Black Hills Power, Inc.
South Dakota
Revenue Requirement Model Description

## Section A

**20:10:13:51. Statement A -- Balance Sheet.** Statement A shall include balance sheets in the form prescribed in the FERC's uniform systems of accounts for public utilities and licensees or for gas companies, 18 C.F.R. 101 (April 1, 1985), and in any other form if ordered by the commission. They shall be as of the beginning and end of the test period and the most recently available balance sheet containing any applicable footnotes.

**Source:** 2 SDR 90, effective July 7, 1976; 12 SDR 86, effective November 24, 1985; 12 SDR 151, 12 SDR 155, effective July 1, 1986.

**General Authority:** SDCL 49-34A-4.

**Law Implemented:** SDCL 49-34A-7, 49-34A-10, 49-34A-12, 49-34A-41.

**BLACK HILLS POWER, INC.**
**ASSETS AND OTHER DEBITS**
**For the Test Year Ended September 30, 2013**



| Line No. | Description | FERC Acct. # | (a) September 30, 2013 (Test Year) | (b) As of September 30, 2012 |
|---|---|---|---|---|
| 1 | Utility Plant | | | |
| 2 | Electric Plant in Service | 101 | $ 986,835,716 | $ 961,000,020 |
| 3 | Completed Construction Not Classified | 106 | 6,475,284 | 14,722,625 |
| 4 | Construction Work in Progress | 107 | 57,271,302 | 8,488,508 |
| 5 | Other-Utility Property | 118 | 25,337,135 | 25,113,061 |
| 6 | | | | |
| 7 | Gross Utility Plant | | 1,075,919,437 | 1,009,324,214 |
| 8 | Accum. Prov. for Depreciation | 108 | (349,622,677) | (332,092,226) |
| 9 | Elec. Plant Acquisition Adjustment | 114 | 4,870,308 | 4,870,308 |
| 10 | Accum. Prov. for Amort. of Acq. Adj. | 115 | (3,204,984) | (3,107,577) |
| 11 | Res. for Depr. Other Utility Property | 119 | (16,648,968) | (17,470,510) |
| 12 | Total Utility Plant | | 711,313,116 | 661,524,209 |
| 13 | | | | |
| 14 | Non-Utility Property | 121 | - | 5,618 |
| 15 | Res. for Depr Non-Utility Property | 122 | - | (3,956) |
| 16 | Net Non-Utility Property | | - | 1,662 |
| 17 | L/T Notes Receivable | 124 | 38,897 | 51,607 |
| 18 | Other Investments | 128 | 4,402,979 | 4,331,235 |
| 19 | Total Other Property & Investments | | 4,441,876 | 4,384,504 |
| 20 | | | | |
| 21 | Current and Accrued Assets | | | |
| 22 | Cash | 131 | 3,747,159 | 2,694,924 |
| 23 | Working Funds | 135 | 4,175 | 4,175 |
| 24 | Notes and Accts. Receivables - Net | 141-145; 173 | 242,310,400 | 41,765,245 |
| 25 | Accts. Rec. Assoc. Company | 146 | 4,989,118 | 5,196,864 |
| 26 | Fuel Stocks | 151 | 5,838,257 | 6,400,519 |
| 27 | Materials and Supplies | 154-163 | 15,268,105 | 14,729,394 |
| 28 | Prepayments | 165 | 3,826,507 | 2,812,158 |
| 29 | Other Current Assets | 176 | - | - |
| 30 | Short Term Def. Tax | 190 | 4,421,996 | 1,612,963 |
| 31 | Total Current & Accrued Assets | | 280,405,717 | 75,216,242 |
| 32 | | | | |
| 33 | Deferred Debits | | | |
| 34 | Unamortized Debt Expense | 181 | 2,844,868 | 2,969,056 |
| 35 | Preliminary Survey | 183 | 2,889,284 | 653,168 |
| 36 | Miscellaneous Debits | 184, 186 | 1,014,731 | 2,028,656 |
| 37 | Other Regulatory Assets | 182 | 52,025,724 | 51,540,185 |
| 38 | Unamortized Loss on Required Debt | 189 | 2,317,825 | 2,561,452 |
| 39 | Deferred Income Tax | 190 | 22,247,226 | 44,104,165 |
| 40 | Total Deferred Debits | | 83,339,658 | 103,856,682 |
| 41 | | | | |
| 42 | Total Assets and Other Debits | | $ 1,079,500,367 | $ 844,981,637 |
| 43 | | | | |

44 Note: The September 2013 FERC Form 3Q, Quarterly Financial Report including footnotes, was filed with the
45 Federal Energy Regulatory Commission and is the most recently filed financial statement prescribed in the
46 FERC's uniform system of accounts. Black Hills Power 10Q as of September 30, 2013, prepared on a
47 Generally Accepted Accounting Principle basis, was filed with the Securities and Exchange Commission in
48 November 2013. Both filings are publicly available.

BLACK HILLS POWER, INC.
LIABILITIES AND OTHER CREDITS
For the Test Year Ended September 30, 2013



| Line No. | Description | FERC Acct. # | (a) September 30, 2013 (Test Year) | (b) As of September 30, 2012 |
|---|---|---|---|---|
| 1 | Proprietary Capital | | | |
| 2 | Common Stock Issued | 201 | $ 23,416,396 | $ 23,416,396 |
| 3 | Premium on Capital stock | 207 | 42,076,811 | 42,076,811 |
| 4 | Capital Stock Expense | 214 | (2,501,882) | (2,501,882) |
| 5 | Unapprop. Retained Earnings | 216 | 271,419,376 | 251,729,059 |
| 6 | Other Comprehensive Income | 219 | (1,356,399) | (1,258,759) |
| 7 | Total Proprietary Capital | | 333,054,302 | 313,461,625 |
| 8 | | | | |
| 9 | Long Term Debt | | | |
| 10 | Bonds | 221 | 255,000,000 | 255,000,000 |
| 11 | Other Long Term Debt | 224 | 15,055,000 | 15,055,000 |
| 12 | Unamort. Discount on Long Term Debt | 226 | (107,985) | 12,075 |
| 13 | Total Long Term Debt | | 269,947,015 | 270,067,075 |
| 14 | | | | |
| 15 | Current & Accrued Liability | | | |
| 16 | Accounts Payable | 228, 229, 232 | 22,406,136 | 9,359,189 |
| 16a | Notes Payable Associated Company | 233 | 192,564,778 | |
| 17 | Accts. Payable Associated Company | 234 | 16,998,582 | 15,438,012 |
| 18 | Customer Deposits | 235 | 948,645 | 948,940 |
| 19 | Taxes Accrued | 236 | 4,303,933 | 3,954,713 |
| 20 | Interest Accrued | 237 | 5,642,152 | 5,671,665 |
| 21 | Tax Collections Payable | 241 | 784,600 | 707,266 |
| 22 | Misc. Current & Accrued Liab. | 242 | 4,581,177 | 5,213,849 |
| 23 | Total Current & Accrued Liability | | 248,230,003 | 41,293,634 |
| 24 | | | | |
| 25 | Deferred Credits | | | |
| 26 | Customer Advance for Construction | 252 | 1,193,758 | 1,482,978 |
| 27 | Other Deferred Credits | 253 | 27,334,204 | 27,191,137 |
| 28 | Acc. Deferred Inv. Tax Credits | 254-255 | 18,660,731 | 16,614,595 |
| 29 | Acc. Deferred Income Taxes - Property | 282 | 161,337,807 | 155,776,454 |
| 30 | Acc. Deferred Income Taxes - Other | 283 | 19,742,547 | 19,094,139 |
| 31 | Total Deferred Credits | | 228,269,047 | 220,159,303 |
| 32 | | | | |
| 33 | Total Liabilities & Other Credits | | $ 1,079,500,367 | $ 844,981,637 |
| 34 | | | | |

35 Note: The September 2013 FERC Form 3Q, Quarterly Financial Report including footnotes, was filed with
36 the Federal Energy Regulatory Commission and is the most recently filed financial statement prescribed in
37 the FERC's uniform system of accounts. Black Hills Power 10Q as of September 30, 2013, prepared on a
38 Generally Accepted Accounting Principle basis, was filed with the Securities and Exchange Commission in
39 November 2013. Both filings are publicly available.

| Name of Respondent | This Report Is: | Date of Report | Year/Period of Report |
|---|---|---|---|
| Black Hills Power, Inc. | (1) [X] An Original<br>(2) [ ] A Resubmission | / / | End of 2013/Q3 |

