KG&E THE ELECTRIC COMPANY

KANSAS GAS AND ELECTRIC COMPANY

GLENN L. KOESTER
VICE PRESIDENT - NUCLEAR

May 12, 1986

Mr. Harold R. Denton, Director
Office of Nuclear Regulation
U.S. Nuclear Regulatory Commission
Washington, D.C. 20555

KMLNRC 86-087
Re: Docket No. STN 50-482
Subj: Transmittal of 1985 Annual Reports

Dear Mr. Denton:

Kansas Gas and Electric Company is transmitting herewith one copy each of the Kansas Gas and Electric Company Report to Stockholders 1985, Kansas City Power & Light Company 1985 Annual Report and Kansas Electric Power Cooperative, Inc. Audited Financial Statement for 1985.

This information is submitted in accordance with 10 CFR 50.71(b). If there are any questions concerning this submittal please contact me or Mr. O. L. Maynard of my staff.

Yours very truly,

John A Bailey
for Glenn L. Koester
Vice President - Nuclear

GLK:see

Attachments

cc: PO'Connor (2)
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Audited Financial Statements

Kansas Electric Power Cooperative, Inc.

December 31, 1985

Ernst & Whinney

Audited Financial Statements

Kansas Electric Power Cooperative, Inc.

December 31, 1985

Ernst & Whinney

Audited Financial Statements

KANSAS ELECTRIC POWER COOPERATIVE, INC.

December 31, 1985

Ernst & Whinney

2000 City Center Square
1100 Main Street
Kansas City, Missouri 64105

816/474-8050

Board of Trustees
Kansas Electric Power Cooperative, Inc.
Topeka, Kansas

We have examined the balance sheets of Kansas Electric Power Cooperative, Inc. as of December 31, 1985 and 1984, and the related statements of patronage capital (deficit) and other equities, operations and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As discussed in Note C, the Kansas Corporation Commission issued a rate order to Kansas Electric Power Cooperative, Inc. which dissallowed a portion of its investment in the Wolf Creek Nuclear Plant. Kansas Electric Power Cooperative, Inc. has been ordered by the Kansas Corporation Commission to present a plan for financial treatment of their disallowed investment in the Wolf Creek Nuclear Plant. Presentation of the plan has been delayed pending the resolution of certain litigation as described in Note C. The ultimate outcome of this issue cannot presently be determined.

In our opinion, subject to the effects on the financial statements of such adjustments, if any, as might have been required had the outcome of the uncertainty referred to in the preceding paragraph been known, the financial statements referred to above present fairly the financial position of Kansas Electric Power Cooperative, Inc. at December 31, 1985 and 1984, and the results of its operations and changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Ernst & Whinney

Kansas City, Missouri
March 10, 1986

BALANCE SHEETS

KANSAS ELECTRIC POWER COOPERATIVE, INC.

	December 31 1985	December 31 1984
ASSETS		
UTILITY PLANT		
Electric plant in service	$ 310,863	$ 272,036
Construction completed not classified--Notes B and C	216,414,864	---
Construction work in progress	---	190,433,724
	216,725,727	190,705,760
Less allowances for depreciation	2,555,428	71,242
	214,170,299	190,634,518
Nuclear fuel, less amortization of $1,400,478 at December 31, 1985	2,899,544	3,686,186
	217,069,843	194,320,704
CURRENT ASSETS		
Cash and short-term investments (including amounts restricted for construction of $490,187 at 1984)	1,244,846	1,601,921
Short term investments restricted for payment of long-term debt--Note E	37,100,000	---
National Rural Utilities Cooperative Finance Corp. patronage capital certificate	1,228,416	---
Accounts receivable from members	8,077,350	5,757,442
Receivable from power suppliers	696,248	3,385,412
Materials and supplies inventory	581,511	---
Other assets and prepaid expenses	231,597	12,679
	49,159,968	10,757,454
OTHER ASSETS		
Investments in associated organizations	7,231,617	6,249,108
Deferred debits--Notes C and D	3,430,915	27,119
Unamortized bond issue costs	802,736	---
Bond fund reserve	3,969,000	---
Decommissioning fund assets	26,499	---
	15,460,767	6,276,227
	$281,690,578	$211,354,385

	December 31 1985	1984
LIABILITIES AND PATRONAGE CAPITAL		
PATRONAGE CAPITAL (DEFICIT) AND OTHER EQUITIES		
Memberships	$ 2,800	$ 2,800
Patronage capital (deficit)	(4,310,701)	(2,008,329)
Other equities	482,768	157,938
	(3,825,133)	(1,847,591)
LONG TERM DEBT, less current portion--Note E	236,669,867	201,370,290
CURRENT LIABILITIES		
Note payable to the National Rural Utilities Cooperative Finance Corp.	3,030,378	---
Accounts payable	5,687,144	6,898,406
Accounts payable to members--Note I	1,483,618	3,986,263
Payroll and payroll related liabilities	19,832	18,164
Accrued property taxes	417,242	337,261
Accrued interest payable	199,771	13,665
Current portion of long-term debt--Note E	37,981,360	577,927
	48,819,345	11,831,686
DECOMMISSIONING LIABILITY	26,499	---
COMMITMENTS AND CONTINGENCIES--Notes B, C, F and I		
	$281,690,578	$211,354,385

See notes to financial statements

STATEMENTS OF PATRONAGE CAPITAL (DEFICIT) AND OTHER EQUITIES

KANSAS ELECTRIC POWER COOPERATIVE, INC.

	Memberships	Patronage Capital (Deficit) Unallocated	Other Equities	Total
Balance at January 1, 1984	$2,800	$ (930,212)	$ 62,991	$ (864,421)
1984 Net Margin (loss)	---	(1,078,117)	94,947	(983,170)
Balance at December 31, 1984	2,800	(2,008,329)	157,938	(1,847,591)
1985 Net Margin (loss)	---	(2,302,372)	324,830	(1,977,542)
Balance at December 31, 1985	$2,800	$(4,310,701)	$482,768	$(3,825,133)

See notes to financial statements

STATEMENTS OF OPERATIONS

KANSAS ELECTRIC POWER COOPERATIVE, INC.

	Year Ended December 31 1985	1984
Operating revenue from member cooperatives	$61,708,116	$64,980,587
Operating expenses:		
Power purchased	51,350,689	63,888,314
Nuclear fuel	945,727	---
Nuclear plant operations	1,344,697	---
Nuclear plant maintenance	180,329	---
Nuclear plant administrative and general	503,169	---
Administrative and general	2,102,725	1,745,480
Depreciation and amortization	1,647,673	30,799
Interest	5,935,479	394,111
	64,010,488	66,058,704
LOSS FROM OPERATIONS	(2,302,372)	(1,078,117)
Other income (expense):		
Interest income	324,830	94,947
Refunds from power suppliers	2,641,494	7,843,213
Refunds to member cooperatives	(2,641,494)	(7,843,213)
	324,830	94,947
NET LOSS	$(1,977,542)	$ (983,170)

See notes to financial statements

STATEMENTS OF CHANGES IN FINANCIAL POSITION

KANSAS ELECTRIC POWER COOPERATIVE, INC.

