Homer Electric Association, Inc. and Subsidiary
(Alaska 5 and Alaska 33 Kenai)

Consolidated Financial Statements and Supplementary Information
Years Ended December 31, 2013 and 2012

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Contents

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Independent Auditor's Report

Board of Directors
Homer Electric Association, Inc. and Subsidiary
Homer, Alaska

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Homer Electric Association, Inc. and Subsidiary (the Association), which comprise the consolidated balance sheet as of December 31, 2013, and the related consolidated statements of operations and patronage capital, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit 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 consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Homer Electric Association, Inc. and Subsidiary as of December 31, 2013, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Supplementary Information
Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating balance sheet and consolidating statement of operations and patronage capital are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

2012 Financial Statements
The consolidated financial statements of Homer Electric Association, Inc. and Subsidiary as of December 31, 2012, were audited by other auditors whose report dated March 13, 2013, expressed an unmodified opinion on those statements.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 28, 2014, on our consideration of Homer Electric Association, Inc. and Subsidiary's internal control over financial reporting and on 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 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 Homer Electric Association, Inc. and Subsidiary's internal control over financial reporting and compliance.

BDO USA, LLP

Anchorage, Alaska
March 28, 2014

Consolidated Financial Statements

Homer Electric Association, Inc. and Subsidiary

Consolidated Balance Sheets

December 31,	2013	2012
Assets		
Utility plant, at cost:		
Electric plant in service	$ 463,540,795	$ 334,938,330
Electric plant held for future use	3,447,637	21,671,980
Construction work in progress	93,276,084	143,489,415
Total utility plant, at cost	560,264,516	500,099,725
Less accumulated depreciation and amortization	(150,782,052)	(144,055,281)
Net utility plant	409,482,464	356,044,444
Other assets and investments:		
Investments in associated organizations	20,740,154	19,078,154
Notes receivable, net of current portion	567,262	812,384
Non-utility property, net of accumulated depreciation of $406,547 ($370,851 in 2012)	338,565	406,118
Total other assets and investments	21,645,981	20,296,656
Current assets:		
Cash and cash equivalents	6,748,714	6,301,607
Accounts receivable, less allowance for doubtful accounts of $112,660 ($86,072 in 2012)	9,400,153	8,285,455
Unbilled revenue	4,823,966	3,935,414
Materials, fuel and supplies inventory	6,629,038	5,314,797
Notes receivable, current portion	524,592	603,981
Other current and accrued assets	371,871	370,023
Total current assets	28,498,334	24,811,277
Deferred charges	5,794,608	9,422,723
Total Assets	$ 465,421,387	$ 410,575,100

See accompanying notes to consolidated financial statements.

Homer Electric Association, Inc. and Subsidiary

Consolidated Balance Sheets, continued

December 31,	2013	2012
Equities and Liabilities		
Equities:		
Memberships	$ 58,630	$ 61,335
Patronage capital	76,712,436	71,785,269
Other equities - donated capital	2,665,429	2,615,806
Total equities	79,436,495	74,462,410
Long-term debt - mortgage notes payable	362,357,918	300,484,642
Current liabilities:		
Current portion of long-term debt	8,683,749	8,524,508
Accounts payable	9,524,543	15,453,189
Consumer deposits	1,125,062	1,068,301
Accrued payroll and benefits	2,630,792	2,441,411
Accrued taxes and other current liabilities	1,123,217	1,140,325
Total current liabilities	23,087,363	28,627,734
Deferred credits	539,611	7,000,314
Total Equities and Liabilities	$ 465,421,387	$ 410,575,100

See accompanying notes to consolidated financial statements.

Homer Electric Association, Inc. and Subsidiary

Consolidated Statements of Operations and Patronage Capital

Years Ended December 31,	2013	2012
Operating revenues	$ 91,940,785	$ 89,557,336
Operating expenses:		
Purchased power costs	45,465,861	45,172,980
Transmission expense	967,979	1,844,697
Distribution operations	2,290,067	2,065,519
Distribution maintenance	5,643,658	4,981,703
Production maintenance	2,243,190	1,677,553
Consumer accounts	3,664,410	3,302,878
Customer service and information	540,338	512,054
Sales expense	111,389	115,361
Administrative and general	8,482,243	7,680,709
Depreciation and amortization	10,688,475	9,109,216
Taxes	238,595	242,975
Miscellaneous	171,722	437,824
Total operating expenses	80,507,927	77,143,469
Operating margins before fixed charges	11,432,858	12,413,867
Fixed charges:		
Interest on debt, net of capitalized interest	8,930,363	9,150,434
Allowance for funds used during construction	(671,472)	(481,127)
Net fixed charges	8,258,891	8,669,307
Operating margins after fixed charges	3,173,967	3,744,560
Patronage capital allocation	1,695,468	1,067,827
Net operating margins	4,869,435	4,812,387
Nonoperating margins:		
Interest income	204,649	216,630
Other income (expense)	(35,106)	(43,757)
Total nonoperating margins	169,543	172,873
Net margins	5,038,978	4,985,260
Patronage capital at beginning of year	71,785,269	68,482,616
Less retirement of patronage capital credits	(111,811)	(1,682,607)
Patronage Capital at End of Year	$ 76,712,436	$ 71,785,269

See accompanying notes to consolidated financial statements.