NOTES TO FINANCIAL STATEMENTS

1. Use the space below for important notes regarding the Balance Sheet, Statement of Income for the year, Statement of Retained Earnings for the year, and Statement of Cash Flows, or any account thereof. Classify the notes according to each basic statement, providing a subheading for each statement except where a note is applicable to more than one statement.
2. Furnish particulars (details) as to any significant contingent assets or liabilities existing at end of year, including a brief explanation of any action initiated by the Internal Revenue Service involving possible assessment of additional income taxes of material amount, or of a claim for refund of income taxes of a material amount initiated by the utility. Give also a brief explanation of any dividends in arrears on cumulative preferred stock.
3. For Account 116, Utility Plant Adjustments, explain the origin of such amount, debits and credits during the year, and plan of disposition contemplated, giving references to Commission orders or other authorizations respecting classification of amounts as plant adjustments and requirements as to disposition thereof.
4. Where Accounts 189, Unamortized Loss on Reacquired Debt, and 257, Unamortized Gain on Reacquired Debt, are not used, give an explanation, providing the rate treatment given these items. See General Instruction 17 of the Uniform System of Accounts.
5. Give a concise explanation of any retained earnings restrictions and state the amount of retained earnings affected by such restrictions.
6. If the notes to financial statements relating to the respondent company appearing in the annual report to the stockholders are applicable and furnish the data required by instructions above and on pages 114-121, such notes may be included herein.
7. For the 3Q disclosures, respondent must provide in the notes sufficient disclosures so as to make the interim information not misleading. Disclosures which would substantially duplicate the disclosures contained in the most recent FERC Annual Report may be omitted.
8. For the 3Q disclosures, the disclosures shall be provided where events subsequent to the end of the most recent year have occurred which have a material effect on the respondent. Respondent must include in the notes significant changes since the most recently completed year in such items as: accounting principles and practices; estimates inherent in the preparation of the financial statements; status of long-term contracts; capitalization including significant new borrowings or modifications of existing financing agreements; and changes resulting from business combinations or dispositions. However were material contingencies exist, the disclosure of such matters shall be provided even though a significant change since year end may not have occurred.
9. Finally, if the notes to the financial statements relating to the respondent appearing in the annual report to the stockholders are applicable and furnish the data required by the above instructions, such notes may be included herein.

PAGE 122 INTENTIONALLY LEFT BLANK
SEE PAGE 123 FOR REQUIRED INFORMATION.

| Name of Respondent | This Report is: | Date of Report (Mo, Da, Yr) | Year/Period of Report |
|---|---|---|---|
| Black Hills Power, Inc. | (1) X An Original<br>(2) _ A Resubmission | / / | 2013/Q3 |

NOTES TO FINANCIAL STATEMENTS (Continued)

There have been no significant changes to the footnotes included in the Form-1 dated December 31, 2012

| Name of Respondent | This Report Is: | Date of Report | Year/Period of Report |
| --- | --- | --- | --- |
| Black Hills Power, Inc. | (1) [X] An Original<br>(2) [ ] A Resubmission | / / | End of 2012/Q4 |

## NOTES TO FINANCIAL STATEMENTS

1. Use the space below for important notes regarding the Balance Sheet, Statement of Income for the year, Statement of Retained Earnings for the year, and Statement of Cash Flows, or any account thereof. Classify the notes according to each basic statement, providing a subheading for each statement except where a note is applicable to more than one statement.
2. Furnish particulars (details) as to any significant contingent assets or liabilities existing at end of year, including a brief explanation of any action initiated by the Internal Revenue Service involving possible assessment of additional income taxes of material amount, or of a claim for refund of income taxes of a material amount initiated by the utility. Give also a brief explanation of any dividends in arrears on cumulative preferred stock.
3. For Account 116, Utility Plant Adjustments, explain the origin of such amount, debits and credits during the year, and plan of disposition contemplated, giving references to Commission orders or other authorizations respecting classification of amounts as plant adjustments and requirements as to disposition thereof.
4. Where Accounts 189, Unamortized Loss on Reacquired Debt, and 257, Unamortized Gain on Reacquired Debt, are not used, give an explanation, providing the rate treatment given these items. See General Instruction 17 of the Uniform System of Accounts.
5. Give a concise explanation of any retained earnings restrictions and state the amount of retained earnings affected by such restrictions.
6. If the notes to financial statements relating to the respondent company appearing in the annual report to the stockholders are applicable and furnish the data required by instructions above and on pages 114-121, such notes may be included herein.
7. For the 3Q disclosures, respondent must provide in the notes sufficient disclosures so as to make the interim information not misleading. Disclosures which would substantially duplicate the disclosures contained in the most recent FERC Annual Report may be omitted.
8. For the 3Q disclosures, the disclosures shall be provided where events subsequent to the end of the most recent year have occurred which have a material effect on the respondent. Respondent must include in the notes significant changes since the most recently completed year in such items as: accounting principles and practices; estimates inherent in the preparation of the financial statements; status of long-term contracts; capitalization including significant new borrowings or modifications of existing financing agreements; and changes resulting from business combinations or dispositions. However were material contingencies exist, the disclosure of such matters shall be provided even though a significant change since year end may not have occurred.
9. Finally, if the notes to the financial statements relating to the respondent appearing in the annual report to the stockholders are applicable and furnish the data required by the above instructions, such notes may be included herein.

PAGE 122 INTENTIONALLY LEFT BLANK
SEE PAGE 123 FOR REQUIRED INFORMATION.

| Name of Respondent | This Report Is: | Date of Report (Mo, Da, Yr) | Year/Period of Report |
| --- | --- | --- | --- |
| Black Hills Power, Inc. | (1) X An Original<br>(2) _ A Resubmission | / / | 2012/Q4 |

NOTES TO FINANCIAL STATEMENTS (Continued)

**NOTES TO FINANCIAL STATEMENTS**
**December 31, 2012, 2011 and 2010**

## (1) BUSINESS DESCRIPTION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Business Description

Black Hills Power, Inc. (the Company, "we," "us" or "our") is an electric utility serving customers in South Dakota, Wyoming and Montana. We are a wholly-owned subsidiary of BHC or the Parent, a public registrant listed on the New York Stock Exchange.

### Basis of Presentation

The financial statements include the accounts of Black Hills Power, Inc. and also our ownership interests in the assets, liabilities and expenses of our jointly owned facilities (Note 4).

The financial statements were prepared in accordance with the accounting requirements of the Federal Energy Regulatory Commission (FERC) as set forth in its applicable Uniform System of Accounts and published accounting releases, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America (GAAP). Additionally, these requirements differ from GAAP related to the presentation of certain items including deferred income taxes, and cost of removal liabilities. The Company's notes to the financial statements are prepared in conformity with GAAP. Accordingly, certain footnotes are not reflective of the Company's FERC basis financial statements contained herein.

### Use of Estimates and Basis of Presentation

The preparation of financial statements in conformity with GAAP 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 Equivalents

We consider all highly liquid investments with an original maturity of three months or less to be cash equivalents.

### Regulatory Accounting

Our regulated electric operations are subject to regulation by various state and federal agencies. The accounting policies followed are generally subject to the Uniform System of Accounts of FERC.

Our regulated utility operations follow accounting standards for regulated operations and our financial statements reflect the effects of the different rate making principles followed by the various jurisdictions regulating our electric operations. If rate recovery becomes unlikely or uncertain due to competition or regulatory action, these accounting standards may no longer apply to our regulated operations. In the event we determine that we no longer meet the criteria for following accounting standards for regulated operations, the accounting impact to us could be an extraordinary non-cash charge to operations in an amount that could be material.

Regulatory assets are included in Regulatory assets, current and Regulatory assets, non-current on the accompanying Balance Sheets. Regulatory liabilities are included in Regulatory liabilities, current and Regulatory liabilities, non-current on the accompanying Balance Sheets.

We had the following regulatory assets and liabilities as follows as of December 31 (in thousands):

| | Maximum Recovery Period (in years) | 2012 | 2011 |
|---|---|---|---|
| Regulatory assets: | | | |
| Unamortized loss on reacquired debt[a] | 14 | $ 2,501 | $ 2,765 |
| AFUDC[b] | 45 | 8,460 | 8,552 |
| Employee benefit plans[c] | 13 | 27,001 | 27,602 |
| Deferred energy costs[a] | 1 | 6,892 | 6,605 |
| Flow through accounting[a] | 35 | 8,019 | 5,789 |
| Other[a] | 2 | 369 | 452 |
| Total regulatory assets | | $ 53,242 | $ 51,765 |
| Regulatory liabilities: | | | |
| Cost of removal for utility plant[a] | 53 | $ 26,630 | $ 23,347 |
| Employee benefit plans[d] | 13 | 15,689 | 15,282 |
| Other[e] | 13 | 1,567 | 1,845 |
| Total regulatory liabilities | | $ 43,886 | $ 40,474 |

(a) Recovery of costs but not allowed a rate of return.
(b) In addition to recovery of costs, we are allowed a rate of return.
(c) ~~In addition to recovery of costs, we are allowed a return on approximately $23.5 million.~~
(d) Approximately $13.2 million is included in our rate base calculation as a reduction to rate base.
(e) Approximately $0.8 million is included in our rate base calculation as a reduction to rate base.

Regulatory assets represent items we expect to recover from customers through probable future rates.

