

Southwest Power Pool, Inc.

Independent Auditor's Report and Financial Statements

December 31, 2016 and 2015



Southwest Power Pool, Inc.
December 31, 2016 and 2015

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Independent Auditor's Report

Board of Directors
Southwest Power Pool, Inc.
Little Rock, Arkansas

We have audited the accompanying financial statements of Southwest Power Pool, Inc., which comprise the balance sheets as of December 31, 2016 and 2015, and the related statements of operations, changes in members' deficit, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 financial statements.

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

Board of Directors
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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Southwest Power Pool, Inc. as of December 31, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

BKD, LLP

Little Rock, Arkansas
April 5, 2017

Southwest Power Pool, Inc.
Balance Sheets (in Thousands)
December 31, 2016 and 2015

Assets

	<u>2016</u>	<u>2015</u>
Current Assets		
Cash and cash equivalents	\$ 75,715	\$ 42,003
Restricted cash deposits	223,964	196,918
Accounts receivable, net	63,702	39,790
Prepaid expenses and other	<u>9,291</u>	<u>8,420</u>
Total current assets	<u>372,672</u>	<u>287,131</u>
Property and Equipment, at Cost		
Land	4,812	4,812
Building	67,338	66,615
Furniture and fixtures	10,211	10,208
Equipment and machinery	46,210	49,549
Software	170,701	167,876
Software in development	5,205	3,396
Equipment under capital lease	<u>4,876</u>	<u>4,876</u>
	309,353	307,332
Less accumulated depreciation and amortization	<u>216,663</u>	<u>170,852</u>
	<u>92,690</u>	<u>136,480</u>
Investments (Note 2)	<u>10,835</u>	<u>9,352</u>
Other Assets, Net	<u>4,628</u>	<u>5,059</u>
	 <u>\$ 480,825</u>	 <u>\$ 438,022</u>

Liabilities and Members' Deficit

	<u>2016</u>	<u>2015</u>
Current Liabilities		
Line of credit	\$ -	\$ 2,000
Accounts payable	66,927	30,609
Customer deposits	223,964	196,918
Current maturities of long-term debt (<i>Note 4</i>)	21,410	21,353
Current maturities of obligations under capital lease (<i>Note 5</i>)	1,817	591
Accrued expenses	54,310	44,092
Deferred revenue	5,127	5,318
	<u>373,555</u>	<u>300,881</u>
Long-term Debt (<i>Note 4</i>)	235,948	226,608
Less unamortized debt issuance costs	(898)	(992)
	<u>235,050</u>	<u>225,616</u>
Obligation Under Capital Lease (<i>Note 5</i>)	<u>3,856</u>	<u>5,674</u>
Other Long-term Liabilities	<u>35,044</u>	<u>35,267</u>
Members' Deficit	<u>(166,680)</u>	<u>(129,416)</u>
	<u>\$ 480,825</u>	<u>\$ 438,022</u>

Southwest Power Pool, Inc.
Statements of Operations (*in Thousands*)
Years Ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Operating Income		
Tariff fees and member assessments	\$ 171,464	\$ 171,717
Other member services	5,131	7,016
	<u>176,595</u>	<u>178,733</u>
Operating Expenses		
Salaries and benefits	90,186	84,043
Employee travel	1,919	1,903
Administrative	4,764	4,928
Regulatory assessment	18,648	13,939
Meetings	974	825
Communications system	3,915	3,758
Leases	-	123
Maintenance	14,775	13,553
Consulting services	15,065	12,529
Depreciation	58,025	59,190
	<u>208,271</u>	<u>194,791</u>
Operating Loss	<u>(31,676)</u>	<u>(16,058)</u>
Other Income (Expense)		
Investment income	191	1,768
Interest expense	(10,687)	(10,616)
Change in fair market value of interest rate swaps	682	(726)
Other expense	(431)	(1,097)
	<u>(10,245)</u>	<u>(10,671)</u>
Loss Before Unrealized Loss and Change in Funded Status of Employee Benefit Plans	(41,921)	(26,729)
Unrealized Gain (Loss) on Investments	659	(2,011)
Change in Funded Status of Employee Benefit Plans	<u>3,998</u>	<u>(13,730)</u>
Net Loss	<u>\$ (37,264)</u>	<u>\$ (42,470)</u>

Southwest Power Pool, Inc.
Statements of Members' Deficit (*in Thousands*)
Years Ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Balance, Beginning of Year	\$ (129,416)	\$ (86,946)
Net loss	<u>(37,264)</u>	<u>(42,470)</u>
Balance, End of Year	<u>\$ (166,680)</u>	<u>\$ (129,416)</u>

Southwest Power Pool, Inc.
Statements of Cash Flows (in Thousands)
Years Ended December 31, 2016 and 2015