Homer Electric Association, Inc. and Subsidiary

Consolidated Statements of Cash Flows

Years Ended December 31,	2013	2012
Cash Flows from Operating Activities		
Cash received from customers	$ 89,705,326	$ 89,922,625
Cash paid to suppliers and employees	(67,751,989)	(69,175,778)
Interest and dividends received	204,649	216,630
Interest paid	(8,258,891)	(8,534,465)
Taxes paid	(255,703)	(242,849)
Other	(35,106)	(43,757)
Net cash provided by operating activities	13,608,286	12,142,406
Cash Flows from Investing Activities		
Plant additions	(72,048,708)	(82,977,031)
Grant reimbursements received	6,878,574	1,764,368
Salvage on plant retirements	849,938	50,735
Cost of removal	(387,934)	(447,560)
Patronage refunds from associated organizations	789,504	623,773
Investments in associated organizations	(736,137)	119,647
Changes in assets and liabilities that provided (used) cash:		
Accounts payable, construction	(6,940,692)	5,471,506
Materials, fuel and supplies inventories	(1,314,241)	(479,593)
Deferred charges	4,184,835	1,017,253
Deferred credits	(6,460,703)	(6,468,053)
Net cash used by investing activities	(75,185,564)	(81,324,955)
Cash Flows from Financing Activities		
Proceeds from long-term debt	70,250,000	76,750,000
Principal payments on long-term debt	(8,217,483)	(7,543,963)
Retirement of capital credits	(62,188)	(1,444,473)
Changes in assets and liabilities that provided (used) cash:		
Consumer deposits	56,761	2,473
Memberships	(2,705)	(2,865)
Net cash provided by financing activities	62,024,385	67,761,172
Net increase (decrease) in cash and cash equivalents	447,107	(1,421,377)
Cash and Cash Equivalents at beginning of year	6,301,607	7,722,984
Cash and Cash Equivalents at end of year	$ 6,748,714	$ 6,301,607

Homer Electric Association, Inc. and Subsidiary

Consolidated Statements of Cash Flows, continued

Years Ended December 31,	2013	2012
Reconciliation of net margins to net cash provided by operating activities:		
Net margins	$ 5,038,978	$ 4,985,260
Adjustments to reconcile net margins to net cash provided by operating activities:		
Depreciation and amortization	11,337,663	9,703,825
Amortization of premium on debt refinancing	-	134,842
Patronage capital from associated organizations (non-cash)	(1,715,367)	(1,297,122)
(Increase) decrease in assets:		
Accounts receivable	(1,114,698)	(468,029)
Notes receivable	324,511	(160,668)
Unbilled revenue	(888,552)	(190,455)
Other current assets	(558,568)	(683,979)
Other investments	-	199,180
Increase (decrease) in liabilities:		
Accounts payable, trade	1,012,046	(568,580)
Accrued payroll and benefits	189,381	488,006
Accrued taxes and other current liabilities	(17,108)	126
Total adjustments	8,569,308	7,157,146
Net Cash Provided by Operating Activities	$ 13,608,286	$ 12,142,406
Supplementary disclosure of cash flow information:		
Allowance for funds used during construction	671,472	481,127
Interest capitalized to construction	3,460,789	2,120,807
	$ 4,132,261	$ 2,601,934

See accompanying notes to consolidated financial statements.

1. Summary of Significant Accounting Policies

The accounting records of Homer Electric Association, Inc. (HEA) conform to the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission as modified for electric borrowers of the Rural Utilities Service (RUS). HEA's accounting policies conform to generally accepted accounting principles as applied in the case of regulated public utilities and are in accordance with the accounting requirements and rate-making practices of the regulatory authorities having jurisdiction. A description of HEA's principle accounting policies follows:

Principles of Consolidation

The consolidated financial statements include a 100% owned subsidiary, Alaska Electric and Energy Cooperative, Inc. (AEEC). AEEC is a single-member cooperative with sales exclusively to HEA and provides all power requirements to HEA. All significant inter-company accounts and transactions have been eliminated in consolidation.

Plant Additions and Retirements

Additions and replacements of electric plant in service are at original cost of contracted services, direct labor and materials, and indirect overhead charges. Except for certain specifically identifiable units of equipment, replacements and retirements of plant are charged to the accumulated provision for depreciation at the average unit cost of the property unit plus removal cost less salvage. The cost of replacement is added to electric plant.

Depreciation

HEA completed a Depreciation Study of utility plant that was approved by the Regulatory Commission of Alaska (RCA) with an effective date of January 1, 2010. The annual depreciation accrual rates were developed using the straight line method, vintage group procedure and remaining life technique. Depreciation accrual rates vary by specific asset type according to these ranges:

HEA production plant	3.29% to 10.39%
HEA distribution plant	1.82% to 4.28%
HEA general plant	0.81% to 8.19%
HEA vehicles & equipment	15.00% to 19.36%
AEEC steam production plant	3.30%
AEEC other production plant	2.45% to 16.67%
AEEC transmission plant	1.42% to 7.57%
AEEC general plant	1.99% to 10.00%
Plant leased to others	2.75%

Overhauls on generation plant are capitalized and depreciated over the projected life of the overhaul.