Unamortized Loss on Reacquired Debt - The early redemption premium on reacquired bonds is being amortized over the remaining term of the original bonds.

AFUDC - The equity component of AFUDC is considered a permanent difference for tax purposes with the tax benefit being flowed through to customers as prescribed or allowed by regulators. If, based on a regulator's action, it is probable the utility will recover the future increase in taxes payable represented by this flow-through treatment through a rate revenue increase, a regulatory asset is recognized. This regulatory asset itself is a temporary difference for which a deferred tax liability must be recognized. Accounting standards for income taxes specifically address AFUDC-equity, and require a gross-up of such amounts to reflect the revenue requirement associated with a rate-regulated environment.

Employee Benefit Plans - Employee benefit plans include the unrecognized prior service costs and net actuarial loss associated with our defined benefit pension plans and post-retirement benefit plans in regulatory assets rather than in accumulated other comprehensive income.

Deferred Energy Costs - Deferred energy and fuel cost adjustments represent the cost of electricity delivered to our utility customers that are either higher or lower than the current rates and will be recovered or refunded in future rates. Deferred energy and fuel cost adjustments are recorded and recovered or amortized as approved by the appropriate state commission.

Flow-Through Accounting - Under flow-through accounting, the income tax effects of certain tax items are reflected in our cost of service for the customer in the year in which the tax benefits are realized and result in lower utility rates. This regulatory treatment was applied to the tax benefit generated by repair costs that were previously capitalized for tax purposes in a rate case settlement that was reached in 2010. In this instance, the agreed upon rate increase was less than it would have been absent the flow-through treatment. A regulatory asset established to reflect the future increases in income taxes payable will be recovered from customers as the temporary differences reverse.

Regulatory liabilities represent items we expect to refund to customers through probable future decreases in rates.

Cost of Removal for Utility Plant - Cost of removal for utility plant represents the estimated cumulative net provisions for future removal costs included in depreciation expense for which there is no legal obligation for removal.

Employee Benefit Plans - Employee benefit plans represent the cumulative excess of pension and retiree healthcare costs recovered in rates over pension expense recorded in accordance with accounting standards for compensation - retirement benefits. In addition, this regulatory liability includes the income tax effect of the adjustment required under accounting for compensation - defined benefit plans, to record the full pension and post-retirement benefit obligations. Such income tax effect has been grossed-up to account for the revenue requirement aspect of a rate regulated environment.

**Accounts Receivable and Allowance for Doubtful Accounts**

Accounts receivable consist of sales to residential, commercial, industrial, municipal and other customers all of which do not bear interest. These accounts receivable are stated at billed and unbilled amounts net of write-offs or payment received.

We maintain an allowance for doubtful accounts which reflects our best estimate of uncollectible trade receivables. We regularly review our trade receivable allowances by considering such factors as historical experience, credit worthiness, the age of the receivable balances and current economic conditions that may affect collectibility. The allowance is calculated by applying estimated write-off factors to various classes of outstanding receivables, including unbilled revenue. The write-off factors used to estimate uncollectible accounts are based upon consideration of both historical collections experience and management's best estimate of future collection success given the existing collections environment.

Following is a summary of accounts receivable at December 31 (in thousands):

| | 2012 | 2011 |
|---|---|---|
| Accounts receivable trade | $ 14,965 | $ 16,447 |
| Unbilled revenues | 9,004 | 8,364 |
| Total accounts receivable - customers | 23,969 | 24,811 |
| Allowance for doubtful accounts | (102) | (143) |
| Net accounts receivable | $ 23,867 | $ 24,668 |

| Name of Respondent | This Report is: | Date of Report (Mo, Da, Yr) | Year/Period of Report |
|---|---|---|---|
| Black Hills Power, Inc. | (1) X An Original<br>(2) _ A Resubmission | / / | 2012/Q4 |

NOTES TO FINANCIAL STATEMENTS (Continued)

**Revenue Recognition**

Revenue is recognized when there is persuasive evidence of an arrangement with a fixed or determinable price, delivery has occurred or services have been rendered, and collectibility is reasonably assured. Taxes collected from our customers are recorded on a net basis (excluded from Revenue).

Utility revenues are based on authorized rates approved by the state regulatory agencies and the FERC. Revenues related to the sale, transmission and distribution of energy, and delivery of service are generally recorded when service is rendered or energy is delivered to customers. To the extent that deliveries have occurred but a bill has not been issued, we accrue an estimate of the revenue since the latest billing. This estimate is calculated based upon several factors including billings through the last billing cycle in a month, and prices in effect in our jurisdictions. Each month the estimated unbilled revenue amounts are trued-up and recorded in Receivables-customers, net on the accompanying Balance Sheets.

**Materials, Supplies and Fuel**

Materials, supplies and fuel used for construction, operation and maintenance purposes are generally stated on a weighted-average cost basis.

**Deferred Financing Costs**

Deferred financing costs are amortized using the effective interest method over the term of the related debt.

**Property, Plant and Equipment**

Additions to property, plant and equipment are recorded at cost when placed in service. Included in the cost of regulated construction projects is AFUDC, which represents the approximate composite cost of borrowed funds and a return on equity used to finance a regulated utility project. The cost of regulated electric property, plant and equipment retired, or otherwise disposed of in the ordinary course of business, less salvage, is charged to accumulated depreciation. Removal costs associated with non-legal obligations are reclassified from accumulated depreciation and reflected as regulatory liabilities. Ordinary repairs and maintenance of property, except as allowed under rate regulations, are charged to operations as incurred.

Depreciation provisions for regulated electric property, plant and equipment are computed on a straight-line basis using an annual composite rate of 2.2% in 2012, 2.2% in 2011 and 2.2% in 2010.

**Derivatives and Hedging Activities**

From time to time we utilize risk management contracts including forward purchases and sales to hedge the price of fuel for our combustion turbines and fixed-for-float swaps to fix the interest on any variable rate debt. Contracts that qualify as derivatives under accounting standards for derivatives, and that are not exempted such as normal purchase/normal sale, are required to be recorded in the balance sheet as either an asset or liability, measured at its fair value. Accounting standards for derivatives require that changes in the derivative instrument's fair value be recognized currently in earnings unless specific hedge accounting criteria are met.

Accounting standards for derivatives allow hedge accounting for qualifying fair value and cash flow hedges. Gain or loss on a derivative instrument designated and qualifying as a fair value hedging instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk should be recognized currently in earnings in the same accounting period. Conversely, the effective portion of the gain or loss on a derivative instrument designated and qualifying as a cash flow hedging instrument should be reported as a component of other comprehensive income and be reclassified into earnings or as a regulatory asset or regulatory liability, net of tax, in the same period or periods during which the hedged forecasted transaction affects earnings. The remaining gain or loss on the derivative instrument, if any, is recognized currently in earnings.

**Fair Value Measurements**

Accounting standards for fair value measurements provide a single definition of 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 and also requires disclosures and establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values giving the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements).

Financial assets and liabilities carried at fair value are classified and disclosed in one of the following three categories:

*Level 1* - Unadjusted quoted prices available in active markets that are accessible at the measurement date for identical unrestricted assets or liabilities.

*Level 2* - Pricing inputs include quoted prices for identical or similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

*Level 3* - Pricing inputs include significant inputs that are generally less observable from objective sources.

**Impairment of Long-Lived Assets**

We periodically evaluate whether events and circumstances have occurred which may affect the estimated useful life or the recoverability of the remaining balance of our long-lived assets. If such events or circumstances were to indicate that the carrying amount of these assets was not recoverable, we would estimate the future cash flows expected to result from the use of the assets and their eventual disposition. If the sum of the expected future cash flows (undiscounted and without interest charges) was less than the carrying amount of the long-lived assets, we would recognize an impairment loss.

**Income Taxes**

We file a federal income tax return with other members of the Parent's consolidated group. For financial statement purposes, federal income taxes are allocated to the individual companies based on amounts calculated on a separate return basis.

We use the liability method in accounting for income taxes. Under the liability method, deferred income taxes are recognized at currently enacted income tax rates, to reflect the tax effect of temporary differences between the financial and tax basis of assets and liabilities, as well as operating loss and tax credit carryforwards. Such temporary differences are the result of provisions in the income tax law that either require or permit certain items to be reported on the income tax return in a different period than they are reported in the financial statements. We classify deferred tax assets and liabilities into current and non-current amounts based on the classification of the related assets and liabilities.

It is the Parent's policy to apply the flow-through method of accounting for investment tax credits. Under the flow-through method, investment tax credits are reflected in net income as a reduction to income tax expense in the year they qualify. Another acceptable accounting method and an exception to this general policy is to apply the deferral method whereby the credit is amortized as a reduction of income tax expense over the useful lives of the related property which gave rise to the credits.

