

Arkansas Electric Cooperative Corporation

Financial Statements as of October 31, 2015
and 2014, and for Each of the Three Years
in the Period Ended October 31, 2015, and
Independent Auditors' Report

ARKANSAS ELECTRIC COOPERATIVE CORPORATION

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INDEPENDENT AUDITOR'S REPORT

Board of Directors
Arkansas Electric Cooperative Corporation
Little Rock, Arkansas

We have audited the accompanying financial statements of Arkansas Electric Cooperative Corporation operations, members' equities and comprehensive income, and of cash flows for each of the three years in the period ended October 31, 2015.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on the financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of AECC as of October 31, 2015 and 2014, and the results of its operations and its cash flows for each of the three years in the period ended October 31, 2015, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 5, 2016 on our consideration of AECC's internal control over financial reporting and our tests of its compliance with

certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering AECC's internal control over financial reporting and compliance.

Deloitte & Touche LLP

January 5, 2016

ARKANSAS ELECTRIC COOPERATIVE CORPORATION

BALANCE SHEETS AS OF OCTOBER 31, 2015 AND 2014 (In thousands)

	2015	2014
ASSETS		
UTILITY PLANT:		
Electric plant in service	\$2,213,083	\$2,167,322
Construction work in progress	<u>209,214</u>	<u>162,157</u>
Total utility plant	2,422,297	2,329,479
Less accumulated depreciation	<u>1,140,792</u>	<u>1,103,038</u>
Net utility plant	<u>1,281,505</u>	<u>1,226,441</u>
LONG-TERM INVESTMENTS:		
Gas reserves—net of amortization	13,683	14,443
Deposit with Rural Utilities Service—restricted investment	70,109	76,596
Other	<u>22,508</u>	<u>22,098</u>
Total long-term investments	<u>106,300</u>	<u>113,137</u>
CURRENT ASSETS:		
Cash and cash equivalents	147,730	197,530
Accounts receivable—members	50,302	52,233
Fuel inventories and prepaid fuel supply	48,354	28,624
Material and supply inventories	22,162	21,199
Prepaid warranty agreement	565	565
Deposit with Rural Utilities Service—restricted investment	21	36
Other current assets	<u>7,939</u>	<u>11,501</u>
Total current assets	<u>277,073</u>	<u>311,688</u>
DEFERRED CHARGES	<u>97,310</u>	<u>111,519</u>
TOTAL	<u>\$1,762,188</u>	<u>\$1,762,785</u>

ARKANSAS ELECTRIC COOPERATIVE CORPORATION

BALANCE SHEETS AS OF OCTOBER 31, 2015 AND 2014 (In thousands)

	2015	2014
LIABILITIES AND MEMBERS' EQUITIES		
MEMBERS' EQUITIES:		
Membership fees	\$ 2	\$ 2
Patronage capital	378,458	378,458
Accumulated margins	47,011	24,341
Other equities	<u>118,140</u>	<u>118,140</u>
Total members' equities	<u>543,611</u>	<u>520,941</u>
LONG-TERM DEBT:		
Federal Financing Bank	590,422	546,005
CoBank, ACB	46,103	58,925
CoBank, ACB—unsecured	9,939	11,325
Series 2011A First Mortgage Obligation Senior Notes	70,500	73,000
Series 2011B First Mortgage Obligation Senior Notes	120,000	120,000
Rural Utilities Service	<u>33</u>	<u>54</u>
Total long-term debt	<u>836,997</u>	<u>809,309</u>
CURRENT LIABILITIES:		
Notes payable—members	124,079	121,775
Notes payable—related parties	30,000	30,000
Notes payable—others	99,965	149,972
Accounts payable and other accrued liabilities	61,820	67,982
Current maturities of long-term debt	39,153	36,464
Accrued property taxes	6,959	6,751
Accrued interest	<u>5,560</u>	<u>5,565</u>
Total current liabilities	<u>367,536</u>	<u>418,509</u>
DEFERRED CREDITS	<u>14,044</u>	<u>14,026</u>
COMMITMENTS AND CONTINGENCIES		
TOTAL	<u>\$1,762,188</u>	<u>\$1,762,785</u>

See notes to financial statements.

(Concluded)

ARKANSAS ELECTRIC COOPERATIVE CORPORATION

STATEMENTS OF OPERATIONS

FOR EACH OF THE THREE YEARS IN THE PERIOD ENDED OCTOBER 31, 2015

(In thousands)

	2015	2014	2013
OPERATING REVENUES	<u>\$ 727,654</u>	<u>\$ 767,470</u>	<u>\$ 736,207</u>
OPERATING EXPENSES:			
Operation and maintenance—generation	279,050	360,726	389,867
Power purchased	212,534	188,621	138,983
Operation and maintenance—transmission	101,862	89,838	70,423
Administrative and general	26,246	25,380	25,646
Depreciation	44,093	46,763	56,915
Interest	44,665	46,140	44,588
Taxes	<u>152</u>	<u>150</u>	<u>152</u>
Total operating expenses	<u>708,602</u>	<u>757,618</u>	<u>726,574</u>
MARGIN FROM ELECTRIC OPERATIONS	19,052	9,852	9,633
OTHER (LOSS) GAIN—Net	(502)	1,188	(182)
INTEREST INCOME—Net	4,024	4,221	3,660
ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION	<u>96</u>	<u>223</u>	<u>414</u>
NET MARGIN	<u>\$ 22,670</u>	<u>\$ 15,484</u>	<u>\$ 13,525</u>

See notes to financial statements.

ARKANSAS ELECTRIC COOPERATIVE CORPORATION

STATEMENTS OF MEMBERS' EQUITIES AND COMPREHENSIVE INCOME FOR EACH OF THE THREE YEARS IN THE PERIOD ENDED OCTOBER 31, 2015 (In thousands)

	Membership Fees	Patronage Capital	Accumulated Margins	Other Equities	Total Members' Equities
BALANCE—October 31, 2012	\$ 2	\$ 389,477	\$ 4,461	\$ 118,140	\$ 512,080
Comprehensive income:					
Net margin	-	-	13,525	-	13,525
Redemption of patronage capital	-	(9,907)	-	-	(9,907)
Allocation of patronage capital	-	9,129	(9,129)	-	-
BALANCE—October 31, 2013	2	388,699	8,857	118,140	515,698
Comprehensive income:					
Net margin	-	-	15,484	-	15,484
Redemption of patronage capital	-	(10,241)	-	-	(10,241)
BALANCE—October 31, 2014	2	378,458	24,341	118,140	520,941
Comprehensive income:					
Net margin	-	-	22,670	-	22,670
Redemption of patronage capital	-	-	-	-	-
BALANCE—October 31, 2015	<u>\$ 2</u>	<u>\$ 378,458</u>	<u>\$ 47,011</u>	<u>\$ 118,140</u>	<u>\$ 543,611</u>

See notes to financial statements.

