

Southwest Power Pool, Inc.

Independent Auditor's Report and Financial Statements

December 31, 2015 and 2014



Southwest Power Pool, Inc.
December 31, 2015 and 2014

Contents

Independent Auditor's Report.....	1
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Financial Statements

Balance Sheets.....	3
Statements of Operations.....	4
Statements of Members' Deficit.....	5
Statements of Cash Flows	6
Notes to Financial Statements	7

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, 2015 and 2014, 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
Southwest Power Pool, Inc.
Page 2

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, 2015 and 2014, 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 11, 2016

Southwest Power Pool, Inc.

Balance Sheets

(in Thousands)

December 31, 2015 and 2014

Assets

	2015	2014
Current Assets		
Cash and cash equivalents	\$ 42,003	\$ 57,534
Restricted cash deposits	196,918	222,285
Accounts receivable, net	39,790	41,826
Prepaid expenses and other	8,420	7,204
Total current assets	287,131	328,849
Property and Equipment, at Cost		
Land	4,812	4,812
Building	66,615	66,354
Furniture and fixtures	10,208	10,016
Equipment and machinery	49,549	44,822
Software	167,876	206,237
Software in development	3,396	12,458
Equipment under capital lease	4,876	-
	307,332	344,699
Less accumulated depreciation and amortization	170,852	167,818
	136,480	176,881
Investments (Note 2)	9,352	10,099
Other Assets, Net	6,051	5,184
	\$ 439,014	\$ 521,013

See Notes to Financial Statements

IESO-N-0057521

Liabilities and Members' Deficit

	2015	2014
Current Liabilities		
Line of credit	\$ 2,000	\$ -
Accounts payable	30,609	31,417
Customer deposits	196,918	222,285
Current maturities of long-term debt (<i>Note 4</i>)	21,353	24,299
Current maturities of obligations under capital lease (<i>Note 5</i>)	591	-
Accrued expenses	44,092	57,943
Deferred revenue	5,318	5,895
Total current liabilities	300,881	341,839
Long-term Debt (<i>Note 4</i>)	226,608	247,961
Obligation Under Capital Lease (<i>Note 5</i>)	5,674	-
Other Long-term Liabilities	35,267	18,159
Members' Deficit	(129,416)	(86,946)
	\$ 439,014	\$ 521,013

Southwest Power Pool, Inc.
Statements of Operations
(in Thousands)
Years Ended December 31, 2015 and 2014

	2015	2014
Operating Income		
Tariff fees and member assessments	\$ 171,717	\$ 158,735
Other member services	7,016	4,802
	<u>178,733</u>	<u>163,537</u>
Operating Expenses		
Salaries and benefits	84,043	85,575
Employee travel	1,903	1,924
Administrative	4,928	4,399
Regulatory assessment	13,939	16,323
Meetings	825	833
Communications system	3,758	3,745
Leases	123	180
Maintenance	13,553	15,149
Consulting services	12,528	16,319
Depreciation and amortization	59,285	51,046
	<u>194,885</u>	<u>195,493</u>
Operating Loss	<u>(16,152)</u>	<u>(31,956)</u>
Other Income (Expense)		
Investment income	1,768	459
Interest expense	(10,522)	(12,554)
Change in fair market value of interest rate swaps	(726)	(1,528)
Other income (expense)	(1,097)	75
	<u>(10,577)</u>	<u>(13,548)</u>
Loss Before Unrealized Gain (Loss) and Change in Funded Status of Employee Benefit Plans	(26,729)	(45,504)
Unrealized Gain (Loss) on Investments	(2,011)	251
Change in Funded Status of Employee Benefit Plans	<u>(13,730)</u>	<u>(797)</u>
Net Loss	<u><u>\$ (42,470)</u></u>	<u><u>\$ (46,050)</u></u>

Southwest Power Pool, Inc.
Statements of Members' Deficit
(in Thousands)
Years Ended December 31, 2015 and 2014

	<u>2015</u>	<u>2014</u>
Balance, Beginning of Year	\$ (86,946)	\$ (40,896)
Net loss	<u>(42,470)</u>	<u>(46,050)</u>
Balance, End of Year	<u><u>\$ (129,416)</u></u>	<u><u>\$ (86,946)</u></u>