	Year Ended December 31 1985	1984
SOURCES OF WORKING CAPITAL		
Net loss	$(1,977,542)	$ (983,170)
Charges to income not affecting working capital:		
Depreciation and amortization	1,647,673	30,799
Amortization of nuclear fuel	809,254	---
TOTAL PROVIDED (USED) FROM OPERATIONS	479,385	(952,371)
Proceeds from long-term debt	72,796,000	53,891,412
Depreciation charged to deferred debits	846,819	---
Amortization of nuclear fuel charged to deferred debits and construction work in progress	591,224	---
Decrease in deferred debits	---	133,095
Increase in decommissioning liability	26,499	---
Other	---	---
	74,739,927	53,072,136
APPLICATION OF WORKING CAPITAL		
Increase in investments in associated	982,509	292,684
Net additions in utility plant	26,030,273	47,709,227
Reduction of long-term debt	37,496,423	588,403
Increase in nuclear fuel	613,836	922,584
Increase in deferred debits	3,403,796	---
Increase in unamortized bond issue costs	802,736	---
Increase in bond fund reserve	3,969,000	---
Increase in decommissioning fund assets	26,499	---
	73,325,072	49,512,898
INCREASE IN WORKING CAPITAL	$ 1,414,855	$ 3,559,238
CHANGES IN COMPONENTS OF WORKING CAPITAL		
Increase (decrease) in current assets:		
Cash and short-term investment	$ (357,075)	$ (151,123)
Short-term investments restricted for payment of long-term debt	37,100,000	---
National Rural Utilities Cooperative Finance Corp. patronage capital certificate	1,228,416	---
Accounts receivable from members	2,319,908	(492,080)
Receivable from power suppliers	(2,689,164)	3,385,412
Material and supplies inventory	581,511	---
Other assets and prepaid expenses	218,918	6,218
	38,402,514	2,748,427

STATEMENTS OF CHANGES IN FINANCIAL POSITION--CONT'D

	Year Ended December 31 1985	1984
CHANGES IN COMPONENTS OF WORKING CAPITAL		
Increase (decrease) in current liabilities		
Note payable to the National Rural Utilities Cooperative Finance Corp.	3,030,378	---
Accounts payable	(1,211,262)	(89,604)
Accounts payable to members	(2,502,645)	3,385,412
Payroll and payroll related liabilities	1,668	(4,208)
Accrued property taxes	79,981	53,018
Accrued interest payable	186,106	(4,733,356)
Current portion of long-term debt	37,403,433	577,927
	36,987,659	(810,811)
INCREASE IN WORKING CAPITAL	$ 1,414,855	$ 3,559,238

See notes to financial statements

NOTES TO FINANCIAL STATEMENTS

KANSAS ELECTRIC POWER COOPERATIVE, INC.

December 31, 1985

NOTE A--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Kansas Electric Power Cooperative, Inc. (KEPCo) maintains its accounting records in accordance with the Federal Energy Regulatory Commission's (FERC) chart of accounts as adopted by the Rural Electrification Administration (REA). The more significant accounting policies are described below.

Utility Plant: Utility plant (see Note B) is stated at cost. Provision for depreciation is computed on the straight-line method at the following annual composite rates:

Construction Completed not Classified	3.44%
Transportation Equipment	25 to 33%
Office Furniture and Fixtures	10%
Leasehold Improvements	20%

Depreciation and lease amortization for 1985 and 1984 amounted to \$2,494,492 and \$14,885, respectively, of which \$1,647,673 and \$14,885, respectively, was charged to depreciation and amortization expense with the remaining amount being charged to various deferred debits, member clearing accounts and construction in progress.

Leases which meet the criteria of the Financial Accounting Standards Board (FASB) Statement No. 13 are accounted for as capital leases. Amortization of equipment under capital leases is computed on the straight-line method over the lease period. Amortization expense for 1985 and 1984 amounted to \$27,283 and \$15,914, respectively. Rentals paid under operating leases are charged to operations as incurred.

Nuclear Fuel: The cost of nuclear fuel (see Note B), including a provision for the disposal of spent fuel, is being amortized to fuel expense based on core burn-up. During 1985, the total provision amounted to \$1,579,121 of which \$945,727 was charged to nuclear fuel expense and the remaining amount was charged to deferred debits or capitalized as part of the cost of capital assets under construction during the testing period.

The owners of the Wolf Creek Nuclear Plant have entered into a contract with the Department of Energy that provides for the permanent disposal of spent fuel.

Investments in Associated Organizations: Investments in associated organizations consist principally of patronage capital certificates and subordinated term certificates of the National Rural Utilities Cooperative Finance Corp. (NRUCFC). NRUCFC patronage capital certificates maturing within a year of the balance sheet date are reflected as a current asset.

Short-Term Investments: Short-term investments consist of NRUCFC commercial paper and are stated at cost which is approximately equal to market.

NOTE A--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES--CONT'D

Receivable From Power Suppliers: Receivable from power suppliers consists of refunds from Kansas Gas and Electric Company (KGE), Kansas Power and Light Company (KPL) and Centel Corporation for retroactive rate and fuel adjustments. A corresponding payable to member cooperatives is included in accounts payable to members.

Materials and Supplies Inventory: Materials and supplies inventory for the Wolf Creek Nuclear Plant (see Note B) are stated at average cost.

Unamortized Bond Issue Costs: Unamortized bond issue costs related to the issuance of the floating/fixed rate pollution control revenue bonds (see Note E) are being amortized over the estimated period the debt is expected to be outstanding.

Decommissioning fund assets/decommissioning liability: Decommissioning fund assets and the corresponding decommissioning liability represent funds collected from members, pursuant to a rate order, to be used for the decommissioning of the Wolf Creek Nuclear Plant.

Refunds from Power Suppliers/Refunds to Member Cooperatives: Refunds from power suppliers for retroactive rate and fuel adjustments are received by KEPCo and are remitted to member cooperatives in accordance with Kansas Corporation Commission (KCC) guidelines.

Reclassifications: Certain amounts in the 1984 financial statements have been reclassified to conform with the 1985 presentation.

NOTE B--WOLF CREEK NUCLEAR PLANT

KEPCo owns six percent of the Wolf Creek Nuclear Plant (Wolf Creek), near Burlington, Kansas. The remainder is owned by the Kansas City Power and Light Company (KCPL) and KGE, the current operating agent. KEPCo is entitled to a proportionate share of the demand and energy from Wolf Creek which is used to supply a portion of KEPCo's members requirements. KEPCo is billed by KGE for 6% of the operations, maintenance and administrative and general costs related to Wolf Creek.

The KCC declared Wolf Creek commercially operable on September 3, 1985. KEPCo's total investment includes interest and administrative costs during construction, and first project developmental costs incurred prior to January 1, 1982. KEPCo's investment in Wolf Creek, including nuclear fuel, at December 31, 1985, was $219,314,408, including approximately $1,452,000 that management invoiced to KCPL and KGE for reimbursable construction costs. Amounts reimbursed will be credited to plant-in-service when received. Management now estimates that KEPCo's total investment in Wolf Creek will be approximately $220,000,000.

NOTE C--DISALLOWED COSTS

Effective October 1, 1985, the KCC issued a rate order relating to KEPCo's investment in Wolf Creek. The rate order disallowed approximately $22,033,000 of the $209,000,000 of KEPCo's investment in Wolf Creek included in the rate request and $2,600,000 of other costs, and disallowed $6,400,000 of the $95,600,000 in annual revenue requested. In the rate order, the KCC recognized that permanent disallowment of this portion of KEPCo's investment would seriously impact the finances of KEPCo and its members, and it ordered KEPCo to present a plan for financial treatment of the disallowed investment. KEPCo filed an application for rehearing with the KCC on the issue of disallowed costs. The application for rehearing was denied and KEPCo subsequently filed an appeal with the Kansas Supreme Court and the Kansas Supreme Court agreed to hear KEPCo's appeal. Consequently, KEPCo has not presented its plan to the KCC. If the Supreme Court allows inclusion of the $22,033,000 in KEPCo's rate, the provision in the KCC order relating to the presentation of a plan will no longer be applicable. If the Supreme Court upholds the KCC Order, a plan for recovering the disallowed costs will be subsequently presented to the KCC. KEPCo has depreciated the disallowed portion of its investment in Wolf Creek. The depreciation expense of $249,185 and the interest costs related to the disallowed portion of $825,559 for the period of September 3, 1985 through December 31, 1985 are included in deferred debits on the accompanying balance sheet. If the KCC does not permit inclusion of $22,033,000 of the investment in Wolf Creek, the net carrying value of the disallowed portion ($21,783,815) and the depreciation and interest costs included in deferred debits will be charged to expense. However, it is management's expectation that such amounts will be recovered through the rate making process.

It is management's opinion that present rates are adequate to generate cash flow sufficient to meet its needs through 1986. However, the present rates are not sufficient to allow KEPCo to recover its investment in Wolf Creek over the life of the facility.

NOTE D--DEFERRED DEBITS

Deferred debits include certain operating expenses incurred by KEPCo during the period of September 3, 1985 through December 31, 1985 related to the operation of the Wolf Creek Nuclear Plant including interest and depreciation of $1,074,744 as explained in Note C.

Although the Wolf Creek Nuclear Plant began commercial operations on September 3, 1985, the KCC ordered KEPCo to accumulate all revenues and expenses related to the operation of Wolf Creek for the period from September 3, 1985 through September 30, 1985 in a deferred debit. These net expenses amounted to $1,884,003. It is management's expectation that such amounts will be recovered through the rate making process.

