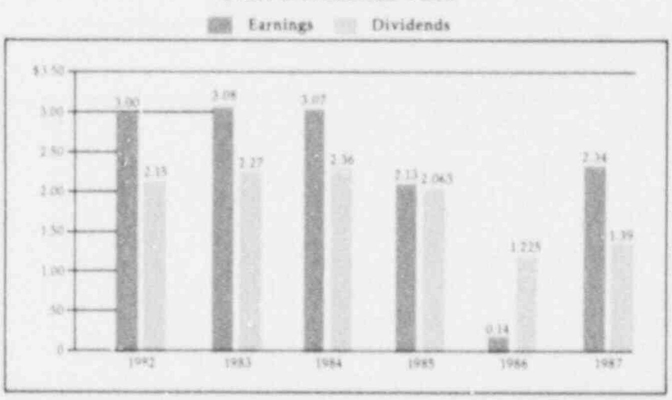
Earnings and Dividends

Earnings applicable to common stock were $95 million in 1987 compared to $6 million in 1986. The increase in earnings applicable to common stock reflects the increase in net income, as well as a $6.7 million decrease in preferred dividends from 1986. The decrease in preferred dividends reflects the retirement of preferred stock by the Company in 1986 and 1987. Earnings for 1985 were $83 million. In 1987, the Company's earned return on average common equity was 12.3% compared to 0.7% in 1986 and 10.7% in 1985. The 1986 equity return excluding the effect of adopting SFAS 90, would have been 7.6%.

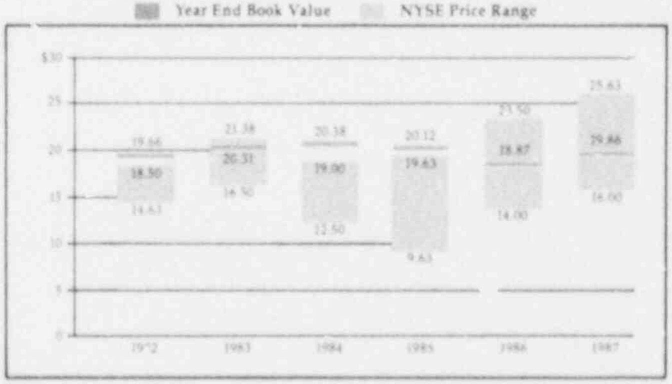
In the fourth quarter of 1987, the Company's Board of Directors declared a common stock dividend of $0.37 per share. This was a $0.03 per share or a 8.8% increase over the dividend paid in each of the previous four quarters. Dividends paid on common stock were $1.39 per share in 1987, an increase of $0.165 per share over 1986.

The Annual Common Stock Earnings Per Share and Cash Dividends Paid graph details for the six years between 1982 and 1987 the earnings per average share of common stock and the common stock dividends paid. Details of the price and book value of the Company's common stock are presented in the Market Price and Book Value of Common Stock graph.

Annual Common Stock Earnings Per Share and Cash Dividends Paid



Market Price and Book Value of Common Stock
(Dollars)



Capital Requirements and Resources

Sale and Leaseback

The Company completed a sale and leaseback of La Cygne 2 in September 1987 for $392 million. The taxable gain from the transaction of approximately $350 million was reduced by $107 million of net operating loss carryforwards, and also resulted in the utilization of approximately $57 million of investment tax credit carryforwards.

The Company has determined the lease is an operating lease for financial reporting purposes. The Company will lease the plant for a term of 29 years with options to renew the term of the lease or purchase the facility. Annual lease expense of $30 million, net of the amortization of the gain, commenced October 1987, and will increase to $37 million after the ninth year for the remainder of the lease. The expense recognition is generally based on the Company's expected pattern of usage of the plant during the lease term. The sale and leaseback is discussed further in Note 6 of the Notes to Financial Statements. Throughout the term of the lease, the Company is responsible for 50% of the costs and expenses associated with the operation of the leased facility as well as being entitled to 50% of the electricity produced by the unit.

The purchase was financed in part by the issuance of $341.1 million of secured facility bonds, with the remainder provided directly by the purchaser. The bonds, which are not a direct obligation of or guaranteed by the Company, are secured by a mortgage on the plant and a security interest in the Company's obligation to make the lease payments throughout the term of the lease.

The sale and leaseback proceeds will be used by the Company to pay approximately $50 million of income taxes and expenses associated with the transaction. In addition, a portion of the proceeds have been used by the Company to buy 2.1 million shares or $39.3 million of its common stock. The Company's Board of Directors have approved the purchase of up to 6 million shares. The remainder of the proceeds is currently held in short-term investments.

While no specific use of the remainder of the proceeds has been determined, the Company is studying alternatives to maximize the return on the remaining proceeds, including: 1) the call and retirement of, and sinking fund payments on, up to $125 million of bonds in 1988 through 1990, 2) the reduction of floating rate debt, and 3) business diversification and investments, particularly those which promote economic development in the Company's service territory.

As part of the Company's application to the KCC, the Company agreed to credit to cost of service the annual amortization of the net gain from the sale and all benefits from the use of the proceeds from the sale. Correspondingly, the KCC included lease expense in cost of service. The KCC, in approving the transaction, directed its staff to review the Company's cost of service and revenues. The staff began its review in January and is expected to complete the review in 1988. The Company believes its cost of service and revenues are reasonable, but is unable to predict the outcome of the KCC's review.

Capital Requirements

Construction expenditures in 1987 remained substantially below levels experienced over the last decade. The decrease is the result of the Company completing its construction program to reduce dependence on natural gas as its principal fuel source. As shown in Table 3, construction expenditures are projected to remain consistent

Table 3

1985-1990 Capital Requirements
(Thousands of Dollars)

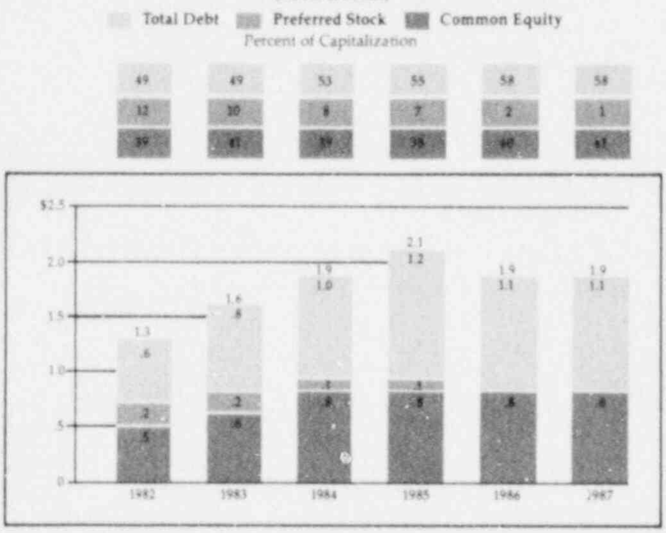
	Actual			Projected		
	1985	1986	1987	1988	1989	1990
Net Construction Expenditures	$115,292	$ 42,046	$ 54,104	$62,579	$ 63,458	$62,019
Add: Securities Redemptions	55,000	234,000	81,300	8,300	108,300	8,300
Total Capital Requirements	$170,292	$276,046	$135,404	$70,879	$171,758	$70,319

Management's Discussion and Analysis of Results of Operations and Financial Condition (continued)

with 1986-1987 levels. The Company anticipates internally generated funds or lease proceeds will meet all capital requirements through 1990.

Securities redemptions consisted of $38 million of high cost debt and preferred stock and $43.3 million in maturing securities. Capital requirements for 1987 were funded 100% with internally generated funds. Details of the Company's capitalization for 1982-1987 are detailed in the Capital Structure graph.

Capital Structure
Includes Short-Term Debt
(Billions of Dollars)



Rating Changes

In August 1987, Moody's Investors Service raised its rating on the Company's first mortgage bonds from Baa2 to Baa1. This followed Duff and Phelps having raised the Company's rating from 9 to 8 in July. These upgrades acknowledge the Company's improved financial condition and prospects for continued improvement. Both firms cited the approval of the rate stabilization plan by the KCC and the favorable impact of the sale and leaseback of La Cygne 2 as key elements in the improvement of the Company's credit quality.

Financing Activities and Liquidity

Significant financing activities by the Company throughout 1987 included:

- ☐ In April, redeemed all of the $8 million outstanding balance of the $8.25 preferred stock series.
- ☐ In August, terminated a $25 million bankers acceptance agreement.
- ☐ In September, completed the sale and leaseback of La Cygne 2 for $392.1 million.
- ☐ In October, the Company's Board of Directors approved the buyback of up to 6 million shares of the 40.8 million shares of common stock then outstanding. At year end, 2.1 million shares had been purchased.
- ☐ In October, redeemed all of the $15 million outstanding balance of the $13.25 preferred stock series.

The following capital resources are available to the Company should additional funds be required.

- ☐ The Company's first mortgage bond indenture contains provisions governing the issuance of additional bonds. Under the earnings test, which is the most limiting, on December 31, 1987, the Company would have been able to issue $572 million of bonds, assuming an interest rate of 10%. The Company's Restated Articles of Incorporation contain no financial tests limiting the issuance of additional shares of preferred stock.
- ☐ Short-term lines of credit are available totaling $75 million, of which there was no outstanding balance at year end.
- ☐ The Company has two long-term revolving credit loan agreements. The first agreement for $100 million is reduced to a maximum of $50 million in December 1992 with the balance, if any, due in December 1993. The second agreement for $150 million will expire June 1994 with the maximum borrowing limit reduced by $37.5 million annually beginning June 30, 1991 until expiration in 1994. Outstanding balances on December 31, 1987 were zero and $150 million, respectively.

Rate Developments

In December 1985, the Company appealed the Wolf Creek rate order to the Kansas Supreme Court. In June 1986, the court held that the KCC had acted within its legal authority.

In November 1986, the Company asked the United States Supreme Court to review the Kansas Supreme Court opinion. The U.S. Supreme Court

dismissed the Company's appeal as "moot" because of the KCC's March 11, 1987 approval of the rate stabilization plan (plan).

The plan substantially modified the 1985 Wolf Creek rate order. The key components of the plan are as follows: 1) delayed the third rate increase of $14.6 million from 1987 to 1989; 2) delayed the fourth rate increase of $15.6 million from 1988 to 1992; 3) made permanent the four increases allowed in the original order; 4) extended the depreciable life of Wolf Creek from 30 to 40 years; 5) included as utility operating revenue an approximate $800 million stream of income generated over the next 40 years by corporate-owned life insurance policies on certain directors, officers and management employees; and 6) revised the rate base valuation of the investment in Wolf Creek to $2,376 per kW. Note 2 of the Notes to Financial Statements provides a more detailed explanation of the rate recognition of Wolf Creek.

In the Wolf Creek rate order, the KCC reserved for further investigation the reasonableness of the Company's 1985 retirement of its 92 MW Ripley Station. As an interim measure, the KCC allowed an additional 46 MW of Wolf Creek capacity to be included in rate base with another 46 MW to be included pending the outcome of the investigation. In March 1987, the KCC ruled the retirement of Ripley was prudent and conditionally ruled that the additional 46 MW of Wolf Creek capacity should be included in rate base. The resulting $8 million increase is to become effective January 1, 1989, if the Company demonstrates that 40 MW of capacity is needed as a result of load growth or a reduction in generating capability.

As electric rates have risen and alternative fuels are in plentiful supply with stable prices, the attractiveness of independent generation has increased. A number of the Company's larger industrial customers have examined the possibility of cogeneration. The loss of these customers from the system would be detrimental to the Company's remaining customers and its shareholders. In the normal ratemaking environment, the fixed costs not recovered due to the loss of load would be borne by the remaining customers, increasing the price to the reduced customer base. The Company has, and will continue to, actively negotiate special rate contracts with its customers who have an economic incentive to cogenerate.