Southwest Power Pool, Inc.
Statements of Cash Flows
(in Thousands)
Years Ended December 31, 2015 and 2014

	2015	2014
Operating Activities		
Net loss	\$ (42,470)	\$ (46,050)
Items not requiring cash		
Depreciation and amortization	59,285	51,046
Change in funded status of employee benefit plans	13,730	797
Unrealized loss (gain) on investments	2,011	(251)
Realized gain on investments	(1,576)	-
Loss (gain) on disposal of fixed assets	5	(23)
Impairment loss	349	-
Change in fair market value of interest rate swaps	726	1,528
Changes in assets and liabilities		
Accounts receivable	2,036	(17,692)
Prepaid expenses and other	809	(227)
Other assets	(962)	(2,472)
Accounts payable	(808)	15,464
Accrued expenses	(14,428)	28,880
Other long-term liabilities	2,652	1,414
Net cash provided by operating activities	<u>21,359</u>	<u>32,414</u>
Investing Activities		
Acquisition of property and equipment	(14,267)	(23,554)
Purchase of investments	(9,764)	(590)
Proceeds from sale of investments	10,076	-
Net cash used in investing activities	<u>(13,955)</u>	<u>(24,144)</u>
Financing Activities		
Repayments of long-term debt	(24,299)	(22,998)
Repayments of capital lease obligation	(636)	-
Repayment of borrowings under line of credit	(9,000)	-
Borrowings under line of credit	11,000	-
Issuance of long-term debt	-	37,000
Net cash provided by (used in) financing activities	<u>(22,935)</u>	<u>14,002</u>
Increase (Decrease) in Cash and Cash Equivalents	<u>(15,531)</u>	<u>22,272</u>
Cash and Cash Equivalents, Beginning of Year	<u>57,534</u>	<u>35,262</u>
Cash and Cash Equivalents, End of Year	<u><u>\$ 42,003</u></u>	<u><u>\$ 57,534</u></u>
Supplemental Cash Flows Information		
Interest paid on long-term debt (net of interest capitalized of \$102 and \$363 in 2015 and 2014, respectively)	\$ 10,326	\$ 10,576
Assets purchased under capital lease obligations	\$ 4,876	\$ -
Property and equipment purchases in accounts payable and accrued liabilities	\$ 1,548	\$ 2,788

Southwest Power Pool, Inc.

Notes to Financial Statements

(in Thousands)

December 31, 2015 and 2014

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. Effective March 1, 2014, the energy imbalance service (EIS) market was replaced with Integrated Marketplace which includes 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, 2015 and 2014, 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.

Southwest Power Pool, Inc.

Notes to Financial Statements

(in Thousands)

December 31, 2015 and 2014

Investments

The Company's investments include domestic and foreign issued stock and 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.

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.

The Company files tax returns in the U.S. federal jurisdiction. With a few exceptions, the Company is no longer subject to U.S. federal examinations by tax authorities for years before 2012.

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, 2015, the Company had recorded \$822 as an allowance for doubtful accounts. No allowance was recorded for 2014.

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 \$102 and \$363 in 2015 and 2014, respectively.

Southwest Power Pool, Inc.

Notes to Financial Statements

(in Thousands)

December 31, 2015 and 2014

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 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 written off in 2015. The amount was recorded as an impairment loss in the accompanying Statements of Operations and is included in other income (expense).

No asset impairment was recognized during the year ended December 31, 2014.

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.

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 tariff to cover the expenses related to the administration of the tariff. The charge is calculated in accordance with the terms of the Company's Open Access Transmission 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.

Southwest Power Pool, Inc.

Notes to Financial Statements

(in Thousands)

December 31, 2015 and 2014

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 2015 and 2014, 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 and transmission owners 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.

Concentration of Credit Risk

The Company is exposed to credit risk primarily through accounts receivable and uninsured cash balances. During 2015 and 2014, 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, 2015 and 2014, 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.

Southwest Power Pool, Inc.