NOTE D--DEFERRED DEBITS--CONT'D

Certain utility plant costs were not included in KEPCo's rate request, which was based on projected utility plant costs. KEPCo anticipates filing an additional rate request in 1986 which will include KEPCo's Wolf Creek investment not included in its original request and will cover more current estimates of other costs. Any changes to KEPCo's rates are subject to KCC approval. The related depreciation and interest on utility plant costs for the period of September 3, 1985 through December 31, 1985 amounted to $472,168, and is included in deferred debits.

NOTE E--LONG TERM DEBT

Long term debts consists of:

	December 31 1985	December 31 1984
Mortgage notes payable to the Federal Financing Bank at rates varying from 8.044% to 13.197%, payable in quarterly installments (interest only through 1988) through 2018. Utility plant assets with a cost of approximately $172,314,864 are pledged as collateral.	$200,000,000	$200,000,000
Mortgage notes payable to the Federal Financing Bank at rates varying from 10.122% to 11.932%, principal and interest payable in quarterly installments through 2015. Utility plant assets with a cost of approximately $172,314,864 are pledged as collateral.	29,888,632	1,265,000
Floating/fixed rate pollution control revenue bonds, City of Burlington, Kansas, Pooled Series 1985C, variable interest rate, principal payments commencing in 1987 and continuing annually through 2015. Utility plant assets with a cost of $44,100,000 are pledged as collateral.	44,100,000	---
Advances from member and non-member cooperatives	557,281	557,281
Capital lease obligation	105,314	125,936
	274,651,227	201,948,217
Less current portion	37,981,360	577,927
	$236,669,867	$201,370,290

NOTE E--LONG TERM DEBT--CONT'D

Aggregate maturities of mortgage notes payable to the Federal Financing Bank (FFB) and floating/fixed rate pollution control bonds as of December 31, 1985 are as follows:

Year	Amount
1986	$ 37,399,479
1987	711,318
1988	724,477
1989	1,154,768
1990	1,401,577
Thereafter	232,597,013
	$273,988,632

The proceeds from the floating/fixed rate pollution control revenue bonds which are unconditionally guaranteed by the National Rural Utilities Cooperative Finance Corporation (CFC), were used for the following purposes:

Payment on mortgage notes payable to FFB which matured on January 3, 1986	$ 37,100,000
Fund a debt service reserve fund	3,969,000
Purchase CFC subordinated term certificates	2,205,000
Payment of bond issue costs	826,000
	$ 44,100,000

Leased computer equipment with a cost of $136,412 and accumulated amortization of $43,197 and $15,914 at December 31, 1985 and 1984, respectively, has been capitalized in accordance with FASB Statement No. 13 and is included in electric plant in service. Future minimum payments, by year and in the aggregate, under the capital lease obligation are as follows:

Year Ending December 31	
1986	$ 41,255
1987	41,255
1988	41,255
1989	17,190
1990	
Total minimum lease payments	$140,955
Amount representing interest	35,641
Present value of net minimum lease payments	$105,314
Less current portion	24,600
	$ 80,714

NOTE E--LONG TERM DEBT--CONT'D

At December 31, 1985, KEPCo has an approved FFB loan guaranteed by REA in the amount of $200,000,000. REA has also guaranteed additional loans of $30,000,000 and $10,000,000. KEPCo has the option on the initial $200,000,000 in FFB mortgage notes to elect short-term maturity dates of not less than two years nor more than seven years after the date of the initial advance or may elect a long-term maturity date of 34 years after the end of the calendar year in which the initial advance was made. On the maturity of a short-term advance, KEPCo may refinance the advance with another short-term advance with a maturity date of not greater than seven years from the date of the original advance or may elect to refinance with a long-term maturity date of 34 years after the end of the calendar year in which the initial advance was made. At December 31, 1985, KEPCo had $152,838,500 of advances with short-term maturity dates between January 1, 1986 and December 31, 1986. KEPCo intends to refinance $115,738,500 of these advances as described above or under other terms and conditions approved by REA. Accordingly, these advances have been classified as long-term debt for financial statement purposes.

KEPCo has the option on the remaining $30,000,000 and $10,000,000 in FFB mortgage notes to elect short-term maturity dates of two years or a long-term maturity date of December 31, 2015. On the maturity of a short-term advance, KEPCo may refinance the advance with another short-term advance with a maturity date of two years or may elect the long-term maturity date of December 31, 2015. At December 31, 1985, no advances had maturity dates between January 1, 1986 and December 31, 1986.

Advances of funds from member and non-member cooperatives resulted from the transfer of assets and liabilities from the Kansas Electric Cooperative Inc. to KEPCo during 1977. These funds were used to finance economic, engineering, legal and administrative investigations of projects that were being contemplated. The agreements with the cooperatives state that should an investigation result in the construction of a project or projects, amounts of investigation and development costs transfered to project utility plant accounts are to be reimbursable to the systems participating in the agreements on a pro rata basis.

During 1985 and 1984, interest incurred totaled approximately $24,157,000 and $20,930,000, respectively, of which $5,935,479 and $394,111, respectively, was charged to interest expense and the remaining amount was charged to various deferred debits (see Notes C and D) or capitalized as part of the cost of capital assets under construction.

NOTE F--OPERATING LEASE

The Company leases office space under a non-cancellable operating lease. The lease expires in 1988 and may be renewed for five years. The related rental expense for 1985 and 1984 was $52,635 and $44,625, respectively. Future minimum lease payments for space currently leased at December 31, 1985 are as follows:

Year	Amount
1986	$59,412
1987	59,412
1988	59,412

The minimum lease payments can be increased to the extent that taxes and insurance paid by the lessor exceed 1984 levels.

NOTE G--PENSION PLAN

KEPCo participates in the National Rural Electric Cooperative Association (NRECA) retirement and security program for its employees. KEPCo makes annual contributions to the plan equal to the amounts accrued for pension costs. In the master multiple-employee plan, which is available to all members of NRECA, the accumulated benefits and plan assets are not determined or allocated by individual employees. KEPCo's pension cost for the plan for the years ended December 31, 1985 and 1984 was $35,215 and $35,707, respectively.

NOTE H--INCOME TAXES

At December 31, 1985, KEPCo had net operating loss carryforwards totalling approximately $64,279,000 available to reduce future taxable income and investment tax credit carryforwards of $12,014,574 as follows:

Net operating loss carryforward	Investment tax credit carryforward	Available Through
$ 8,199,000	$ $ ---	1996
12,410,000	---	1997
17,124,000	1,378	1998
21,467,000	1,862	1999
5,079,000	12,011,334	2000
$64,279,000	$12,014,574	

NOTE H--INCOME TAXES--CONT'D

The difference between the net operating loss shown in the accompanying financial statements and the net operating loss for tax purposes for 1984 was due primarily to interest costs related to construction which was capitalized as part of construction work in progress for financial statement purposes and expensed for tax purposes. The difference between the net operating loss shown in the accompanying financial statement and the net operating loss for tax purposes in 1985 is due primarily to operating expenses deferred for financial statement purposes (see Note D) and expensed for tax purposes.

NOTE I--CONTINGENCIES

During 1982, KEPCo became a defendant in certain litigation concerning disputed power billings from KGE of approximately $746,000. The dispute was over the effective date of a rate increase and the allowability of a capacity credit related to 30 MW of KEPCo's hydro power that was used in KGE's control area in May, 1982. In 1983, the litigation relating to the effective date was dismissed without prejudice and in 1984 final resolution of the rate increase issue was settled but the capacity credit issue was not resolved. Consequently, KEPCo member funds in the amount of approximately $596,000 have been retained, with the approval of the KCC, for use as needed upon final resolution of this issue. The $596,000 is included in accounts payable to members at December 31, 1985 and 1984.

In connection with the purchase of KEPCo's six percent interest in Wolf Creek, KGE and KCPL have made claims against KEPCo for approximately $3,700,000 of KEPCo's capital credits from CFC. KEPCo's management believes there is no basis to the claims, however, should KGE and KCPL prevail, any amounts paid will be added to KEPCo's investment in Wolf Creek. In addition, the purchase agreement provided that KGE and KCPL would be indemmified for the tax consequences of the sale of Wolf Creek to KEPCo. KCPL and KGE have received unfavorable Internal Revenue Service rulings which assessed KCPL and KGE approximately $3,000,000 and $250,000, respectively, in additional taxes resulting from the sale. If KCPL and KGE are unsuccessful in appealing these rulings, they have indicated they will make claims against KEPCo for the amount of additional taxes paid. Any amounts paid by KEPCo as a result of these claims will be added to KEPCo's investment in Wolf Creek. Any changes to KEPCo's rates as a result of this additional investment will be subject to KCC approval.