Amortization

Deferred charges are amortized on a straight-line basis over periods ranging from 12 months to 180 months.

Materials and Supplies

Materials and supplies are primarily held for HEA's use in construction and maintenance projects and are stated at a moving weighted-average cost.

Revenues

Revenues are based on cycle billings rendered to customers monthly as well as the estimated amount accrued for services rendered but not billed at the end of the year.

Contributions in Aid of Construction

Contributions in aid of construction are credited to the associated cost of the property unit constructed.

Allowance for Funds Used During Construction

HEA capitalizes, as an additional cost of property, an allowance for funds used during construction that represents the allowed cost of borrowings and equity used to finance a portion of construction work in progress. The allowance for funds used during construction is recorded as revenue and allocated to special projects over $10,000.

Interest Capitalized During Construction

Actual interest incurred on major generation projects is capitalized as a direct cost of the project.

Income Taxes

HEA and AEEC are exempt from federal income taxes under provisions of Section 501(c)(12) of the Internal Revenue Code.

HEA applies the provisions of Topic 740 of the FASB Accounting Standards Codification relating to accounting for uncertainty in income taxes. HEA annually reviews its tax positions taken in accordance with the recognition standards. It is HEA management's opinion that it has no uncertain tax positions which would require disclosure or adjustment in these financial statements.

Cost of Power Adjustment

Effective April 1, 1988, HEA adopted, with regulatory approval, a wholesale cost of power adjustment clause which provides for current collection of estimated amounts of purchased power costs with a subsequent settlement of amounts collected.

Based on the 2010 rate study which, after regulatory approval, became effective January 1, 2012, the Wholesale Power Cost Rate Adjustment (WPCRA) was changed to separate all fuel and purchased energy costs into a new single-item cost element on customer bills called a Cost of Power Adjustment (COPA). This rate includes the fuel cost rate adjustment for energy purchased from Chugach Electric Association, Inc. (CEA) and power purchased from Bradley Lake. The customer, demand, and energy charges from the CEA bills are recovered through HEA's base rate and changes to these components appear in HEA's simplified rate filings. In 2013, HEA received regulatory approval to recover through COPA the incremental demand and energy increase of the CEA interim rate effective February 6, 2013.

Statement of Cash Flows

For purposes of the statements of cash flows, HEA considers all cash and short-term investments that are readily convertible to known amounts of cash and that present an insignificant risk of change in value due to changes in interest rates or other factors to be cash equivalents.

Reclassification

Certain amounts included in the comparative financial statements have been reclassified to achieve comparability.

Credit Risk

Financial instruments which potentially subject HEA to concentrations of credit risk consist principally of temporary cash investments. HEA places its temporary cash investments with high credit quality financial institutions. Concentrations of credit risk with respect to trade receivables are limited to HEA's large number of customers.

Accounting Estimates

The presentation of the consolidated financial statements in conformity with generally accepted accounting principles 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.

Fair Value of Financial Instruments

HEA measures certain items in these financial statements at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, that is, other than in a forced liquidation or distress sale.

HEA's financial assets and liabilities carried at fair value have been classified based on a hierarchy as defined in generally accepted accounting principles and are generally measured using the market approach or the income approach.

Subsequent Events

HEA has evaluated subsequent events through March 28, 2014, the date on which the financial statements were issued.

2. **Utility Plant and Depreciation Summary**

Major classes of HEA's utility plant at December 31, 2013 and 2012 are as follows:

	2013	2012
Production plant	$ 161,587,250	$ 54,997,171
Distribution plant	207,007,112	196,415,267
Transmission plant	50,370,055	41,370,962
General plant	32,739,203	30,317,755
Plant leased to others	11,837,175	11,837,175
Total electric plant in service	463,540,795	334,938,330
Electric plant held for future use	3,447,637	21,671,980
Construction work in progress	93,276,084	143,489,415
Total Utility Plant, At Cost	$ 560,264,516	$ 500,099,725

Total depreciation and amortization for the years ended December 31, 2013 and 2012 is summarized below:

	2013	2012
Depreciation and amortization expense	$ 10,688,475	$ 9,109,216
Depreciation on leased plant	362,158	360,916
Total Depreciation and Amortization	$ 11,050,633	$ 9,470,132
Depreciation Charged to Clearing Accounts	$ 675,119	$ 629,303

Plant leased to others consists of transmission lines which were used by the wholesale power supplier to deliver purchased power to HEA. Depreciation of plant leased to others is reflected as a reduction of operating revenues in the consolidated statements of operations and patronage capital.

The Bernice Lake Power Plant purchased from Chugach Electric Association on December 31, 2012, included an acquisition adjustment of approximately $7.4 million. HEA received regulatory approval to recover the amortization of the acquisition adjustment through rates over a period of 15 years. The asset is recorded as part of production plant.

Electric plant held for future use includes $1.2 million in vacant land owned by HEA and $2.2 million in generation equipment owned by AEEC. The heat recovery steam generator (HRSG), formerly classified as electric plant held for future use, was refurbished as part of the Independent Light Program and placed back into service in August 2013.