ARKANSAS ELECTRIC COOPERATIVE CORPORATION

STATEMENTS OF CASH FLOWS

FOR EACH OF THE THREE YEARS IN THE PERIOD ENDED OCTOBER 31, 2015

(In thousands)

	2015	2014	2013
OPERATING ACTIVITIES:			
Net margin	\$ 22,670	\$ 15,484	\$ 13,525
Adjustments to reconcile net margin to net cash provided by operating activities:			
Depreciation	44,093	46,763	56,915
Amortization of gas reserves	760	923	1,070
Allowance for funds used during construction	(96)	(223)	(414)
Allocation of patronage from associated organization	(1,270)	(1,440)	(1,407)
Interest income on deposits with RUS—cushion of credit	(3,482)	(3,601)	(2,315)
Changes in operating assets and liabilities:			
Accounts receivable—members	1,931	6,217	(7,270)
Fuel inventories and prepaid fuel supply	(19,730)	7,586	10,373
Material and supply inventories	(963)	740	(2,365)
Other current assets	3,562	(5,094)	1,901
Deferred charges	14,209	9,225	(9,769)
Accounts payable and other accrued liabilities	(22,170)	(11,579)	(4,041)
Other deferred credits	(557)	(1,614)	(1,718)
Net cash provided by operating activities	<u>38,957</u>	<u>63,387</u>	<u>54,485</u>
INVESTING ACTIVITIES:			
Sales of marketable securities	-	10,000	-
Sales of other investments	1,436	1,465	1,236
Deposit with RUS—restricted investment	-	(40,000)	-
Withdrawals from RUS—restricted investment	9,984	9,874	17,147
Capital expenditures	(82,849)	(88,544)	(53,645)
Net cash used in investing activities	<u>(71,429)</u>	<u>(107,205)</u>	<u>(35,262)</u>
FINANCING ACTIVITIES:			
Net borrowings (payments) on notes payable, members	2,304	(42,523)	6,007
(Payments) borrowings on notes payable, other	(50,009)	139,977	(239,879)
Principal payments on long-term debt	(36,812)	(30,169)	(31,012)
Redemption of patronage capital	-	(10,241)	(9,907)
Proceeds from long-term debt	67,189	77,117	272,294
Net cash (used in) provided by financing activities	<u>(17,328)</u>	<u>134,161</u>	<u>(2,497)</u>
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(49,800)	90,343	16,726
CASH AND CASH EQUIVALENTS—Beginning of year	<u>197,530</u>	<u>107,187</u>	<u>90,461</u>
CASH AND CASH EQUIVALENTS—End of year	<u>\$ 147,730</u>	<u>\$ 197,530</u>	<u>\$ 107,187</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION—Noncash transactions:			
Increase in accounts payable related to capital expenditures	<u>\$ 16,212</u>	<u>\$ 16,482</u>	<u>\$ 9,542</u>
Cash paid for interest—net of amounts capitalized	<u>\$ 34,248</u>	<u>\$ 36,398</u>	<u>\$ 35,121</u>

See notes to financial statements.

ARKANSAS ELECTRIC COOPERATIVE CORPORATION

NOTES TO FINANCIAL STATEMENTS AS OF OCTOBER 31, 2015 AND 2014, AND FOR EACH OF THE THREE YEARS IN THE PERIOD ENDED OCTOBER 31, 2015

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization—Arkansas Electric Cooperative Corporation (AECC), an electric generation and transmission cooperative, follows the Uniform System of Accounts prescribed by the Rural Utilities Service (RUS) and the Federal Energy Regulatory Commission (FERC).

AECC was organized and exists under Arkansas law to provide wholesale electric power and associated energy to its 17 members (Members). AECC provides electric power to its Members under wholesale power contracts, which may be terminated only upon 60 months prior written notice and, in any event, no earlier than January 1, 2042. The wholesale power contracts require Members to purchase, with the limited exception of one Member, 100% of their energy requirements from AECC. AECC's rate to its Members includes a demand charge, an energy charge and certain rate riders, the combination of which are designed to recover the operating costs of AECC, plus a margin as approved by AECC's board of directors (the Board) and the Arkansas Public Service Commission (APSC). APSC approval is required for any rate adjustments and RUS approval is required for all rate decreases.

AECC's power supply resources are primarily composed of leased, owned, and co-owned generating facilities. AECC delivers energy over its owned and contracted transmission facilities via participation in two regional FERC-designated regional transmission organizations' day-ahead and real-time energy markets.

Carrying Value of Certain Assets and Liabilities—AECC's accounting policies and the accompanying financial statements conform to accounting principles generally accepted in the United States of America applicable to rate-regulated enterprises and reflect for financial reporting purposes the effects of the rate-making process in accordance with Financial Accounting Standards Board's Accounting Standards Codification (ASC) 980, *Regulated Operations*. In accordance with ASC 980, AECC has regulatory assets in the amount of approximately \$78.0 million and \$88.5 million as of October 31, 2015 and 2014, respectively. As of October 31, 2015 and 2014, regulatory assets included \$3.2 million and \$4.0 million, respectively, attributable to premiums associated with debt refinancings and retirements (which are being amortized over the life of the related debt instruments); deferred past service pension cost of \$0.3 million and \$0.4 million, respectively; \$49.6 million and \$57.8 million, respectively, for the purchase of the lease residual and subsequent reclassification from an operating lease to a capital lease for the Independence Steam Electric Station Unit 2 (ISES 2) in June 2003; and regulatory assets associated with the Clyde T. Ellis Hydroelectric Station (Ellis) lease and subsequent lease residual purchase of \$24.9 million and \$26.3 million, respectively (see "Rental and Lease Commitments"—Note 12). In the event operations are no longer subject to the provisions of ASC 980, as a result of a change in regulation or the effects of competition, AECC would be required to recognize the effects of any regulatory change in assets currently in its statements of operations.

Utility Plant and Related Depreciation—All utility plant is recorded at original cost. The cost of additions to utility plant includes contracted work, direct labor, materials, allocable overhead, and an allowance for funds used during construction as allowed by the APSC. The major classes of utility plant as of October 31, 2015, and 2014, are listed below (in thousands):

	2015	2014
Generation plant	\$2,028,258	\$2,003,070
Transmission plant	149,364	132,392
General plant	<u>35,461</u>	<u>31,860</u>
Electric plant in service	2,213,083	2,167,322
Construction work in progress	<u>209,214</u>	<u>162,157</u>
Total	<u><u>\$2,422,297</u></u>	<u><u>\$2,329,479</u></u>

The cost of retirements, replacements, or betterments are removed from utility plant and, in accordance with industry practice, the cost of the unit and its removal cost, less salvage, are charged to accumulated depreciation. Maintenance and repairs are charged to operating expenses as incurred.

Depreciation of utility plant is typically recorded using guidelines prescribed by the RUS. A provision has been made for depreciation of steam generation plant, gas turbine generation plant, hydroelectric generation plant, and transmission plant at annual straight-line composite rates of 3.1%, 3%, 2%, and 2.75%, respectively. Effective January 1, 2014, AECC received approval from the RUS to apply special rates to three existing coal plants. The special rates for these plants range from 0.73% to 1.08%.