	2016	2015
Operating Activities		
Net loss	\$ (37,264)	\$ (42,470)
Items not requiring cash		
Depreciation and amortization	58,120	59,285
Change in funded status of employee benefit plans	(3,998)	13,730
Unrealized loss (gain) on investments	(659)	2,011
Realized gain on investments	-	(1,576)
Loss on disposal of fixed assets	-	5
Impairment loss	82	349
Change in fair market value of interest rate swaps	(682)	726
Changes in assets and liabilities		
Accounts receivable	(23,912)	2,036
Prepaid expenses and other	(871)	809
Other assets	431	(962)
Accounts payable	36,318	(808)
Accrued expenses	10,027	(14,428)
Other long-term liabilities	4,456	2,652
	42,048	21,359
Investing Activities		
Acquisition of property and equipment	(14,317)	(14,267)
Purchase of investments	(825)	(9,764)
Proceeds from sale of investments	-	10,076
	(15,142)	(13,955)
Financing Activities		
Repayments of long-term debt	(23,603)	(24,299)
Repayments of capital lease obligation	(591)	(636)
Repayment of borrowings under line of credit	(16,000)	(9,000)
Borrowings under line of credit	14,000	11,000
Issuance of long-term debt	33,000	-
	6,806	(22,935)
Increase (Decrease) in Cash and Cash Equivalents	33,712	(15,531)
Cash and Cash Equivalents, Beginning of Year	42,003	57,534
Cash and Cash Equivalents, End of Year	\$ 75,715	\$ 42,003
Supplemental Cash Flows Information		
Interest paid on long-term debt (net of interest capitalized of \$121 and \$102 in 2016 and 2015, respectively)	\$ 10,591	\$ 10,326
Assets purchased under capital lease obligations	\$ -	\$ 4,876
Property and equipment purchases in accounts payable and accrued liabilities	\$ 1,991	\$ 1,548

Southwest Power Pool, Inc.
Notes to Financial Statements (*in Thousands*)
December 31, 2016 and 2015

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

Nature of Operations

Southwest Power Pool, Inc. (the Company) is a not-for-profit entity formed in 1941 and incorporated in 1994. The Company is a Federal Energy Regulatory Commission (FERC)-approved regional transmission organization (RTO) serving more than 18 million ultimate customers across all or parts of 14 states. The Company's membership consists of investor-owned utilities, municipal systems, generation and transmission cooperatives, state authorities, federal agencies, independent power producers, contract participants, power marketers and independent transmission companies.

Major services provided by the Company to its members and customers include tariff administration, reliability coordination, regional scheduling, market operations and regional transmission expansion planning. Market operations encompass day-ahead and real time markets, transmission congestion rights, reliability unit commitment, operating reserve market and consolidated balancing authority.

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.

Cash and Cash Equivalents and Deposits

The Company considers all highly liquid interest-earning investments with stated maturities and coupon rate reset dates of no more than three months to be cash equivalents. At December 31, 2016 and 2015, the Company's cash and cash equivalents, including restricted deposits, are invested primarily in money market funds, mutual funds and repurchase agreements. These investments are typically revalued to the market each day and, in the case of repurchase agreements, are collateralized by U.S. government and federal agency securities. The Company's cash and cash equivalents consist primarily of funds accumulated for general operating purposes. Restricted cash deposits consist primarily of customer security deposits, amounts deposited for engineering studies and funds held in escrow for disputed invoices.

Investments

The Company's investments include equity and fixed income mutual funds. These investments are recorded at fair value, with unrealized gains and losses reported as non-operating income. Dividends, interest income and realized gains and losses are reported as investment income. The Company's investments are intended to be utilized in funding benefits associated with the Company's postretirement health care plan and 457f deferred compensation plan.

Income Taxes

The Company is exempt from income taxes under Section 501c(6) of the Internal Revenue Code and a similar provision of state law. However, the Company is subject to federal income tax on any unrelated business taxable income.

Southwest Power Pool, Inc.
Notes to Financial Statements (*in Thousands*)
December 31, 2016 and 2015

Accounts Receivable

Accounts receivable are stated at the amount billed to members, customers and others plus any accrued and unpaid interest. The Company provides an allowance for doubtful accounts, when necessary, which is based upon a review of outstanding receivables, historical collection information and existing economic conditions. Accounts that are unpaid after the due date are subject to interest at a rate set by FERC. At December 31, 2016 and 2015, the Company had recorded an allowance for doubtful accounts of \$822.

Property and Equipment

Property and equipment are recorded at cost and depreciated on a straight-line basis over the estimated useful life of each asset. The estimated useful lives are as follows:

Building	20 years
Building improvements	Shorter of useful life or remaining life of building
Furniture and fixtures	5 years
Vehicles	5 years
Equipment and machinery	3 years
Software	3 years

The Company capitalizes interest cost incurred on funds used to construct property, plant and equipment. The capitalized interest is recorded as part of the asset to which it relates and is amortized over the asset's estimated useful life. Interest cost capitalized was \$121 and \$102 in 2016 and 2015, respectively.