We recognize interest income or interest expense and penalties related to income tax matters in Income tax (expense) benefit on the Statements of Income. We account for uncertainty in income taxes recognized in the financial statements in accordance with accounting standards for income taxes. The unrecognized tax benefit is classified in Other - non-current liabilities on the accompanying Balance Sheets. See Note 7 for additional information.

## (2) RECENTLY ADOPTED AND RECENTLY ISSUED ACCOUNTING STANDARDS

**Recently Adopted Accounting Standards**

Other Comprehensive Income: Presentation of Comprehensive Income, ASU 2011-05 and Deferral of the Effective Date for Amendments to the Presentation of Reclassification of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update 2011-05 and ASU 2011-12

FASB issued an accounting standards update amending ASC 220 to improve the comparability, consistency and transparency of reporting of comprehensive income. It amends existing guidance by allowing only two options for presenting the components of net income and other comprehensive income: (1) in a single continuous financial statement, statement of comprehensive income or (2) in two separate but consecutive financial statements, consisting of an income statement followed by a separate statement of other comprehensive income. Also, items that are reclassified from other comprehensive income to net income must be presented on the face of the financial statements. ASU No. 2011-05 requires retrospective application, and it is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, with early adoption permitted. In December 2011, FASB issued ASU 2011-12. ASU 2011-12 indefinitely deferred the provisions of ASU 2011-05 requiring the presentation of reclassification adjustments for items reclassified from other comprehensive income to net income be presented on the face of the financial statements. Ultimately FASB chose not to reinstate the reclassification adjustment requirements in ASU 2011-05 but instead issued ASU 2013-02 in February 2013.

We have elected to early adopt the provisions of ASU 2011-05 as amended by ASU 2011-12. The adoption changed the presentation of certain financial statements and provided additional details in notes to the financial statements, but did not have any other impact on our financial statements. See the accompanying Comprehensive Income Statement and additional disclosures in Note 8.

Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements, ASU 2011-04

In May 2011, FASB issued an accounting standards update amending ASC 820, Fair Value Measurements and Disclosures, to achieve common fair value measurement and disclosure requirements between GAAP and IFRS. Additional disclosure requirements in the update include: (1) for Level 3 fair value measurements - quantitative information about unobservable inputs used, a description of the valuation processes used by the entity, and a qualitative discussion about the sensitivity of the measurements to changes in the unobservable inputs; (2) for an entity's use of a non-financial asset that is different from the asset's highest and best use - the reason for the difference; (3) for financial instruments not measured at fair value but for which disclosure of fair value is required - the fair value hierarchy level in which the fair value measurements were determined; and (4) the disclosure of all transfers between Level 1 and Level 2 of the fair value hierarchy. ASU 2011-04 is effective for fiscal years, and interim periods within those years, beginning after December 31, 2011. The amendment required additional details in notes to financial statements, but did not have any other impact on our financial statements. The additional disclosures are included in Note 9.

**Recently Issued Accounting Pronouncements and Legislation**

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income, ASU 2013-02

In February 2013, the FASB issued new disclosure requirements for items reclassified out of AOCI to expand the disclosure requirements in ASC 220, Comprehensive Income, for presentation of changes in AOCI. ASU 2013-02 requires disclosure of (1) changes in components of other comprehensive income, (2) for items reclassified out of AOCI and into net income in their entirety, the effect of the reclassification on each affected net income line item and (3) cross references to other disclosures that provide additional detail for components of other comprehensive income that are not reclassified in their entirety to net income. Disclosures are required either on the face of the statements of income or as a separate disclosure in the notes to the financial statements. The new disclosure requirements are effective for interim and annual periods beginning after December 15, 2012. The adoption of this standard will not have an impact on our financial position, results of operations or cash flows.

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NOTES TO FINANCIAL STATEMENTS (Continued)

## (3) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at December 31 consisted of the following (dollars in thousands):

| | 2012 | 2012 Weighted Average Useful Life (in years) | 2011 | 2011 Weighted Average Useful Life (in years) | Lives (in years) Minimum | Maximum |
|---|---|---|---|---|---|---|
| Electric plant: | | | | | | |
| Production | $ 510,674 | 51 | $ 504,088 | 51 | 45 | 65 |
| Transmission | 115,092 | 46 | 115,063 | 47 | 40 | 60 |
| Distribution | 304,113 | 38 | 289,833 | 39 | 16 | 45 |
| Plant acquisition adjustment [(a)] | 4,870 | 32 | 4,870 | 32 | 32 | 32 |
| General | 71,802 | 22 | 72,045 | 21 | 8 | 45 |
| Construction work in progress | 18,217 | | 9,873 | | | |
| Total electric plant | 1,024,768 | | 995,772 | | | |
| Less accumulated depreciation and amortization | (322,830) | | (313,581) | | | |
| Electric plant net of accumulated depreciation and amortization | $ 701,938 | | $ 682,191 | | | |

(a) The plant acquisition adjustment is included in rate base and is being recovered with 18 years remaining.

## (4) JOINTLY OWNED FACILITIES

We use the proportionate consolidation method to account for our percentage interest in the assets, liabilities and expenses of the following facilities:

- We own a 20% interest in the Wyodak Plant (the "Plant"), a coal-fired electric generating station located in Campbell County, Wyoming. PacifiCorp owns the remaining ownership percentage and is the operator of the Plant. We receive our proportionate share of the Plant's capacity and are committed to pay our share of its additions, replacements and operating and maintenance expenses.

- We own a 35% interest in, and are the operator of, the Converter Station Site and South Rapid City Interconnection (the transmission tie), an AC-DC-AC transmission tie. Basin Electric owns the remaining ownership percentage. The transmission tie provides an interconnection between the Western and Eastern transmission grids, which provides us with access to both the WECC region and the MAPP region. The total transfer capacity of the transmission tie is 400 MW - 200 MW West to East and 200 MW from East to West. We are committed to pay our proportionate share of the additions, replacements and operating and maintenance expenses.

- We own a 52% interest in the Wygen III power plant. MDU and the City of Gillette each owns an undivided ownership interest in Wygen III and are obligated to make payments for costs associated with administrative services and a proportionate share of the costs of operating the plant for the life of the facility. We retain responsibility for plant operations.

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The investments in our jointly owned plants and accumulated depreciation are included in the corresponding captions in the accompanying Balance Sheets. Our share of direct expenses of the Plant is included in the corresponding categories of operating expenses in the accompanying Statements of Income. Each of the respective owners is responsible for providing its own financing.

As of December 31, 2012, our interests in jointly-owned generating facilities and transmission systems included on our Balance Sheets were as follows (in thousands):

| Interest in jointly-owned facilities | Plant in Service | Construction Work in Progress | Accumulated Depreciation |
|---|---|---|---|
| Wyodak Plant | $ 109,465 | $ 451 | $ 47,776 |
| Transmission Tie | $ 19,648 | $ — | $ 4,414 |
| Wygen III | $ 130,267 | $ 565 | $ 8,376 |

## (5) LONG-TERM DEBT

Long-term debt outstanding at December 31 was as follows (in thousands):

| | Maturity Date | Interest Rate | 2012 | 2011 |
|---|---|---|---|---|
| First Mortgage Bonds due 2032 | August 15, 2032 | 7.23% | $ 75,000 | $ 75,000 |
| First Mortgage Bonds due 2039 | November 1, 2039 | 6.125% | 180,000 | 180,000 |
| Unamortized discount, First Mortgage Bonds due 2039 | | | (111) | (115) |
| Pollution control revenue bonds due 2014[(a)] | October 1, 2014 | 4.80% | — | 6,450 |
| Pollution control revenue bonds due 2024 | October 1, 2024 | 5.35% | 12,200 | 12,200 |
| Series 94A Debt[(b)] | June 1, 2024 | 1.35% | 2,855 | 2,855 |
| Other | May 25, 2012 | 13.66% | — | 37 |
| Total long-term debt | | | 269,944 | 276,427 |
| Less current maturities | | | — | (37) |
| Net long-term debt | | | $ 269,944 | $ 276,390 |

(a) On May 15, 2012 we repaid in full $6.5 million principal and interest on the Pollution Control Revenue Bonds originally due to mature on October 1, 2014.

(b) Variable interest rate of 1.35% at December 31, 2012.

Net deferred financing costs of approximately $2.9 million and $3.1 million were recorded on the accompanying Balance Sheets in Other, non-current assets at December 31, 2012 and 2011, respectively, and are being amortized over the term of the debt. Amortization of deferred financing costs of approximately $0.2 million, $0.5 million and $0.4 million for the years ended December 31, 2012, 2011 and 2010, respectively, are included in Interest expense on the accompanying Statements of Income.

Substantially all of our property is subject to the lien of the indenture securing our first mortgage bonds. First mortgage bonds may be issued in amounts limited by property, earnings and other provisions of the mortgage indentures. We were in compliance with our debt covenants at December 31, 2012.