General plant depreciation rates are applied on an annual straight-line composite basis as follows:

Structures and improvements	2%
Office furniture and equipment	4.8 and 9.6
Transportation equipment	20
Power-operated equipment	15
Tools, shop, and garage equipment	5
Communication equipment	8
Other general plant	5 and 6

Asset Retirement Obligations—AECC has recognized a conditional Asset Retirement Obligation (ARO) related to the future removal and disposal of asbestos from three oil-/gas-fired plants and one coal-fired plant and oil and gas plugging obligations. As of October 31, 2015, there are no assets legally restricted for the purpose of settling any AROs. These AROs are recorded as other deferred credits on the balance sheets. A reconciliation of the aggregate carrying amount of the obligation as of October 31, 2015, is as follows (in thousands):

Balance—October 31, 2014	\$ 2,345
Accretion expense	<u>108</u>
Balance—October 31, 2015	<u><u>\$ 2,453</u></u>

Electric Revenues and Fuel—Revenues are recorded in the same month that power is generated and billed. AECC charges the cost of fuel to expense as fuel is consumed. Uncollectible accounts have historically been negligible, so AECC does not provide an allowance for doubtful accounts.

Carrying Costs Capitalized During Construction—AECC capitalizes the carrying costs on certain significant construction and development projects while in progress. AECC is allowed, based on approval from the APSC, to capitalize the interest costs for debt specifically borrowed to finance projects during construction and development. Additionally, for the portion of construction and development projects funded without specific borrowings, the APSC allows AECC to capitalize carrying costs based first on the incremental rate incurred in relation to its notes payable, and to the extent the construction and development project costs exceed the balance of the notes payable, AECC may capitalize carrying costs attributable to the remaining costs based on the weighted-average interest rate of AECC's long-term debt, excluding any amounts representing specific borrowings.

AECC records the interest costs capitalized related to debt specifically borrowed for construction and development projects as interest during construction, which is reflected as a credit to interest expense as part of operating expenses in the accompanying statements of operations. Additionally, AECC is allowed to record the carrying costs capitalized related to construction and development projects funded without specific borrowings as an allowance for funds used during construction, which is reflected below the margin from operations in the accompanying statements of operations.

Interest cost capitalized related to debt specifically borrowed was approximately \$3.3 million, \$1.3 million, and \$1.0 million for the years ended October 31, 2015, 2014, and 2013, respectively, and was recorded as a reduction in interest expense. In addition, for the years ended October 31, 2015, 2014, and 2013, the carrying costs capitalized relating to projects funded without specific borrowings were approximately \$0.1 million, \$0.2 million, and \$0.4 million, respectively, and were recorded as an allowance for funds used during construction in the accompanying statements of operations.

Statements of Cash Flows—For purposes of the statements of cash flows, cash and cash equivalents represent demand deposits in financial institutions and securities with original maturity dates of three months or less when issued. No amounts were paid for income taxes for the years ended October 31, 2015, 2014, and 2013.

Inventories—Fuel inventories and material and supply inventories are stated at average cost.

Use of Estimates—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and assumptions used in preparing the accompanying financial statements.

Changes in Accounting Standards—In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update No. 2014-09 (ASU 2014-09), *Revenue from Contracts with Customers*. ASU 2014-09 introduces new, increased requirements for disclosure of revenue in financial statements and is intended to eliminate inconsistencies in revenue recognition and thereby improve financial reporting comparability across entities, industries and capital markets. In August 2015, ASU 2015-14 was issued that deferred the effective date of ASU 2014-09. The revised effective date is for annual reporting periods beginning after December 15, 2017. Early application is not permitted. AECC is currently evaluating the potential impact of ASU 2014-09, however, currently the adoption of

ASU 2014-09 is not expected to have a material effect on our reported results of operations, financial condition or cash flows.

Restricted Investment—AECC has established a cushion of credit program administered by the RUS. Under the cushion of credit program, RUS borrowers may make voluntary irrevocable deposits into a special account. The account balance accrues interest at a rate of 5% per year. The amounts in the cushion of credit account (deposits and earned interest) can only be used to make scheduled payments on loans made or guaranteed by the RUS. As of October 31, 2015 and 2014, AECC’s balances in the cushion of credit program were \$70.1 million and \$76.6 million, respectively. AECC made deposits into the cushion of credit program in the amount of \$40.0 million for the year ended October 31, 2014. There were no deposits made into the program for the years ended October 31, 2015 and 2013. During the years ended October 31, 2015 and 2014, AECC made scheduled payments from the cushion of credit program in the amount of \$10.0 million and \$9.9 million, respectively. In addition, AECC earned interest income from the cushion of credit program in the amount of \$3.5 million, \$3.6 million, and \$2.3 million for the years ending October 31, 2015, 2014, and 2013, respectively.

Fair Value Measurements—AECC has adopted ASC 820, *Fair Value Measurements and Disclosures*, which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The statement applies to reported balances that are required or permitted to be measured at fair value under existing accounting pronouncements.

ASC 820 emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, ASC 820 establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Level 1 and 2 of the hierarchy) and the reporting entity’s own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

Level 1 inputs utilize observable market data in active markets for identical assets or liabilities. Level 2 inputs consist of observable market data, other than that included in Level 1, that are either directly or indirectly observable. Level 3 inputs consist of unobservable market data, which are typically based on an entity’s own assumptions of what a market participant would use in pricing an asset or liability if there is little, if any, related market activity. In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest-level input that is significant to the fair value measurement in its entirety. AECC’s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

The following tables summarize AECC’s assets and liabilities measured at fair value on a recurring basis as of October 31, 2015 and 2014, aggregated by the level in the fair value hierarchy within which those measurements fall (in thousands):

	Fair Value Measurements as of October 31, 2015			Total
	Level 1	Level 2	Level 3	
Assets—marketable securities	\$3,538	\$ -	\$ -	\$3,538

**Fair Value Measurements
as of October 31, 2014**

	Level 1	Level 2	Level 3	Total
Assets—marketable securities	<u>\$3,716</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,716</u>

ASC 825, *Financial Instruments*, which was issued in February 2007, permits entities to choose to measure many financial instruments and certain other items at fair value (Fair Value Option). Election of the Fair Value Option is made on an instrument-by-instrument basis and is irrevocable. At the adoption date, unrealized gains and losses on financial assets and liabilities for which the Fair Value Option has been elected would be reported as a cumulative adjustment to beginning accumulated margins. Following the election of the Fair Value Option for certain financial assets and liabilities, unrealized gains and losses would be reported due to changes in fair value in earnings at each subsequent reporting date.

Regional Transmission Organization Accounting—Beginning December 19, 2013 AECC began participation in the Regional Transmission Organization (RTO) operated by the Midcontinent Independent System Operator Inc. (MISO), and became a transmission-owning member of MISO on June 1, 2014. Additionally on March 1, 2014, AECC joined the Integrated Marketplace launched by Southwest Power Pool (SPP) RTO. MISO covers, among other areas, approximately the eastern two-thirds of Arkansas. SPP covers, among other areas, the western one-third of Arkansas. Both RTO's operate wholesale energy markets, in day-ahead and real-time, and are responsible for moving electricity over large interstate areas. They also coordinate, control and monitor the electricity transmission grid within their respective areas. As a result of this, AECC now sells all plant generation into the RTO markets and purchases energy to serve all load from the markets. Transactions within each individual hour are netted to a single purchase or sale, within each individual market (MISO and SPP) based on the actual load and net megawatt hour generation.