KEPCo is a defendant in various lawsuits which are in various stages of investigation and litigation. In the opinion of management and KEPCo's legal counsel, these lawsuits are of doubtful merit and will be settled in KEPCo's favor.

1985 Annual Report To Stockholders

Kansas Gas and Electric Company

LETTER TO STOCKHOLDERS

1985 Was a Landmark Year

Our main goal came in three parts, each challenging in itself:

- Completing Wolf Creek Generating Station,
- Maintaining our historic good service to customers,
- Starting to restore our financial health.

We accomplished all three.

On March 11 the Nuclear Regulatory Commission awarded Wolf Creek its low power license. By September 3 the plant was in commercial operation. Since then its performance has been outstanding.

Service to our customers remained at a high level during the challenging time of bringing Wolf Creek into operation. The credit goes to an outstanding effort by our employees.

We expect 1986 to produce cash earnings, the first cash earnings in three years. They will be lower than we'd like. But, we have taken a number of steps to control expenses and have appealed the rate order received late in 1985.

CONTENTS

Wolf Creek Operation Outstanding

Wolf Creek was built in less time than other comparable nuclear units. Still, we constantly stressed quality so the plant would operate both safely and efficiently. The results of this emphasis are evident.

In November and December, Wolf Creek, even though new, ranked second nationally among nuclear units in electricity produced. Availability of the unit has been phenomenal. From commercial operation in September through January 1986, the plant was available 97% of the time. The plant operated continuously for 134 days. Already we know the unit will set a new U.S. record for power generated in the first six months of operation.

Major Construction Program Successfully Concluded

Completing Wolf Creek ends the huge construction program we started in the late 1960s. Our goal was to reduce the use of gas and oil as power plant fuel by building plants fueled by coal and uranium. To do so we invested $1.8 billion in six new generating units built in partnership with other utilities. Five of the units are coal fired, providing 1,060 megawatts of capacity. Our share of Wolf Creek is 530 megawatts.

KG&E now has generating capacity to meet customer needs into the 1990s. Equally important, reliability is enhanced by the mix of fuels. Government orders to reduce oil and gas use have also been met.

With our major construction program complete, we expect construction expense to fall from the yearly average of $188 million for the past three years to $45 million in 1986, $54 million in 1987 and $60 million in 1988.

Rate Relief Picture Mixed

Most of the increased rates we requested for the first year were approved — $135 million of the requested $145 million. However, the amount requested over the long term was reduced. We had requested an increase of $370.9 million to be phased in over five years. The Kansas Corporation Commission allowed $169.6 million phased in over three years. However, the KCC has left open the door for eventual rate recognition of all but about 10% of our Wolf Creek investment.

Still we have appealed the KCC rate order. The Kansas Supreme Court will hear our case March 28. A decision is expected shortly thereafter.

Financial Results Summarized

Earnings per share of common stock in 1985 were $2.13 compared with $3.07 in 1984. As a result of our rate order, earnings per share in the last quarter of 1985 were 12 cents compared to 58 cents for the same period the year before.

On October 4, directors approved a dividend of 29.5 cents per share. While that was just half of the former rate, the board's action stopped speculation about the impact of the Wolf Creek rate order on our dividend. On January 28, 1986, directors declared the first quarter of 1986 dividend at the 29.5 cent rate. The price per share of our common stock as of the date of this letter was $16.50, a considerable improvement over the 1985 low price of $9.625 on October 3.

We expect total earnings in 1986 to be below those of 1985, but the situation is being managed. Earnings from allowance for funds used during construction (AFC), non-cash income, has been largely lost now that the construction program has been completed.

Three major rating agencies reviewed our financial condition late in 1985. Now, for the first time since 1983, all three agencies describe our securities as "investment grade."

Earnings Have Urgent Priority

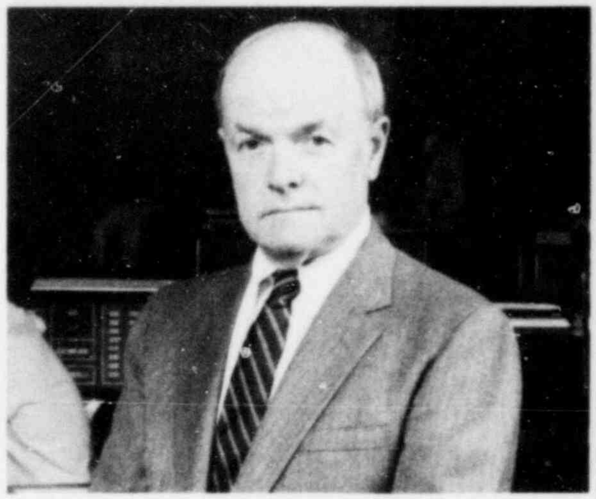
Continuing to improve our financial health is an important goal. In addition to appealing the rate order, we have already taken several steps to accomplish this.

- Two generating plants have been closed, one retired because of age and the second gas/oil unit taken out of service and mothballed.
- Some 200 jobs have been eliminated, one of every seven among non-nuclear employees.
- Our cost cuts will mean that 1986 non-nuclear operating expenses will be lower than in 1985. Our commitment for Wolf Creek is to provide all necessary resources to operate the plant safely.
- Cost savings will also result from lower interest rates. With our power plant construction program complete, most future financing will be to replace high-cost debt and preferred stock with lower-cost securities.

New Directors Named

Two new directors were elected in 1985 to succeed two who had retired.

Howard Brenneman, president and chief executive of the Hesston Corporation in Hesston, Kansas, one of the nation's leading manufacturers of farm equipment, was elected to succeed Lyle Yost, founder and chairman of Hesston Corporation. Dr. Newton Smith, physician and surgeon of Arkansas City, Kansas, was named to replace Robert A. Brown, chairman of the board of The Home National Bank, also of Arkansas City. Mr. Brown and Mr. Yost had compiled 48 years of service to KG&E.



Both had reached the mandatory retirement age.

On January 28, 1986, three additional directors were named, expanding the board from 15 to 18 and providing increased experience to draw on in these important times. The new board members are Glenn Biggs, chairman of the board of trustees of the San Antonio City Public Service Board and vice chairman of the board, InterFirst Bank, San Antonio, Texas; James J. Noone, attorney and retired administrative judge for the District Court of Sedgwick County, Wichita, and Lawrence E. Walsh, former president of the American Bar Association and retired federal district court judge, Oklahoma City, Oklahoma.

A Final Note

Before closing, it is important to say "thank you" to 125 loyal KG&E employees who retired in 1985. Among those were Bernard Ruddick, vice president - engineering, and Howard J. Hansen, who as group vice president directed financing and accounting functions. Mr. Hansen was succeeded by James Haines, former vice president-regulatory affairs. William B. Moore, who had been manager of finance, was named vice president-finance and chief financial officer.

The continuing support of stockholders has been a major factor in our ability to successfully deal with the critical issues that have been faced in recent years. Your supportive calls and letters, your questions and your concerns have helped. The board of directors and officers fully understand and appreciate the obligation we have to you as owners.

Please review all sections of this report for more detailed discussions of the points raised. Let me know if you have questions or comments.

I call 1985 a landmark year because of the significance of completion of Wolf Creek and our major construction program. We are now poised to meet other challenges head-on and to take advantage of new opportunities.