Long-term Debt Maturities

Scheduled maturities of our outstanding long-term debt (excluding unamortized discounts) are as follows (in thousands):

| | | |
|---|---|---|
| 2013 | $ | — |
| 2014 | $ | — |
| 2015 | $ | — |
| 2016 | $ | — |
| 2017 | $ | — |
| Thereafter | $ | 270,055 |

**(6) FAIR VALUE OF FINANCIAL INSTRUMENTS**

The estimated fair values of our financial instruments at December 31 were as follows (in thousands):

| | 2012 | | 2011 | |
|---|---|---|---|---|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Cash and cash equivalents (a) | $ 3,805 | $ 3,805 | $ 2,812 | $ 2,812 |
| Long-term debt, including current maturities (b) | $ 269,944 | $ 359,567 | $ 276,427 | $ 362,055 |

(a) Fair value approximates carrying value due to either short-term length of maturity or variable interest rates that approximate prevailing market rates and therefore is classified in Level 1 in the fair value hierarchy.
(b) Long-term debt is valued using the market approach based on observable inputs of quoted market prices and yields available for debt instruments either directly or indirectly for similar maturities and debt ratings in active markets and therefore is classified in Level 2 in the fair value hierarchy. The carrying amount of our variable rate debt approximates fair value due to the variable interest rates with short reset periods. For additional information on our long-term debt, see Note 5 to the Financial Statements.

The following methods and assumptions were used to estimate the fair value of each class of our financial instruments.

**Cash and Cash Equivalents**

Included in cash and cash equivalents is cash and overnight repurchase agreement accounts. As part of our cash management process, excess operating cash is invested in overnight repurchase agreements with our bank. Repurchase agreements are not deposits and are not insured by the U.S. Government, the FDIC or any other government agency and involve investment risk including possible loss of principal. We believe however, that the market risk arising from holding these financial instruments is minimal.

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NOTES TO FINANCIAL STATEMENTS (Continued)

## (7) INCOME TAXES

Income tax expense (benefit) from continuing operations for the years ended December 31 was (in thousands):

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| Current | $ (10,319) | $ 14,921 | $ (14,885) |
| Deferred | 24,628 | (2,931) | 25,626 |
| Total income tax expense | $ 14,309 | $ 11,990 | $ 10,741 |

The temporary differences which gave rise to the net deferred tax liability, for the years ended December 31 were as follows (in thousands):

| | 2012 | 2011 |
|---|---|---|
| Deferred tax assets: | | |
| Employee benefits | $ 5,094 | $ 5,008 |
| Net operating loss | 10,441 | 28,072 |
| Regulatory liabilities | 13,433 | 14,644 |
| Other | 2,381 | 3,049 |
| Valuation allowance | — | — |
| Total deferred tax assets | 31,349 | 50,773 |
| Deferred tax liabilities: | | |
| Accelerated depreciation and other plant related differences | (154,989) | (148,254) |
| AFUDC | (5,499) | (5,559) |
| Regulatory assets | (5,767) | (5,019) |
| Employee benefits | (3,610) | (2,356) |
| Other | (3,771) | (3,753) |
| Total deferred tax liabilities | (173,636) | (164,941) |
| Net deferred tax assets (liabilities) | $ (142,287) | $ (114,168) |

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NOTES TO FINANCIAL STATEMENTS (Continued)

The effective tax rate differs from the federal statutory rate for the years ended December 31, as follows:

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| Federal statutory rate | 35.0% | 35.0% | 35.0% |
| Amortization of excess deferred and investment tax credits | (0.3) | (0.4) | (0.6) |
| Equity AFUDC | (0.1) | (0.6) | (2.0) |
| Flow through adjustments * | (3.5) | (3.4) | (7.4) |
| Prior year deferred adjustment | 3.6 | — | — |
| Other | (0.1) | 0.1 | 0.6 |
| | 34.6% | 30.7% | 25.6% |

* The flow-through adjustments relate primarily to an accounting method change for tax purposes that was filed with the 2008 tax return and for which consent was received from the IRS in September 2009. The effect of the change allows us to take a current tax deduction for repair costs that were previously capitalized for tax purposes. These costs will continue to be capitalized for book purposes. We recorded a deferred income tax liability in recognition of the temporary difference created between book and tax treatment and we flowed the tax benefit through to our customers in the form of lower rates as a result of a rate case settlement that occurred during 2010. A regulatory asset was established to reflect the recovery of future increases in taxes payable from customers as the temporary differences reverse. Due to this regulatory treatment, we recorded an income tax benefit in 2010 that was attributable to the 2008 through 2010 tax years. We continue to record a tax benefit consistent with the flow through method in accordance with such regulatory treatment.

The following table reconciles the total amounts of unrecognized tax benefits at the beginning and end of the period (in thousands):

| | 2012 | 2011 |
|---|---|---|
| Unrecognized tax benefits at January 1 | $ 3,595 | $ 3,094 |
| Additions for prior year tax positions | — | 795 |
| Reductions for prior year tax positions | (1,586) | (294) |
| Additions for current year tax positions | 69 | — |
| Unrecognized tax benefits at December 31 | $ 2,078 | $ 3,595 |

The reductions for prior year tax positions relate to the reversal attributable to otherwise allowed tax depreciation. The total amount of unrecognized tax benefits that, if recognized, would impact the effective tax rate is approximately $0.7 million. The unrecognized tax benefit is classified in Other, non-current liabilities on the accompanying Balance Sheets.

During the year ended December 31, 2012 and 2011, the interest expense recognized related to income tax matters was not material to our financial results.

We do not anticipate that total unrecognized tax benefits will significantly change due to the settlement of any audits or the expiration of statutes of limitations prior to December 31, 2013.

At December 31, 2012, we have federal NOL carry forward of $30.5 million, expiring in 2031. Ultimate usage of this NOL depends upon our ability to generate future taxable income, which is expected to occur within the prescribed carryforward period.

## (8) ACCUMULATED OTHER COMPREHENSIVE INCOME

Balances by classification included within Accumulated other comprehensive loss on the accompanying Balance Sheets were as follows (in thousands):

| | Derivatives Designated as Cash Flow Hedges | Employee Benefit Plans | Total |
|---|---|---|---|
| As of December 31, 2011 | $ (801) | $ (489) | $ (1,290) |
| Other comprehensive income (loss) | 41 | (171) | (130) |
| As of December 31, 2012 | $ (760) | $ (660) | $ (1,420) |
| | | | |
| As of December 31, 2010 | $ (843) | $ (419) | $ (1,262) |
| Other comprehensive income (loss) | 42 | (70) | (28) |
| As of December 31, 2011 | $ (801) | $ (489) | $ (1,290) |

Derivatives designated as cash flow hedges relate to a treasury lock entered into in August 2002 to hedge a portion of the $75.0 million First Mortgage Bonds due on August 15, 2032. The treasury lock cash settled on August 8, 2002, the bond pricing date, and resulted in a $1.8 million loss. The treasury lock is treated as a cash flow hedge and the resulting loss is carried in Accumulated Other Comprehensive Loss and is being amortized over the life of the related bonds.

## (9) EMPLOYEE BENEFIT PLANS

### Funded Status of Benefit Plans

The funded status of the postretirement benefit plan is required to be recognized in the statement of financial position. The funded status for the pension plan is measured as the difference between the projected benefit obligation and the fair value of plan assets. The funded status for all other benefit plans is measured as the difference between the accumulated benefit obligation and the fair value of plan assets. A liability is recorded for an amount by which the benefit obligation exceeds the fair value of plan assets or an asset is recorded for any amount by which the fair value of plan assets exceeds the benefit obligation. The measurement date of the plans is December 31, our year-end balance sheet date. As of December 31, 2012, the funded status of our Defined Benefit Pension Plan was $(16.4) million, the funded status of our Supplemental Non-qualified Defined Benefit Plans was $(3.4) million and the funded status of our Non-pension Defined Benefit Postretirement Healthcare Plans was $(6.8) million.

We apply accounting standards for regulated operations, and accordingly, the unrecognized net periodic benefit cost that would have been reclassified to Accumulated other comprehensive income (loss) was alternatively recorded as a regulatory asset or regulatory liability, net of tax.

### Defined Benefit Pension Plan

We have a noncontributory defined benefit pension plan ("Pension Plan") covering employees who meet certain eligibility requirements. The benefits are based on years of service and compensation levels during the highest five consecutive years of the last ten years of service. Our funding policy is in accordance with the federal government's funding requirements. The Pension Plan's assets are held in trust and consist primarily of equity and fixed income investments.

The Pension Plan has been frozen to new employees and certain employees who did not meet age and service based criteria at the time the Plan was frozen. Plan benefits are based on years of service and calculations of average earnings during a specific time period prior to retirement.