The Tax Reform Act of 1986

The Tax Reform Act of 1986 reduces the corporate tax rate from 46% to 40% in 1987 and to 34% in 1988. This is expected to reduce the Company's effective tax rate on its income statement, causing reported earnings to increase. However, the act imposes a new alternative minimum tax, which reduces the Company's ability to defer the payment of income taxes with tax benefits. Consequently actual taxes paid during the remainder of the 1980's and most of the 1990's will likely be higher than under the prior tax laws, thus reducing the Company's cash flow.

Other Matters

Accounting Standards Changes

The Company has adopted SFAS 90 by restating its 1986 financial statements to recognize a loss principally as a result of the Company not being permitted to receive a return on $125 million of its investment in Wolf Creek. The net of tax loss resulting from adoption of SFAS 90, $44.9 million, together with the effect of adopting SFAS 96 on this loss, resulted in a total reduction to net income of $54.7 million, or $1.35 per share. See Note 2 of the Notes to Financial Statements for further discussion.

Under the KCC's Wolf Creek rate order and the plan, the Company has recorded deferred phase-in revenues as current income and has recorded accumulated deferred phase-in revenues as an asset. Under the plan, accumulated deferred phase-in revenues will be recovered through rates on a sinking fund basis over 33 years beginning in 1992. In August 1987, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 92 (SFAS 92), *Regulated Enterprises — Accounting for Phase-In Plans*. The Company's plan does not meet the requirement of SFAS 92 in that accumulated deferred phase-in revenues are not recovered within 10 years.

Under SFAS 92, the Company would be

Management's Discussion and Analysis of Results of Operations and Financial Condition (continued)

required to discontinue recording phase-in revenues and to write-off against retained earnings all amounts previously recorded.

The Federal Energy Regulatory Commission (FERC), pursuant to authority of the Federal Power Act, has established the Uniform System of Accounts which governs the Company's accounting for rate-making purposes. The Company believes the KCC, through the plan, has established a regulatory asset that has a very high probability of recovery in future years. The Company is in the process of seeking specific approval from the Securities and Exchange Commission (SEC) for continued recognition of its deferred phase-in revenue asset and accrual of additional phase-in revenues in its financial statements in accordance with the plan. As part of this process the Company is seeking specific authorization from the FERC for continued recognition of such amounts in its regulatory accounting records.

If the Company is unable to obtain SEC approval, it will adopt SFAS 92 for financial reporting purposes in 1988. In such event, the Company would restate prior years' financial statements. In accordance with SFAS 92, the Company would eliminate phase-in revenues previously accrued, resulting in reductions to 1987, 1986 and 1985 net income of $51, $30.6 and $8.8 million, respectively. Corresponding reduction in earnings per share would be $1.26, $0.75 and $0.22, respectively. In addition, the Company would cease accruing additional phase-in revenues. The Company believes adoption of SFAS 92 for financial reporting purposes would not affect future recovery of phase-in revenues specified by the plan. See Note 2 of the Notes to Financial Statements for further discussion.

In December 1987, FASB released SFAS 96 which requires companies to change from the deferred method to the liability method of accounting for income taxes. The Company has adopted SFAS 96 in 1987 by restating its 1985 and 1986 financial statements. See Note 1 of the Notes to Financial Statements for further discussion.

Impact of Inflation and Changing Prices

In December 1986, FASB issued Statement of Financial Accounting Standards No. 89, *Financial Reporting and Changing Prices*. As a result of this statement, supplementary disclosure of current costs and constant purchasing power information in the Notes to the Financial Statements is now voluntary. The Company has elected not to make these supplementary disclosures.

Management Statement of Responsibility for Financial Statements

The management of Kansas Gas and Electric Company is responsible for the financial statements, notes thereto, and other information in this report. The accompanying financial statements have been prepared by management in accordance with generally accepted accounting principles consistently applied. The accounting system is in accordance with the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission and the State Corporation Commission of the State of Kansas.

The integrity of the accounting records is upheld by a comprehensive system of internal accounting controls, monitored on a regular basis by the internal audit staff of the Company. This system is complemented by a set of accounting policies and procedures which provide the necessary guidance needed to institute effective internal control.

The Board of Directors maintains its oversight responsibility through an Audit Committee, consisting of three outside directors. The Committee meets with management, the internal auditors, and the independent auditors in connection with its review of matters relating to the Company's financial reporting; the Company's internal audit program; the Company's system of internal accounting controls; and services of the independent auditors. The Committee meets with the auditors without management present in order to assure independent treatment of matters brought to its attention. The Committee also recommends to the directors the selection of independent auditors.

Wichita, Kansas
February 9, 1988

James T. Clark
Vice President - Accounting

Statements of Income

For the Years Ended December 31

	1987	1986	1985
	(Thousands of Dollars)		
Operating Revenues (Note 2)	$ 512,126	$ 496,340	$ 410,786
Operating Expenses			
Fuel and purchased power	103,944	110,417	141,291
Other operation	97,646	86,422	59,314
Maintenance	43,952	41,048	34,540
Total operation and maintenance	245,542	237,887	235,145
Depreciation	72,266	84,756	45,375
Income taxes (Note 8)	22,788	21,139	26,481
Other taxes	30,764	25,176	19,246
Total operating expenses	371,360	368,958	326,247
Operating Income	140,766	127,382	84,539
Other Income and Deductions			
Phase-in revenues (Note 2)	51,037	57,518	16,306
Allowance for other funds used during construction	(431)	(680)	62,652
Miscellaneous - net	8,626	5,477	5,309
Income taxes - net (Note 8)	(1,357)	(29,639)	(10,252)
Total other income and deductions	57,875	32,676	74,015
Loss from Application of SFAS 90 (Note 2)			
Disallowed plant costs	—	89,183	—
Income taxes	—	(34,475)	—
Net effect of SFAS 90	—	54,708	—
Income Before Interest Charges and Cumulative Effect of a Change in Accounting Method	198,641	105,350	158,554
Interest Charges			
Long-term debt	93,733	98,202	103,433
Other interest	7,143	2,650	3,742
Allowance for borrowed funds used during construction	328	560	(46,353)
Total interest charges - net	101,204	101,412	60,822
Income Before Cumulative Effect of a Change in Accounting Method	97,437	3,938	97,732
Cumulative Effect to January 1, 1986 of Accruing Unbilled Revenues (Net of Income Taxes of $10,763) (Note 1)	—	10,918	—
Net Income	97,437	14,856	97,732
Preferred Stock Dividends	2,476	9,187	14,355
Earnings Applicable to Common Stock	$ 94,961	$ 5,669	$ 83,377
Average Shares of Common Stock Outstanding	40,522,801	40,752,852	39,118,105
Earnings (Loss) Per Share of Common Stock:			
Before Change in Accounting Principle	$ 2.34	$ (0.13)	$ 2.13
Cumulative Effect	—	0.27	—
Total	$ 2.34	$ 0.14	$ 2.13

See notes to financial statements.

Balance Sheets December 31

	1987	1986
	(Thousands of Dollars)	
Assets		
Electric Plant - at original cost (Notes 2 and 5)		
Plant in service	$2,321,992	$2,400,384
Less accumulated depreciation	414,640	393,540
Net plant in service	1,907,352	2,006,844
Construction work in progress	5,483	8,146
Electric plant held for future use - net	6,727	6,445
Nuclear fuel - net	6,974	7,157
Total electric plant - net	1,926,536	2,028,592
Other Property and Investments		
Special deposits (Note 5)	38,846	15,858
Other	559	556
Total other property and investments	39,405	16,414
Current Assets		
Cash and cash equivalents	7,662	5,514
Short-term investments (Note 1)	297,851	—
Accounts receivable and unbilled revenues	35,383	41,507
Fossil fuel - at average cost	23,125	23,866
Materials and supplies - at average cost	27,022	26,607
Prepayments and other current assets	6,884	10,987
Total current assets	397,927	108,481
Deferred Debits		
Deferred regulatory revenue	98,422	28,635
Phase-in revenues (Note 2)	124,861	73,824
Unamortized debt expense	9,299	10,422
Other	15,337	16,492
Total deferred debits	247,919	129,373
Total	$2,611,787	$2,282,860

Capitalization and Liabilities

	1987	1986
Capitalization (See Statements of Capitalization)		
Common stock equity	$ 769,900	$ 769,729
Preferred stock - redemption not required	18,701	18,701
Preferred stock - redemption required	—	18,000
Long-term debt	1,016,096	1,063,464
Total capitalization	1,804,697	1,869,894
Current Liabilities		
Short-term borrowings (Note 3)	47,000	7,500
Securities due within one year (Note 5)	8,300	43,300
Accounts payable	55,251	42,482
Interest accrued	24,830	21,482
Taxes accrued	32,156	8,512
Customers' deposits	3,548	3,316
Total current liabilities	171,085	126,592
Deferred Credits and Other Liabilities		
Deferred income taxes (Note 8)	218,742	236,271
Deferred investment tax credits (Note 8)	76,284	29,636
Customers' advances	21,172	20,467
Deferred gain from sale-leaseback (Note 6)	319,807	—
Total deferred credits and other liabilities	636,005	286,374
Commitments and Contingencies (Notes 2 and 9)		
Total	$2,611,787	$2,282,860

See notes to financial statements.

Statements of Cash Flows

For the Years Ended December 31

Increase (Decrease) in Cash and Cash Equivalents

	1987	1986	1985
	(Thousands of Dollars)		
Cash Flows From Operating Activities			
Net income	$ 97,437	$ 14,856	$ 97,732
Adjustments to reconcile net income to net cash provided:			
Depreciation and amortization	84,167	105,838	52,739
Deferred income taxes	(77,492)	28,450	37,785
Deferred investment tax credits - net	51,596	(1,384)	(1,052)
Phase-in revenues	(51,037)	(57,518)	(16,306)
Disallowed plant cost	—	89,183	—
Customer advances	(702)	14,242	—
Allowance for other funds used during construction	431	680	(62,652)
Changes in current assets and liabilities:			
Accounts receivable and unbilled revenues	6,124	(21,996)	12,511
Other current assets	4,429	(6,391)	(18,138)
Accounts payable	12,769	(3,889)	(18,942)
Accrued liabilities	26,992	(7,432)	3,311
Other current liabilities	232	485	360
Other	(10,951)	(3,448)	10,649
Net cash provided by operating activities	143,995	151,676	97,997
Cash Flows From Financing Activities			
Proceeds from:			
Issuance of first mortgage bonds	—	50,000	30,000
Issuance of pollution control bonds	—	—	142,500
Issuance of common stock	533	4,814	67,192
Revolving bank loans	150,000	25,000	50,000
Special deposits	(22,988)	7,875	17,156
Borrowings against cash surrender value of life insurance policies	45,944	—	—
Net borrowings (repayments) under:			
Other credit agreements	923	20,902	(43,480)
Short-term borrowing agreements	39,500	7,500	(13,000)
Redemptions of:			
Revolving bank loans	(170,000)	(5,000)	—
Other long-term debt	(58,300)	(134,000)	(40,000)
Preferred stock	(23,000)	(100,000)	(15,000)
Purchases of treasury stock	(39,259)	—	—
Dividends paid	(58,536)	(59,115)	(94,781)
Net cash provided by (used in) financing activities	(135,183)	(182,024)	100,587
Cash Flows From Investing Activities			
Additions to electric plant (less allowance for other funds used during construction)	(53,920)	(41,488)	(161,589)
Investments in life insurance policies	(47,121)	—	—
Proceeds from sale-leaseback	392,100	—	—
Purchase of short-term investments	(373,723)	—	—
Drawdown of short-term investments	76,000	—	—
Net cash used in investing activities	(6,664)	(41,488)	(161,589)
Net Increase (Decrease) in Cash and Cash Equivalents	2,148	(71,836)	36,995
Cash and Cash Equivalents at Beginning of Year	5,514	77,350	40,355
Cash and Cash Equivalents at End of Year	$ 7,662	$ 5,514	$ 77,350

See notes to financial statements.