Prior to joining MISO Day-Ahead, Real-Time and Energy Operating Reserve Markets and SPP Integrated Marketplace, AECC participated in the Energy Imbalance Service Market operated by SPP.

2. INCOME TAXES

In December 1982, AECC elected to revoke its tax-exempt status for federal income tax purposes. For state income tax purposes, AECC operates as a tax-exempt cooperative under Arkansas statutes. No amounts were expensed for income taxes for the years ended October 31, 2015, 2014, and 2013.

The differences between the statutory federal income tax rate on income before income taxes and AECC's effective income tax rate are summarized as follows (in thousands):

	2015	Percent	2014	Percent	2013	Percent
Statutory federal income	\$ 7,935	35.0 %	\$ 5,419	35.0 %	\$ 4,734	35.0 %
Nontaxable member income	(7,935)	(35.0)	(5,419)	(35.0)	(4,734)	(35.0)
Tax credit carryforwards not benefited	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Effective income tax rate	<u>\$ -</u>	<u>- %</u>	<u>\$ -</u>	<u>- %</u>	<u>\$ -</u>	<u>- %</u>

The components of the net deferred tax liability as of October 31, 2015 and 2014, were as follows (in thousands):

	2015	2014
Deferred tax assets:		
Patronage exclusions available	\$ 101,208	\$ 97,063
Alternative minimum tax (AMT) credit carryforwards	4,052	4,052
Other	<u>8,433</u>	<u>8,708</u>
	113,693	109,823
Valuation allowance	<u>(4,052)</u>	<u>(4,052)</u>
	<u>109,641</u>	<u>105,771</u>
Deferred tax liabilities:		
Utility plant	(76,101)	(68,395)
Safe harbor lease	(30,287)	(30,287)
Other	<u>(3,253)</u>	<u>(7,089)</u>
	<u>(109,641)</u>	<u>(105,771)</u>
Net deferred tax liability	<u>\$ -</u>	<u>\$ -</u>

As of October 31, 2015, AECC had an AMT credit carryforward of approximately \$4.1 million. Based on AECC's historical transactions resulting in nonmember losses and the patronage provisions of its bylaws, AECC does not anticipate any future taxable income sufficient to realize the benefit of the tax credits existing as of October 31, 2015. Accordingly, AECC has established a valuation allowance for these credits as reflected above.

During fiscal 2014 and 2015, AECC's federal tax returns for the years ended October 31, 2011 and 2012 were under examination by the Internal Revenue Service (IRS). Following the examination, the assigned IRS personnel issued a revenue agent's report (RAR) that resulted in AECC owing no tax liability for the examination period. However, due to certain findings contained in the RAR to which AECC objects, AECC management has submitted a formal protest regarding certain assertions in the RAR. AECC's protest is currently in the appeals process. Even if AECC's appeal is denied, the RAR findings will not have a material impact on the financial statements, separately or taken as a whole.

3. INVESTMENTS

Subordinated term certificates were purchased in connection with the issuance of the National Rural Utilities Cooperative Finance Corporation (CFC) Guaranteed Pollution Control Revenue Bonds. These amounts are recorded in the accompanying balance sheets as part of long-term investments—other, and totaled \$6.7 million at October 31, 2015 and 2014. In accordance with ASC 320, *Investments: Debt and Equity Securities*, these investments have been classified as held to maturity and, accordingly, are recorded at amortized cost. These investments have maturity dates which extend through 2080.

AECC has a leasehold interest in the revenue stream of certain gas wells. AECC is accounting for its mineral interest using the successful efforts method of accounting and the mineral interest is being depleted on a field-by-field basis using the unit-of-production method based on estimated proven

reserves. As of October 31, 2015, and 2014, AECC's leasehold interests in the gas reserves totaled approximately \$13.6 million and \$14.4 million, respectively. The net interest received less the depletion of the gas reserves resulted in a gain of approximately \$1.1 million for the year ended October 31, 2014 and losses of \$0.5 million and 0.1 million for the years ended October 31, 2015 and 2013, respectively.

AECC evaluates the recoverability of assets by comparing the carrying amount of the relevant asset group against the related estimated undiscounted future cash flows expected over the remaining useful life of the asset group. When an evaluation indicates that the future undiscounted cash flows are not sufficient to recover the carrying value of the asset group, the carrying value of the asset group is reduced to its estimated fair value. AECC completed an impairment valuation as of October 31, 2015, related to its leasehold interest in the gas reserves and concluded that the gas reserves were not impaired.

4. PATRONAGE CAPITAL

Patronage allocations are based on an amount not less than the fiscal year's taxable income for federal income tax purposes. Patronage allocations are assigned to patrons' accounts as credits on a patronage basis. Using this allocation method, there was no patronage allocated for the years ended October 31, 2015 and 2014. The patronage allocated for the year ended October 31, 2013 was \$9.1 million.

Patronage retirements are restricted by the Indenture of Mortgage, Security, and Financing Statement dated as of June 1, 2009, made by AECC, as grantor, to Regions Bank, as trustee, as supplemented (the Indenture). The Indenture prohibits AECC from making any distribution of patronage capital to its members if, at the time of the distribution or immediately following the distribution, (i) an event of default exists or (ii) AECC's aggregate margins and equities at the end of the most recent fiscal quarter would be less than 20% of its total long-term debt and equities. AECC may, however, distribute up to the lesser of 5% of its aggregate margins and equities as of the end of the immediate preceding fiscal year, or 25% of its prior year's margins.

During the years ended October 31, 2014 and 2013, the Board authorized patronage retirements of approximately \$10.2 million and \$9.9 million, respectively. There was no patronage retirement for the year ended October 31, 2015.

5. OTHER EQUITIES

Other equities include proceeds of approximately \$43.2 million from the sale of tax benefits in 1982 under the Economic Recovery Tax Act of 1981—net of applicable expenses. The tax benefits sold were the depreciation and tax credits applicable to the Independence Steam Electric Station Unit No. 1 (ISES 1) boiler and turbine, coal handling equipment, and certain common and related items having a cost of approximately \$113.6 million.

The other equities balance also includes \$75.6 million of income related to the amortization of the deferred gain resulting from the ISES 2 sale and leaseback transaction. In accordance with ASC 980, due to rate-making treatment, the gain from this sale was recognized for financial reporting purposes over the lease term until June 27, 2003, when AECC purchased the ISES 2 lease residual resulting in the operating lease being reclassified as a capital lease. On December 16, 2009, AECC entered into a purchase and sale agreement to buyout the ISES 2 leased assets. On December 30, 2009, closing of the transaction, the ISES 2 lease was terminated and now AECC owns a 35.0% undivided interest in ISES 2 (see "Rental and Lease Commitments"—Note 12).