Construction work in progress at December 31, 2013, includes approximately $68.5 million for production plant construction in progress related to the Independent Light Program (ILP). The ILP was approved by the Board of Directors to build production assets sufficient to generate all of HEA's power requirements by December 31, 2013, which coincided with the conclusion of HEA's purchased power agreement with Chugach Electric Association. The Nikiski generation site was converted into a combined cycle facility with the addition of a steam turbine generator to the existing gas turbine, increasing the electrical production to a total of eighty (80) Megawatts. A commercial acceptance certificate for the Nikiski plant was issued to settle the general construction contract on July 28, 2013. Additionally, AEEC is repowering the Soldotna production facility by installing an aero derivative simple cycle unit on the site which will nominally be capable of producing forty-eight (48) Megawatts of electrical generation. The Soldotna production facility is expected to be commissioned in the months of March and April 2014.

3. Investments in Associated Organizations

Investments in associated organizations at December 31, 2013 and 2012 consisted of the following:

	2013	2012
Capital term certificates of the National Rural Utilities Cooperative Finance Corporation	$ 2,628,308	$ 2,628,308
Capital term non-interest bearing certificates of the National Rural Utilities Cooperative Finance Corporation	3,210,531	3,451,235
Investment in Kenai Hydro LLC	1,526,614	790,477
Patronage capital credits issued by:		
Southeastern Data Cooperative	174,077	151,342
Chugach Electric Association	6,962,885	6,731,467
National Rural Utilities Cooperative Finance Corporation	4,031,501	3,632,306
National Rural Telecommunications Cooperative, Inc.	588,550	586,170
Other	70,701	50,992
Equity contribution to the Alaska Rural Electric Cooperative Association Reciprocal Insurance Exchange	40,702	40,702
Allocation of margins from Alaska Rural Electric Cooperative Association Reciprocal Insurance Exchange	1,506,285	1,015,155
Total Investment in Associated Organizations	$ 20,740,154	$ 19,078,154

4. Cash and Cash Equivalents

The Association maintains all of its cash with Wells Fargo Bank, N.A. Accounts at this institution are insured by Federal Deposit Insurance Corporation (FDIC) up to $250,000. The unlimited insurance coverage for noninterest-bearing transaction accounts provided under the Dodd-Frank Wall Street Reform and Consumer Protection Act expired on December 31, 2012. Deposits held in noninterest-bearing transaction accounts are now aggregated with any interest-bearing deposits in the same ownership category, and the combined total is insured up to a minimum of $250,000. At December 31, 2013 and 2012, the uninsured cash balance was $5,744,981 and $0, respectively.

5. Accounts Receivable

Accounts receivable at December 31, 2013 and 2012 consisted of the following:

	2013	2012
Consumer accounts (energy bills)	$ 5,983,454	$ 5,961,869
Off system power sales	722,294	-
Contract services	1,295,992	845,730
Grants receivable	1,455,509	1,345,819
Other	55,564	207,109
Total accounts receivable	9,512,813	8,371,527
Allowance for doubtful accounts	(112,660)	(86,072)
Accounts Receivable, Net	$ 9,400,153	$ 8,285,455

6. Deferred Charges

At December 31, 2013 and 2012, deferred charges consisted of the following:

	2013	2012
Unamortized expense on refinanced debt, to be amortized over 13 years	$ -	$ 6,432
Unused steam rights, to be amortized over 15 years	4,159,996	4,506,664
Future steam rights	-	2,600,000
Storm damage costs	14,157	638,709
Facilities in progress	19,605	248,343
Nikiski transmission study	-	30,257
Deferred charges on cost of power adjustment	995,812	439,092
HEA rate case	605,038	806,716
CEA rate case	-	146,510
Total Deferred Charges	$ 5,794,608	$ 9,422,723

7. Equities

At December 31, 2013 and 2012, equities consisted of the following:

	2013	2012
Memberships	$ 58,630	$ 61,335
Patronage capital:		
Assignable	5,038,978	4,985,260
Assigned	71,785,269	68,482,616
Total patronage capital	76,824,247	73,467,876
Less capital credits retired:		
General retirement	-	(1,499,841)
Estates of deceased	(49,582)	(108,320)
Discounted portion	(61,339)	(72,921)
Applied to customer accounts	(890)	(1,525)
Total capital credits retired	(111,811)	(1,682,607)
Net patronage capital	76,712,436	71,785,269
Other equities – donated capital at beginning of year	2,615,806	2,377,672
Net transfers from patronage capital for unlocated customers and other adjustments	49,623	238,134
Other equities – donated capital at end of year	2,665,429	2,615,806
Total Equities and Margins	$ 79,436,495	$ 74,462,410

Patronage capital credits are paid to the estates of deceased members and applied to customer accounts in accordance with the by-law requirements.

Provisions in the long-term debt agreements with NRUCFC allow return of patrons' capital if after the distribution, equity of HEA will be at least twenty percent (20%) of its total assets. If, after giving effect to the distribution, total equity of HEA will be less than twenty percent (20%) of its total assets, then HEA may nevertheless make distributions up to thirty percent (30%) of its patronage capital or operating margins for the preceding calendar year.