Statements of Capitalization December 31

	1987		1986	
	(Thousands of Dollars)			
Common Stock Equity (See Statements of Common Stock Equity)				
Common stock, without par value, authorized 50,000,000 shares	**$ 633,645**	**35.1%**	$ 633,112	33.8%
Retained earnings	**175,249**	**9.7**	136,352	7.3
Other paid-in capital	**265**	**—**	265	—
Subtotal	**809,159**	**44.8**	769,729	41.1
Treasury stock, at cost	**(39,259)**	**(2.1)**	—	—
Total Common Stock Equity	**769,900**	**42.7**	769,729	41.1
Cumulative Preferred Stock (Note 4)				
Redemption not required:				
4-1/2%, $100 par value; authorized and outstanding 82,011 shares	**8,201**		8,201	
Serial, $100 par value; authorized 255,000 shares:				
4.28% series, outstanding 45,000 shares	**4,500**		4,500	
4.32% series, outstanding 60,000 shares	**6,000**		6,000	
Redemption required Serial, without par value, authorized 6,000,000 shares:				
$8.25 series, 80,000 shares	**—**		8,000	
$13.25 series, 150,000 shares	**—**		15,000	
Securities due within one year	**—**		(5,000)	
Total Cumulative Preferred Stock	**18,701**	**1.0**	36,701	2.0

Long-Term Debt (Note 5)

First Mortgage Bonds:

Series	**Due**	**1987**	**1986**	**Series**	**Due**	**1987**	**1986**
16%	1986-96	$ 20,400	$ 22,700	7⅜%	2002	$ 25,000	$ 25,000
10⅞%	1987	—	30,000	6.8%	2004	14,500	14,500
14⅞%	1987-91	24,000	30,000	9⅝%	2005	40,000	40,000
13½%	1989	100,000	100,000	8⅜%	2006	25,000	25,000
4⅝%	1991	7,000	7,000	8½%	2007	25,000	25,000
14.05%	1991	30,000	30,000	6%	2007	10,000	10,000
14⅛%	1991	20,000	20,000	5⅞%	2007	21,940	21,940
5⅝%	1996	16,000	16,000	8⅞%	2008	30,000	30,000
8½%	2000	35,000	35,000	9¾%	2016	50,000	50,000
8⅛%	2001	35,000	35,000				

	Due	1987	1986	1987 Total	%	1986 Total	%
Total First Mortgage Bonds				**528,840**		567,140	
Other Long-Term Debt:							
Pollution Control Revenue Bonds:							
5-3/4% series	2003	15,000	15,000				
Adjustable rate series	2013	63,000	63,000				
Adjustable rate series	2013	87,000	87,000				
Adjustable rate series	2014	98,000	98,000				
Adjustable rate series	2015	79,500	79,500				
Revolving bank loan	1992-93	—	100,000				
Revolving bank loan	1991-94	150,000	70,000				
Bankers acceptance agreement	1987	—	20,000				
Other long-term agreements		3,070	2,147				
Unamortized premium and discount-net		(14)	(23)				
Total Other Long-Term Debt				**495,556**		534,624	
Securities due within one year				**(8,300)**		(38,300)	
Total Long-Term Debt				**1,016,096**	**56.3**	1,063,464	56.9
Total Capitalization				**$1,804,697**	**100.0%**	$1,869,894	100.0%

See notes to financial statements.

Statements of Common Stock Equity

	Common Stock Shares Issued	Common Stock Amount	Other Paid-In Capital	Retained Earnings	Treasury Stock Shares	Treasury Stock Amount	Total
			(Thousands of Dollars)				
Balance January 1, 1985	36,524,434	$561,106	$ 1,661	$181,452			$744,219
Net Income				97,732			97,732
Cash Dividends:							
Common Stock-$2.065 per share				(80,426)			(80,426)
Preferred Stock				(14,355)			(14,355)
Sale of Common Stock	2,000,000	38,620					38,620
Employee Stock Purchase Plan, Employee Stock Ownership Plan and Dividend Reinvestment Plan	1,940,376	28,572					28,572
Capital Stock Expense				(67)			(67)
Balance December 31, 1985	40,464,810	628,298	1,661	184,336			814,295
Net Income				14,856			14,856
Cash Dividends:							
Common Stock-$1.225 per share				(49,928)			(49,928)
Preferred Stock				(9,187)			(9,187)
Employee Stock Purchase Plan, Employee Stock Ownership Plan and Dividend Reinvestment Plan	334,889	4,814					4,814
Capital Stock Expense				(66)			(66)
Loss on Reacquired Preferred Stock			(1,396)	(3,659)			(5,055)
Balance December 31, 1986	40,799,699	633,112	265	136,352			769,729
Net Income				97,437			97,437
Cash Dividends:							
Common Stock-$1.39 per share				(56,060)			(56,060)
Preferred Stock				(2,476)			(2,476)
Purchase of Treasury Stock					(2,055,300)	$(39,259)	(39,259)
Employee Stock Purchase Plan, Employee Stock Ownership Plan and Dividend Reinvestment Plan	23,548	533					533
Loss on Reacquired Preferred Stock				(4)			(4)
Balance December 31, 1987	40,823,247	$633,645	$ 265	$175,249	(2,055,300)	$(39,259)	$769,900

See notes to financial statements.

Notes to Financial Statements

1. Summary of Significant Accounting Policies

System of Accounts - The Company is subject to the jurisdiction of the State Corporation Commission of the State of Kansas (KCC) and the Federal Energy Regulatory Commission (FERC) and maintains its accounts in accordance with the uniform system of accounts prescribed by these regulatory commissions. As a regulated utility, the accounting principles applied by the Company differ in certain respects from those applied by non-regulated business.

Electric Plant - The cost of plant includes contracted work, direct labor and materials, allocable engineering, supervision, general and administrative costs, and allowance for funds used during construction (AFC). AFC is defined in the applicable regulatory system of accounts as the net cost during the period of construction of borrowed funds used for construction purposes, including nuclear fuel, and a reasonable rate on other funds when so used. The AFC rate (net of income taxes) was 9.18% in 1987 and 1986, and 9.38% in 1985.

Maintenance and repairs of property, and replacements and renewals of items determined to be less than units of property, are charged to operating expenses. The cost of units of property replaced or renewed, plus removal costs, less salvage, is charged to accumulated depreciation, and the cost of related replacements and renewals is added to electric plant. Betterments are charged to electric plant.

Revenues - Prior to January 1, 1986, operating revenues included amounts actually billed for services rendered. To

provide a better matching of the Company's revenues and expenses, effective January 1, 1986, the Company adopted a change in accounting method to provide for accrual of estimated unbilled revenues. Unbilled revenues result from services delivered since the period covered by the latest billings to customers. The cumulative effect to January 1, 1986 of this accounting change increased 1986 net income approximately $10.9 million (net of related income taxes of $10.8 million).

Had this new accounting method been in effect during 1985, net income would not have been materially different than that shown in the financial statements.

Statements of Cash Flows - The Company has adopted Statement of Financial Accounting Standards No. 95, *Statement of Cash Flows*, in 1987, and has conformed its 1986 and 1985 financial statements to include statements of cash flows for those years. For purposes of the statements of cash flows, the Company considers highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

The following amounts of interest (net of amounts capitalized) and income taxes paid for each of the three years in the period ended December 31, 1987, are as follows:

	1987	1986	1985
Interest	$98,248	$105,552	$57,176
Income taxes	$34,800	$ —	$ —

Cash Surrender Value of Life Insurance Policies - Other deferred debits at December 31, 1987, include $1.2 million representing the excess of the cash surrender value of the Company's investment in life insurance contracts ($47.1 million) over the amount of borrowings ($45.9 million) against such contracts.

Short-Term Investments - Short-term investments represent the unexpended proceeds at December 31, 1987, from the sale-leaseback described in Note 6. These investments consist primarily of certificates of deposit and variable rate municipal and state debt instruments having an average maturity of approximately 30 days and variable rate preferred stock. Cost of these investments approximates market.

Fuel Costs - The cost of nuclear fuel in process of refinement, conversion, enrichment, and fabrication is recorded as an asset at original cost and is amortized to expense based upon the quantity of heat produced for the generation of electricity. The accumulated amortization of nuclear fuel was $39 million at December 31, 1987, and $25 million at December 31, 1986.

The Company's rate schedules include a fuel adjustment clause which permits current recoveries of fuel costs.

Depreciation - For financial reporting purposes, the Company uses the straight-line method to depreciate the original cost of property over its estimated remaining service life. The provision for depreciation stated as a percent of original cost of depreciable property was 2.9% for 1987 and 3.4% for 1986 and 1985.

Income Taxes - The Company has adopted Statement of Financial Accounting Standards No. 96, *Accounting for Income Taxes* (SFAS 96), in 1987, and has elected to restate its 1986 and 1985 financial statements to conform to the provisions of this statement. This statement requires the Company to establish deferred tax liabilities or assets, as appropriate, for all temporary differences, and to adjust deferred tax balances to reflect changes in tax rates expected to be in effect during the periods in which the temporary differences reverse. The significant temporary differences that give rise to the net accumulated deferred income tax liabilities as of December 31, 1987 and 1986 include accelerated tax depreciation, AFC, unamortized investment tax credits, deferred gain from sale-leaseback, and phase-in revenues.

In accordance with various rate orders received from the KCC, the Company has not yet collected through rates the amounts necessary to pay a significant portion of the net deferred income tax liabilities recorded at December 31, 1987 and 1986. As the Company believes it is probable that the net future increases in income taxes payable will be recovered from customers through future rates, it has recorded net deferred regulatory revenue assets for the portions of the net income tax liabilities not yet collected through rates. These assets are also a temporary difference for which additional deferred income tax liabilities have been provided at each balance sheet date.

The effects of adopting SFAS 96 on net income for the years ended December 31, 1987 and 1985 were not significant; 1986 net income was reduced by $7.8 million.

Investment Tax Credits - The Tax Reform Act of 1986 repealed the investment tax credit on property placed into service after December 31, 1985, subject to certain transition rules. In accordance with KCC requirements, investment tax credits relating to utility property placed into service are deferred when utilized and are being amortized to income over the remaining lives of the related property.

2. Regulatory Matters

Rate Recognition of Wolf Creek - In connection with the start of commercial operation of Wolf Creek Generating Station (Wolf Creek) in 1985, the KCC granted the Company, effective October 3, 1985, a $169.6 million interim rate increase subject to refund or adjustment. In determining the amount of the rate increase, the KCC tentatively disallowed a rate of return on a significant portion of the Company's investment in Wolf Creek, and disallowed recovery of approximately $125 million it deemed imprudent. The rate increase of $169.6 million was to be phased-in over three years in the amounts of $135, $20 and $14.6 million in years one through three, respectively. Revenues recorded but not currently billed under the phase-in plan, plus a rate of return on such amounts, were to be collected in years four through eight via an additional rate increase in those years.

In March 1987, the KCC approved the rate stabilization plan (plan) which modified its interim rate order for Wolf Creek. Significant modifications of the interim rate order affecting the rate recognition of Wolf Creek included:

- ☐ The $135 and $20 million rate increases were made permanent. The $14.6 million rate increase was delayed to January 1, 1989, and will also be a permanent increase. A fourth permanent rate increase of $15.6 million will become effective January 1, 1992.
- ☐ The Company will be permitted to earn a rate of return on its entire investment in Wolf Creek other than the

approximately $125 million of costs which the KCC found to be imprudent. Approximately 50% of Wolf Creek's capacity deemed to be excess capacity by the KCC will be phased into rate base over five years beginning in 1987, with the remaining portion of the Wolf Creek investment not in rate base accruing a rate of return of approximately 5%. The Company will be permitted to recover costs deemed imprudent over the life of Wolf Creek.