The Company capitalizes development costs, including interest, for internal use software costs. These costs are included in software in development. Management of the Company is of the opinion that all costs capitalized in association with the software in development are fully recoverable over the anticipated life of the asset.

Long-Lived Asset Impairment

The Company evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimated future cash flows expected to result from the use and eventual disposition of the asset is less than the carrying amount of the asset, the asset cost is adjusted to fair value and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value.

In 2016, the Company recorded an impairment loss of \$82 for previously capitalized costs associated with the development of an engineering software tool. In 2015, management of the Company made the decision to switch vendors for the system development associated with the Z2 project. The Z2 project implements Attachment Z2 of the tariff, which provides for payments of credits for use by others of sponsored transmission upgrades. Previously capitalized development costs of \$349 were determined to be impaired and an impairment loss was recorded in 2015. The amounts are recorded as an impairment loss in the accompanying Statements of Operations and are included in other income (expense).

Revenue Recognition

Revenues, consisting of member assessments, tariff administrative fees, contract services and miscellaneous revenues are recognized when earned, and expenses are recognized when incurred.

Southwest Power Pool, Inc.
Notes to Financial Statements (*in Thousands*)
December 31, 2016 and 2015

Customer Deposits

Customers may be required to make deposits with the Company prior to the performance of transmission services, market transactions and engineering studies. An offsetting liability equal to the deposit balance is recorded in current liabilities. Funds held in escrow related to disputed invoices are also recorded as a customer deposit under current liabilities.

Tariff Fees and Member Assessments

An administrative charge is applied to all transmission service under the Company's Open Access Transmission Tariff (tariff) to cover the expenses related to its administration. The charge is calculated in accordance with the terms of the Company's tariff. The administrative rate used for the calculation is established by the board of directors.

Members are assessed monthly based on their prior year average 12-month peak demand multiplied by the total hours in a month and by the monthly assessment rate as established by the board of directors.

A member's monthly assessment is offset dollar for dollar for qualifying tariff administrative fees collected from a member in any given assessment period.

The Company collects a membership fee from each member annually. The amount of the membership fee is established by the board of directors of the Company. For 2016 and 2015, all members paid a \$6 membership fee.

The Company also bills transmission customers and transmission owners a charge under Schedule 12 on all energy delivered under point-to-point transmission service and network integration transmission service. This provides a mechanism for recovering from transmission customers the annual charges the Company pays to FERC.

Deferred Revenue

Revenues for contract services received in advance are recognized over the periods to which the revenues relate.

Other Member Services

The Company provides reliability, tariff administration and scheduling for non-members on a contract basis. The Company also provides engineering study services for long-term transmission service and generation interconnection requests.

Withdrawing Members

Members wishing to withdraw their membership from the Company must provide 24 months' written notice and are responsible for their portion of the Company's existing obligations as defined in the bylaws, which include unpaid membership fees, any assessments imposed prior to the effective withdrawal date, any costs or expenses imposed upon the Company as a direct consequence of the member's withdrawal and the member's share of long-term obligations and related interest. Withdrawing members may also be responsible for all financial obligations incurred and costs allocated to its load for transmission facilities approved prior to their withdrawal. As of December 31, 2016 and 2015, the Company had not been notified by any member of their intent to withdraw their membership from the Company.

Southwest Power Pool, Inc.
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Concentration of Credit Risk

The Company is exposed to credit risk primarily through accounts receivable and uninsured cash balances. During 2016 and 2015, the Company maintained cash balances, including transaction accounts and short-term investment accounts that are not insured by the Federal Deposit Insurance Corporation. At December 31, 2016 and 2015, the Company did not have transaction accounts exceeding federal insurance limits. The Company's investment accounts were primarily invested in highly liquid short-term investments such as money market funds, mutual funds and repurchase agreements. The Company also requires the financial institutions holding its cash balances to be rated A or better by nationally recognized rating agencies.

The Company considers its accounts receivable to be highly probable of collection. At December 31, 2016 and 2015, the Company had \$822 recorded as allowance for doubtful accounts.

The Company requires its customers to meet certain minimum standards of financial condition and creditworthiness to receive unsecured credit from the Company. If these standards cannot be met by a customer, the Company requires the posting of defined financial security instruments to cover potential liabilities.

Reclassifications

Certain reclassifications have been made to the 2015 financial statements for the adoption of Accounting Standards Update 2015-03, *Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*, that were deemed to be immaterial. These reclassifications had no effect on net loss.