Notes to Financial Statements

(in Thousands)

December 31, 2015 and 2014

The Company considers its accounts receivable to be highly probable of collection. At December 31, 2015, the Company had recorded \$822 as an allowance for doubtful accounts. No allowance was recorded for 2014.

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 counterparty, the Company requires the posting of defined financial security instruments to cover potential liabilities.

Note 2: Investment and Investment Returns

Investments at December 31 consisted of the following:

	2015	2014
Mutual Funds		
Equity	\$ 6,536	\$ 3,186
Fixed income	2,816	2,732
Financials	-	610
Alternative assets	-	271
Total mutual funds	9,352	6,799
Domestic Common Stock		
Consumer discretionary	-	417
Consumer staples	-	393
Energy	-	229
Financial	-	452
Health care	-	456
Industrials	-	404
Information technology	-	574
Materials	-	172
Telecommunication	-	37
Utilities	-	125
Total common stock	-	3,259
Foreign Stocks		
Industrials	-	41
	<u>\$ 9,352</u>	<u>\$ 10,099</u>

Southwest Power Pool, Inc.
Notes to Financial Statements
(in Thousands)
December 31, 2015 and 2014

Total investment return is comprised of the following:

	2015	2014
Interest and dividends reported at fair value	\$ 192	\$ 242
Net realized and unrealized gains (losses) on investments reported at fair value	<u>(435)</u>	<u>468</u>
	<u>\$ (243)</u>	<u>\$ 710</u>

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

Note 3: Line of Credit

The Company has a \$30,000 revolving line of credit expiring in 2016. At December 31, 2015, \$2,000 was borrowed against this line. No amounts were borrowed against this line at December 31, 2014. The agreement has 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, 2015.

Southwest Power Pool, Inc.

Notes to Financial Statements

(in Thousands)

December 31, 2015 and 2014

Note 4: Long-term Debt and Interest Rate Swaps

Long-term Debt

	2015	2014
Variable Rate Term Note due 2027 (A)	\$ 3,341	\$ 3,547
5.45% Senior Notes due 2016 (B)	3,000	9,000
4.82% Series 2010-A Senior Notes due 2042 (C)	28,555	29,060
4.82% Series 2010-B Senior Notes due 2042 (D)	33,315	33,903
3.55% Series 2010-C Senior Notes due 2024 (E)	57,750	64,750
3.00% Series 2012-D-1 Senior Notes due 2024 (F)	41,250	46,250
3.25% Series 2012-D-2 Senior Notes due 2024 (G)	43,750	48,750
3.80% Series 2014-E Senior Notes due 2025 (H)	37,000	37,000
	<u>247,961</u>	<u>272,260</u>
Less current maturities	<u>21,353</u>	<u>24,299</u>
	<u>\$ 226,608</u>	<u>\$ 247,961</u>

- (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 monthly based on LIBOR plus 0.85%. At December 31, 2015 and 2014, the interest rate was 1.28% and 1.02%, 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 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.
- (E) Due March 30, 2024; principal and interest are payable quarterly based on 13-year amortization. Principal payments commenced on June 30, 2014. The interest rate is fixed at 3.55%. The note is unsecured.

Southwest Power Pool, Inc.

Notes to Financial Statements

(in Thousands)

December 31, 2015 and 2014

- (F) Due March 30, 2024; principal and interest are payable quarterly based on 10-year amortization. Principal payments commenced on June 30, 2014. The interest rate is fixed at 3.00%. The note is unsecured.
- (G) Due September 30, 2024; principal and interest are payable quarterly based on 10-year amortization. Principal payments commenced on December 30, 2014. The interest rate is fixed at 3.25%. The note is unsecured.
- (H) 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.

Aggregate annual maturities of long term debt at December 31, 2015, are:

2016	\$	21,353
2017		18,410
2018		18,469
2019		18,531
2020		18,596
Thereafter		<u>152,602</u>
	\$	<u>247,961</u>

On March 10, 2014, the Company obtained a \$33,000 senior unsecured term note facility. This facility remains undrawn at December 31, 2015, but allows the Company to obtain advances as needed during a two year draw period, after which it will convert into an amortizing term loan with escalating principal payments through 2024. Interest will be payable monthly at LIBOR plus 1.75%.