Wilson K. Cadman

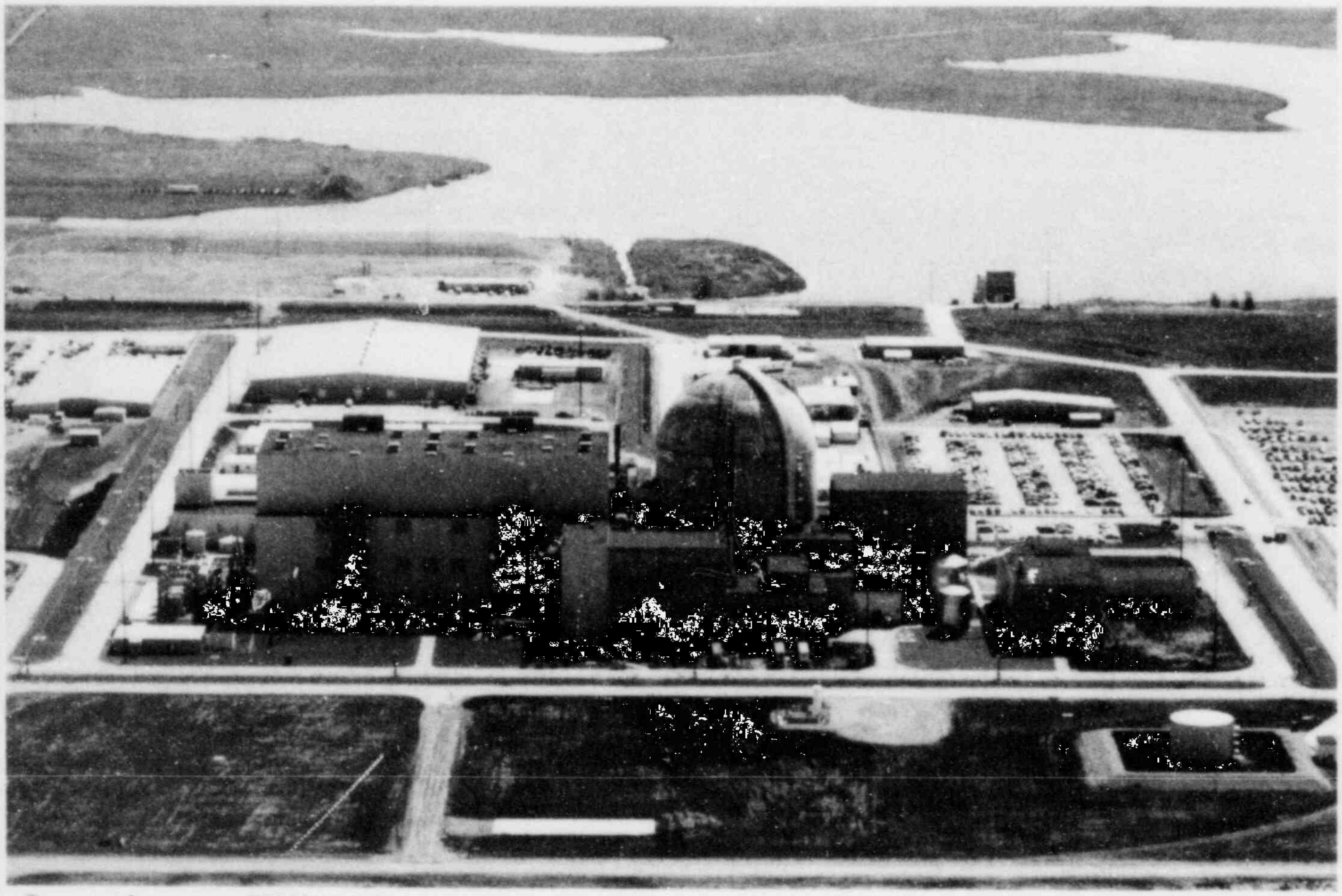
Wilson K. Cadman
Chairman of the Board and President

February 25, 1986

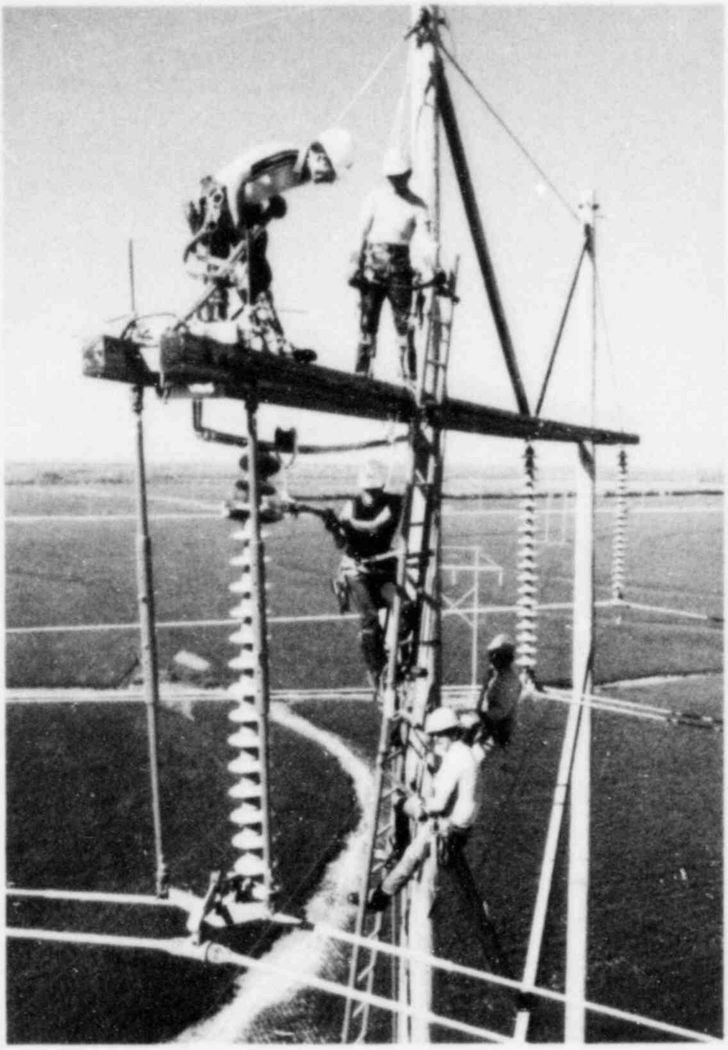
FINANCIAL HIGHLIGHTS, FIVE-YEAR COMPARISON

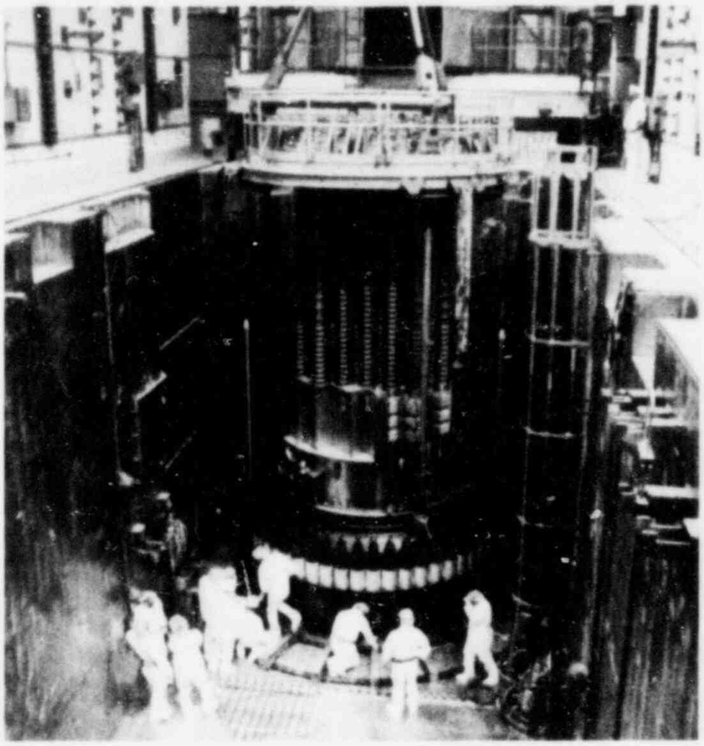
(Dollars in Thousands except per share data)