Note 2: Investment and Investment Returns

Investments at December 31 consisted of the following:

	<u>2016</u>	<u>2015</u>
Mutual Funds		
Equity	\$ 7,789	\$ 6,536
Fixed income	<u>3,046</u>	<u>2,816</u>
Total mutual funds	<u>10,835</u>	<u>9,352</u>
	<u>\$ 10,835</u>	<u>\$ 9,352</u>

Southwest Power Pool, Inc.
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Total investment return is comprised of the following:

	2016	2015
Interest and dividends reported at fair value	\$ 191	\$ 192
Net realized and unrealized gains (losses) on investments reported at fair value	659	(435)
	\$ 850	\$ (243)

Interest, dividends and realized gains and losses are reported as investment income, while unrealized gains and losses are reported separately in the Statements of Operations.

Note 3: Line of Credit

In October 2016, the Company established a new \$30,000 revolving line of credit expiring in 2019. At December 31, 2016, no amounts were borrowed against this line. At December 31, 2015, \$2,000 was borrowed against the previous \$30,000 revolving line of credit. Both agreements had a variable interest rate equal to the London Interbank Offered Rate (LIBOR) plus a credit margin. The Company's line of credit requires compliance with certain financial and non-financial covenants as well as periodic reporting requirements. The Company was in compliance with the covenant and reporting requirements throughout and at December 31, 2016.

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December 31, 2016 and 2015

Note 4: Long-term Debt and Interest Rate Swaps

Long-term Debt

	2016	2015
Variable Rate Term Note due 2027 (A)	\$ 3,136	\$ 3,341
5.45% Senior Notes due 2016 (B)	-	3,000
4.82% Series 2010-A and B Senior Notes due 2042 (C)	60,722	61,870
3.55% Series 2010-C Senior Notes due 2024 (D)	50,750	57,750
3.00% Series 2012-D-1 Senior Notes due 2024 (E)	36,250	41,250
3.25% Series 2012-D-2 Senior Notes due 2024 (F)	38,750	43,750
3.80% Series 2014-E Senior Notes due 2025 (G)	37,000	37,000
Floating Series Note - 2024 (H)	30,750	-
	257,358	247,961
Less unamortized debt issuance costs	898	992
Less current maturities	21,410	21,353
	\$ 235,050	\$ 225,616

- (A) Due February 1, 2027; principal and interest are payable quarterly based on a 25-year amortization. Payments commenced on May 1, 2007. The interest rate adjusts quarterly based on LIBOR plus 0.85%. At December 31, 2016 and 2015, the interest rate was 1.75% and 1.18%, respectively. The note is secured by a first mortgage on the Company's operation facility.
- (B) Due July 23, 2016; principal and interest are payable quarterly based on a seven-year amortization. Payments commenced on September 30, 2011. The interest rate is fixed at 5.45%. The note is unsecured.
- (C) Due December 30, 2042; principal and interest are payable quarterly based on a 32-year amortization. Principal payments commenced on March 30, 2013. The interest rate is fixed at 4.82%. The note is unsecured.
- (D) Due March 30, 2024; principal and interest are payable quarterly based on a 13-year amortization. Principal payments commenced on June 30, 2014. The interest rate is fixed at 3.55%. The note is unsecured.
- (E) Due March 30, 2024; principal and interest are payable quarterly based on a 10-year amortization. Principal payments commenced on June 30, 2014. The interest rate is fixed at 3.00%. The note is unsecured.
- (F) Due September 30, 2024; principal and interest are payable quarterly based on a 10-year amortization. Principal payments commenced on December 30, 2014. The interest rate is fixed at 3.25%. The note is unsecured.

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- (G) Due December 30, 2025; principal and interest are payable quarterly based on an 11 year and 9 months amortization. Principal payments commence on March 30, 2024. The interest rate is 3.80%. The note is unsecured.
- (H) Due March 30, 2024; principal and interest are payable monthly based on an 8-year amortization. Payments commenced on June 30, 2016. The interest rate adjusts monthly based on LIBOR plus 1.75%. At December 31, 2016, the interest rate was 2.37%. The note is unsecured.

Aggregate annual maturities of long term debt at December 31, 2016, are:

2017	\$	21,410
2018		21,469
2019		22,281
2020		22,596
2021		23,208
Thereafter		146,394
	\$	257,358

Certain of the Company's term notes require compliance with financial and non-financial covenants, as well as periodic reporting requirements. The Company was in compliance with the covenant and reporting requirements throughout and at December 31, 2016.

Variable-to-Fixed Interest Rate Swap

As a strategy to maintain acceptable levels of exposure to the risk of changes in future cash flows due to interest rate fluctuations, the Company enters into interest rate swap agreements.