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, 2015.

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 \$3,315 and \$3,519 at December 31, 2015 and 2014, 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).

Southwest Power Pool, Inc.

Notes to Financial Statements

(in Thousands)

December 31, 2015 and 2014

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 \$33,000. Under the agreement, the Company pays or receives the net interest amount monthly, commencing on March 30, 2016, with the monthly settlements included in interest expense. The swap was established to hedge interest rate risk on its floating rate debt obligation associated with the \$33,000 note that remained undrawn at December 31, 2015.

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

	2015	2014
Fair value of interest rate swap agreements	\$ 3,188	\$ 2,462
Balance sheet location of fair value amounts	Other Long-term Liabilities	Other Long-term Liabilities
Loss recognized in statement of operations	\$ (726)	\$ (1,528)
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, to finance data storage equipment. The term of the financing is five years and expires on November 1, 2019. At December 31, 2015, accumulated depreciation for equipment purchased under the capital lease was \$1,490. Future minimum payments on the capital lease obligation at December 31, 2015, are:

2016	\$ 830
2017	2,015
2018	2,015
2019	2,015
Total minimum lease payments	6,875
Less: Amount representing interest	610
Present value of minimum lease payments	<u>\$ 6,265</u>

Southwest Power Pool, Inc.

Notes to Financial Statements

(in Thousands)

December 31, 2015 and 2014

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 and \$180 in 2015 and 2014, respectively.

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 \$5,400 to the plan in 2016.

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 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	
	2015	2014	2015	2014
Benefit obligation	\$ 68,088	\$ 50,702	\$ 9,289	\$ 8,900
Fair value of plan assets	<u>47,735</u>	<u>45,903</u>	<u>-</u>	<u>-</u>
Funded status	<u>\$ (20,353)</u>	<u>\$ (4,799)</u>	<u>\$ (9,289)</u>	<u>\$ (8,900)</u>

Southwest Power Pool, Inc.
Notes to Financial Statements
(in Thousands)
December 31, 2015 and 2014

Amounts recognized in the balance sheets:

	Pension Benefits		Postretirement Health Care Benefits	
	2015	2014	2015	2014
Noncurrent assets	\$ -	\$ -	\$ -	\$ -
Noncurrent liabilities	(20,353)	(4,799)	(9,289)	(8,900)
	<u>\$ (20,353)</u>	<u>\$ (4,799)</u>	<u>\$ (9,289)</u>	<u>\$ (8,900)</u>

Amounts recognized in members' equity not yet recognized as components of net periodic benefit cost as of December 31, 2015 and 2014, consist of:

	Pension Benefits		Postretirement Health Care Benefits	
	2015	2014	2015	2014
Net loss	\$ 21,588	\$ 6,746	\$ 6,599	\$ 6,113
Prior service credit	(22)	(22)	(1,487)	-
Transition obligation	82	99	22	26
	<u>\$ 21,648</u>	<u>\$ 6,823</u>	<u>\$ 5,134</u>	<u>\$ 6,139</u>

The accumulated benefit obligation for the defined benefit pension plan was \$53,754 and \$40,001 at December 31, 2015 and 2014, respectively.

Other significant balances and costs are:

	Pension Benefits		Postretirement Health Care Benefits	
	2015	2014	2015	2014
Employer contributions	\$ 3,760	\$ 3,660	\$ -	\$ 441
Benefits paid	612	433	90	83
Benefit costs	4,488	4,199	1,485	1,435

Contributions to the postretirement health care plan represent funding to the agency account holding assets intended to be utilized in providing benefits for eligible retirees.

Southwest Power Pool, Inc.

Notes to Financial Statements

(in Thousands)

December 31, 2015 and 2014

The following amounts have been recognized in the statements of operations for the years ended December 31, 2015 and 2014:

	Pension Benefits		Postretirement Health Care Benefits	
	2015	2014	2015	2014
Amounts arising during the period				
Net gain (loss)	\$ (3,791)	\$ (1,403)	\$ 881	\$ 143
Amounts recognized as benefit components of net periodic cost of the period				
Net loss	105	58	275	303
Net prior service credit	1	1	-	-
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 \$985, \$1 and \$16, respectively. The estimated net gain, 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 \$315, \$83 and \$4, respectively.