6. LONG-TERM DEBT

Long-term debt as of October 31, 2015, and 2014, consisted of the following (in thousands):

	2015	2014
Mortgage notes payable to Federal Financing Bank (FFB) at varying interest rates from 0.153% to 6.89%, due in quarterly installments through December 2041	\$ 612,845	\$ 566,337
Series 2011A First Mortgage Obligation Senior Notes payable at an annual interest rate of 4.71%, due in semiannual installments through December 2030	73,000	75,500
Series 2011B First Mortgage Obligation Senior Notes payable at an annual interest rate of 5.62%, due in semiannual installments beginning December 2031 through December 2041	120,000	120,000
CoBank ACB (CoBank) notes payable at an annual interest rate of 4.74%, due in quarterly installments through January 2020	58,926	71,157
CoBank unsecured notes payable at an annual interest rate of 2.62%, due in quarterly installments through March 2023	11,325	12,676
RUS 2% and 5% mortgage notes, due in quarterly installments through May 2018	54	90
Other debt	<u>-</u>	<u>13</u>
Total debt	876,150	845,773
Current maturities of long-term debt	<u>39,153</u>	<u>36,464</u>
Total long-term debt less current maturities	<u><u>\$ 836,997</u></u>	<u><u>\$ 809,309</u></u>

The estimated maturities of long-term debt for each of the next five years ending October 31, and in the aggregate thereafter are as follows (in thousands):

	2016	2017	2018	2019	2020	Thereafter	Total
FFB	\$ 22,423	\$ 21,065	\$ 19,799	\$ 19,964	\$ 20,583	\$ 509,011	\$ 612,845
CoBank	12,823	13,441	14,090	14,769	3,803	-	58,926
CoBank—unsecured	1,386	1,424	1,463	1,502	1,542	4,008	11,325
Series 2011A	2,500	2,500	3,000	3,000	3,500	58,500	73,000
Series 2011B	-	-	-	-	-	120,000	120,000
RUS	<u>21</u>	<u>22</u>	<u>11</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>54</u>
Total	<u><u>\$ 39,153</u></u>	<u><u>\$ 38,452</u></u>	<u><u>\$ 38,363</u></u>	<u><u>\$ 39,235</u></u>	<u><u>\$ 29,428</u></u>	<u><u>\$ 691,519</u></u>	<u><u>\$ 876,150</u></u>

All long-term debt, with the exception of the above disclosed CoBank unsecured debt, is secured equally and ratably by a first priority lien on substantially all of the owned tangible and certain of the intangible assets of AECC, subject to certain exceptions and limitations. Under the terms of AECC's Indenture,

substantially all of the after-acquired assets of AECC become subject to the lien of the Indenture. Also, under the terms of the Indenture, the RUS loan contract and other loan agreements, AECC must maintain certain financial covenants. AECC was in compliance with these financial covenants at October 31, 2015.

AECC entered into a long-term loan agreement with CoBank on December 9, 2009 in the amount of \$122.0 million for the purpose of funding the lease buyout and purchase of ISES 2. The loan has a maturity date of January 20, 2020. As of October 31, 2015, and 2014, \$58.9 and \$71.2 million, respectively, was outstanding to CoBank. On April 23, 2013, AECC entered into an unsecured long-term loan agreement with CoBank in the amount of \$14.7 million for the purpose of funding certain pension plan prepayments (see “Employee Benefits”—Note 8). The loan has a maturity date of March 30, 2023. As of October 31, 2015, and 2014, \$11.3 and \$12.7 million, respectively, was outstanding to CoBank—Unsecured.

AECC entered into a long-term loan agreement on December 8, 2010, with RUS on the FFB S-8 loan in the amount of \$621.0 million. This loan is being used to finance \$103.6 million of system improvements mostly incurred at AECC’s coal-fired plants. The remaining \$517.4 million of the loan will be used to finance AECC’s share of environmental control equipment upgrades at Flint Creek Power Plant (Flint Creek) and White Bluff Steam Electric Station (WBSSES) (see “Commitments and Contingencies”—Note 13). The loan commitment had an original maximum draw period ending on September 30, 2015. This draw period has been extended through December 31, 2016 with a maturity date of December 31, 2040. The total unadvanced amount as of October 31, 2015, and 2014, was \$402.6 million and \$464.9 million, respectively.

AECC completed a private placement debt issuance on February 22, 2011, by issuing \$200.0 million in First Mortgage Obligation Senior Notes. The debt issuance involved two tranches, with outstanding amounts of \$73.0 million in Series 2011A Notes, due December 30, 2030, at a coupon rate of 4.71% and \$120.0 million in Series 2011B Notes, due December 30, 2041, at a coupon rate of 5.62%.

RUS approved a loan guarantee commitment on September 25, 2012, in the amount of \$245.0 million. AECC subsequently entered into a long-term loan agreement with RUS by executing the Series 2012 (FFB T-8) Note, dated November 30, 2012, in the amount of \$245.0 million. This loan was used to finance AECC’s acquisition of the Magnet Cove Power Plant (Magnet Cove) (see “Power Plants”—Note 10). All funds have been advanced on this loan which has a maturity date of December 31, 2041.

7. NOTES PAYABLE

AECC maintains a \$75.0 million perpetual line of credit with CFC, which bears interest at a rate of 1.0% above the prime rate or such lesser total rate per annum as may be fixed by CFC. AECC also has a \$10.0 million committed line of credit with Regions Bank through August 15, 2016, which bears interest at 1.5% over the 30-day London InterBank Offered Rate. No amounts were outstanding under these lines of credits during the fiscal years 2015 and 2014.

AECC has signed related-party master promissory notes with all of its Members. These notes allow Members to advance AECC funds with such advances payable upon demand. When needed, AECC may use such advances for its own operating requirements and recognizes interest as a component of interest expense in the statements of operations. However, when AECC is in a financial position such that it does not require these advances for operations, Members may continue to advance funds to AECC for investment purposes, in which case AECC recognizes the interest expense in interest income—net, in the statements of operations. AECC collectively invests such funds, along with AECC’s general funds, and pays its Members an interest rate comparable to the monthly average rate earned on the combined

investments. AECC invests these funds in U.S. Treasury notes, bills and bonds, other U.S. government agency securities, and various other debt securities, such as corporate notes, bonds, and commercial paper.

As of October 31, 2015, and 2014, Member advances to AECC totaled approximately \$124.1 million and \$121.8 million, respectively. As of October 31, 2015 and 2014, the variable interest rate on the notes payable was 0.90% and 1.07%, respectively.

Total interest expense related to the Member advances for the years ended October 31, 2015, 2014, and 2013, was as follows (in thousands):

	2015	2014	2013
Operating interest, included in interest expense	\$ 1,149	\$ 1,469	\$ 1,780
Nonoperating interest, included in interest income—net	<u>121</u>	<u>408</u>	<u>842</u>
Total interest expense	<u>\$ 1,270</u>	<u>\$ 1,877</u>	<u>\$ 2,622</u>

AECC entered into a three year \$250.0 million senior unsecured revolving credit agreement on April 28, 2011, with a syndication of financial institutions. On June 13, 2013, this agreement was extended through June 12, 2016. Since obtaining Arkansas Public Service Commission approval to extend the facility, AECC is nearing completion on a new five-year \$250.0 million senior unsecured revolving credit facility. Upon the tentative closing of the new facility on December 21, 2015, the current agreement will be terminated. This \$250.0 million credit facility is used to support AECC’s commercial paper program, for general purposes and for the issuance of letters of credit. There was no outstanding balance on this credit agreement as of October 31, 2015, or 2014.