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On October 29, 2012, the Board of Directors approved a new Investment Policy. The objective of the Investment Policy is to manage assets in such a way that will allow the eventual settlement of our obligations to the Plans' beneficiaries. To meet this objective, our pension plan assets are managed by an outside adviser using a structured portfolio strategy that will provide liquidity to meet the Plans' benefit payment obligations and an asset allocation that will comprise a mix of return-seeking and liability-hedging assets. Our Pension Plan funding policy is in accordance with the federal government's funding requirements. The Pension Plan's assets are held in trust and consist primarily of equity and fixed income investments. The expected long-term rate of return for investments was 7.25% and 8.75% for the 2012 and 2011 plan years, respectively.

Pension Plan Assets

The percentages of total plan asset fair value by investment category of our Pension Plan assets at December 31 were as follows:

| | 2012 | 2011 |
|---|---|---|
| Equity securities | 51% | 69% |
| Fixed income funds | 48% | 28% |
| Cash and cash equivalents | 1% | 3% |
| Total | 100% | 100% |

**Supplemental Non-qualified Defined Benefit Retirement Plans**

We have various supplemental retirement plans ("Supplemental Plans") for key executives. The Supplemental Plans are non-qualified defined benefit plans. The Supplemental Plans are subject to various vesting schedules.

Supplemental Plan Assets

We do not fund our Supplemental Plans. We fund on a cash basis as benefits are paid.

**Non-pension Defined Benefit Postretirement Healthcare Plan**

Employees who are participants in our Non-Pension Postretirement Healthcare Plan ("Healthcare Plan") and who retire on or after attaining minimum age and years of service requirements are entitled to postretirement healthcare benefits. These benefits are subject to premiums, deductibles, co-payment provisions and other limitations. We may amend or change the Healthcare Plan periodically. We are not pre-funding our retiree medical plan. We have determined that the Healthcare Plan's post-65 retiree prescription drug plans are actuarially equivalent and qualify for the Medicare Part D subsidy.

Plan Assets

We do not fund our Healthcare Plans. We fund on a cash basis as benefits are paid.

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**Plan Contributions and Estimated Cash Flows**

Contributions made to the Pension Plans are cash contributions made directly to the Pension Plan Trust accounts. Healthcare and Supplemental Plan contributions are made in the form of benefit payments. Contributions for the years ended December 31 were as follows (in thousands):

| | 2012 | 2011 |
|---|---|---|
| Defined Benefit Plans | | |
| Defined Benefit Pension Plan | $ 6,835 | $ — |
| Non-pension Defined Benefit Postretirement Healthcare Plan | $ 835 | $ 428 |
| Supplemental Non-qualified Defined Benefit Plan | $ 256 | $ 130 |
| | | |
| Defined Contribution Plans | | |
| Company Retirement Contribution | $ 404 | $ 371 |
| Matching Contributions | $ 1,328 | $ 1,296 |

We expect to make a contribution of $1.6 million to our employee defined benefit pension plan in 2013.

**Fair Value Measurements**

As required by accounting standards for fair value measurements, assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect their placement within the fair value hierarchy levels. The following tables set forth, by level within the fair value hierarchy, the assets that were accounted for at fair value on a recurring basis as of December 31 (in thousands):

| **Defined Benefit Pension Plan** | 2012 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total Fair Value |
| Cash and cash equivalents | $ 535 | $ — | $ — | $ 535 |
| Common collective trust - equity | — | 27,267 | — | 27,267 |
| Common collective trust - fixed income | — | 21,127 | — | 21,127 |
| Insurance contracts | — | — | — | — |
| Structured products | — | 4,536 | — | 4,536 |
| Total investments measured at fair value | $ 535 | $ 52,930 | $ — | $ 53,465 |

| **Defined Benefit Pension Plan** | 2011 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total Fair Value |
| Cash and cash equivalents | $ 40 | $ — | $ — | $ 40 |
| Registered investment companies - equity | 12,743 | — | — | 12,743 |
| Registered investment companies - fixed income | 12,603 | — | — | 12,603 |
| Common collective trust - equity | — | 16,143 | — | 16,143 |
| Insurance contracts | — | 1,288 | — | 1,288 |
| Structured products | — | 2,200 | — | 2,200 |
| Total investments measured at fair value | $ 25,386 | $ 19,631 | $ — | $ 45,017 |

*Registered Investment Companies*: Investments are valued at the closing price reported on the active market on which the individual securities are traded.

*Common Collective Trust*: The Pension Plan owns units of the Common Collective Trust funds that they are utilizing in their portfolio. The value of each unit of any fund as of any valuation date shall be determined by calculating the total value of such fund's assets as of the close of business on such valuation date, deducting its total liabilities as of such time and date, and then dividing the so-determined net asset value of such fund by the total number of units of such fund outstanding on the date of valuation.

*Insurance Contract*: These investments are valued on a cash basis on any given valuation date which approximates fair value.

*Structured Products*: Investments are created through the process of financial engineering (that is, by combining underlying securities like equity, bonds, or indices with derivatives). The value of derivative securities, such as options, forwards and swaps is determined by (respectively, derives from) the prices of the underlying securities.

**Plan Reconciliations**

The following tables provide a reconciliation of the Employee Benefit Plan's obligations and fair value of assets, components of the net periodic expense and elements of regulatory assets and liabilities and AOCI (in thousands):

Benefit Obligations

| | Defined Benefit Pension Plan | | Supplemental Non-qualified Defined Benefit Retirement Plans | | Non-pension Defined Benefit Postretirement Healthcare Plan | |
|---|---|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 |
| Change in benefit obligation: | | | | | | |
| Projected benefit obligation at beginning of year | $ 65,557 | $ 57,753 | $ 2,292 | $ 2,152 | $ 8,207 | $ 7,517 |
| Service cost | 765 | 798 | — | — | 214 | 210 |
| Interest cost | 2,969 | 3,092 | 104 | 114 | 343 | 365 |
| Actuarial loss (gain) | 4,510 | 852 | 1,287 | (30) | (1,748) | (308) |
| Amendments | — | — | — | — | — | — |
| Change in participant assumptions | — | — | — | — | — | 171 |
| Discount rate change | — | 6,668 | — | 186 | — | 433 |
| Benefits paid | (2,850) | (2,899) | (256) | (130) | (835) | (707) |
| Asset transfer (to) from affiliate | (1,131) | (707) | — | — | 26 | (40) |
| Plan curtailment reduction | — | — | — | — | — | — |
| Medicare Part D adjustment | — | — | — | — | 71 | 67 |
| Plan participants' contributions | — | — | — | — | 488 | 499 |
| Projected benefit obligation at end of year | $ 69,820 | $ 65,557 | $ 3,427 | $ 2,292 | $ 6,766 | $ 8,207 |

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A reconciliation of the fair value of Plan assets (as of the December 31 measurement date) is as follows (in thousands):

| | Defined Benefit Pension Plan | | Supplemental Non-qualified Defined Benefit Retirement Plans | | Non-pension Defined Benefit Postretirement Healthcare Plan | |
|---|---|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 |
| Beginning market value of plan assets | $ 45,017 | $ 48,228 | $ — | $ — | $ — | $ — |
| Investment income | 5,240 | 66 | — | — | — | — |
| Benefits paid | (2,850) | (2,899) | — | — | — | — |
| Employer contributions | 6,835 | — | — | — | — | — |
| Asset transfer to affiliate | (777) | (378) | — | — | — | — |
| Ending market value of plan assets | $ 53,465 | $ 45,017 | $ — | $ — | $ — | $ — |

Amounts recognized in the Balance Sheets at December 31 consist of (in thousands):

| | Defined Benefit Pension Plan | | Supplemental Non-qualified Defined Benefit Retirement Plans | | Non-pension Defined Benefit Postretirement Plan | |
|---|---|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 |
| Regulatory asset (liability) | $ 26,683 | $ 27,284 | $ — | $ — | $ (2,174) | $ (590) |
| Current (liability) | $ — | $ — | $ (216) | $ (154) | $ (438) | $ (658) |
| Non-current (liability) | $ (16,356) | $ (20,540) | $ (3,211) | $ (3,060) | $ (6,321) | $ (7,497) |

Accumulated Benefit Obligation (dollars in thousands)

| | Defined Benefit Pension Plan | | Supplemental Non-qualified Defined Benefit Retirement Plans | | Non-pension Defined Benefit Postretirement Healthcare Plan | |
|---|---|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 |
| Accumulated benefit obligation | $ 63,417 | $ 59,823 | $ 3,427 | $ 2,292 | $ 6,766 | $ 8,207 |

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Components of Net Periodic Expense (dollars in thousands)

| | Defined Benefit Pension Plan | | | Supplemental Non-qualified Defined Benefit Retirement Plans | | | Non-pension Defined Benefit Postretirement Healthcare Plan | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | 2012 | 2011 | 2010 | 2012 | 2011 | 2010 |
| Service cost | $ 765 | $ 798 | $ 1,214 | $ — | $ — | $ — | $ 214 | $ 210 | $ 340 |
| Interest cost | 2,969 | 3,092 | 3,280 | 104 | 114 | 100 | 343 | 365 | 547 |
| Expected return on assets | (3,139) | (3,619) | (3,008) | — | — | — | — | — | — |
| Amortization of prior service cost (credits) | 57 | 62 | 62 | — | — | — | (278) | (314) | (141 |
| Amortization of transition obligation | — | — | — | — | — | — | — | — | 171 |
| Recognized net actuarial loss (gain) | 2,599 | 1,486 | 1,378 | 55 | 48 | 30 | 139 | 163 | — |
| Curtailment expense | — | — | 57 | — | — | — | — | — | — |
| Net periodic expense | $ 3,251 | $ 1,819 | $ 2,983 | $ 159 | $ 162 | $ 130 | $ 418 | $ 424 | $ 917 |