On September 15, 2006, the Company entered into an interest rate swap agreement with U.S. Bank National Association. The agreement provides for the Company to receive interest from the counterparty at LIBOR and to pay interest to the counterparty at a fixed rate of 5.51% on notional amounts of \$3,111 and \$3,315 at December 31, 2016 and 2015, respectively. Under the agreement, the Company pays or receives the net interest amount quarterly, with the quarterly settlements included in interest expense. The swap was established to hedge interest rate risk on its floating rate debt obligation (Loan A).

The Company entered into another interest rate swap agreement on March 10, 2014, with Regions Bank. The agreement provides for the Company to receive interest from the counterparty at LIBOR and to pay interest to the counterparty at a fixed rate of 3.225% on a notional amount of \$30,750 at December 31, 2016. Under the agreement, the Company pays or receives the net interest amount monthly, with the monthly settlements included in interest expense. The swap was established to hedge interest rate risk on its floating rate debt obligation (Loan I).

Southwest Power Pool, Inc.
Notes to Financial Statements (in Thousands)
December 31, 2016 and 2015

The table below presents certain information regarding the Company's interest rate swap agreements.

	<u>2016</u>	<u>2015</u>
Fair value of interest rate swap agreements	\$ 2,506	\$ 3,188
Balance sheet location of fair value amounts	Other Long-term Liabilities	Other Long-term Liabilities
Gain/(Loss) recognized in statement of operations	\$ 682	\$ (726)
Location of loss recognized in statement of operations	Change in Fair Market Value of Interest Rate Swaps	Change in Fair Market Value of Interest Rate Swaps

Note 5: Capital Lease Obligation

The Company entered into a capital lease obligation on February 1, 2015, in the amount of \$6,901, to finance data storage equipment. The term of the financing is five years and expires on November 1, 2019. At December 31, 2016 and 2015, accumulated depreciation for equipment purchased under the capital lease was \$3,115 and \$1,490, respectively. Future minimum payments on the capital lease obligation at December 31, 2016, are:

2017	\$ 2,015
2018	2,015
2019	<u>2,015</u>
Total minimum lease payments	6,045
Less: Amount representing interest	<u>372</u>
Present value of minimum lease payments	<u><u>\$ 5,673</u></u>

Note 6: Operating Leases

The Company had noncancellable operating leases for certain office equipment that expired in 2015. The Company incurred lease expense related to these operating leases of \$123 in 2015.

Southwest Power Pool, Inc.
Notes to Financial Statements (in Thousands)
December 31, 2016 and 2015

Note 7: Employee Benefit Plans

Pension and Other Postretirement Benefit Plans

The Company has a noncontributory defined benefit pension plan covering all employees meeting eligibility requirements. The Company's funding policy is to make the minimum annual contribution that is required by applicable regulations, plus such amounts as the Company may determine to be appropriate from time to time. The Company expects to contribute approximately \$5,200 to the plan in 2017.

The Company has a noncontributory defined benefit postretirement health care plan covering eligible retirees, including those retiring between the ages of 55–65 and hired prior to January 1, 1996. Employees hired after June 1, 2006, are not eligible to participate in the noncontributory defined postretirement health care plan.

The Company uses a December 31 measurement date for the plans. Information about the plans' funded status is as follows:

	Pension Benefits		Postretirement Health Care Benefits	
	2016	2015	2016	2015
Benefit obligation	\$ 76,969	\$ 68,088	\$ 9,426	\$ 9,289
Fair value of plan assets	57,739	47,735	-	-
Funded status	<u>\$ (19,230)</u>	<u>\$ (20,353)</u>	<u>\$ (9,426)</u>	<u>\$ (9,289)</u>

Amounts recognized in the balance sheets:

	Pension Benefits		Postretirement Health Care Benefits	
	2016	2015	2016	2015
Noncurrent liabilities	\$ (19,230)	\$ (20,353)	\$ (9,426)	\$ (9,289)

Amounts recognized in members' equity not yet recognized as components of net periodic benefit cost as of December 31, 2016 and 2015, consist of:

	Pension Benefits		Postretirement Health Care Benefits	
	2016	2015	2016	2015
Net loss	\$ 18,681	\$ 21,588	\$ 5,538	\$ 6,599
Prior service credit	(23)	(22)	(1,405)	(1,487)
Transition obligation	66	82	18	22
	<u>\$ 18,724</u>	<u>\$ 21,648</u>	<u>\$ 4,151</u>	<u>\$ 5,134</u>

Southwest Power Pool, Inc.
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The accumulated benefit obligation for the defined benefit pension plan was \$61,476 and \$53,754 at December 31, 2016 and 2015, respectively.

Other significant balances and costs are:

	Pension Benefits		Postretirement Health Care Benefits	
	2016	2015	2016	2015
Employer contributions	\$ 5,380	\$ 3,760	\$ -	\$ -
Benefits paid	713	612	91	90
Benefit costs	7,182	4,488	1,210	1,485

During 2016, the Company transferred \$250 into the investment account holding assets intended to be utilized in providing benefits for eligible retirees.