AECC has agreements with Goldman Sachs and Wells Fargo Securities, LLC to act as dealers for commercial paper notes issued by AECC. As of October 31, 2015, \$100.0 million of commercial paper notes were outstanding at rates varying from 0.17% to 0.29% and with maturities varying from 6 to 91 days. As of October 31, 2014, \$150.0 million of commercial paper notes were outstanding at rates varying from 0.13% to 0.20% and with maturities varying from 5 to 95 days.

AECC has a 3.57% promissory note with Arkansas Electric Cooperatives, Inc. (AECI) for \$30.0 million with a maturity date of December 31, 2015. A new promissory note with AECI was executed to replace this expiring promissory note (see “Subsequent Events”—Note 16).

8. EMPLOYEE BENEFITS

The National Rural Electric Cooperative Association (NRECA) Retirement Security Plan (RS Plan) is a defined benefit pension plan qualified under Section 401 and tax-exempt under Section 501(a) of the Internal Revenue Code. It is considered a master multiple employer plan under the accounting standards. The RS Plan sponsor’s Employer Identification Number is 53-0116145 and the RS Plan Number is 333.

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

AECC’s contributions to the RS Plan in 2015, 2014, and in 2013 represented less than 5% of the total contributions made to the RS Plan by all participating employers. AECC made contributions to the RS

Plan of \$4.9 million, \$4.7 million, and \$19.3 million for the years ended October 31, 2015, 2014, and 2013, respectively. Contributions in 2013 were significantly higher than those in 2015 and 2014 due to AECC electing to participate in the prepayment option offered to participating employers in 2013. See description below for more information on the prepayment program.

For the RS Plan, a “zone status” determination is not required, and therefore not determined, under the Pension Protection Act (PPA) of 2006. In addition, the accumulated benefit obligations and plan assets are not determined or allocated separately by individual employer. In total, the RS Plan was over 80% funded on January 1, 2015, and 2014, based on the PPA funding target and PPA actuarial value of assets on those dates.

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

At the December 2012 meeting of the Insurance and Financial Services Committee of the NRECA Board of Directors (Committee), the Committee approved an option to allow participating cooperatives in the RS Plan to make a contribution prepayment and reduce future required contributions. The prepayment amount is the cooperative’s share, as of January 1, 2013, of future contributions required to fund the RS Plan’s unfunded value of benefits earned to date using RS Plan actuarial valuation assumptions. The prepayment amount will typically equal approximately 2.5 times a cooperative’s annual RS Plan required contribution as of January 1, 2013. After making the prepayment, for most cooperatives the billing rate is reduced by approximately 25%, retroactive to January 1, 2013. The 25% differential in billing rates is expected to continue for approximately 15 years. However, changes in interest rates, asset returns and other plan experience different from that expected, plan assumption changes, and other factors may have an impact on the differential in billing rates and the 15 year period. On April 3, 2013, the Board approved a prepayment of \$14.7 million to the RS Plan. AECC is amortizing this amount over ten years. As of October 31, 2015 and 2014, the balance of the prepayment was \$10.5 million and \$12.0 million, respectively.

AECC also has a defined contribution plan for eligible employees, for which contributions are determined annually. Additionally, AECC contributes a portion of the premiums related to medical insurance for eligible employees. Total benefit costs were approximately \$10.5 million, \$10.2 million, and \$9.5 million for the years ended October 31, 2015, 2014, and 2013, respectively.

AECC has deferred compensation agreements with certain employees that provide benefits upon death, disability, at age 65 and retired, or retirement. The present value of total estimated deferred compensation is being accrued over the remaining years to the full eligibility date. Contributions to the plans were \$0.2 million, \$0.2 million and \$0.1 million for the years ended October 31, 2015, 2014, and 2013, respectively. AECC has acquired certain assets, principally life insurance policies and mutual fund shares, to provide benefits under the deferred compensation agreements. As of October 31, 2015 and 2014, AECC had accrued deferred compensation liabilities of \$8.8 million and \$9.1 million, respectively, which are reflected in other deferred credits in the accompanying balance sheets. In addition, as of October 31, 2015, and 2014, AECC had \$10.3 million and \$10.2 million, respectively, related to life insurance policies and mutual fund shares to fund the deferred compensation plans, which are reflected in other long-term investments in the accompanying balance sheets.

AECC provides certain postretirement benefits to employees. In accordance with ASC 715, *Compensation—Retirement Benefits*, the accumulated postretirement benefit obligation was calculated to be \$1.7 million, which is included in deferred credits on AECC’s balance sheets.

9. RELATED-PARTY TRANSACTIONS

AECC has limited joint management with AECI and certain members of the Board also serve on the AECI board. AECI, among other things, is engaged, via subsidiaries, in the construction and maintenance of electrical substations and transmission facilities, and the marketing of new pole-mount and pad-mount transformers and pole-line hardware. Under a contractual agreement, AECC and AECI share certain facilities and personnel. Separate accounting records and related information are maintained for each cooperative. AECC had patronage allocations outstanding from AECI in the amount of \$1.0 million at October 31, 2015, and 2014, respectively.

AECI pays AECC monthly rent for use of the general office facilities and other expenses. The total amounts paid to AECC for the years ended October 31, 2015, 2014, and 2013, were approximately \$4.0 million, \$3.7 million, and \$3.4 million, respectively. AECI owed AECC approximately \$0.3 million and \$0.3 million at October 31, 2015, and 2014, respectively, related to the reimbursement of these expenses. As of October 31, 2015, and 2014, AECC owed AECI \$30.0 million in notes payable (see “Notes Payable”—Note 7).

AECI provides various services for AECC. The amounts incurred by AECC for shared salaries, reimbursement of expenses, purchases of supplies and services, and right-of-way clearing and construction were approximately \$9.4 million, \$6.2 million, and \$4.4 million for the years ended October 31, 2015, 2014, and 2013, respectively. As of October 31, 2015, and 2014, AECC owed AECI approximately \$0.6 million and \$0.7 million, respectively, for materials and services.

10. POWER PLANTS

AECC has an ownership or leasehold interest in and is responsible for providing its share of the costs for wholly owned, jointly owned or certain leased facilities in Arkansas, with the corresponding direct expenses included in the statements of operations as operating expenses. AECC’s share of each facility in operation as of October 31, 2015, is as follows (in thousands):

Generating Plants	Ownership or Leasehold Interest %	Utility Plant in Service	Accumulated Provision for Depreciation	Amount of Plant under Construction	Current Available Net Capacity (MW) (Unaudited)
Flint Creek	50 %	\$ 113,716	\$ 78,907	\$ 171,399	264 MW
White Bluff 1 and 2	35	317,992	262,614	9,238	580
ISES 1 and 2	35	358,649	285,641	5,071	588
Fitzhugh	100	71,491	32,736	565	165
Bailey	100	13,539	13,391	360	122
McClellan	100	19,226	19,101	588	134
Ellis	100	70,392	68,454	415	32
Whillock	100	75,534	31,912	297	32
Electric Cooperatives of Arkansas	100	184,444	58,862	517	103
Fulton CT 1	100	58,702	25,169	117	153
Oswald	100	84,749	29,964	386	548
Elkins	100	35,238	4,755	135	60
Magnet Cove (Lease)	100	264,183	34,590	888	660
Turk (Lease)	11.667	224,326	19,782	1,876	73

Under a power purchase agreement with Southwestern Power Administration (SPA), which expires June 30, 2020, AECC has the right to purchase, except in certain circumstances, up to 189 MW of power and associated energy from SPA. AECC can draw power and energy under this contract for up to

200 hours a month, but not over 600 hours in any four consecutive months and not over 1,200 hours in any 12-month period.