- The depreciation rate for Wolf Creek was changed from approximately 3.4% to 2.6% as a result of a change in its depreciable life from 30 to 40 years.
- The order reaffirmed the March 1986 order permitting the eight-year amortization of approximately $96 million of deferred income taxes. Such an amount represents the tax effects relating to the allowance for borrowed funds used during construction capitalized for Wolf Creek.
- The Company will accrue phase-in revenues of $14.6 million annually, plus a rate of return on total phase-in revenues accrued, until the third rate increase of $14.6 million is implemented in 1989. The Company will accrue a rate of return on accumulated phase-in revenues for years 1989 through 1991. The gross method will be used to record the income tax effects of these accruals.
- Beginning January 1, 1992, the accumulated phase-in revenues and accrued rates of return on excess capacity will be amortized for recovery over the remaining life of Wolf Creek.

The KCC is permitting the Company to combine an approximate $800 million stream of income to be generated over the next 40 years through corporate-owned life insurance policies on certain company directors, officers and management employees with utility operating revenue to cover the revenue requirements as a result of the preceding regulatory accounting changes.

Statement of Financial Accounting Standards No. 90 (SFAS 90) - In December 1986, the Financial Accounting Standards Board (FASB) issued SFAS 90, *Regulated Enterprises - Accounting for Abandonments and Disallowances of Plant Costs,* which amends the presently prescribed accounting standards for these two types of events that have occurred primarily in the electric utility industry. Among the provisions of SFAS 90 is a requirement that any disallowance of the cost of a recently completed plant, including a return on such cost, be recognized as a loss. As permitted by the new standard, the Company has elected to adopt SFAS 90 in 1987 by retroactively restating its 1986 financial statements for the effects of Wolf Creek related disallowances (principally the KCC's disallowance of a return on approximately $125 million of the Company's investment in Wolf Creek). Restatement of the Company's 1986 financial statements for the effects of SFAS 90 resulted in reductions of net income of $44.9 million and earnings per share of $1.10 from previously reported amounts. This reduction, together with the effect of adopting SFAS 96 on this loss, resulted in a total reduction to net income of $54.7 million or $1.35 per share.

Statement of Financial Accounting Standards No. 92 (SFAS 92) - In August 1987, the FASB issued SFAS 92, *Regulated Enterprises - Accounting for Phase-In Plans.* The new statement, which becomes effective in 1988, specifies certain requirements which must be met in order to recognize phase-in plans (as defined by SFAS 92) for financial reporting purposes. The SFAS 92 requirement that all phase-in revenues be recovered within 10 years is not met by the plan, which provides for recovery of Wolf Creek related phase-in revenues over the remaining life of Wolf Creek beginning in 1992.

The Company believes the KCC, through the plan, has established (and continues to establish through additional phase-in revenue accruals) a regulatory asset that has a very high probability of recovery in future years. Accordingly, management, with approval from the Company's Board of Directors, is in the process of seeking specific approval from the Securities and Exchange Commission (SEC) for continued recognition of its deferred phase-in revenue asset and accrual of additional phase-in revenues in its financial statements in accordance with the plan. As part of this process the Company is seeking specific authorization from the FERC for continued recognition of such amounts in its regulatory accounting records.

If the Company is unable to obtain SEC approval, it will adopt SFAS 92 for financial reporting purposes in 1988 by restating prior year financial statements as permitted by the statement. In accordance with SFAS 92, the Company would eliminate phase-in revenues previously accrued, resulting in reductions to 1987, 1986 and 1985 net income of $51, $30.6, and $8.8 million, respectively, and corresponding reductions in earnings per share of $1.26, $0.75, and $0.22, respectively. In addition, the Company would cease accruing additional phase-in revenues. The Company believes adoption of SFAS 92 for financial reporting purposes would not affect future recovery of phase-in revenues specified by the plan.

3. Short-Term Borrowings

At December 31, 1987, the Company had bank credit arrangements available of $75 million. Maximum short-term borrowings outstanding during 1987 and 1986 were $156 million on November 10 and 11, 1987 and $17.5 million on March 17, 1986. The weighted average interest rates, excluding fees, were 7.7% for 1987 and 8.1% for 1986.

4. Cumulative Preferred Stock

The call prices at December 31, 1987, on the 4-1/2%, 4.28% and 4.32% series preferred stocks are $110, $101 and $101.64, respectively. The embedded costs of preferred stock at December 31, 1987, 1986 and 1985 were 4.44%, 8.38% and 10.06%, respectively.

5. Long-Term Debt

Required redemptions and sinking fund payments for 1988 through 1992 for long-term debt are $8.3, $108.3, $8.3, $102.8 and $39.8 million, respectively. The redemption requirements for 1991 and 1992 would be increased by $220 and $28 million, respectively, in the event that the irrevocable letter of credit agreements with respect to the $63, $87 and $98 million adjustable rate series are not extended or other arrangements for collateral are not made.

First mortgage bonds may be issued in additional amounts, limited by property, earnings and other provisions of the Company's Mortgage dated April 1, 1940, as

supplemented (Mortgage). Electric plant is subject to the lien of the Mortgage except for transportation equipment. In 1987, the Company placed funds of $24 million in an irrevocable trust to be used solely to repay the 5-7/8%, $25 million first mortgage bonds due 2007 if certain conditions are not met. The funds were placed in trust as a result of the sale and leaseback of La Cygne 2 described in Note 6.

The 6.8% series, due 2004, and the 5-7/8% and 6% series due 2007 are pledged as collateral for pollution control revenue bonds issued by Kansas municipalities.

The four adjustable rate series pollution control revenue bonds are secured by irrevocable letters of credit. Interest rates for these bonds are variable and are determined on the basis of prevailing market rates for debt instruments of like tenor and quality. The Company is required to maintain special deposits to be used for debt service for the $87 and $98 million adjustable rate series. Such accounts may be used for interest payments, but must be subsequently replenished to the required account balance of $15.7 million. The following information is applicable to these issues:

Description	Letters of Credit Expiration Dates	Weighted Average Net Interest Rate 1987	1986
Series due 2013 $63 million	December 17, 1991	5.4%	4.6%
Series due 2013 $87 million	December 2, 1991 and May 1, 1992	5.0%	5.0%
Series due 2014 $98 million	November 3, 1991	6.0%	6.2%
Series due 2015 $79.5 million	August 15, 1993	6.0%	6.1%

The Company has two revolving bank loans. One loan, due 1993, is comprised of a revolving credit loan up to $100 million until December 19, 1992, followed by a $50 million loan. A second loan, due 1994, enables the Company to borrow up to $150 million on a revolving credit basis until June 30, 1991, at which time the maximum borrowing limit is reduced by $37.5 million. The limit is further reduced by an additional $37.5 million on both June 30, 1992 and 1993, and the loan terminates on June 30, 1994. Both loans may be repaid prior to their due dates without penalty. The weighted average interest rate, including fees, was 7.7% for 1987 and 8.0% for 1986.

The embedded costs of long-term debt at December 31, 1987, 1986 and 1985 were 8.93%, 8.88% and 9.07%, respectively.

6. Sale and Leaseback of La Cygne 2

In September 1987, the Company sold and leased back its 50% undivided interest in La Cygne 2. The lease has an initial term of 29 years with various options to renew the lease or repurchase its 50% undivided interest. The Company remains responsible for all operation and maintenance costs, and other related operating costs of La Cygne 2. The Company has determined the lease is an operating lease for financial reporting purposes.

The lease requires an initial lease payment of approximately $19.9 million due in September 1988, followed by unequal semiannual lease payments for the remainder of the lease. The total of such lease payments for each year after the first year of the lease generally range from approximately $41.7 million to $51.2 million, except that total payments of approximately $69.6 and $23.3 million are due in years 20 and 29 of the lease, respectively. The Company is accruing annual lease expense based on the expected usage of the plant for the year in relation to total expected usage over the initial lease term. The gain of approximately $322 million realized as a result of the sale of La Cygne 2 has been deferred for financial reporting purposes, and is being amortized over the initial lease term in proportion to the related lease expense. The Company's 1987 lease expense, net of amortization of the deferred gain, is approximately $7.5 million.

Future minimum annual lease payments required under the agreement are as follows (in thousands):

1988	$ 19,851
1989	41,737
1990	41,856
1991	41,856
1992	41,856
Thereafter	1,138,276

7. Retirement Plan:

The Company has a noncontributory, defined benefit pension plan for all employees. Plan benefits are generally based on years of service and the employee's highest aggregate compensation in five consecutive years of the final ten years of service. Due to the present funding status of the plan, the Company's current funding policy is to contribute the minimum amount required by federal law.

During 1986, the Company adopted Statement of Financial Accounting Standards No. 87, *Employers' Accounting for Pensions* (SFAS 87), which changed the Company's method used to determine its net periodic pension cost. Annual pension costs for the years 1987, 1986 and 1985 were $1.0, $2.1 and $3.7 million, respectively. The decrease in 1987 and 1986 pension costs from 1985 costs resulted primarily from changes in the Company's method of determining pension expense due to its adoption of SFAS 87.

Net periodic pension cost for 1987 and 1986 included the following components (in millions):

	1987	1986
Service cost — benefits earned during period	$ 2.0	$ 3.0
Interest cost on projected benefit obligation	5.2	4.9
Actual return on assets	2.9	(18.1)
Net amortization and deferral	(9.1)	12.3
Net periodic pension cost	$ 1.0	$ 2.1

The following table sets forth the plan's funded status at November 30, 1987 and 1986 (the plan years) and a reconciliation of such status to the December 31, 1987 and 1986 financial statements (in millions):

	1987	1986
Actuarial present value at November 30:		
Vested benefit obligation	$ 49.7	$ 48.0
Accumulated benefit obligation	$ 53.5	$ 53.7
Plan assets at November 30 (principally common stock of public companies and U.S. government securities)	$ 77.8	$ 84.7
Projected benefit obligation at November 30	(67.9)	(72.2)
Plan assets in excess of projected benefit obligation at November 30	9.9	12.5
Unrecognized net gain from past experience different from that assumed	(9.8)	(11.3)
Prior service cost not yet recognized in net periodic pension cost	2.2	2.3
Recognition of net asset at January 1, 1986 over 18 years	(4.4)	(4.7)
Contribution accrued for December	(.1)	(.2)
Pension liability recognized in the balance sheet at December 31	$ (2.2)	$ (1.4)

The following were used in the determination of actuarial present values of the projected benefit obligations at December 31:

	1987	1986
Weighted average discount rate	8.0%	7.5%
Rate of increase in future compensation	6.0%	6.0%
Long-term rate of return on assets	8.0%	8.0%

8. Income Taxes:

The effective federal income tax rates differ from the amounts computed by applying the federal statutory rates to income before federal income taxes. The reasons, with related percentage effects, are:

	1987	1986	1985
Statutory federal income tax rate	40%	46%	46%
Add (Deduct) income tax effects of:			
Phase-in revenues (Note 2)	(17)	—	—
Accelerated amortization of deferred income tax credits (Note 2)	(11)	(33)	—
Effect of change in tax rates	—	18	—
Allowances for other funds used during construction	—	—	(21)
Depreciation	6	35	—
Benefit from state income taxes	(2)	(7)	(2)
Amortization of investment tax credit	(2)	(3)	(1)
Other items - net (no one item makes up up more than 2%)	1	3	3
Effective federal income tax rate	15%	59%	25%

Income taxes as recorded in the Statements of Income are:

	1987	1986	1985
	(Thousands of Dollars)		
Operating expenses:			
Currently payable -			
Federal	$ 32,858	$ —	$ —
State	15,736	—	—
Deferred -			
Federal	(65,729)	19,190	24,101
State	(11,763)	3,333	3,432
Investment tax credit -			
Deferral	54,542	—	—
Amortization	(2,856)	(1,384)	(1,052)
Total	22,788	21,139	26,481
Other income and deductions:			
Currently payable -			
Federal	1,017	—	—
State	430	—	—
Deferred -			
Federal	—	25,608	8,858
State	—	4,031	1,394
Investment tax credit amortization	(90)	—	—
Total	1,357	29,639	10,252
Disallowance of plant costs- deferred (Note 2)	—	(34,475)	—
Change in accounting method - deferred (Note 1)	—	10,763	—
Income tax expense - net	$ 24,145	$ 27,066	$ 36,733
Deferred income taxes consist of:			
Accelerated depreciation	$ 34,464	$ 54,780	$ 41,179
Disallowance of plant costs (Note 2)	—	(34,475)	—
Phase-in revenues (Note 2)	—	26,876	7,536
Unbilled revenues	(2,550)	10,199	—
Accelerated amortization	(13,015)	(13,920)	—
AFC - borrowed	(144)	(27[illegible])	[illegible]
Overheads capitalized - net	115	433	6,467
Net operating tax loss	47,291	(13,160)	(40,[illegible]98)
Deferred gain on sale-leaseback	(140,926)	—	—
Other - net	(2,727)	(2,005)	(211)
Total	$ (77,492)	$ 28,450	$ 37,785

At December 31, 1987, the Company has unused investment tax credits of approximately $35 million available for carryforward to future years which, if not utilized, will expire in the years 2000 through 2002. As a result of the Tax Reform Act of 1986, these unused credits will be reduced to approximately $28 million effective January 1, 1988. These credits have been applied in determining the Company's net deferred income tax liability and

corresponding deferred regulatory revenue asset at December 31, 1987.