8. Long-Term Debt

Long-term debt consists of notes payable to National Rural Utilities Cooperative Finance Corporation (NRUCFC), National Cooperative Services Corporation (NCSC) and Farmer Mac (FMAC). The interest rates may be fixed or variable under conversion options provided in the loan agreements. The loans are collateralized by all of HEA's and AEEC's assets except for vehicles. The loans require HEA to maintain a modified debt service coverage ratio of not less than 1.35. AEEC's loans require a modified debt service coverage ratio of not less than 1.05. HEA and AEEC were in compliance with these debt covenants.

Mortgage notes payable at December 31, 2013 and 2012 were as follows:

	2013	2012
NRUCFC:		
HEA mortgage notes payable at varying interest rates from 2.85% to 6.00%; interest only due quarterly until 2015; thereafter, principal and interest due quarterly until maturity in 2034.	$ 28,787,879	$ 28,787,879
HEA mortgage notes payable at varying interest rates from 5.70% to 5.75%; interest only due quarterly until 2022; thereafter, principal and interest due quarterly until maturity in 2040.	15,500,000	15,500,000
HEA mortgage notes payable at varying interest rates from 2.90% to 7.30%; principal and interest due quarterly until maturity in 2043.	60,262,687	67,756,878
AEEC mortgage notes payable at varying interest rates from 2.90% to 4.95%; principal and interest due quarterly until maturity in 2043.	37,634,157	28,981,240
AEEC mortgage notes payable at varying interest rates from 2.35% to 6.15%; interest due quarterly; principal due annually until maturity in 2017.	11,000,000	14,000,000
AEEC mortgage notes payable at 6.15% interest; interest due quarterly; principal payments to begin in 2015 due quarterly until maturity in 2043.	15,000,000	15,000,000
Total NRUCFC	168,184,723	170,025,997
FMAC -		
HEA mortgage notes payable at varying interest rates from 1.265% to 4.960%; principal and interest due semi-annually until maturity in 2042.	29,856,944	20,733,153
Subtotal long-term debt	198,041,667	190,759,150

	2013	2012
NCSC -		
AEEC construction line of credit payable at varying interest rates from 2.414% to 2.417%; interest only due quarterly until maturity in 2014. This obligation will be refinanced upon maturity on a long-term basis with NCSC and RUS, hence included in noncurrent liabilities.	$ 173,000,000	$ 118,250,000
Total long-term debt	371,041,667	309,009,150
Less current portion	(8,683,749)	(8,524,508)
Total Long-Term Debt, Excluding Current Portion	$ 362,357,918	$ 300,484,642

Receipt of NRUCFC loans requires commitments to purchase non-interest bearing capital term certificates of the NRUCFC in the amount of $3,210,531 and $3,451,235 for 2013 and 2012, respectively (See Note 3).

The annual requirements for reduction of long-term debt outstanding as of December 31, 2013, excluding obligations expected to be refinanced in 2014, are estimated to be as follows:

2014	$ 8,683,749
2015	9,892,387
2016	10,068,170
2017	9,174,467
2018	7,277,932
Thereafter	152,944,962
	$ 198,041,667

At December 31, 2013, HEA and AEEC had long-term unadvanced loan funds available from NRUCFC of $31,500,000 and $25,000,000, respectively. At December 31, 2012, HEA and AEEC had long-term unadvanced loan funds available from NRUCFC of $37,500,000 and $34,500,000, respectively.

At December 31, 2013, AEEC had unadvanced line of credit construction funds available from NCSC of $7,000,000 ($61,750,000 at December 31, 2012). Permanent financing will replace the $180,000,000 construction line of credit in 2014. AEEC has signed loan facilities in place from NCSC and RUS for this purpose. On February 26, 2104, AEEC made a loan draw on its RUS loan in the amount of $30,000,000. Interest capitalized directly to the Independent Light Program totaled $3,460,789 and $2,120,807 for the years ended December 31, 2013 and 2012, respectively.

9. Lines of Credit

HEA and AEEC each established a revolving line of credit loan with NRUCFC in amounts not to exceed $5,000,000 and $5,500,000, respectively. HEA and AEEC may borrow, repay, and reborrow funds for a period up to twelve months of the first advance at which time the balance of the loan must be reduced to zero for at least five consecutive days. Loan payments are due yearly with interest until final maturity, which for HEA is 2049, and for AEEC is 2014. There were no outstanding balances at December 31, 2013 and 2012 on the lines of credit. In 2013, AEEC obtained a Standby Letter of Credit up to $4,500,000 related to new fuel contracts.

10. Accounts Payable

At December 31, 2013 and 2012, accounts payable consisted of the following:

	2013	2012
Trade accounts payable	$ 6,326,331	$ 5,314,285
Construction accounts payable	3,198,212	7,679,466
Construction retainage	-	2,459,438
	$ 9,524,543	$ 15,453,189

The amount recorded in accounts payable at year end includes both normal trade accounts payable and current liabilities related to the Independent Light Program construction projects. Current assets are available to satisfy trade accounts payable. The construction line of credit is available to satisfy the construction accounts payable.