	1985	1984	1983	1982	1981
Operating Revenues	$ 410,786	$ 410,753	$ 393,053	$ 350,937	$ 313,039
Net Income	$ 97,732	$ 121,858	$ 107,538	$ 84,663	$ 65,975
Earnings Applicable to Common Stock	$ 83,377	$ 106,495	$ 92,027	$ 70,521	$ 53,060
Average Shares of Common Stock Outstanding	39,118,105	34,698,342	29,912,327	23,503,302	18,631,479
Common Stock Per Share Data					
Earnings	$ 2.13	$ 3.07	$ 3.08	$ 3.00	$ 2.85
Cash Dividends	$ 2.065	$ 2.36	$ 2.27	$ 2.15	$ 2.06
Indicated Year-End Dividend Rate	$ 1.18	$ 2.36	$ 2.36	$ 2.24	$ 2.12
Market Value Year-End	$ 14.125	$ 17.25	$ 17.25	$ 18.375	$ 14.875
Book Value (Moody's Net Tangible Assets) Year-End	$ 20.12	$ 20.38	$ 20.31	$ 19.66	$ 20.08
Available Capacity *(Megawatts)*	2,097	2,099	2,160	2,029	2,064
System Peak Responsibility *(Megawatts)*	1,612	1,633	1,700	1,626	1,707
Reserve Capacity *(Megawatts)*	485	466	460	403	357
Average Use Per Residential Customer *(Kilowatthours)*	9,435	9,812	9,901	9,529	9,433
Average Price Per Residential Kilowatthour	7.13¢	6.98¢	6.77¢	6.05¢	5.04¢
Number of Customers at End of Year	246,017	242,666	238,591	234,972	233,421
Long-Term Debt	$ 1,047,420	$ 991,004	$ 753,242	$ 613,781	$ 607,256
Redemption Required Preferred Stock	$ 76,000	$ 78,000	$ 95,000	$ 95,855	$ 82,000
Total Utility Plant (Net)	$ 2,132,047	$ 1,989,013	$ 1,657,203	$ 1,423,043	$ 1,222,372
Total Assets	$ 2,348,203	$ 2,150,558	$ 1,778,232	$ 1,515,517	$ 1,300,495



Commercial operation of Wolf Creek Generating Station September 3, 1985, represented completion of KG&E's major construction program.





Workers re-position the head on the reactor at Wolf Creek Station after completion of fuel loading March 17, 1985.

These skilled linemen are learning a technique to perform important maintenance on major transmission lines while power flows.

Financing Activity Summarized

Long-term financing in 1985 totalled $259.7 million. The proceeds were used primarily for financing construction including the repayment of short-term borrowings for that purpose and the refunding of outstanding securities.

Financing activity included:

- $30 million raised in February through the sale of 10⅛% Series First Mortgage Bonds due 1987. The proceeds were used to redeem the Company's 16¼% Series First Mortgage Bonds due 1987.
- $38.6 million raised in April through the sale of 2 million shares of common stock at $19.31 per share.
- $79.5 million of pollution control revenue bonds relating to Wolf Creek issued in August by the City of Burlington, Kansas. Of this, $2.8 million was deposited with the trustee in a construction fund pending additional pollution control expenditures.
- $20 million raised in December through a Trade Receivable Purchase and Sale Agreement.
- $63 million of Pollution Control Refunding Revenue Bonds relating to Wolf Creek and Jeffrey Energy Center Unit 3 issued in December by the Cities of Burlington and Wamego, Kansas. The proceeds were used to fund, in part, the redemption in June 1986 of $70 million of pollution control bonds issued by these cities in June 1983.
- $28.6 million raised during the year through the sale of 1,940,376 shares of common stock under the dividend reinvestment and employee stock plans.

On March 3, 1986, 300,000 shares of the $15.50 Series Preferred Stock will be redeemed at a call price of $105.81 per share. In addition, the company's subsidiary, Kansas Gas and Electric International Finance, N.V., anticipates retiring $40 million of its 15¾% guaranteed notes due May 1, 1989, on or about May 1, 1986, at a price of 101.5%.

Dividend Reinvestment Offered

The Automatic Dividend Reinvestment and Stock Purchase Plan permits preferred and common stockholders to automatically reinvest their dividends and/or invest optional cash payments up to $5,000 per quarter.

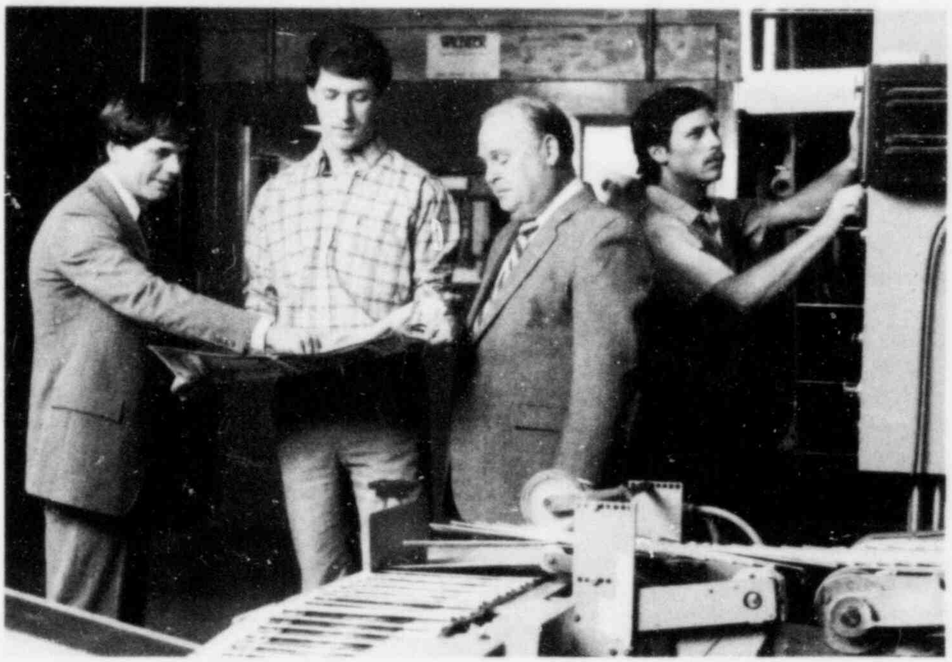
The plan was revised effective February 1, 1986, to utilize outstanding shares of common stock purchased through a broker at market value and to eliminate the 5% discount on reinvested dividends. Prior to that date, the plan allowed for the purchase of unissued shares without brokerage charges. Shares will be purchased at 100% of the market value plus brokerage fees.

The program was changed because of the reduced need for additional equity capital.

Three Named Customer First Employee

Three employees named by independent judges as "Customer First Employee of the Year" reflect the special characteristics of KG&E employees. Employees recognized include:

- Bob Stockton, journeyman lineman, with his crew helped develop procedures for working on energized high voltage transmission lines that will result in important cost savings.
- Pam Vineyard, marketing representative, volunteered hours outside of the work day providing leadership for several community development committees.
- Terrance Wilson, marketing representative, worked with city officials in ways to use electricity efficiently, and reorganized the United Way structure and campaign.



Valassis Color Graphics, a division of GFV Communications Company, is one of the new firms opening plants in 1985 contributing to the diversification of industrial base in KG&E's service area.

Marketing Theme: Selling Makes the Difference

Both present and potential customers are reached by aggressive marketing, sales and industrial development efforts.

Industrial and commercial expansion in 1985 created more than 2,600 new jobs in KG&E's service area. Twenty-six new or expanding industries provided 855,000 additional square feet of space.

And there were 25 major commercial buildings completed or underway at year end.

Approval was secured in September from the Kansas Corporation Commission to offer firms creating new or reinstated jobs a discount based on new power demand.

Nine companies are already taking advantage of these discounts and more than double that number were seeking the benefits at year end.

"Selling Makes the Difference" is the 1986 marketing theme. Marketing targets include increasing electric space heating for residential and commercial customers, and increased use of electricity for industrial processing.

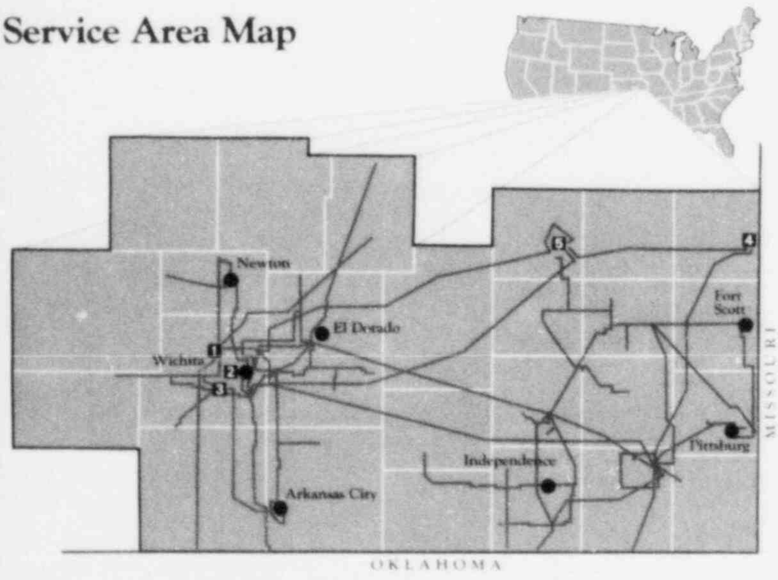
About This Report

This report is a specific example of cost cutting measures company-wide.