9. Commitments and Contingencies:

Spent Nuclear Fuel Disposal - Under the Nuclear Waste Policy Act of 1982, the U.S. Department of Energy (DOE) is responsible for the ultimate storage and disposal of spent nuclear fuel removed from nuclear reactors. Under a contract with the DOE for disposal of spent nuclear fuel, the Company pays a quarterly fee to DOE of 1 mill per kilowatthour on net nuclear generation. Such fees were $3.1 and $3.3 million in 1987 and in 1986, respectively.

Decommissioning - The Company's share of Wolf Creek decommissioning costs are estimated to be approximately $66 million in 1985 dollars. Electric rates charged to customers provide for recovery of decommissioning costs over the life of Wolf Creek. Amounts so collected from customers are deposited in an external trust fund and will be used solely for the physical decommissioning of the plant. At December 31, 1987 and 1986, $1.8 and $0.8 million, respectively, was on deposit in the decommissioning fund.

Nuclear Insurance - The Price-Anderson Act currently limits the combined public liability of the owners of 112 nuclear power plants to $720 million for a single nuclear incident. The Wolf Creek Owners have purchased the maximum available private insurance of $160 million and the balance is provided by an assessment plan mandated by the Nuclear Regulatory Commission. Under this plan, the Wolf Creek Owners are jointly and severally subject to a retrospective assessment of up to $5 million ($2.35 million, Company's share) in the event there is a nuclear incident involving any of the nation's licensed reactors. There is a limitation of $10 million ($4.7 million, Company's share) in retrospective assessments in any one year. Although certain provisions of the Act expired in 1987, the owners remain covered under it. Congress is considering a renewal and modification of the Act. Should it be renewed, the new provisions are expected to apply to the Company. The Company is unable to predict the effect such actions may have on the Company's potential liability.

The Company carries the maximum property and decontamination insurance, approximately $1.4 billion, provided by a combination of "nuclear insurance pools" and Nuclear Electric Insurance Limited (NEIL). The insurance provides coverage against decontamination and property damage to nuclear generating facilities. The minimum coverage currently required by the Nuclear Regulatory Commission is $1.1 billion. The Company also carries additional insurance with NEIL to cover the costs of replacement power during prolonged outage at Wolf Creek. In the event of a claim by any member of NEIL under the above coverages, the Company may be subject to an assessment if losses exceed premiums, reserves and other NEIL resources. As of December 31, 1987, the maximum potential assessments to the Company under the NEIL policies total approximately $28.2 million.

Director's and Officer's Insurance - The Company carries director's and officer's liability insurance with a mutual insurance company. The Company is subject to a retrospective assessment of up to $19.8 million in the event there are losses which exceed premiums and reserves of the insurer.

10. Joint Ownership of Utility Plants:

	Company's Ownership at December 31, 1987				
	In-Service Dates	Investment in Millions	Accumulated Depreciation	Net (MW)	Percent
La Cygne #1(a)	June 1973	$ 118	$59	343	50
Jeffrey #1(b)	July 1978	64	18	132	20
Jeffrey #2(b)	May 1980	62	15	134	20
Jeffrey #3(b)	May 1983	89	14	137	20
Wolf Creek #1(c)	Sept. 1985	1,356	96	530	47

(a) Jointly owned with Kansas City Power & Light Company.

(b) Jointly owned with The Kansas Power and Light Company, Central Telephone and Utilities Corp. and Missouri Public Service Company.

(c) Jointly owned with Kansas City Power & Light Company and Kansas Electric Power Cooperative, Inc.

Amounts and capacity represent the Company's share and have been financed by the Company. The Company's share of operating expenses of the plants in service above, as well as such expenses for a 50% undivided interest in La Cygne 2 (representing 315 MW capacity) sold and leased back to the Company in 1987, are included in the operating expenses on the Statements of Income.

11. Quarterly Financial Statistics (Unaudited)

(Thousands, except per share amounts)

	1987			
	4th Qtr.	3rd Qtr.	2nd Qtr.	1st Qtr.
Operating Revenues	$110,488	$163,954	$124,349	$113,335
Operating Income	19,063	54,034	35,586	32,083
Net Income	12,408	43,138	22,768	19,123
Earnings Applicable to Common Stock	12,203	42,436	22,066	18,256
Average Shares Outstanding	39,661	40,820	40,818	40,801
Earnings Per Share	$ 0.31	$ 1.04	$ 0.54	$ 0.45

	1986			
	4th Qtr.	3rd Qtr.	2nd Qtr.	1st Qtr.
Operating Revenues	$114,269	$156,736	$116,985	$108,350
Operating Income	17,633	45,750	33,519	30,480
Net Income (Loss)	(54,998)	29,680	16,574	23,600
Earnings (Loss) Applicable to Common Stock	(56,387)	27,368	14,220	20,468
Average Shares Outstanding	40,800	40,744	40,742	40,735
Earnings (Loss) Per Share	$ (1.38)	$ 0.67	$ 0.35	$ 0.50

In the fourth quarter of 1986, the Company changed its method of accounting to provide for accrual of estimated unbilled revenues. Accordingly, the results for prior 1986 quarters have been restated to reflect the accounting change as of January 1, 1986. The effect of the accounting change was to increase (decrease) 1986 first, second and third quarter net income before cumulative effect of accounting change by $(1.5), $1.4 and 2.3 million, respectively or $(0.03), $0.03 and $0.05 per share, respectively. Net income and earnings applicable to common stock for the first quarter of 1986 include the net cumulative effect to January 1, 1986, of the change in accounting method of approximately $10.9 million, or $.27 per share (see Note 1).

As discussed in Notes 1 and 2, the Company elected to adopt in 1987, SFAS 90 and SFAS 96 by restating its financial statements from prior periods. As a result, net loss and loss applicable to common stock for the fourth quarter of 1986 have been increased by approximately $52.8 million, or $1.30 per share, from previously reported amounts.

The Company's business is subject to seasonal fluctuations with the peak period occurring during the summer months. Accordingly, earnings information for any three-month period should not be considered as a basis for estimating results of operations for a full year.

Market Prices and Dividend Rates of Common Stock:

Common-NYSE	High/Low Market Price 1987		1986		Dividends 1987	1986
First Quarter	$25⅜	$21⅝	$18⅛	$14	$.34	$.295
Second Quarter	23⅞	18¾	19	15¾	.34	.295
Third Quarter	25⅝	19⅝	20¾	17¼	.34	.295
Fourth Quarter	22¼	16	23½	18½	.37	.34

The Company had 34,648 common stockholders as of December 31, 1987.

Auditors' Opinion

To the Stockholders and the
Board of Directors of
Kansas Gas and Electric Company:

We have examined the balance sheets and statements of capitalization of Kansas Gas and Electric Company as of December 31, 1987 and 1986 and the related statements of income, of common stock equity, and of cash flows for each of the three years in the period ended December 31, 1987. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, such financial statements present fairly the financial position of the Company at December 31, 1987 and 1986 and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1987, in conformity with generally accepted accounting principles applied on a consistent basis, except for the change in 1986 in the method of recognizing unbilled revenues and after restatement for changes in 1987 in the methods of accounting for income taxes and disallowed plant costs; we concur with these changes, which are described in Notes 1 and 2 to the financial statements.

Kansas City, Missouri
February 9, 1988

Deloitte Haskins & Sells

Comparative Electric Statements

				Annual Compound Growth Rates	
	1987	1986	1985	5 Year	10 Year
Electric Operating Revenues (Thousands)					
Residential	**$ 187,256**	$ 181,605	$ 147,183	9.1	11.9
Commercial	**129,667**	125,979	100,651	10.3	10.9
Industrial	**155,645**	151,699	129,313	7.3	10.0
Public street and highway lighting	**5,472**	5,385	4,241	9.2	12.5
Retail rates	**478,040**	464,668	381,388	8.8	11.0
Wholesale rates	**26,383**	24,756	23,873	(6.2)	(.1)
Total sales of electricity	**504,422**	489,424	405,261	7.6	10.0
Other	**7,704**	6,916	5,525	46.6	22.0
Total electric operating revenues	**$ 512,126**	$ 496,340	$ 410,786	7.9	10.1
Sales in Kilowatthours (Thousands)					
Residential	**2,076,150**	2,034,158	2,063,973	.8	1.6
Commercial	**1,681,847**	1,658,665	1,629,227	2.3	2.4
Industrial	**2,862,695**	2,671,181	2,694,588	2.0	1.5
Public street and highway lighting	**53,022**	54,792	56,817	(4.1)	(1.6)
Retail rates	**6,673,714**	6,418,796	6,444,605	1.6	1.7
Wholesale rates	**1,253,644**	1,157,888	983,983	3.1	(2.3)
Total kilowatthours sold	**7,927,358**	7,576,684	7,428,588	1.8	.9
Customers at End of Year					
Residential	**224,162**	222,283	220,516	1.2	1.7
Commercial	**20,619**	20,286	20,206	1.5	1.1
Industrial	**4,365**	4,356	4,542	(.5)	2.8
Public street and highway lighting	**785**	762	715	5.1	7.1
Retail rates	**249,931**	247,687	245,979	1.2	1.6
Wholesale rates	**39**	39	38	(1.5)	(9.0)
Total electric customers	**249,970**	247,726	246,017	1.2	1.6
Residential					
Average kilowatthours per customer	**9,314**	9,202	9,435	(.5)	(.1)
Average revenue per customer	**$ 840.07**	$ 821.51	$ 672.85	7.8	10.0
Average revenue per kilowatthour	**9.02¢**	8.93¢	7.13¢	8.3	10.2
Kilowatthours Generated and Purchased (Thousands)					
Generated (net after station use)	**8,348,820**	7,879,853	6,506,528	3.9	2.2
Purchased	**226,251**	350,405	1,590,515	(24.4)	(13.3)
Total available	**8,575,071**	8,230,258	8,097,043	1.9	1.1
Company use, line loss, etc.	**647,713**	653,574	668,455	2.4	3.3
Total kilowatthours sold	**7,927,358**	7,576,684	7,428,588	1.8	.9
Average BTU per Net Kilowatthour Generated	**11,010**	11,001	11,184	(.1)	—
Average Fuel Cost per Million BTU	**$ 1.09**	$ 1.20	$ 1.54	(8.3)	.9
Power Resources (Megawatts)					
Available capacity	**2,399**	2,435	2,097	3.4	1.7
System peak responsibility	**1,653**	1,627	1,612	.3	1.5
Reserve capacity	**746**	808	485	13.1	2.2
Utility Plant at Original Cost (Thousands)					
Beginning of year	**$2,460,050**	$2,556,439	$2,358,404	11.2	13.8
Capital expenditures	**53,489**	40,808	224,241	(25.2)	(6.7)
Retirements	**119,660**	137,197	26,206	—	44.9
End of year	**2,393,879**	2,460,050	2,556,439	7.5	11.9
Accumulated depreciation	**467,343**	431,458	338,961	13.7	12.7
Net utility plant	**$1,926,536**	$2,028,592	$2,217,478	6.2	11.7
Employees at End of Year	**1,275**	2,410	2,513	(7.2)	(.5)

Stockholder Information

Annual Meeting

The annual stockholders' meeting will be held May 25, 1988, at the General Office of the company, 120 East First, Wichita. Proxies for this meeting will be solicited by management. A proxy statement will be mailed to stockholders about April 15, 1988.