11. Deferred Credits

At December 31, 2013 and 2012, accounts payable consisted of the following:

	2013	2012
Consumer prepayments	$ 124,079	$ 197,190
Standard labor on transformers and meters	415,532	400,913
Prepaid capacity for Bernice Lake power plant	-	928,878
Deferred revenue on future obligations	-	5,473,333
	$ 539,611	$ 7,000,314

HEA received a prepayment of future fuel obligations which was amortized over the remaining life of the original co-generation project agreement. The prepayment was fully amortized on December 31, 2013. As part of the Bernice Lake Power Plant purchase, AEEC received prepaid capacity that was recognized as revenue each month through December 2013.

12. Employee Benefits

Defined Benefit Pension Plans

Pension benefits for substantially all employees are provided through participation in the National Rural Electric Cooperative Association (NRECA) and Alaska Electrical Trust Fund retirement programs. Both plans are master multi-employer defined benefit plans qualified under Section 401 and tax exempt under Section 501(a) of the Internal Revenue Code. A unique characteristic of a multi-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.

NRECA Retirement Security Plan Information

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 multi-employer plan under the accounting standards. The Plan sponsor's Employer Identification Number is 53-0116145 and the Plan Number is 333.

Plan Information

HEA contributions to the RS Plan in 2013 and in 2012 represented less than 5 percent of the total contributions made to the RS Plan by all participating employers. The Association made contributions to the Plan of $2,550,276 in 2013 and $2,050,781 in 2012. There have been no significant changes that affect the comparability of 2013 and 2012 contributions.

For the RS Plan, a "zone status" determination is not required, and therefore not determined, under the Pension Protection Act (PPA) of 2006. In addition, the accumulated benefit obligations and plan assets are not determined or allocated separately by individual employer. In total, the RS Plan was over 80 percent funded on January 1, 2013 and between 65 percent and 80 percent funded on January 1, 2012 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.

Alaska Electrical Pension Plan Information

The Alaska Electrical Pension Plan sponsor's Employer Identification Number is 92-6005171 and the Plan Number is 001. The Association's contributions to the Plan in 2013 and in 2012 represented less than 5% of the total contributions made to the Plan by all participating employers. The Association made contributions to the Plan of $1,557,170 in 2013 and $1,344,702 in 2012. There have been no significant changes that affect the comparability of 2013 and 2012 contributions. In total, the Alaska Electrical Pension Plan was more than 80% funded at December 31, 2013 and 2012 as certified by the Plan actuary. The Plan is not subject to funding improvement plans or rehabilitation plans and as a result, the Association is not subject to contribution surcharges. There are no minimum funding commitments as negotiated contributions currently satisfy the Association's commitment towards meeting the annual minimum funding requirement for the

Alaska Electrical Pension Plan. 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.

The expiration dates for the Association's collective bargaining agreements range from April 30, 2015 to April 30, 2016.

401(K) Plan

Effective January 1, 1988, HEA adopted a 401(k) plan covering substantially all employees who elect to participate. Employees are allowed to contribute up to the maximum dollar amounts permitted by the IRS each year. HEA contributes 1.0% of the straight time compensation for nonunion employees and an additional 2.0% on a matching basis. HEA contributes 6.0% of the straight time compensation on inside union employees. The employer contribution made for generation unit and outside union employees was $1.75 per hour. The total contributions to the Plan for the years ended December 31, 2013 and 2012 were $539,814 and $464,432, respectively

13. Deferred Compensation Plan

HEA participates in the deferred compensation plan offered to similar cooperatives by NRECA. This program provides a deferral of current earnings by select or qualifying employees to a future period and is entirely funded by the employee.

14. Purchased Power

Effective June 30, 2003, the all-requirements contract between HEA and Alaska Electric Generation and Transmission Cooperative, Inc. (AEG&T) was assigned to Alaska Electric and Energy Cooperative. This agreement shall remain in effect until December 31, 2050 and thereafter until terminated by either party. The amount charged by AEEC provides for the payment by HEA of all fixed and variable costs for operation of the generation and transmission assets, adjusted for revenues from sales to other utilities. Additionally, the amount charged must provide a minimum modified debt service coverage ratio of 1.05 as defined in the NRUCFC mortgage.

Effective September 27, 1986, HEA entered into an agreement of sale of electric power energy with Chugach Electric Association, Inc. (Chugach) and AEG&T. Effective June 30, 2003 this agreement was transferred to AEEC from AEG&T. HEA and AEEC are members of Chugach. Terms of the agreement provided for Chugach to sell to AEEC power to supply a portion of HEA's requirements in an initial contract capacity of 73,000 kilowatts and associated energy at an initial minimum amount of not less than 350,000 megawatt hours per year. The rate charged by Chugach, which includes a TIER component, is established by tariffs approved by the Regulatory Commission of Alaska. The only variable to the rate is the fuel adjustment factor developed by combining all fuel costs incurred during the month and dividing by the total kilowatt hours generated. Such factor is then applied to purchased kilowatt hours as a separate component of cost and passed through to the customers. Additionally, HEA guaranteed payment to Chugach of all charges incurred by AEEC under the agreement.