The following amounts have been recognized in the statements of operations for the years ended December 31, 2016 and 2015:

	Pension Benefits		Postretirement Health Care Benefits	
	2016	2015	2016	2015
Amounts arising during the period				
Net gain (loss)	\$ 2,092	\$ (3,791)	\$ 783	\$ 881
Amounts recognized as benefit components of net periodic cost of the period				
Net loss	985	105	315	275
Net prior service credit	1	1	(83)	-
Net transition obligation	16	16	4	4

The estimated net loss, prior service cost and transition obligation for the defined benefit pension plan that will be amortized from members' equity into net period benefit cost over the next fiscal year are \$785, \$1 and \$16, respectively. The estimated net loss, prior service cost, and net obligation for the defined benefit postretirement health care plan that will be amortized from members' equity into net periodic benefit cost over the next fiscal year are \$255, \$83 and \$4, respectively.

Weighted-average assumptions used to determine benefit obligations and costs:

	Pension Benefits		Postretirement Health Care Benefits	
	2016	2015	2016	2015
Discount rate benefit obligation	5.0%	5.0%	5.0%	5.0%
Expected return on plan assets	7.0%	7.0%	N/A	N/A
Rate of compensation increase	4.0%	4.0%	N/A	N/A

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The Company changed the discount rate and mortality table used in its actuarial calculation of the pension benefit obligation for the defined benefit plan as of December 31, 2015. The decrease in the discount rate and increase in life expectancy assumptions each increased the pension benefit obligation by \$5,570 and \$5,585, respectively as of December 31, 2015. Additionally, the actual return on plan assets was significantly lower than the actuarial assumption. The loss from this difference has been deferred and increased the negative position of the funded status by \$4,630 as of December 31, 2015. Effective October 1, 2015, eligible retirees no longer participate in the Company sponsored medical plan. Eligible retirees are now provided monies through a tax-free health reimbursement account to pay for individual Medicare supplemental health insurance plans or other eligible health care expenses. This change resulted in a decrease to the benefit obligation for the postretirement health care plan of \$1,487 as of December 31, 2015.

The Company has estimated the long term rate of return on plan assets based primarily on historical returns on plan assets, adjusted for changes in target portfolio allocations and recent changes in long-term interest rates based on publicly available information.

For measurement purposes, a 9% annual rate of increase in the per capita cost of covered health care benefits in the next year was assumed for 2016 and 2015. The rate was assumed to decrease gradually to 5% by the year 2021 and remain at that level thereafter.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid as of December 31:

	Pension Benefits	Postretirement Health Care Benefits
2017	\$ 842	\$ 129
2018	1,040	160
2019	1,187	179
2020	1,294	187
2021	1,505	195
2022–2026	13,382	1,881

The Company's investment strategy is based on an expectation that equity securities will outperform fixed income securities over the long term. Accordingly, the composition of the Company's plan assets is broadly characterized as a 70/30 allocation between equity and fixed income securities. The strategy utilizes indexed and actively managed mutual fund instruments as well as direct investment in individual equity and fixed income securities. Investments in the plan must adhere to the Investment Policy Statement developed by the Company. The Investment Policy Statement limits investments in foreign securities to 20% of the total fair value of plan assets. The Investment Policy Statement is reviewed annually.

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At December 31, 2016 and 2015, plan assets by category are as follows:

	Pension Plan Assets	
	2016	2015
Fixed income securities	27%	24%
Equity securities	67	68
Cash and equivalents	6	8
	100%	100%

Pension Plan Assets

Following is a description of the valuation methodologies used for the pension plan assets measured at fair value on a recurring basis and recognized in the accompanying balance sheets, as well as the general classification of the assets pursuant to the valuation hierarchy.

Where quoted market prices are available in an active market, plan assets are classified within Level 1 of the valuation hierarchy. Level 1 plan assets include cash, money market accounts, closed-end mutual funds and common and foreign company stock. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of plan assets with similar characteristics or discounted cash flows. Level 2 plan assets include open-end mutual funds, corporate debt obligations, foreign corporate debt obligations, government securities and foreign government securities.

In certain cases where Level 1 or Level 2 inputs are not available, plan assets are classified within Level 3 of the hierarchy. At December 31, 2016 and 2015, the Company does not hold any plan assets valued using Level 3 inputs.