Accumulated Other Comprehensive Income (Loss)

Amounts included in AOCI, after-tax, that have not yet been recognized as components of net periodic benefit cost at December 31 were as follows (in thousands):

| | Defined Benefit Pension Plan | | Supplemental Non-qualified Defined Benefit Retirement Plans | | Non-pension Defined Benefit Postretirement Healthcare Plan | |
|---|---|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 |
| Net loss | $ — | $ — | $ (660) | $ (489) | $ — | $ — |
| Prior service cost | — | — | — | — | — | — |
| Total accumulated other comprehensive income (loss) | $ — | $ — | $ (660) | $ (489) | $ — | $ — |

The amounts in AOCI, regulatory assets or regulatory liabilities, after-tax, expected to be recognized as a component of net periodic benefit cost during calendar year 2013 were as follows (in thousands):

| | Defined Benefits Pension Plan | Supplemental Non-qualified Defined Benefit Retirement Plans | Non-pension Defined Benefit Postretirement Healthcare Plan |
|---|---|---|---|
| Net loss | $ 1,696 | $ 43 | $ 6 |
| Prior service cost | 27 | — | (181) |
| Total net periodic benefit cost expected to be recognized during calendar year 2013 | $ 1,723 | $ 43 | $ (175) |

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NOTES TO FINANCIAL STATEMENTS (Continued)

Assumptions

| | Defined Benefit Pension Plan | | | Supplemental Non-qualified Defined Benefit Retirement Plans | | | Non-pension Defined Benefit Postretirement Healthcare Plan | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | 2012 | 2011 | 2010 | 2012 | 2011 | 2010 |
| Weighted-average assumptions used to determine benefit obligations: | | | | | | | | | |
| Discount rate | 4.35% | 4.65% | 5.50% | 4.25% | 4.70% | 5.50% | 3.65% | 4.35% | 5.00% |
| Rate of increase in compensation levels | 3.91% | 3.67% | 3.70% | N/A | N/A | 5.00% | N/A | N/A | N/A |
| Weighted-average assumptions used to determine net periodic benefit cost for plan year: | | | | | | | | | |
| Discount rate | 4.65% | 5.50% | 6.05% | 4.70% | 5.00% | 6.10% | 4.35% | 5.00% | 5.90% |
| Expected long-term rate of return on assets* | 7.25% | 7.75% | 8.00% | N/A | N/A | N/A | N/A | N/A | N/A |
| Rate of increase in compensation levels | 3.67% | 3.70% | 4.25% | N/A | N/A | 5.00% | N/A | N/A | N/A |

* The expected rate of return on plan assets is 7.25% for the calculation of the 2013 net periodic pension cost.

The healthcare benefit obligation was determined at December 31 as follows:

| | 2012 | 2011 |
|---|---|---|
| Healthcare trend rate pre-65 | | |
| Trend for next year | 7.75% | 9.01% |
| Ultimate trend rate | 4.50% | 4.50% |
| Year Ultimate Trend Reached | 2027 | 2027 |
| Healthcare trend rate post-65 | | |
| Trend for next year | 6.50% | 9.01% |
| Ultimate trend rate | 4.50% | 4.50% |
| Year Ultimate Trend Reached | 2026 | 2027 |

We do not pre-fund our post-retirement benefit plan. The table below shows the estimated impacts of an increase or decrease to our healthcare trend rate for our Retiree Health Care Plan (dollars in thousands):

| Change in Assumed Trend Rate | Service and Interest Costs | Accumulated Periodic Postretirement Benefit Obligation |
|---|---|---|
| 1% increase | $ 11 | $ 278 |
| 1% decrease | $ (10) | $ (250) |

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NOTES TO FINANCIAL STATEMENTS (Continued)

The following benefit payments, which reflect future service, are expected to be paid (in thousands):

| | Defined Benefit Pension Plan | Supplemental Non-qualified Defined Benefit Retirement Plans | Non-pension Defined Benefit Postretirement Healthcare Plan |
|---|---|---|---|
| 2013 | $ 3,150 | $ 216 | $ 438 |
| 2014 | $ 3,227 | $ 215 | $ 489 |
| 2015 | $ 3,325 | $ 212 | $ 455 |
| 2016 | $ 3,417 | $ 181 | $ 469 |
| 2017 | $ 3,516 | $ 212 | $ 498 |
| 2018-2021 | $ 20,144 | $ 1,187 | $ 2,728 |

**Defined Contribution Plan**

The Parent sponsors a 401(k) retirement savings plan in which our employees may participate. Participants may elect to invest up to 50% of their eligible compensation on a pre-tax or after-tax basis, up to a maximum amount established by the Internal Revenue Service. The plan provides for company matching contributions and company retirement contributions. Employer contributions vest at 20% per year and are fully vested when the participant has 5 years of service.

**(10) RELATED-PARTY TRANSACTIONS**

Non-Cash Dividend to Parent

We have recorded a non-cash dividend to our Parent for $44.0 million in 2012 and decreased the utility money pool note receivable, net for the amount of $44.0 million.

Receivables and Payables

We have accounts receivable and accounts payable balances related to transactions with other BHC subsidiaries. These balances as of December 31 were as follows (in thousands):

| | 2012 | 2011 |
|---|---|---|
| Receivable - affiliates | $ 5,027 | $ 6,998 |
| Accounts payable - affiliates | $ 21,896 | $ 18,598 |

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NOTES TO FINANCIAL STATEMENTS (Continued)

Money Pool Notes Receivable and Notes Payable

We have a Utility Money Pool Agreement (the Agreement) with the Parent. Under the agreement, we may borrow from the Parent. The Agreement restricts us from loaning funds to the Parent or to any of the Parent's non-utility subsidiaries; the Agreement does not restrict us from making dividends to the Parent. Borrowings under the agreement bear interest at the daily cost of external funds as defined under the Agreement, or if there are no external funds outstanding on that date, then the rate will be the daily one month LIBOR rate plus 1%.

Advances under this notes receivable bear interest at 1.50% above the daily LIBOR rate (1.71% at December 31, 2012). We had the following balances with the Utility Money Pool as of and for the years ended December 31 (in thousands):

| Utility Money Pool | 2012 | 2011 | 2010 |
|---|---|---|---|
| Notes receivable (payable), net | $ 31,645 | $ 50,477 | $ 39,862 |
| Net interest income (expense) | $ 617 | $ 1,414 | $ 467 |

Other Balances and Transactions

We have the following Power Purchase and Transmission Services Agreements with affiliated entities:

- Cheyenne Light entered into a PPA with Happy Jack. Under a separate inter-company agreement expiring on September 3, 2028, Cheyenne Light has agreed to sell up to 15 MW of the facility output from Happy Jack to us.
- Cheyenne Light entered into a PPA with Silver Sage. Under a separate inter-company agreement expiring on September 30, 2029, Cheyenne Light has agreed to sell 20 MW of energy from Silver Sage to us.
- A Generation Dispatch Agreement with Cheyenne Light that requires us to purchase all of Cheyenne Light's excess energy.