AEEC paid Chugach approximately $35,817,129 and $41,217,101 for purchased power in 2013 and 2012, respectively.

15. Bradley Lake Hydroelectric Project

The Bradley Lake Hydroelectric Project Power Sales Agreement between the owner, the Alaska Energy Authority, and the utility participants was approved by RUS on June 29, 1989. In exchange for HEA's payment of its proportionate share of the debt service on the project bonds and actual operation and maintenance costs, HEA is entitled to 12% (11 megawatts) of the project's minimum 90 megawatt capacity, and 12% of the plant's energy production, of which HEA's share averages 42,000 megawatt hours annually. HEA entered into a scheduling agreement during 1992 that gave Chugach Electric Association the right to schedule usage of HEA's portion of Bradley Lake Power. Effective June 30, 2003 HEA has assigned its share of Bradley Lake power to AEEC pursuant to its requirements contract with AEEC.

AEEC paid $1,738,932 and $1,855,521 for Bradley Lake power during 2013 and 2012, respectively. Minimum future payments, which started January 1, 2000 and will continue until 2027, are approximately $1,400,000 per year.

16. Regulatory Matters

HEA was granted approval to use the Simplified Rate Filing Procedures for Electric Cooperatives on June 10, 1991. During 2013, HEA received approval for an 8.00% rate increase effective July 1st. In 2012, there was an 8.00% rate increase effective May 1st.

On December 9, 2011 HEA was granted Commission approval through U-10-97 (12) for its general rate case filing for test year 2010. The rate case included a rate redesign, most notably consolidating customer classes and adding a system delivery charge to residential and general service classes. Additionally the Commission authorized new returns for HEA's Times Interest Earned Ratio (TIER), increasing it from 1.64 to 2.00; and increasing AEEC's Modified Debt Service Coverage Ratio (MDSC) from 1.05 to 1.25. Overall the rate case resulted in a 0.7% rate increase effective January 1, 2012.

17. Affiliated Organizations

Kenai Hydro, a limited liability company, was formed for the purpose of evaluating, investigating and planning low impact hydroelectric facilities on the Kenai Peninsula. Grants from the State of Alaska awarded to Kenai Hydro LLC have been used to pursue a FERC license for hydroelectric facilities. Currently HEA is the sole member of the LLC.

18. Major Customer

Power sales to two commercial customers totaled $8,584,895 and $9,078,394, or 10.7% and 11.4% of total power sales revenue in 2013 and 2012, respectively.

19. Contingencies and Commitments

HEA is subject to extensive federal, state and local environmental laws and regulations. These laws and regulations, which are constantly changing, regulate the discharge of materials into the environment and may require HEA to remove or mitigate the environmental effects of the disposals or release of substances at various sites. Environmental expenditures are expensed or capitalized depending on their future economic benefit. Expenditures that relate to an existing condition caused by past operations and that have no economic benefits are either expensed in the current period or amortized over an approved period of time. Liabilities for expenditures of a noncapital nature are recorded when environmental assessments and/or remediation is probable, and the costs can be reasonably estimated.

Although the level of future expenditures for environmental matters is impossible to determine, it is management's opinion that such costs when finally determined will not have a material effect on the financial position of HEA.

The construction of generation assets under the Independent Light Program (ILP) has required purchase commitments to contractors and suppliers at December 31, 2013, of approximately $7 million. As noted under Long-Term Debt (see Note 7), AEEC has loan facilities and lending commitment letters for long term financing in place.

In the normal course of business, HEA is involved in various claims and litigation. In the opinion of management and HEA's legal counsel, the disposition of these matters is not expected to have a material adverse effect on HEA's financial statements.

20. Grant Revenues

HEA has received grant funding from various federal and State of Alaska agencies to assist with the costs of several different projects, including the following: removal of trees killed by spruce bark beetles which are a hazard to the power lines; hydroelectric facilities feasibility studies; repair and construction of transmission lines and structures; significant upgrades to substations; and replacement of facilities damaged by floods and wind. In accordance with industry standards, HEA has chosen to account for grant revenues either as a reduction of expenses or as a reduction in the costs of capital improvements. HEA incurred grant reimbursable expenses of $7,902,087 and $2,834,069 in 2013 and 2012, respectively.

Due to a series of wind events in November 2011, HEA incurred substantial damage to the electric system. In 2012, HEA submitted requests for $1.7 million in Public Assistance Grants from the Federal Emergency Management Agency (FEMA) and the State of Alaska Division of Homeland Security and Emergency Management (DHS&EM). HEA received $186,689 from DHS&EM in 2013 and $437,862 and $66,613 from FEMA in 2013 and 2012, respectively. The remaining requests are still under review by the agencies.