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The fair values of the Company's pension plan assets at December 31, 2016 and 2015, by asset category are as follows:

	2016			
	Fair Value Measurements Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market mutual funds	\$ 3,518	\$ 3,518	\$ -	\$ -
Mutual funds				
Equity funds	28,500	19,766	8,734	-
Fixed income funds	8,795	5,785	3,010	-
Other funds	1,363	255	1,109	-
	<u>38,658</u>	<u>25,805</u>	<u>12,853</u>	<u>-</u>
Domestic common stock				
Energy	3,456	3,456	-	-
Financials	1,536	1,536	-	-
Healthcare	1,961	1,961	-	-
Other	1,858	1,858	-	-
	<u>8,811</u>	<u>8,811</u>	<u>-</u>	<u>-</u>
Foreign stocks	303	303	-	-
Corporate debt obligations	5,945	-	5,945	-
Foreign government securities	505	-	505	-
	<u>57,739</u>	<u>38,436</u>	<u>19,302</u>	<u>-</u>
Total	<u>\$ 57,739</u>	<u>\$ 38,436</u>	<u>\$ 19,302</u>	<u>\$ -</u>

	2015			
	Fair Value Measurements Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash equivalents	\$ 1	\$ 1	\$ -	\$ -
Money market mutual funds	3,637	3,637	-	-
Mutual funds				
Equity funds	24,088	16,615	7,473	-
Fixed income funds	5,833	4,311	1,522	-
Other Funds	583	-	583	-
	<u>30,504</u>	<u>20,926</u>	<u>9,578</u>	<u>-</u>
Domestic common stock				
Energy	3,573	3,573	-	-
Financials	1,316	1,316	-	-
Healthcare	2,019	2,019	-	-
Other	1,543	1,543	-	-
	<u>8,452</u>	<u>8,452</u>	<u>-</u>	<u>-</u>
Foreign stocks	342	342	-	-
Corporate debt obligations	4,281	-	4,281	-
Foreign government securities	519	-	519	-
	<u>47,735</u>	<u>33,357</u>	<u>14,378</u>	<u>-</u>
Total	<u>\$ 47,735</u>	<u>\$ 33,357</u>	<u>\$ 14,378</u>	<u>\$ -</u>

Southwest Power Pool, Inc.
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Defined Contribution Plans

The Company has a 401(k) defined contribution plan covering substantially all employees. The Company matches contributions at 4.75% for those employees deferring 6% of compensation, with the match fluctuating from 1% to 4.75% for each percentage of compensation contributed under 6%. Contributions to the plan were \$2,600 and \$2,473 for 2016 and 2015, respectively.

The Company has a 457(b) non-qualified tax-deferred compensation plan. This plan is an unfunded plan maintained for the purpose of providing deferred compensation for a select group of management or highly-compensated employees and, therefore, is intended to be exempt from the participation, vesting, funding and fiduciary requirements of Title I of the *Employee Retirement Income Security Act of 1974* (ERISA). Accumulated contributions and earnings of \$1,924 and \$1,557 are recorded in other long-term liabilities at December 31, 2016 and 2015, respectively. The Company also offers a 457(f) non-qualified tax-deferred compensation plan to a select group of executive management. The 457(f) plan was intended to be exempt from the participation, vesting, funding and fiduciary requirements of Title I of ERISA and serves to further supplement benefits lost due to IRS limits on compensation and benefits. There were accrued benefits of \$460 recorded in other long-term liabilities for the 457(f) plan participants at December 31, 2016. At December 31, 2015, there were no active agreements under the current 457(f) plan.

Note 8: Related Party Transactions

General disbursements of the Company are apportioned to members based on the formula described in the bylaws of the Company (see *Note 1*). The Company's receivables from members totaled \$19,661 and \$26,541 as of December 31, 2016 and 2015, respectively. The Company recognized revenues of \$124,652 and \$129,021, including assessments and tariff administrative fees, from members for the years ended December 31, 2016 and 2015, respectively.

The Southwest Power Pool Regional State Committee (RSC) was incorporated on April 7, 2004, in the State of Arkansas. The RSC is comprised of commissioners from public service commissions or equivalent, having regulatory authority over Company members. FERC, in its February 20, 2004, order regarding the Company's RTO application, stated, "the RSC should have primary responsibility for determining regional proposals and the transition process for funding of regional transmission enhancements, rate structure for a regional access charge and allocation of transmission rights." The RSC prepares budgets annually for the expected costs of its operations. This budget is submitted to the Company's board of directors for approval. The Company includes in its annual budget funds sufficient to cover 100% of the operating costs of the RSC. During 2016 and 2015, the Company incurred \$257 and \$233, respectively, in expenses attributable to RSC operations. Management of the Company expects such expenditures for 2017 to be approximately \$322.

Note 9: Open Access Transmission and Market Operations

The Company provides short- and long-term firm and non-firm point-to-point transmission services and network integration transmission service across 43 providers in 14 states. The Company is responsible for the billing of the transmission customers for the respective services and the remittance of the subsequent collections to the transmission owner on a monthly basis. Billings for these transmission services are not included in the statements of operations. The Company receives a fee for facilitating the transmission process, which is recorded as tariff fees in the Company's statements of operations. For the years ended December 31, 2016 and 2015, the Company billed transmission customers \$2,009,809 and \$1,672,796, respectively. For the years ended December 31, 2016 and 2015, the Company remitted to transmission owners \$1,850,198 and \$1,509,656, respectively. At December 31, 2016 and 2015, the Company was due to collect from customers and remit to owners transmission service charges of \$161,852 and \$144,843, respectively.