1987 Annual Report

This report is prepared primarily for the information of company stockholders and is not issued in connection with the sale, or offer for sale of, or solicitation of an offer to buy any securities of the company.

General Offices

120 East First
P.O. Box 208
Wichita, Kansas 67201
Phone: (316) 264-1141

Transfer Agents

Preferred Stock:
First National Bank in Wichita
Trust Department
Box One
Wichita, Kansas 67201

Common Stock:
First National Bank in Wichita
Trust Department
Box One
Wichita, Kansas 67201

First National Bank of Chicago
Stock Transfer - Suite 0122
One First National Plaza
Chicago, Illinois 60670

Registrars

Preferred Stock:
Bank IV, Wichita

Common Stock:
Bank IV, Wichita, and
First National Bank of Chicago

Bonds: Trustee, Registrar and Paying Agent
Morgan Guaranty Trust Company of New York
30 West Broadway
New York, New York 10015

Stock Exchange Listing

The company's common stock is listed on the New York and Pacific Stock Exchanges.
Stock Symbol: KGE

Stockholder Records and Dividend Reinvestment

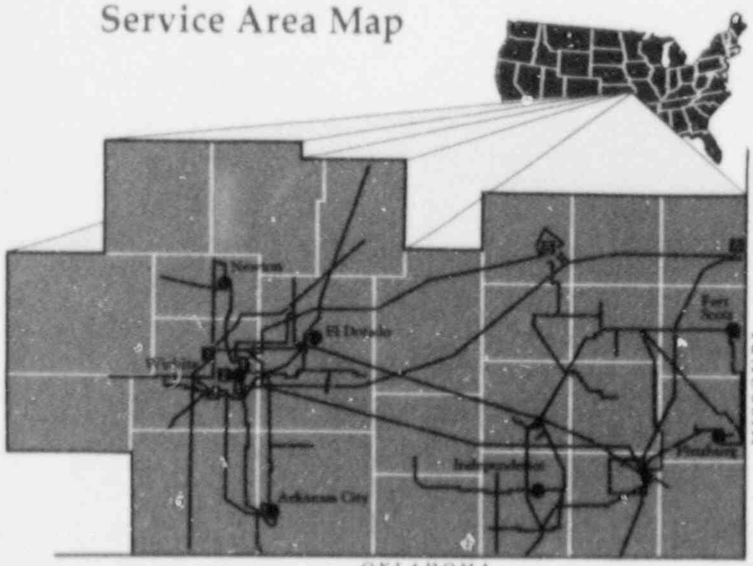
KG&E Stockholder Records Department
P.O. Box 208
Wichita, Kansas 67201
Phone: Kansas — (call collect)
(316) 261-6640
Outside Kansas
1-800-527-2495, Ext. 6640

Additional Information

The company's form 10-K is filed with the Securities and Exchange Commission and is available upon request from that agency or from the Company.

For a copy of KG&E's "Financial and Statistical Report 1977-1987" or other information, contact:
KG&E Investor Relations Department
P. O. Box 208
Wichita, Kansas 67201
Phone: Kansas — (call collect)
(316) 261-6929
Outside Kansas
1-800-527-2495, Ext. 6929

Service Area Map



Map Legend

Cities with Customer Services Offices •
Transmission Lines ——

Interconnections and Power Pool Memberships

Direct interconnections are maintained with 10 other utilities and the company is a member of the Southwest Power Pool. Power is regularly transmitted to and from other utilities to ensure reliability and economy.

Generating Station, Capability and Fuel

1. Gordon Evans Steam Electric Station, 510 MW, Natural Gas
2. Wichita Steam Electric Station, 3 MW, Diesel
3. Murray Gill Steam Electric Station, 324 MW, Natural Gas
4. La Cygne Steam Electric Station, 658 MW*†, Coal
5. Wolf Creek Generating Station, 530 MW*, Nuclear
6. Jeffrey Energy Center,+ 403 MW*, Coal

* *Jointly owned with other utilities. Capacity stated is KG&E allocation.*
† *Unit 2 representing 315 MW is leased long-term.*
\+ *Located 130 miles northeast of Wichita. Not shown on map.*

Kansas Gas and Electric Company
P.O. Box 208
Wichita, Kansas 67201

Address Correction Requested
Return Postage Guaranteed

Key Number 10

Bulk Rate
U.S. Postage
PAID
Permit 165
Wichita, KS

Directors*

Frank J. Becker (1981)
(1,4,7) Chairman and Chief Executive Officer, Becker Corporation and First National Bank & Trust Co., El Dorado, KS

Glenn Biggs (1986)
(6) Chairman and Chief Executive Officer, Gill Savings Association, San Antonio, TX

Howard Brenneman (1985)
Investment/Financial Consultant, Hesston, KS

A. Dwight Button (1976)
(1,2,4,7) Retired Chairman of the Board, Fourth Financial Corp., Wichita, KS

Wilson K. Cadman (1978)
(1,7) Chairman of the Board and President of the Company, Wichita, KS

C. T. Carter (1968)
(1,3) Retired Vice President, Pipeline Transportion, Atlantic Richfield Company, Independence, KS

C. Q. Chandler (1974)
(1,4,5,7) Chairman of the Board, First National Bank in Wichita, KS

Robert T. Crain (1981)
(5) Crain Realty Company, Fort Scott, KS

Ralph Foster (1970)
(4,7) Vice President - General Counsel of the Company, Wichita, KS

Donald A. Johnston (1980)
(2,5) Corporate General Manager, Maupintour, Inc., Lawrence, KS

Glenn L. Koester (1986)
Vice President - Nuclear of the Company, Wichita, KS

Russell W. Meyer, Jr. (1982)
(5,7) Chairman and Chief Executive Officer, Cessna Aircraft Company, Wichita, KS

James J. Noone (1986)
(6) Attorney and Retired Administrative Judge for the District Court of Sedgwick County, Wichita, KS

Terence J. Scanlon (1980)
(2,3,4) Publisher, "Wichita Business Journal," Wichita, KS

Marjorie I. Setter (1980)
(4) President, Setter and Associates, Inc., Adverstising and Public Relations, Wichita, KS

Donald C. Slawson (1983)
(3,7) Chairman of the Board and President Slawson Companies, Wichita, KS

Dr. Newton Smith (1985)
Physician, Arkansas City, KS

Lawrence E. Walsh (1986)
(6) Attorney and Former Federal District Court Judge, Oklahoma City, OK

Advisory Director

Ralph P. Fiebach (1967)
Retired Chairman of the Board of the Company, Wichita, KS

*Year elected and committee assignments.

Committees: (1) Executive; (2) Compensation and Benefit; (3) Audit; (4) Shareholder Relations; (5) Nominating; (6) Special Litigation; (7) Planning

Officers

Wilson K. Cadman, 60*
Chairman of the Board and President

Kent R. Brown, 43*
Group Vice President

Richard M. Haden, 48*
Group Vice President

James S. Haines, Jr., 41*
Group Vice President

Robert L. Rives, 54*
Group Vice President

James T. Clark, 47
Vice President - Accounting

Ralph B. Foster, 59*
Vice President - General Counsel

Glenn L. Koester, 62*
Vice President - Nuclear

William B. Moore, 35
Vice President - Finance

Tom Underwood, 50
Vice President - Human Resources

E. D. Prothro, 55
Controller and Assistant Secretary

Richard D. Terrill, 33
Secretary and Attorney

W. R. Whitmer, 54
Treasurer

Verna L. Ridgeway, 60
Assistant Vice President - Consumer Affairs

J. F. Klassen, 58
Assistant Treasurer

Jack Skelton, 57
Assistant Secretary

*Policy Group member

Audited Financial Statements
and Other Financial Information

Kansas Electric Power Cooperative, Inc.

December 31, 1987

Ernst & Whinney

Audited Financial Statements and
Other Financial Information

KANSAS ELECTRIC POWER COOPERATIVE, INC.

December 31, 1987

Audited Financial Statements

Other Financial Information

Ernst & Whinney

2000 City Center Square
1100 Main Street
Kansas City, Missouri 64105

816/474-8050

Board of Trustees
Kansas Elec'   Power Cooperative, Inc.
Topeka, Kan

We have examined the balance sheets of Kansas Electric Power Cooperative, Inc. (KEPCo) as of December 31, 1987 and 1986, and the related statements of patronage capital (deficit) and other equities, operations and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our report dated March 5, 1987, our opinion on the 1986 financial statements was qualified as being subject to the effects on the financial statements of such adjustments, if any, as might have been required had the outcome of an issue with the Kansas Corporation Commission (KCC) for recovery of depreciation, interest and property taxes on previously excluded utility plant costs been known. As explained in Note C, The KCC subsequently issued an order dated February 11, 1988 which provides KEPCo with the option to recover these costs from savings achieved from the refinancing of a certain portion of KEPCo's long-term debt in 1988, as discussed in Notes D and I. Accordingly, our present opinion on the 1986 financial statements, as presented herein, is different from that expressed in our previous report.

As discussed in Note B, effective February 1, 1987, the KCC issued an order to KEPCo to utilize a present worth (sinking fund) depreciation method, which does not conform with generally accepted accounting principles. If depreciation on the electric plant in service was calculated using a method in accordance with generally accepted accounting principles, depreciation expense, net loss and patronage capital (deficit) unallocated would be increased by $4,154,568 for the year ended December 31, 1987.

As discussed in Note H, the KCC has not issued an order addressing the disposition of refunds of power costs KEPCo is to receive from a power supplier. The ultimate disposition of this refund cannot presently be determined, and accordingly, no amounts to be received and retained by KEPCo have been recorded in the 1987 financial statements.

In our opinion, except for the effect of using the depreciation method prescribed by the KCC as discussed above and subject to the effects on the 1987 financial statements of such adjustments, if any, as might have been required had the outcome of the uncertainty referred to in the preceding paragraph been known, the financial statements referred to above present fairly the financial position of Kansas Electric Power Cooperative, Inc. at December 31, 1987 and 1986, and the results of its operations and changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

In our opinion, however, subject to the effects on the 1987 financial statements of such adjustments, if any, as might have been required had the outcome of the uncertainty referred to in the fourth paragraph been known, the accompanying financial statements present fairly the financial position of Kansas Electric Power Cooperative, Inc. at December 31, 1987 and 1986, and the results of its operations and changes in its financial position for the years then ended, in conformity with accounting practices prescribed by the Kansas Corporation Commission applied on a consistent basis.

Ernst + Whinney

Kansas City, Missouri
February 23, 1988

BALANCE SHEETS

KANSAS ELECTRIC POWER COOPERATIVE, INC.