In March 2012, AECC entered into a purchase power agreement with BP Wind Energy North America, Inc., to purchase the net output from a wind-powered generating facility for a fixed price. The facility has 51 MW of installed capacity and became operational on December 26, 2012. The agreement is for a 20-year term.

AECC entered into a purchase power agreement on July 17, 2013, with Origin Wind Energy, LLC, to purchase the net output from a wind-powered generating facility for a fixed price. The facility has 150 MW of installed capacity and began commercial operation on November 24, 2014. The agreement is for a 20-year term.

AECC entered into a purchase power agreement with Drift Sand Project, LLC, on May 15, 2015, to purchase the net output from a wind-powered generating facility for a fixed price. The facility has 108 MW of committed capacity and is expected to begin commercial operation on December 31, 2016. The agreement is for a 20-year term.

AECC entered into a purchase power agreement on November 9, 2015, with Enel Kansas, LLC, to purchase the net output from a wind-powered generating facility for a fixed price. The facility has 64 MW of committed capacity and is expected to begin commercial operation on December 31, 2016. The agreement is for a 25-year term.

RUS regulatory accounting requires AECC to record the Magnet Cove purchase at the original cost incurred by the entity which first devoted the property to utility service, along with a related acquisition adjustment. Accordingly, AECC has recorded the Magnet Cove purchase at its original cost of \$423.0 million with the related \$85.0 million of accumulated depreciation, representing depreciation on Magnet Cove from its initial commercial operation in January 2006 through AECC's acquisition in September 2012. As a result of acquiring Magnet Cove at its original net book value cost of \$338.0 for \$240.0 million, AECC recorded a related acquisition adjustment credit in the amount of \$98.0 million as of October 31, 2012.

11. FUEL SUPPLY AND TRANSMISSION AGREEMENTS

AECC pays Entergy Arkansas, Inc. (Entergy), in accordance with provisions of joint operating agreements, for its 35% interest in the coal stockpiles at the WBSSES and ISES generating plants. Entergy retains all ownership rights to the coal. AECC makes monthly payments to Entergy to maintain the stockpiles. These payments are classified as prepaid fuel supply in the accompanying balance sheets.

AECC also has a joint operating agreement with Southwestern Electric Power Company (SWEPCO), in connection with its 50% interest of the Flint Creek generating station and 11.667% interest in the John W. Turk, Jr. Power Plant, whereby AECC pays for its share of the fuel consumed at those stations.

AECC owns approximately 329 miles of transmission lines, but relies primarily on the transmission facilities of Entergy, SWEPCO, Oklahoma Gas & Electric, and SPA to deliver electricity to the members pursuant to FERC approved tariffs.

12. RENTAL AND LEASE COMMITMENTS

ISES 2—Pursuant to the terms of a sale-leaseback agreement dated December 4, 1984, AECC sold and leased back for 35 years its 35% undivided interest in ISES 2. On June 27, 2003, AECC repurchased its

future ownership interest in the leased ISES 2 assets effective December 31, 2019. As a result of this transaction, the operating lease was reclassified as a capital lease and an associated regulatory asset was created. The balance of this regulatory created asset was \$49.6 million and \$57.8 million as of October 31, 2015, and 2014, respectively.

AECC executed a purchase and sale agreement on November 23, 2009, with General Electric Capital Corporation (GECC) to purchase the entire beneficial interest that GECC retained in the ISES 2 leased assets (the Transaction). On December 16, 2009, the APSC entered an order that the Transaction was in the public interest and approved the Transaction. The Transaction closed on December 30, 2009, with a purchase price of \$122.2 million (see “Long-term Debt”—Note 6).

AECC negotiated with a lender for a 10-year term loan for approximately \$122.0 million in order to fund the lease buyout and purchase of ISES 2 (see “Long-term Debt”—Note 6). As a result of this buyout transaction, the ISES 2 finance obligation of approximately \$115.4 million was effectively refinanced with the new \$122.0 million loan with CoBank. Upon the closing of the Transaction, the ISES 2 lease terminated and AECC now owns a 35.0% undivided interest in ISES 2.

Related expenses were \$15.3 million for each of the years ended October 31, 2015, 2014, and 2013, respectively. These expenses include depreciation expense of approximately \$3.9 million for each of the years ended October 31, 2015, 2014, and 2013, respectively. In addition, interest expense was approximately \$3.2 million, \$3.8 million, and \$4.3 million for the years ended October 31, 2015, 2014, and 2013, respectively. Amortization expense on the regulatory-created asset was approximately \$8.2 million, \$7.6 million, and \$7.1 million for the years ended October 31, 2015, 2014, and 2013, respectively.

Ellis—AECC sold and leased back on December 19, 1988, its interest in Ellis. As a result of the sale and leaseback, under the provisions of ASC 840, *Leases*, this transaction was accounted for as a long-term finance obligation. This lease was treated as an operating lease for rate-making purposes. In accordance with ASC 980, the timing of expense recognition was modified during the lease term to conform to rate treatment. As a result, an associated regulatory asset exists with a balance of \$3.6 million and \$3.7 million as of October 31, 2015 and 2014, respectively.

AECC executed an agreement of sale and purchase on November 30, 2011, with The Bank of New York Mellon as owner trustee, to purchase the Ellis leased assets and the entire beneficial interest that the owner trustee retained in the leased assets for \$35.6 million (the Lease Buyout). On December 20, 2011, the purchase closed with the purchase price being funded by AECC’s use of general funds in the amount of \$25.6 million and \$10.0 million of trust funds. Upon closing, the Ellis lease and trust agreement terminated.

As a result of the Lease Buyout, \$25.9 million was accounted for as a deferred regulatory asset and is being amortized straight line over the remaining FERC license life for Ellis through 2033. As of October 31, 2015 and 2014 this regulatory asset had a balance of \$21.4 million and \$22.6 million, respectively. Upon the lease buyout the remaining unamortized regulatory and other deferred costs were \$5.5 million which are also being amortized straight line through 2033. As of October 31, 2015 and 2014 these remaining unamortized costs were \$3.2 million and \$4.0 million, respectively.

Related expenses, including the effect of the Lease Buyout and legal defeasance, were \$2.9 million, for each of the years ended October 31, 2015, 2014, and 2013, respectively. These expenses include depreciation expense of approximately \$1.5 million for each of the years ended October 31, 2015, 2014, and 2013, respectively. Amortization of regulatory and other deferred costs was approximately \$1.4 million for each of the years ended October 31, 2015, 2014, and 2013, respectively.

13. COMMITMENTS AND CONTINGENCIES

AECC is not a party to any pending legal proceedings that management believes are material to the financial condition or results of its operations. AECC maintains liability insurance against risks, subject to certain self-insurance limits, arising out of the normal course of its business.