Supplementary Information

Homer Electric Association, Inc. and Subsidiary

Consolidating Balance Sheet

December 31, 2013	Homer Electric Association	Alaska Electric and Energy Cooperative	Eliminations	Consolidated Totals
Assets				
Utility plant at cost:				
Electric plant in service	$ 242,145,128	$ 221,395,667	$ -	$ 463,540,795
Electric plant held for future use	1,224,344	2,223,293	-	3,447,637
Construction work in progress	13,528,123	79,747,961	-	93,276,084
Total utility plant, at cost	256,897,595	303,366,921	-	560,264,516
Less accumulated depreciation and amortization	(96,466,837)	(54,315,215)	-	(150,782,052)
Net utility plant	160,430,758	249,051,706	-	409,482,464
Other assets and investments:				
Investments in associated organizations	39,194,864	10,416,431	(28,871,141)	20,740,154
Notes receivable, net of current portion	567,262	-	-	567,262
Non-utility property, net of accumulated depreciation of $406,547	338,565	-	-	338,565
Total other assets and investments	40,100,691	10,416,431	(28,871,141)	21,645,981
Current assets:				
Cash and cash equivalents	3,836,251	2,912,463	-	6,748,714
Accounts receivable, less allowance for doubtful accounts of $112,660	10,395,206	7,393,514	(8,388,567)	9,400,153
Unbilled revenue	4,823,966	-	-	4,823,966
Materials, fuel and supplies inventory	4,778,455	1,850,583	-	6,629,038
Notes receivable, current portion	524,592	-	-	524,592
Other current and accrued assets	371,741	130	-	371,871
Total current assets	24,730,211	12,156,690	(8,388,567)	28,498,334
Deferred charges	1,634,612	4,159,996	-	5,794,608
Total Assets	$ 226,896,272	$ 275,784,823	$ (37,259,708)	$ 465,421,387

See accompanying notes to consolidated financial statements.

Homer Electric Association, Inc. and Subsidiary

Consolidating Balance Sheet, continued

December 31, 2013	Homer Electric Association	Alaska Electric and Energy Cooperative	Eliminations	Consolidated Totals
Equities and Liabilities				
Equities:				
Memberships	$ 58,630	$ -	$ -	$ 58,630
Patronage capital	76,712,436	22,871,141	(22,871,141)	76,712,436
Other equities - donated capital	2,665,429	6,000,000	(6,000,000)	2,665,429
Total equities	79,436,495	28,871,141	(28,871,141)	79,436,495
Long-term debt - mortgage notes payable	129,680,545	232,677,373	-	362,357,918
Current liabilities:				
Current portion of long-term debt	4,726,965	3,956,784	-	8,683,749
Accounts payable	7,633,585	10,279,525	(8,388,567)	9,524,543
Consumer deposits	1,125,062	-	-	1,125,062
Accrued payroll and benefits	2,630,792	-	-	2,630,792
Accrued taxes and other current liabilities	1,123,217	-	-	1,123,217
Total current liabilities	17,239,621	14,236,309	(8,388,567)	23,087,363
Deferred credits	539,611	-	-	539,611
Total Equities and Liabilities	$ 226,896,272	$ 275,784,823	$ (37,259,708)	$ 465,421,387

Homer Electric Association, Inc. and Subsidiary

Consolidating Statement of Operations and Patronage Capital

Year Ended December 31, 2013	Homer Electric Association	Alaska Electric and Energy Cooperative	Eliminations	Consolidated Totals
Operating revenues	$ 81,056,877	$ 57,465,268	$ (46,581,360)	$ 91,940,785
Operating expenses:				
Purchased power costs	46,880,188	45,167,033	(46,581,360)	45,465,861
Transmission expense	-	967,979.00	-	967,979
Distribution operations	2,290,067	-	-	2,290,067
Distribution maintenance	5,643,658	-	-	5,643,658
Production maintenance	-	2,243,190.00	-	2,243,190
Consumer accounts	3,664,410	-	-	3,664,410
Customer service and information	540,338	-	-	540,338
Sales expense	111,389	-	-	111,389
Administrative and general	7,789,547	692,696	-	8,482,243
Depreciation and amortization	6,012,497	4,675,978	-	10,688,475
Taxes	238,595	-	-	238,595
Miscellaneous	171,722	-	-	171,722
Total operating expenses	73,342,411	53,746,876	(46,581,360)	80,507,927
Operating margins before fixed charges	7,714,466	3,718,392	-	11,432,858
Fixed charges:				
Interest on debt, net of capitalized interest	6,064,101	2,866,262	-	8,930,363
Allowance for funds used during construction	(671,472)	-	-	(671,472)
Net fixed charges	5,392,629	2,866,262	-	8,258,891
Operating margins after fixed charges	2,321,837	852,130	-	3,173,967
Patronage capital allocation	2,584,972	508,533	(1,398,037)	1,695,468
Net operating margins	4,906,809	1,360,663	(1,398,037)	4,869,435
Nonoperating margins:				
Interest income	162,699	41,950	-	204,649
Other income (expense)	(30,530)	(4,576)	-	(35,106)
Total nonoperating margins	132,169	37,374	-	169,543
Net margins	5,038,978	1,398,037	(1,398,037)	5,038,978
Patronage capital at beginning of year	71,785,269	21,473,104	(21,473,104)	71,785,269
Less retirement of patronage capital credits	(111,811)	-	-	(111,811)
Patronage Capital at End of Year	$ 76,712,436	$ 22,871,141	$ (22,871,141)	$ 76,712,436