By reducing the number of pages from 32 to 24, and eliminating colored pictures, cost of this report has been reduced by more than 40 percent from the 1984 report - or $25,000.

Last year KG&E's 1984 report cost 55 cents each. Cost this year is 32 cents. A sample of electric utility annual reports showed costs ranging from KG&E's last year low of 55 cents to more than $3 each.

Service Area Map



Map Legend

Cities with Customer Services Offices ●
Regional Headquarters ■
Transmission Lines ——

Interconnections and Power Pool Memberships

Direct interconnections are maintained with 10 other utilities and the Company is a member of the Southwest Power Pool and the Mokan Pool. Power is regularly transmitted to and from other utilities to ensure reliability and economy.

Generating Station, Capability and Fuel

1. Gordon Evans Steam Electric Station, 516 MW, Natural Gas
2. Wichita Steam Electric Station, 23 MW, Natural Gas
3. Murray Gill Steam Electric Station, 324 MW, Natural Gas
4. La Cygne Steam Electric Station, 658 MW*, Coal
5. Wolf Creek Generating Station, 530 MW*, Nuclear
6. Jeffrey Energy Center,+ 402 MW*, Coal

* *Jointly owned with other utilities. Capacity stated is KG&E allocation.*

\+ *Located 170 miles northeast of Wichita. Not shown on map.*

Management's Discussion and Analysis of Financial Condition and Results of Operations

Completion of Wolf Creek Marks Construction Program End

Commercial operation of Wolf Creek Generating Station (Wolf Creek) marked the completion of the final phase of a major construction program to diversify fuel usage from oil and natural gas to coal and nuclear.

Wolf Creek is jointly owned by the Company, Kansas City Power and Light Company (KCPL) and Kansas Electric Power Cooperative, Inc. (KEPCo). The Company and KCPL each own a 47% interest while KEPCo owns a 6% share.

Wolf Creek construction began in 1977. The Company was granted a low-power license in March 1985 and a full-power license in June. The plant was placed in commercial operation on September 3, 1985.

During the first four months of commercial operation Wolf Creek has performed above expectations. The plant was available 95% of the time and actual electricity production represented 89% of its capacity, both factors being well above industry norms. Wolf Creek produced more than 2.1 billion kilowatthours (kWh) of electricity during this period.

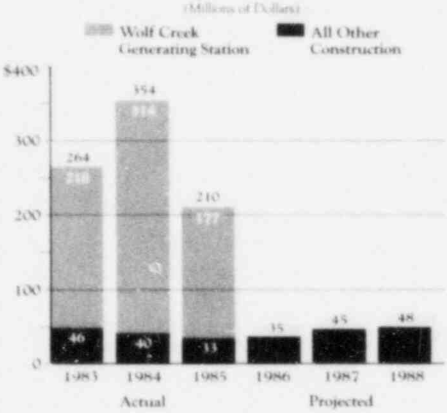
The Company's fuel diversification program involved partial ownership of five coal units completed in 1973, 1977, 1978, 1980 and 1983, in addition to Wolf Creek. Net construction expenditures since 1977 have been more than $100 million yearly with a peak outlay of $258 million in 1984.

KG&E's share of the cost of Wolf Creek was $1,390 million which included $429 million of Allowance For Funds Used During Construction (AFC).

The Company has no plans for the construction of additional generating capacity. As a result, net construction expenditures, including nuclear fuel, are estimated to total $159 million for the years 1986 -1988, far below what has been experienced in the past.

Table 1 and the related graph depict actual expenditures and AFC for Wolf Creek and other construction in 1983-1985 and estimates for 1986-1988.

Total Construction Expenditures
Includes AFC
(Millions of Dollars)



New Company Will Operate Wolf Creek

The owners of Wolf Creek plan to establish a jointly-owned corporation to operate the facility. There will be no transfer of utility assets to the corporation. The new corporation will not own Wolf Creek but will take over responsibility for its operation and maintenance.

It is anticipated that the new corporation will commence operations by year-end 1986. Regulatory approvals from the Kansas Corporation Commission (KCC) and the Nuclear Regulatory Commission (NRC) must be obtained prior to transferring operations from KG&E to the new corporation.

Liquidity, Capital Resources

Three major rating agencies reviewed and issued public ratings on the Company's first mortgage bonds in 1985. After the KCC issued its decision in the Wolf Creek rate case in September, Standard and Poor's upgraded its rating from BB+ to BBB–, Moody's Investors Service maintained the Company's bond rating at Baa3, and Duff and Phelps, Inc. downgraded its rating from a 9 to a 10. All three ratings are presently at comparable levels and are considered investment grade.

The Company's long-term financial goals include a ratio of net cash flow from operations to total capitalization of at least 5%, a common stock market value equal to or greater than book value and a common equity ratio of 45%. For the year ending December 31, 1985, the Company had a negative ratio of net cash flow from operations to total capitalization of 0.9%, and as of year-end had a common stock market value of $14⅛ per share or 70% of book value and a common equity ratio of 38%. The "Capital Structure" graph reviews the 1980-1985 period.

Since 1978, Kansas law has virtually prohibited the inclusion of Construction Work in Progress (CWIP) in the rate base upon which customer rates are set. Because Wolf Creek has represented a major

Table 1

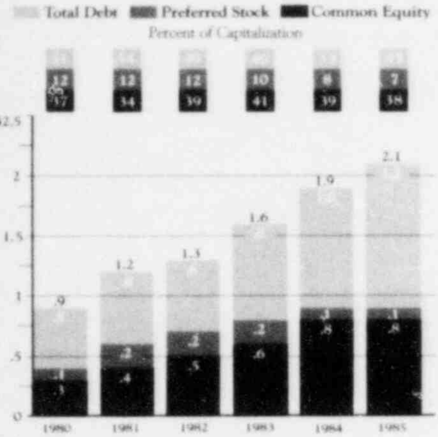
1983-1988 Construction Expenditures

	Actual (Thousands) 1983	1984	1985	Estimated (Thousands) 1986	1987	1988
Wolf Creek Generation	$217,692	$313,591	$177,456	$ —	$ —	$ —
All Other Construction	46,210	40,492	32,700	34,975	44,967	47,687
Total Construction	263,902	354,083	210,156	34,975	44,967	47,687
Nuclear Fuel	(1,382)	10,740	2,284	9,443	8,914	12,892
Total	262,520	364,823	212,440	44,418	53,881	60,579
Less: AFC	83,143	106,464	85,993	(164)	(148)	219
Net Construction Expenditures	$179,377	$258,359	$126,447	$44,582	$54,029	$60,360

Capital Structure

Includes Short-Term Debt

(Billions of Dollars)



investment, CWIP became increasingly large during its construction. Cash was not generated from this investment. All of the Company's capital requirements for 1983-1985 shown in Table 2 were generated externally.

Capital requirement needs are typically first met through utilization of short-term borrowing arrangements. These short-term borrowings are refinanced by issuing long-term debt, preferred stock or common stock. For the 1983-1985 period the Company had sales of securities totalling $829 million which included $584 million of long-term debt and $245 million of common stock.

"The Company does not anticipate the need for external financing for construction purposes during 1986-88."

In view of the greatly reduced construction expenditures (see Table 1), and increased internal cash generation resulting from the September 1985 Wolf Creek rate increase, the Company does not anticipate the need for external financing for construction purposes during 1986-1988.

At year-end 1985, KG&E's sinking fund and debt maturities on outstanding long-term debt and preferred stock, including redemption of the $15.50 series preferred stock on March 3, 1986, were $140.1 million, $44.3 million and $26.3 million in 1986, 1987 and 1988, respectively. The Company intends to meet these redemption requirements through issuance of securities and internal cash generation.

Should additional funds be required, the following capital resources will be available.