AECC purchased a leasehold interest in Magnet Cove (see “Power Plant”—Note 10) on September 10, 2012. At that time, AECC also purchased the Hot Spring Power Company, LLC interest in a long-term warranty agreement with Siemens and executed a new agreement (the Agreement) between AECC and Siemens. The Agreement calls for quarterly payments to Siemens based on, among other items, the number of hours that Magnet Cove runs during a quarter. The Agreement covers, among other items, regularly scheduled maintenance and all replacement costs related to the 501G Combustion Turbine replacements at regularly schedule intervals during the life of the Agreement. As of October 31, 2015, and 2014, a balance of \$0.6 million was included in the current assets on AECC’s balance sheets.

As of October 31, 2015, contractual commitments have been entered into for construction totaling approximately \$79.8 million related to capital improvements estimated for 2016 at AECC’s jointly owned coal-fired power plants.

As of October 31, 2015, projects to install flue gas desulfurization equipment and activated carbon injection (ACI) equipment at Flint Creek are underway. This equipment is expected to become operational during the second calendar quarter of 2016. ACI has been installed and is currently in operation on the four units at WBSES and ISES. This equipment allows each plant to achieve compliance with the Utility Mercury and Air Toxics Standard (MATS), and in the case of Flint Creek, expected compliance with Regional Haze Rule (RHR) requirements. Contractual commitments to complete the Flint Creek project have been entered into with approximately \$47.0 million expected to be spent in fiscal 2016.

In 2015, the federal Environmental Protection Agency (EPA) finalized two significant rules, the Clean Power Plan (CPP) and the National Ambient Air Quality Standard (NAAQS) for ozone, as well as the Coal Combustion Residuals (CCR) rule and the updated effluent limitation guidelines (ELG) for steam electric generating stations. In addition, the EPA proposed the Cross State Air Pollution Rule (CSAPR) Update rule which addresses interstate transport of nitrogen oxide and sulfur dioxide. The impact of the final CPP is not nearly as significant to AECC as the proposed CPP. Any impacts from the new NAAQS ozone standard will not be felt for several years; however, all counties in Arkansas are currently in attainment with the new standard. AECC believes the impacts of the CCR and ELG rules will be negligible since dry ash handling will be practiced at all of AECC’s co-owned coal-fired units by mid-2016. If finalized as proposed, the CSAPR Update rule will impact AECC beginning in 2017. CSAPR requires AECC to procure allowances to cover its emissions of nitrogen oxides (NOx) during the ozone season (May 1 to September 30). The proposed CSAPR Update Rule reduces Arkansas’ current emission allowance allocation by 54% beginning in 2017. AECC anticipates that low NOx burners will be installed at WBSES and possibly ISES prior to the 2017 ozone season; however, this decision will likely not be made until the CSAPR Update rule is finalized because the proposed requirement may change.

The EPA issued a ruling in 2012 that partially disapproved Arkansas’ RHR State Implementation Plan (RHR SIP). This ruling gave the Arkansas Department of Environmental Quality (ADEQ) two years to update, submit, and receive EPA approval of a revised RHR SIP. The ADEQ failed to submit a revised RHR SIP for EPA approval thereby requiring EPA to impose a Federal Implementation Plan (FIP) for the state. The draft FIP was issued in April 2015 and is not expected to be final until August 2016. Plants subject to the FIP will be required to be in compliance on or about October 2021. AECC expects

Flint Creek to be in compliance by April 2016 (with the addition of the scrubber to comply with MATS). Proposed compliance for WBSES is the installation of a scrubber on both units; however, Entergy and the co-owners are evaluating alternative compliance proposals. ISES should not be subject to the FIP; however, EPA believes that ISES is subject and proposes to add environmental controls to ISES. AECC believes that the proposed ISES requirements will be removed from the final FIP.

AECC's current estimate, based on certain plans and cost estimates provided by Entergy and SWEPCO, for its total ownership share of these emission control equipment upgrades is approximately \$325.0 million. AECC has incurred related project costs of approximately \$171.1 million as of October 31, 2015, AECC has secured financing for these equipment upgrades from the RUS with an FFB loan in the amount of \$517.4 million (see "Long-term Debt"—Note 6).

14. SIGNIFICANT CUSTOMERS

Sales to members amounted to 94%, 94%, and 95% of operating revenues for the years ended October 31, 2015, 2014, and 2013, respectively. For the years ended October 31, 2015, 2014, and 2013, AECC had the following members that accounted for more than 10% of operating revenue (in thousands):

Customer	2015		2014		2013	
	Amount	%	Amount	%	Amount	%
Mississippi County Electric Cooperative, Inc.	\$131,937	18.1 %	\$ 151,385	19.7 %	\$ 147,076	20.0 %
First Electric Cooperative Corporation	107,010	14.7	108,983	14.2	106,962	14.5
Carroll Electric Cooperative Corporation	102,572	14.1	105,692	13.8	102,386	13.9

15. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate the fair value of each class of financial instruments, other than those instruments recorded at fair value in the accompanying balance sheets, at October 31, 2015 and 2014, for which it is possible to estimate the fair value:

Long-Term Investments—The fair value of the gas reserves is estimated based on reserve estimates provided by an independent oil and gas consulting firm and using current market prices at October 31, 2015. Future cash flows were discounted using a rate of 10%.

Cash and Cash Equivalents—The carrying amount of cash and cash equivalents approximates fair value.

Long-Term Debt—The fair value of long-term debt is estimated based on quoted market prices for the same or similar issues or on the current rates available to AECC for debt of the same remaining maturation.

Notes Payable—The carrying amount of the notes payable to distribution members and others represents the fair value as these notes are due on demand and bear interest at market rates.

Based on the above methods and assumptions, as of October 31, 2015 and 2014, the following amounts represent the carrying amount and fair value of each financial instrument of AECC (in thousands):

	2015		2014	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term investments:				
Gas reserves	\$ 13,683	\$ 8,464	\$ 14,443	\$ 10,201
Other	16,590	16,590	16,446	16,446
Cash and cash equivalents	147,730	147,730	197,530	197,530
Long-term debt:				
FFB	612,845	659,568	566,337	608,060
CoBank	58,925	62,585	71,157	74,901
CoBank—unsecured	11,325	11,235	12,676	10,701
Series 2011A Notes	73,000	77,280	75,500	83,361
Series 2011B Notes	120,000	130,969	120,000	143,440
RUS	54	55	90	92
Notes payable—members	124,079	124,079	121,775	121,775
Notes payable—others	30,000	30,000	30,000	30,000

16. SUBSEQUENT EVENTS

AECC has evaluated events or transactions through January 5, 2016, in conjunction with the preparation of these financial statements.

AECC's board approved on December 8, 2015, a 4.69% revenue increase, subject to APSC approval under Arkansas Act 676 of 2009 (the Act), to be effective in May 2016 for April 2016 usage. The rate increase is expected to result in \$17.5 million of additional revenue for fiscal year 2016. Under the Act, within certain limits, AECC can receive modified and expedited rate treatment from the APSC. The Act also provides member cooperatives with a means of incorporating any wholesale rate relief granted under the Act into their retail rates.

AECC's Board authorized a patronage retirement on November 5, 2015, to be paid on December 15, 2015 in the amount of \$10.4 million.

Effective December 31, 2015, AECC executed a new 3.57% promissory note in the amount of \$30.0 million with AECC with a maturity date of March 31, 2016.

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