	December 31 1987	December 31 1986
ASSETS		
UTILITY PLANT--Notes B, C and D		
Electric plant in service	$193,768,894	$215,529,992
Construction work in progress	286,492	846,445
	194,055,386	216,376,437
Less allowances for depreciation	11,186,323	9,982,356
	182,869,063	206,394,081
Nuclear fuel, less accumulated amortization of $5,229,248 and $3,720,755 at December 31, 1987 and 1986, respectively	2,466,662	2,174,390
	185,335,725	208,568,471
CURRENT ASSETS		
Cash and short-term investments	3,556,672	264,611
National Rural Utilities Cooperative Finance Corp. patronage capital certificate	2,316,004	2,279,549
Accounts receivable from members	6,643,889	7,996,347
Receivable from power suppliers	4,730,000	4,730,000
Materials and supplies inventory	2,185,281	2,089,609
Other assets and prepaid expenses	637,062	312,385
	20,068,908	17,672,501
OTHER ASSETS		
Investments in associated organizations	2,690,536	4,959,888
Deferred debits, less accumulated amortization of $377,640 at December 31, 1987--Note C	31,045,430	7,372,409
Unamortized bond issue costs	794,834	823,875
Bond fund reserve	3,969,000	3,969,000
Decommissioning fund assets	255,109	136,770
	38,754,909	17,261,942
	$244,159,542	$243,502,914

	December 31 1987	1986
LIABILITIES AND PATRONAGE CAPITAL		
PATRONAGE CAPITAL (DEFICIT) AND OTHER EQUITIES		
Memberships	$ 2,800	$ 2,800
Patronage capital (deficit) unallocated	(9,419,733)	(7,534,162)
Other equities	2,027,986	1,230,095
	(7,388,947)	(6,301,267)
LONG-TERM DEBT, less current portion--Note D	238,860,689	237,972,616
CURRENT LIABILITIES		
Note payable to the National Rural Utilities Cooperative Finance Corp.	---	174,945
Accounts payable	5,851,112	5,059,552
Accounts payable to members	5,029,000	5,029,000
Payroll and payroll related liabilities	27,630	25,222
Accrued property taxes	673,900	534,964
Accrued interest payable	230,857	143,889
Current portion of long-term debt--Note D	620,192	727,223
	12,432,691	11,694,795
DECOMMISSIONING LIABILITY	255,109	136,770
COMMITMENTS AND CONTINGENCIES--Notes C, E and H		
	$244,159,542	$243,502,914

See notes to financial statements

STATEMENTS OF PATRONAGE CAPITAL (DEFICIT) AND OTHER EQUITIES

KANSAS ELECTRIC POWER COOPERATIVE, INC.

	Memberships	Patronage Capital (Deficit) Unallocated	Other Equities	Total
BALANCE AT JANUARY 1, 1986	$2,800	$(4,310,701)	$ 482,768	$(3,825,133)
1986 Net Margin (loss)	---	(3,223,461)	747,327	(2,476,134)
BALANCE AT DECEMBER 31, 1986	2,800	(7,534,162)	1,230,095	(6,301,267)
1987 Net Margin (loss)	---	(1,885,571)	797,891	(1,087,680)
BALANCE AT DECEMBER 31, 1987	$2,800	$(9,419,733)	$2,027,986	$(7,388,947)

See notes to financial statements

STATEMENTS OF OPERATIONS

KANSAS ELECTRIC POWER COOPERATIVE, INC.

	Year Ended December 31 1987	1986
Operating revenue from member cooperatives	$68,917,263	$74,251,801
Operating expenses:		
Power purchased	38,835,145	40,528,468
Nuclear fuel	1,921,626	2,726,491
Nuclear plant operations	2,426,389	2,210,426
Nuclear plant maintenance	1,643,295	1,399,400
Nuclear plant administrative and general	2,859,605	2,700,044
Administrative and general	1,729,249	1,904,739
Amortization of deferred debits	377,640	---
Depreciation	2,012,198	6,398,241
Interest	18,997,687	19,607,473
	70,802,834	77,475,262
LOSS FROM OPERATIONS	(1,885,571)	(3,223,461)
Other income (expense):		
Interest income	797,891	747,327
Refunds from power suppliers	---	5,049,360
Refunds to member cooperatives	---	(5,049,360)
	797,891	747,327
NET LOSS	$(1,087,680)	$(2,476,134)

See notes to financial statements

STATEMENTS OF CHANGES IN FINANCIAL POSITION

KANSAS ELECTRIC POWER COOPERATIVE, INC.

	Year Ended December 31 1987	1986
CASH PROVIDED BY (USED IN) OPERATIONS		
Net loss	$ (1,087,680)	$ (2,476,134)
Charges to income not affecting cash:		
Provision for depreciation	2,012,198	6,398,241
Amortization of nuclear fuel	1,508,493	2,320,277
Amortization of deferred debits	377,640	---
Amortization of bond issue costs	29,041	28,410
Changes in components of working capital affecting operations	1,777,036	33,111,974
Decrease in investments in associated organizations	2,232,897	1,220,596
Depreciation charged to deferred debits	487,359	1,027,129
Increase in deferred debits	(957,887)	(3,941,494)
Increase in decommissioning fund assets	(118,339)	(110,271)
Increase in decommissioning liability	118,339	110,271
TOTAL PROVIDED BY OPERATIONS	6,379,097	37,688,999
CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES		
Repayment of long-term debt	(691,958)	(37,993,388)
Proceeds from issuance of long-term debt	1,473,000	2,042,000
Increase in unamortized bond issue costs	---	(49,549)
	781,042	(36,000,937)
CASH USED IN INVESTING ACTIVITIES		
Net additions to utility plant	(2,067,313)	(1,073,174)
Increase in nuclear fuel	(1,800,765)	(1,595,123)
	(3,868,078)	(2,668,297)
INCREASE (DECREASE) IN CASH AND SHORT-TERM INVESTMENTS	3,292,061	(980,235)
Cash and short-term investments at beginning of year	264,611	1,244,846
CASH AND SHORT-TERM INVESTMENTS AT END OF YEAR	$ 3,556,672	$ 264,611

STATEMENTS OF CHANGES IN FINANCIAL POSITION--CONT'D

	Year Ended December 31 1987	1986
CHANGES IN COMPONENTS OF WORKING CAPITAL AFFECTING OPERATIONS		
Change provided (used) cash:		
Short-term investments restricted for payment of long-term debt	$ ---	$ 37,100,000
Accounts receivable from members	1,352,458	81,003
Receivable from power suppliers	---	(4,033,752)
Materials and supplies in entory	(95,672)	(84,076)
Other assets and prepaid expenses	(324,677)	(80,788)
Note payable to National Rural Utilities Cooperative Finance Corp.	(174,945)	(2,855,433)
Accounts payable	791,560	(627,592)
Accounts payable to members	---	3,545,382
Payroll and payroll related liabili..es	2,408	5,390
Accrued property taxes	138,936	117,722
Accrued interest payable	86,968	(55,882)
CASH PROVIDED BY CHANGES IN COMPONENTS OF WORKING CAPITAL	$ 1,777,036	$ 33,111,974

See notes to financial statements

NOTES TO FINANCIAL STATEMENTS

KANSAS ELECTRIC POWER COOPERATIVE, INC.

December 31, 1987

NOTE A--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Kansas Electric Power Cooperative, Inc. (KEPCo) maintains its accounting records in accordance with the Federal Energy Regulatory Commission's chart of accounts as adopted by the Rural Electrification Administration (REA). The more significant accounting policies are described below.

Utility Plant: Utility plant (see Note B) is stated at cost. Provision for depreciation is computed on the straight-line method at the following annual composite rates:

Transportation Equipment	25 to 33%
Office Furniture and Fixtures	10%
Leasehold Improvements	20%

Provision for depreciation for electric plant in service for 1986 and January 1987 was computed over the straight-line method at a 3.[illegible]4% annual composite rate. Effective February 1, 1987, the provision for depreciation annual composite rate for electric plant in service was 1.0846% and will increase each year over the next 27 years (see Note B).

Depreciation for 1987 and 1986 amounted to $2,499,557 and $7,425,370, respectively, of which $2,012,198 and $6,398,241, respectively, was charged to depreciation expense with the remaining amount being charged to various deferred debits (see Note C).

Leases which meet the criteria of the Financial Accounting Standards Board (FASB) Statement No. 13 are accounted for as capital leases. Amortization of equipment under capital leases is computed on the straight-line method over the lease period and is included in depreciation in the financial statements. Amortization expense for 1987 and 1986 amounted to $27,283 and $25,009, respectively. Rentals paid under operating leases are charged to operations as incurred.

Nuclear Fuel: The cost of nuclear fuel, including a provision for the disposal of spent fuel, is being amortized to fuel expense based on core burn-up.

The owners of the Wolf Creek Nuclear Plant have entered into a contract with the Department of Energy that provides for the permanent disposal of spent fuel.

Investments in Associated Organizations: Investments in associated organizations consist principally of patronage capital certificates and subordinated term certificates of the National Rural Utilities Cooperative Finance Corp. (NRUCFC). NRUCFC patronage capital certificates maturing within a year of the balance sheet date are reflected as a current asset.

NOTE A--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES--CONT'D

Short-Term Investments: Short-term investments consist of NRUCFC commercial paper and are stated at cost which is approximately equal to market.

Receivable From Power Suppliers: Receivable from power suppliers consists of refunds from power suppliers for retroactive rate and fuel adjustments. A corresponding payable to member cooperatives is included in accounts payable to members.

Materials and Supplies Inventory: Materials and supplies inventory for the Wolf Creek Nuclear Plant (see Note B) is stated at average cost.

Unamortized Bond Issue Costs: Unamortized bond issue costs related to the issuance of the floating/fixed rate pollution control revenue bonds (see Note D) are being amortized over the estimated period the debt is expected to be outstanding.

Decommissioning Fund Assets/Decommissioning Liability: Decommissioning fund assets and the corresponding decommissioning liability represent funds collected from members, pursuant to a rate order, to be used for the decommissioning of the Wolf Creek Nuclear Plant (Wolf Creek).

Refunds from Power Suppliers/Refunds to Member Cooperatives: Refunds from power suppliers for retroactive rate and fuel adjustments are received by KEPCo and are remitted to member cooperatives in accordance with KCC guidelines.

Reclassifications: Certain amounts have been reclassified on the 1986 financial statements to conform with the 1987 presentation.

NOTE B--WOLF CREEK NUCLEAR PLANT

KEPCo owns six percent of the Wolf Creek Nuclear Plant, near Burlington, Kansas. The remainder is owned by the Kansas City Power and Light Company (KCPL) and Kansas Gas & Electric Company (KGE). KEPCo is entitled to a proportionate share of the demand and energy from Wolf Creek which is used to supply a portion of KEPCo's members' requirements. KEPCo is billed for 6% of the operations, maintenance, and administrative and general costs related to Wolf Creek.

The KCC declared Wolf Creek commercially operable on September 3, 1985. KEPCo's total investment includes interest and administrative costs during construction, and first project developmental costs incurred prior to January 1, 1982.

NOTE B--WOLF CREEK NUCLEAR PLANT--CONT'D

Effective February 1, 1987, the KCC issued an order to KEPCo to utilize a present worth (sinking fund) depreciation method which does not conform with generally accepted accounting principles. If depreciation on electric plant in service was calculated using a method in accordance with generally accepted accounting principles, depreciation expense and KEPCo's net loss and patronage capital (deficit) unallocated would be increased by $4,154,568 for the year ended December 31, 1987.

NOTE C--DEFERRED DEBITS

Reimbursable Construction Costs

Reimbursable construction costs amounting to $1,451,976 invoiced by KEPCo to KCPL and KGE previously included as part of KEPCo's investment in Wolf Creek along with related accumulated depreciation amounting to $70,429 were reclassified to deferred debits by management pursuant to a KCC rate order dated February 1, 1987 and are reflected as such in the accompanying 1987 balance sheet. Depreciation and interest costs associated with the invoiced amounts are also included in deferred debits.

Disallowed Costs

Effective October 1, 1985, the KCC issued a rate order relating to KEPCo's investment in Wolf Creek which disallowed $22,818,028 of KEPCo's investment in Wolf Creek. A subsequent rate order, effective February 1, 1987, allows KEPCo to recover these disallowed costs, as well as interest costs and property taxes related to the disallowed portion for the period from September 3, 1985 through January 31, 1987, over a 27.736 year period. Annual amortization of such costs will increase over the recovery period. In connection with this rate order, these costs and related accumulated depreciation of $1,106,801, were reclassified from electric plant in service to deferred debits.