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

	Pension Benefits		Postretirement Health Care Benefits	
	2015	2014	2015	2014
Discount rate benefit obligation	5.0%	5.5%	5.0%	5.5%
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

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. 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 funded status by \$4,630. 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 supplement 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.

Southwest Power Pool, Inc.

Notes to Financial Statements

(in Thousands)

December 31, 2015 and 2014

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% and 10% annual rate of increase in the per capita cost of covered health care benefits in the next year was assumed for 2015 and 2014, respectively. The rate was assumed to decrease gradually to 5% by the year 2020 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
2016	\$ 720	\$ 105
2017	852	141
2018	1,041	183
2019	1,211	219
2020	1,341	243
2021–2025	11,741	1,860

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.

Southwest Power Pool, Inc.
Notes to Financial Statements
(in Thousands)
December 31, 2015 and 2014

At December 31, 2015 and 2014, plan assets by category are as follows:

	Pension Plan Assets	
	2015	2014
Fixed income securities	24%	23%
Equity securities	68	72
Cash and equivalents	8	5
	<u>100%</u>	<u>100%</u>

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, 2015 and 2014, the Company does not hold any plan assets valued using Level 3 inputs.

Southwest Power Pool, Inc.

Notes to Financial Statements

(in Thousands)

December 31, 2015 and 2014

The fair values of the Company's pension plan assets at December 31, 2015 and 2014, by asset category are as follows:

		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				
Alternative assets	583	-	583	-
Equity funds	24,088	16,615	7,473	-
Fixed income funds	5,833	4,311	1,522	-
	<u>30,504</u>	<u>20,926</u>	<u>9,578</u>	<u>-</u>
Domestic common stock				
Consumer discretionary	62	62	-	-
Energy	3,573	3,573	-	-
Financials	1,316	1,316	-	-
Healthcare	2,019	2,019	-	-
Industrials	450	450	-	-
Materials	416	416	-	-
Telecommunication services	616	616	-	-
	<u>8,452</u>	<u>8,452</u>	<u>-</u>	<u>-</u>
Foreign stocks				
Energy	148	148	-	-
Materials	193	193	-	-
	<u>342</u>	<u>342</u>	<u>-</u>	<u>-</u>
Corporate debt obligations	4,281	-	4,281	-
Foreign government securities	519	-	519	-
Total	<u>\$ 47,735</u>	<u>\$ 33,357</u>	<u>\$ 14,378</u>	<u>\$ -</u>

Southwest Power Pool, Inc.

Notes to Financial Statements

(in Thousands)

December 31, 2015 and 2014

	2014			
	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	2,356	2,356	-	-
Mutual funds				
Alternative assets	596	-	596	-
Equity funds	23,118	16,029	7,089	-
Fixed income funds	3,584	2,069	1,515	-
	<u>27,298</u>	<u>18,098</u>	<u>9,200</u>	<u>-</u>
Domestic common stock				
Consumer discretionary	68	68	-	-
Energy	4,269	4,269	-	-
Financials	1,376	1,376	-	-
Healthcare	2,068	2,068	-	-
Industrials	432	432	-	-
Materials	624	624	-	-
Telecommunication services	613	613	-	-
	<u>9,450</u>	<u>9,450</u>	<u>-</u>	<u>-</u>
Foreign stocks				
Energy	407	407	-	-
Materials	285	285	-	-
	<u>692</u>	<u>692</u>	<u>-</u>	<u>-</u>
Corporate debt obligations	4,734	-	4,734	-
Foreign debt obligations	774	-	774	-
Foreign government securities	598	-	598	-
Total	<u>\$ 45,903</u>	<u>\$ 30,597</u>	<u>\$ 15,306</u>	<u>\$ -</u>

Southwest Power Pool, Inc.