We had the following related party transactions for the years ended December 31 included in the corresponding captions in the accompanying Statements of Income:

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| | | (in thousands) | |
| Revenues: | | | |
| Energy sold to Cheyenne Light | $ 2,372 | $ 957 | $ 1,200 |
| Rent from electric properties | $ 2,661 | $ 7,523 | $ 7,884 |
| Purchases: | | | |
| Purchase of coal from WRDC | $ 20,690 | $ 21,319 | $ 13,569 |
| Purchase of excess energy from Cheyenne Light | $ 3,139 | $ 4,127 | $ 4,126 |
| Purchase of renewable wind energy from Cheyenne Light - Happy Jack | $ 1,988 | $ 1,955 | $ 2,815 |
| Purchase of renewable wind energy from Cheyenne Light - Silver Sage | $ 3,269 | $ 3,281 | $ 1,723 |
| Purchase of natural gas - other | $ 7 | $ 647 | $ 1,652 |
| Corporate support services from Parent, Black Hills Service Company and Black Hills Utility Holdings | $ 24,163 | $ 18,567 | $ 17,145 |

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NOTES TO FINANCIAL STATEMENTS (Continued)

## (11) SUPPLEMENTAL CASH FLOW INFORMATION

| Years ended December 31, | | 2012 | | 2011 | | 2010 |
|---|---|---|---|---|---|---|
| | | | | (in thousands) | | |
| Non-cash investing and financing activities - | | | | | | |
| Property, plant and equipment financed with accrued liabilities | $ | 3,969 | $ | 1,882 | $ | 7,188 |
| Non-cash decrease to money pool note receivable, net | $ | (43,984) | $ | — | $ | — |
| Non-cash dividend to Parent company | $ | 43,984 | $ | — | $ | — |
| Supplemental disclosure of cash flow information: | | | | | | |
| Cash (paid) refunded during the period for - | | | | | | |
| Interest (net of amounts capitalized) | $ | (17,099) | $ | (16,294) | $ | (19,554) |
| Income taxes | $ | 7,176 | $ | (15,347) | $ | 15,805 |

## (12) COMMITMENTS AND CONTINGENCIES

**Partial Sale of Wygen III**

On July 14, 2010, we sold a 23% ownership interest in Wygen III to the City of Gillette for $62.0 million. The purchase terminated the then current PPA with the City of Gillette, and the Wygen III Participation Agreement has been amended to include the City of Gillette. The Participation Agreement provides that the City of Gillette will pay us for administrative services and share in the costs of operating the plant for the life of the facility. The amount of net fixed assets sold totaled $55.8 million. We recognized a gain on the sale of $6.2 million.

**Power Purchase and Transmission Services Agreements**

We have the following power purchase and transmission agreements, not including related party agreements, as of December 31, 2012 (see Note 10 for information on related party agreements):

- A PPA with PacifiCorp expiring on December 31, 2023, which provides for the purchase by us of 50 MW of electric capacity and energy. The price paid for the capacity and energy is based on the operating costs of one of PacifiCorp's coal-fired electric generating plants;

- A firm point-to-point transmission access agreement to deliver up to 50 MW of power on PacifiCorp's transmission system to wholesale customers in the western region through December 31, 2023; and

- An agreement with Thunder Creek for gas transport capacity, expiring in October 31, 2019.

Costs incurred under these agreements were as follows for the years ended December 31 (in thousands):

| Contract | Contract Type | | 2012 | | 2011 | | 2010 |
|---|---|---|---|---|---|---|---|
| PacifiCorp | Electric capacity and energy | $ | 13,224 | $ | 12,515 | $ | 12,936 |
| PacifiCorp | Transmission access | $ | 1,215 | $ | 1,215 | $ | 1,215 |
| Thunder Creek | Gas transport capacity | $ | 633 | $ | 633 | $ | 633 |

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**Future Contractual Obligations**

The following is a schedule of future minimum payments required under the power purchase, transmission services, facility and vehicle leases, and gas supply agreements (in thousands):

| | | |
|---|---|---|
| 2013 | $ | 11,909 |
| 2014 | $ | 11,904 |
| 2015 | $ | 11,903 |
| 2016 | $ | 11,899 |
| 2017 | $ | 11,895 |
| Thereafter | $ | 30,884 |

**Long-Term Power Sales Agreements**

We have the following power sales agreements as of December 31, 2012:

- During periods of reduced production at Wygen III in which MDU owns a portion of the capacity, or during periods when Wygen III is off-line, MDU will be provided with 25 MW from our other generation facilities or from system purchases with reimbursement of costs by MDU;

- During periods of reduced production at Wygen III in which the City of Gillette owns a portion of the capacity, or during periods when Wygen III is off-line, we will provide the City of Gillette with its first 23 MW from our other generating facilities or from system purchases with reimbursement of costs by the City of Gillette. Under this agreement, Black Hills Power will also provide the City of Gillette their operating component of spinning reserves;

- An agreement under which we supply energy and capacity to MEAN expiring on May 31, 2023. This contract is unit-contingent based on up to 10 MW from our Neil Simpson II and up to 10 MW from our Wygen III plants. The energy and capacity purchase requirements decrease over the term of the agreement; and

- A PPA with MEAN, expiring on April 1, 2015. Under this contract, MEAN purchases 5 MW of unit-contingent energy and capacity from Neil Simpson II and 5 MW of unit-contingent capacity from Wygen III.

**Oil Creek Fire**

On June 29, 2012, a forest and grassland fire occurred in the western Black Hills. It is alleged the fire occurred when a high voltage electrical transmission line maintained by us fell to the ground, and that electrical arcing from the downed line ignited dry grass or brush. The fire burned approximately 60,000 acres of land owned by private landowners as well as the United States Bureau of Land Management and the State of Wyoming. We have received written claims from the State of Wyoming and a landowner seeking recovery of damages for alleged injury to timber, grass, fencing, fire suppression and rehabilitation costs. The total amount of damages currently claimed by the State of Wyoming and the landowners is approximately $8 million. We have been notified that additional private landowner claims are forthcoming. Our investigation into the cause and origin of the fire is still pending. Based upon information developed in our investigation to date, we expect to deny and will vigorously defend all claims arising out of the fire. Given the uncertainty of litigation, however, a loss relating to the fire and the litigation is reasonably possible. We cannot reasonably estimate the amount of a potential loss because our investigation is ongoing, and because we expect further claims to be presented by other parties. Although we cannot predict the outcome of our investigation or the viability of potential claims, based on information currently available, management believes that any such claims, if determined adversely to us, will not have a material effect on our financial statements.

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NOTES TO FINANCIAL STATEMENTS (Continued)

**Legal Proceedings**

We are subject to various legal proceedings, claims and litigation which arise in the ordinary course of operations. In the opinion of management, the amount of liability, if any, with respect to these actions would not materially affect our financial position, results of operations or cash flows.

In the normal course of business, we enter into agreements that include indemnification in favor of third parties, such as information technology agreements, purchase and sale agreements and lease contracts. We have also agreed to indemnify our directors, officers and employees in accordance with our articles of incorporation, as amended. Certain agreements do not contain any limits on our liability and therefore, it is not possible to estimate our potential liability under these indemnifications. In certain cases, we have recourse against third parties with respect to these indemnities. Further, we maintain insurance policies that may provide coverage against certain claims under these indemnities.

**Environmental Matters**

We are subject to costs resulting from a number of federal, state and local laws and regulations which affect future planning and existing operations. They can result in increased capital expenditures, operating and other costs as a result of compliance, remediation and monitoring obligations. Due to the environmental issues discussed below, we may be required to modify, curtail, replace or cease operating certain facilities or operations to comply with statutes, regulations and other requirements of regulatory bodies.

*Air*

Our generation facilities are subject to federal, state and local laws and regulations relating to the protection of air quality. These laws and regulations cover, among other pollutants, carbon monoxide, $SO_2$, $NO_x$, mercury particulate matter and GHG. Power generating facilities burning fossil fuels emit each of the foregoing pollutants and, therefore, are subject to substantial regulation and enforcement oversight by various governmental agencies.

Title IV of the Clean Air Act applies to several of our generation facilities, including the Neil Simpson II, Neil Simpson CT II, Lange CT, Wygen III and Wyodak plants. Title IV of the Clean Air Act created an $SO_2$ allowance trading program as part of the federal acid rain program. Without purchasing additional allowances, we currently hold sufficient allowances to satisfy Title IV at all such plants through 2042.

The EPA issued the Industrial and Commercial Boiler Regulations for Area Sources of Hazardous Air Pollutants, with updates which impose emission limits, fuel requirements and monitoring requirements. The rule has a compliance deadline of March 21, 2014. In anticipation of this rule we suspended operations at the Osage plant on October 1, 2010 and as a result of this rule, we suspended operations at the Ben French facility on August 31, 2012 with plans to retire Osage, Ben French and Neil Simpson I on or before March 21, 2014. While the net book value of these plants is estimated to be insignificant at the time of retirement, we would reasonably expect any remaining value to be recovered through future rates.

*Solid Waste Disposal*

Various materials used at our facilities are subject to disposal regulations. Our Osage plant, at which operations have been suspended, has an on-site ash impoundment that is near capacity. An application to close the impoundment was approved by the State of Wyoming on April 13, 2012. Site closure work is underway with post closure monitoring to continue for 30 years.

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**(13) QUARTERLY HISTORICAL DATA (Unaudited)**

We operate on a calendar year basis. The following table sets forth selected unaudited historical operating results data for each quarter (in thousands):

| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|---|---|---|---|---|
| **2012** | | | | |
| Operating revenues | $ 62,270 | $ 58,372 | $ 61,134 | $ 61,533 |
| Operating income | $ 12,742 | $ 13,859 | $ 15,361 | $ 15,619 |
| Net income | $ 6,053 | $ 6,727 | $ 8,147 | $ 6,159 |
| **2011** | | | | |
| Operating revenues | $ 59,194 | $ 56,098 | $ 64,940 | $ 65,399 |
| Operating income | $ 11,917 | $ 9,181 | $ 19,175 | $ 14,447 |
| Net income | $ 5,881 | $ 3,741 | $ 10,510 | $ 6,965 |