Southwest Power Pool, Inc.
Notes to Financial Statements (*in Thousands*)
December 31, 2016 and 2015

The Company's Integrated Marketplace includes a day-ahead market with transmission congestion rights, a reliability unit commitment process, a real-time balancing market, an operating reserve market and a consolidated balancing authority. Weekly settlements of market participants' energy transactions are not reflected in the Company's statements of operations since they do not represent revenues or expenses of the Company, as the Company merely acts as an intermediary in the settlement process. In this role, the Company receives and disburses funds to/from market participants on a weekly basis. At December 31, 2016 and 2015, the Company held \$19,694 and \$13,494, respectively, in cash collections from the settlement of auction revenue rights in accordance with terms of the Company's tariff. These funds are disbursed annually in June for collections from the previous twelve months. A corresponding liability is reflected in accrued expenses on the Balance Sheets.

Note 10: Commitments and Contingencies

Litigation and Regulatory Matters

The Company is engaged in various legal and regulatory proceedings at both the federal and state levels. The Company is also subject to claims and lawsuits that arise primarily in the ordinary course of business.

It is the opinion of management that the disposition or ultimate resolution of such proceedings, claims and lawsuits will not have a material adverse effect on the financial position, results of operations and cash flows of the Company.

Note 11: Disclosures About Fair Value of Financial Instruments

ASC Topic 820, *Fair Value Measurements*, defines fair value as 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. Topic 820 also specifies a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

- Level 1** Quoted prices in active markets for identical assets or liabilities
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
- Level 3** Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities

Southwest Power Pool, Inc.
Notes to Financial Statements (*in Thousands*)
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	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2016				
Cash equivalents	\$ 15,073	\$ 15,073	\$ -	\$ -
Mutual funds				
Equity	7,789	-	7,789	-
Fixed income	3,046	-	3,046	-
Interest rate swap agreements	(2,506)	-	(2,506)	-

	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2015				
Cash equivalents	\$ 13,942	\$ 13,942	\$ -	\$ -
Mutual funds				
Equity	6,536	-	6,536	-
Fixed income	2,816	-	2,816	-
Interest rate swap agreements	(3,188)	-	(3,188)	-

Following is a description of the valuation methodologies used for assets and liabilities measured at fair value on a recurring basis and recognized in the accompanying balance sheets, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during the year ended December 31, 2016.

Investments

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing models, the inputs of which are market-based or independently sourced market parameters, including, but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections and cash flows. Such securities are classified in Level 2 of the valuation hierarchy. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy. At December 31, 2016 and 2015, the Company does not hold any assets valued using Level 3 inputs.

Interest Rate Swap Agreements

The fair value is estimated using forward-looking interest rate curves and discounted cash flows that are observable or that can be corroborated by observable market data and, therefore, are classified within Level 2 of the valuation hierarchy.

Southwest Power Pool, Inc.
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Cash Equivalents

The fair value of money market mutual funds included in cash equivalents is estimated using quoted prices in active markets for identical assets or liabilities and, therefore, is classified within Level 1 of the valuation hierarchy.

The Company has no assets or liabilities measured and recognized in the accompanying balance sheets on a nonrecurring basis.

The following methods were used to estimate the fair value of all other financial instruments recognized in the accompanying balance sheets at amounts other than fair value.

Restricted Cash Deposits

For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

Customer Deposits

The carrying amount is a reasonable estimate of fair value.

Long-term Debt and Capital Lease Obligations

Fair value is estimated based on the borrowing rates currently available to the Company for bank loans with similar terms and maturities.

The following table presents estimated fair values of the Company's financial instruments at December 31, 2016 and 2015:

	2016		2015	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	\$ 75,715	\$ 75,715	\$ 42,003	\$ 42,003
Restricted cash deposits	\$ 223,964	\$ 223,964	\$ 196,918	\$ 196,918
Investments	\$ 10,835	\$ 10,835	\$ 9,352	\$ 9,352
Financial liabilities				
Customer deposits	\$ 223,964	\$ 223,964	\$ 196,918	\$ 196,918
Capital lease obligations	\$ 5,673	\$ 5,791	\$ 6,265	\$ 6,400
Long-term debt	\$ 257,358	\$ 256,665	\$ 247,961	\$ 247,531
Swap agreements	\$ 2,506	\$ 2,506	\$ 3,188	\$ 3,188

Note 12: Subsequent Events

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