Utility Plant Costs

Certain utility plant costs were not included in KEPCo's 1985 rate request because the KCC required KEPCo to file the rate request based on projected total utility plant costs. The February 1, 1987 rate order included these costs in KEPCo's rate prospectively. However, no provision was made in the rate order for recovery of the related depreciation, property taxes and interest costs for the period from September 3, 1985 through January 31, 1987. Accordingly, KEPCo included the related depreciation, property taxes and interest costs for the period from September 3, 1985 through January 31, 1987 in deferred debits in the accompanying balance sheets.

NOTE C--DEFERRED DEBITS--CONT'D

The KCC issued a rate order dated February 11, 1988 which provides KEPCo with the option to recover these costs from savings achieved from the refinancing of a certain portion of KEPCo's long-term debt in 1988. KEPCo has not made a decision whether to exercise this option or to request that the KCC allow them to recover these costs in future rate filings. Should the savings from refinancing not be used for recovery of the above mentioned costs, and KEPCo's request for recovery through future rates, if made, is not granted, the amounts included in deferred debits will be charged to expense. It is management's expectation that KEPCo will be able to recover such costs.

Revenues and Expenses for the Period September 3, 1985 through September 30, 1985

Although the Wolf Creek Nuclear Plant began commercial operations on September 3, 1985, the KCC ordered KEPCo to accumulate all revenues and expenses related to the operation of Wolf Creek for the period from September 3, 1985 through September 30, 1985 in a deferred debit. These net expenses amounted to $1,884,003 and are included in deferred debits in the accompanying balance sheets at December 31, 1987 and 1986. The KCC issued an order on February 1, 1987 which will allow KEPCo to recover these costs over a ten-year period. Annual amortization of such costs will increase over the recovery period.

The following table summarizes the above described deferred debits as of December 31, 1987 and 1986 and related activity for the years then ended:

	Reimbursable Construction Costs	Disallowed Costs	Utility Plant Costs	Revenues and Expenses for the Period September 3, 1985 through September 30, 1985	Other
BALANCE AT JANUARY 1, 1986	$ ---	$ 1,074,744	$ 472,168	$1,844,003	$ ---
Additions	---	2,920,264	1,017,878	---	3,352
BALANCE AT DECEMBER 31, 1986	---	3,995,008	1,490,046	$1,884,003	3,352
Additions	186,461	276,686	381,288	---	113,452
Amortization	---	(258,328)	---	(119,312)	---
Transfer from utility plant at net book value	1,381,547	21,711,227	---	---	---
BALANCE AT DECEMBER 31, 1987	$1,568,008	$25,724,593	$1,871,334	$1,764,691	$116,804

NOTES TO FINANCIAL STATEMENTS--CONT'D

NOTE C--DEFERRED DEBITS--CONT'D

FASB Statement No. 92, "Regulated Enterprises--Accounting for Phase-in Plans," was issued in December 1987 and is effective for fiscal years beginning after December 15, 1987. It requires that allowable costs deferred for future recovery related to plants completed prior to January 1, 1988 be recovered within a ten-year period from date of initial deferral. $27,489,284 of the deferred debits do not currently meet this criteria and the costs will be required to be written off in 1988 for KEPCo to be in conformity with generally accepted accounting principles, unless an amended rate order is received which meets this criteria or unless the FASB amends Statement No. 92.

NOTE D--LONG TERM DEBT

Long term debts consists of:

	December 31 1987	1986
Mortgage notes payable to the Federal Financing Bank (FFB) at rates varying from 7.316% to 11.486%, payable in quarterly installments (interest only through 1988) through 2018. Utility plant assets with a cost of $172,854,014 are pledged as collateral. Subsequent to December 31, 1987, KEPCo secured refinancing of certain of its FFB loans (see Note I).	$162,900,000	$162,900,000
Mortgage notes payable to the Federal Financing Bank at rates varying from 7.784% to 11.932%, principal and interest payable in quarterly installments through 2015. Utility plant assets with a cost of $172,854,014 are pledged as collateral. Subsequent to December 31, 1987, KEPCo secured refinancing of certain of its FFB loans (see Note I).	32,829,225	31,619,097
Floating/fixed rate pollution control revenue bonds, City of Burlington, Kansas, Pooled Series 1985C, variable interest rate, principal payments commencing in 1987 and continuing annually through 2015. Utility plant assets with a cost of $44,100,000 are pledged as collateral.	43,700,000	44,100,000

NOTE D--LONG TERM DEBT--CONT'D

Capital lease obligation	51,656	80,742
	239,480,881	238,699,839
Less current portion	620,192	727,223
	$238,860,689	$237,972,616

Aggregate maturities of mortgage notes payable to the Federal Financing Bank and floating/fixed rate pollution control bonds as of December 31, 1987 are as follows:

Year	Amount
1988	$ 590,881
1989	1,732,566
1990	1,852,276
1991	1,982,742
1992	2,124,926
Thereafter to 2015	231,145,834
	$239,429,225

Leased computer equipment with a cost of $136,412 and accumulated amortization of $95,488 and $43,197 at December 31, 1987 and 1986, respectively, has been capitalized in accordance with FASB Statement No. 13 and is included in electric plant in service. Future minimum payments, by year and in the aggregate, under the capital lease obligation are as follows:

Year Ending December 31	
1988	$41,255
1989	17,190
Total minimum lease payments	58,445
Amount representing interest	6,789
Present value of net minimum lease payments	51,656
Less current portion	29,311
	$22,345

NOTE D--LONG TERM DEBT--CONT'D

At December 31, 1987, KEPCo has an approved FFB loan guaranteed by REA with a balance of $162,900,000. REA has also guaranteed additional loans of $30,000,000 and $10,000,000 with outstanding principal at December 31, 1987 amounting to $32,829,225. KEPCo has the option on the $162,900,000 in FFB mortgage notes to elect short-term maturity dates of not less than two years nor more than seven years after the date of the initial advance or may elect a long-term maturity date of 34 years after the end of the calendar year in which the initial advance was made. On the maturity of a short-term advance, KEPCo may refinance the advance with another short-term advance with a maturity date of not greater than seven years from the date of the original advance or may elect to refinance with a long-term maturity date of 34 years after the end of the calendar year in which the initial advance was made. At December 31, 1987, KEPCo had no advances with short-term maturity dates between January 1, 1988 and December 31, 1988.

KEPCo has the option on the remaining $30,000,000 and $10,000,000 in FFB mortgage notes to elect short-term maturity dates of two years or a long-term maturity date of December 31, 2015. On the maturity of a short-term advance, KEPCo may refinance the advance with another short-term advance with a maturity date of two years or may elect the long-term maturity dates of December 31, 2015. At December 31, 1987, KEPCo had no advances with short-term maturity dates between January 1, 1988 and December 31, 1988.

During 1987 and 1986, interest incurred totaled approximately $19,356,000 and $22,328,000, respectively, of which $18,997,687 and $19,607,473 respectively, was charged to interest expense and the remaining amount was charged to various deferred debits (see Note C).

NOTE E--OPERATING LEASE

KEPCO leases office space under a non-cancellable operating lease. The related rental expense for 1987 and 1986 was $61,250 and $60,786, respectively.

NOTE E--OPERATING LEASE--CONT'D

Future minimum lease payments for space currently leased at December 31, 1987 are as follows:

Year	Amount
1988	$61,250
1989	65,448
1990	65,448
1991	65,448
1992	65,448

The minimum lease payments can be increased to the extent that taxes and insurance paid by the lessor exceed 1987 levels.

NOTE F--PENSION PLAN

KEPCo participates in the National Rural Electric Cooperative Association (NRECA) retirement and security program for its employees. All employees of members of NRECA are eligible to participate in the program. KEPCo makes annual contributions to the plan equal to the amounts accrued for pension costs. In the master multiemployer plan which is available to all members of NRECA, the accumulated benefits and plan assets are not determined or allocated by individual employee. KEPCo's pension cost for the plan for the years ended December 31, 1987 and 1986 was $16,082 and $39,929, respectively.

NOTE G--INCOME TAXES

At December 31, 1987, KEPCo had net operating loss carryforwards totalling approximately $71,231,000 available to reduce future taxable income and investment tax credit carryforwards of $7,735,089 as follows:

Net operating loss carryforward	Investment tax credit carryforward	Available Through
$ 8,199,000	$ ---	1996
12,410,000	203	1997
17,124,000	896	1998
21,467,000	1,210	1999
4,443,000	7,732,780	2000
3,418,000	---	2001
4,170,000	---	2002
$71,231,000	$7,735,089	

NOTE G--INCOME TAXES--CONT'D

The difference between the net operating loss shown in the accompanying financial statements and the net operating losses for tax purposes in 1987 and 1986 is due primarily to operating expenses deferred for financial statement purposes (see Note C) and expensed for tax purposes and timing differences related to depreciation expense.

NOTE H--CONTINGENCIES

In connection with the purchase of KEPCo's six percent interest in Wolf Creek, KGE and KCPL have filed lawsuits against KEPCo for approximately $3,700,000 of KEPCo's capital credits from CFC. KEPCo's management believes there is no basis to the claims, however, should KGE and KCPL prevail, any amounts paid will be added to KEPCo's investment in Wolf Creek.

As a result of settlement of litigation during 1987 involving Kansas Power and Light Company (KPL), KEPCo is entitled to refunds of power costs attributable to retroactive rate and fuel adjustments. While receipt of such amounts in the future is probable, the actual amount of refunds and the amount of refunds to be retained by KEPCo are presently not determinable. Accordingly, no amounts to be received and retained by KEPCo have been recorded in the 1987 financial statements. The KCC has not issued an order addressing the disposition of the refunds due from KPL. As such, the ultimate outcome of the issue cannot presently be determined.

KEPCo is a defendant in various lawsuits which are in various stages of investigation and litigation. In the opinion of management and KEPCo's legal counsel, these lawsuits are of doubtful merit and will be settled in KEPCo's favor.

NOTE I--SUBSEQUENT EVENT

Subsequent to December 31, 1987, KEPCo refinanced approximately $62,500,000 of FFB loans with a variable interest, short-term loan from the National Rural Utilities Cooperation Finance Corp. This loan is scheduled to be refinanced with long-term, fixed rate debt certificates, which will be guaranteed by REA. No gain or loss will result from such refinancing.

Ernst & Whinney

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Kansas Electric Power Cooperative, Inc.
Topeka, Kansas

The audited financial statements of Kansas Electric Power Cooperative, Inc. and our report thereon are presented in the preceding section of this report. The information presented hereinafter is for purposes of additional analysis and is not required for a fair presentation of the financial position, results of operations, or changes in financial position of Kansas Electric Power Cooperative, Inc. Such information has not been subjected to the auditing procedures applied in the examination of the basic financial statements, and, accordingly, we express no opinion on it.

Ernst & Whinney

Kansas City, Missouri
February 23, 1988

WHOLESALE POWER DATA (UNAUDITED)

KANSAS ELECTRIC POWER COOPERATIVE, INC.

	Year Ended December 31, 1987	
SALES		
Noncoincidental peak demand		318,426 kW
Total energy		1,231,398,969 kWh
REVENUES		
Total electric sales	$68,917,263	
Average per kWh		55.97 Mills
OPERATING EXPENSES		
Total purchased power costs (Includes transmission)	$38,835,145	
Nuclear fuel expense, nuclear plant operations and nuclear plant maintenance costs	8,850,915	
	$47,686,060	
Average per kWh		38.73 Mills
Total administrative and general, depreciation and interest costs	$23,116,774	
Average per kWh		18.77 Mills
LOSS FROM OPERATIONS	$(1,885,571)	
Average per kWh		(1.53) Mills