Notes to Financial Statements

(in Thousands)

December 31, 2015 and 2014

Defined Contribution Plans

The Company has a 401(k) defined contribution plan covering substantially all employees. The Company contributes funds to the plan on behalf of plan participants equal to 75% of the participants' elective deferrals up to 6% of deferred compensation. Contributions to the plan were \$2,473 and \$2,466 for 2015 and 2014, 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 \$1,557 and \$1,584 are recorded in other long-term liabilities at December 31, 2015 and 2014, 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. 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 \$26,541 and \$31,590 as of December 31, 2015 and 2014, respectively. The Company recognized revenues of \$161,949 and \$149,170, including assessments and tariff administrative fees, from members for the years ended December 31, 2015 and 2014, 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 2015 and 2014, the Company incurred \$233 and \$248, respectively, in expenses attributable to RSC operations. Management of the Company expects such expenditures for 2016 to be approximately \$313.

Southwest Power Pool, Inc.

Notes to Financial Statements

(in Thousands)

December 31, 2015 and 2014

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, 2015 and 2014, the Company billed transmission customers \$1,672,796 and \$1,505,561, respectively. For the years ended December 31, 2015 and 2014, the Company remitted to transmission owners \$1,509,656 and \$1,358,434, respectively. At December 31, 2015 and 2014, the Company was due to collect from customers and remit to owners transmission service charges of \$144,843 and \$110,019, respectively.

In March 2014, the Company launched the Integrated Marketplace, which includes a day-ahead market with transmission congestion rights, a reliability unit commitment process, a real-time balancing market replacing the EIS 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, 2015 and 2014, the Company held \$13,494 and \$28,102, 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.

Southwest Power Pool, Inc.

Notes to Financial Statements

(in Thousands)

December 31, 2015 and 2014

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

	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)	-

Southwest Power Pool, Inc.

Notes to Financial Statements

(in Thousands)

December 31, 2015 and 2014

	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)
December 31, 2014				
Cash equivalents	\$ 11,241	\$ 11,241	\$ -	\$ -
Mutual funds				
Equity	3,186	1,075	2,111	-
Fixed income	2,732	332	2,400	-
Financials	610	-	610	-
Alternative assets	271	271	-	-
Domestic common stock				
Consumer discretionary	417	417	-	-
Consumer staples	393	393	-	-
Energy	229	229	-	-
Financial	452	452	-	-
Healthcare	456	456	-	-
Industrials	404	404	-	-
Information technology	574	574	-	-
Materials	172	172	-	-
Telecommunication	37	37	-	-
Utilities	125	125	-	-
Foreign stocks				
Industrials	41	41	-	-
Interest rate swap agreements	(2,462)	-	(2,462)	-

Southwest Power Pool, Inc.

Notes to Financial Statements

(in Thousands)

December 31, 2015 and 2014

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, 2015.

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, 2015 and 2014, 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.

Cash Equivalents

The fair value of money market mutual funds included in cash equivalents are estimated using quoted prices in active markets for identical assets or liabilities and, therefore, are 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.

Southwest Power Pool, Inc.
Notes to Financial Statements
(in Thousands)
December 31, 2015 and 2014

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, 2015 and 2014:

	2015		2014	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	\$ 42,003	\$ 42,003	\$ 57,534	\$ 57,534
Restricted cash deposits	\$ 196,918	\$ 196,918	\$ 222,285	\$ 222,285
Investments	\$ 9,352	\$ 9,352	\$ 10,099	\$ 10,099
Financial liabilities				
Customer deposits	\$ 196,918	\$ 196,918	\$ 222,285	\$ 222,285
Capital lease obligations	\$ 6,265	\$ 6,400	\$ -	\$ -
Long-term debt	\$ 247,961	\$ 247,531	\$ 272,260	\$ 274,271
Swap agreements	\$ 3,188	\$ 3,188	\$ 2,462	\$ 2,462

Note 12: Subsequent Events

On March 30, 2016, the Company drew \$33,000 from its senior term note. Principal amounts are payable quarterly and commence on June 30, 2016. Interest is payable monthly based on LIBOR plus 1.75%. The maturity date is March 30, 2024. The note is unsecured.

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.