(a) The Company's first mortgage bond indenture contains provisions which restrict the issuance of additional bonds. While 1985 earnings would limit the issuance of bonds to $4 million, the Company anticipates that revenues subject to refund will be made permanent and increase the Company's ability to issue additional bonds.

The Company's Restated Articles of Incorporation contain no financial tests limiting the issuance of additional shares of preferred stock.

(b) The Company has short-term lines of credit totalling $91 million. No short-term borrowings were outstanding at year-end 1985.

(c) The Company has two long-term revolving credit loan facilities. The first for $100 million expires September 1, 1986, and the second for $200 million expires May 31, 1987, at which times the amounts then outstanding under these facilities may be converted to four-year term loans. As of December 31, 1985, $100 million was outstanding under the first of these agreements and $50 million under the second, leaving $150 million available.

(d) In December 1984, the Company entered into a 3½ year $100 million revolving underwriting facility with a group of international banks. This agreement enables the Company to sell promissory notes in foreign markets or to borrow from international banks in an amount of up to $100 million. The Company did not borrow under this agreement in 1985.

(e) As of December 31, 1985, the Company had $28.8 million of commercial paper outstanding. The paper is supported by a bank letter of credit (LOC). The LOC provides support for up to $50 million of commercial paper. The LOC agreement expires July 8, 1986 and will not be renewed. At that time, outstanding amounts will be repaid.

(f) A bankers acceptance facility in the amount of $25 million, all of which was available at year-end 1985, expires February 1988. The facility is collateralized by fossil fuel inventory.

Discussion pertaining to a December 19, 1985 Exposure Draft to amend Financial Accounting Standards Board Statement No. 71 (FAS 71) is included in Note 10 of the "Notes to the Financial Statements". The proposed revisions to FAS 71, if adopted, could have a material adverse effect upon the Company's financial statements. The Company's literal interpretation of the proposed revisions could require electric plant in service, common stock equity and book value to decline by 40%, 58% and 58%, respectively. In addition, the Company's retained earnings could be a deficit. The Company vigorously opposes the proposed revisions to FAS 71 as they would not properly reflect the Company's financial position. The KCC also opposes several of the significant concepts that affect the Company, although the KCC agrees with the concept of writing-off 10% or $125 million of the costs deemed imprudent in its rate decision. If approved, the revisions to FAS 71 might have an adverse effect on the liquidity of the Company.

Table 2 **1983-1985 Capital Requirements**

(Thousands)

	1983	1984	1985
Net Construction Expenditures ...	$179,377	$258,359	$126,447
Add: Sinking Fund and Debt Maturities	51,283	2,073	55,000
Total Capital Requirements	$230,660	$260,432	$181,447

Management's Discussion and Analysis of Financial Condition and Results of Operations

Wolf Creek Rate Increase Order Issued September 27

The KCC issued its rate order in the Company's Wolf Creek rate case in September 1985. The order permits the Company to increase retail rates by $166.7 million, which was later amended to $169.6 million, with the increase to be phased-in over a three-year period. This amount represents 45% of the Company's $373.4 million projected revenue deficiency.

The rate order permits retail rates to be increased, subject to refund, by $135 million during the first year, and upon application to and approval by the KCC, $20 million in the second year and $14.6 million in the third year. The difference between the amount the Company would have received had the $169.6 million rate increase been granted at one time and what the Company receives during the three year phase-in in each year will be deferred. This deferral along with associated carrying charges computed at the Company's overall cost of money is recorded net of taxes on the income statement as phase-in revenues and like AFC reflects a non-cash adjustment to earnings. The KCC's order states that a recovery of the deferrals and associated carrying charges should take place by the end of the eighth year.

"The Company appealed the KCC order. The appeal is pending in the Kansas Supreme Court."

The KCC in its order reached the following conclusions with respect to the Company's requested rate base treatment for Wolf Creek:

1. The Company will be allowed to recover, through depreciation, $1,170 million or 90% of its $1,295 million total Kansas jurisdictional investment in Wolf Creek. The remaining $125 million was found by the KCC to have been imprudently incurred and, therefore, the Company will not be allowed to recover, through depreciation, or earn a return on this amount.
2. No rate of return or deferred carrying charges will be allowed currently for the portion of Wolf Creek costs that exceeds $1.29 million per MW, which the KCC found to be the hypothetical cost of coal-fired generation. After taking into account the imprudency exclusion, this adjustment reduces the valuation of Wolf Creek by $499 million to $671 million.
3. Only 39% of the Company's share of Wolf Creek will be necessary to meet peak requirements projected for 1990. Consequently, the Company will be permitted to earn a rate of return of 11.99% on 39% of its interest in Wolf Creek, after taking into account the preceding adjustments. This values Wolf Creek at $260 million for full rate of return purposes. The remaining 61%, valued at $411 million, will be treated as excess capacity upon which the Company will not be allowed a cash return but will be allowed to record a carrying charge as described below.

Should the KCC find that, in the future, excess Wolf Creek capacity is needed to serve the Company's Kansas jurisdictional customers, the Company anticipates that the KCC will permit it to earn a full rate of return on that capacity priced at the then hypothetical cost of coal-fired generation. Until that time, the carrying charge will be recorded, net of taxes, as phase-in revenues. As in the case of AFC, it represents a non-cash adjustment to earnings which is subject to recovery in future years. This carrying charge, $14 million annually, represents the cost of money associated with the debt and preferred stock portion of the $411 million of Wolf Creek treated as excess capacity, and will be recovered in a manner determined by the KCC over the remaining life of the plant.

The Company judged the rate relief granted by the KCC to be inadequate and requested a rehearing, which request was denied.

The Company appealed the KCC order on December 12, 1985. The appeal is pending in the Kansas Supreme Court. The Company is hopeful that a decision will be rendered in the second quarter.

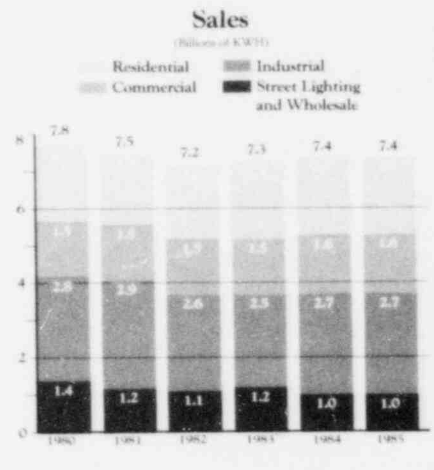
The Company also filed an application on April 29, 1985, with the Federal Energy Regulatory Commission (FERC) for a wholesale rate increase in the amount of $8.1 million on an annual basis. The request includes the investment in Wolf Creek for approximately half of the test year and proposes rate increases from 22% to 42%.

The FERC has permitted rate increases totalling $6.6 million or 81% of the requested amount to become effective on the date Wolf Creek began commercial operation (September 3, 1985), affecting customers whose contracts allow unilateral rate changes. For other customers, except one whose rates will become effective on November 11, 1986, rates will become effective on the date of the final order.

For further information with respect to rates, see Note 2 of the Notes to Financial Statements.

Results of Operations

Details of sales and customer statistics are presented in Table 3 and the accompanying graph.



Total sales during 1985 remained virtually unchanged from 1984. Milder temperatures throughout the year and a reduction in sales to a refinery in the Company's service area were factors in the declines in residential and industrial sales, respectively. Sales to the refinery are expected to increase slightly during 1986, but are not expected to reach former levels.

Wholesale sales, which accounted for 13% and 12% of total electric sales in 1985 and 1984, respectively, increased 6% during 1985 as a result of increased economy sales to other utilities. The commercial operation of Wolf Creek in the fourth quarter of 1985 provided available capacity for economy sales to wholesale customers. The Company expects the level of wholesale sales to be very volatile in the future depending upon market conditions.

The increase did not restore wholesale sales to former levels after experiencing a 17% decrease in 1984 over 1983. The decline resulted from the decisions of several partial requirement municipal customers to generate or purchase from other sources a greater portion of their power requirements. The Company does not expect to serve these customers in the future other than through economy sales.

In 1984, sales in all major retail categories increased compared to 1983. A 12% increase in industrial sales resulted primarily because of the improvement in the national economy and increased sales to KG&E's largest customer. Commercial sales were up 4% in 1984 over 1983 and sales to residential customers increased less than 1%.

Details of changes in revenues and rates are shown in Tables 4 and 5 and the accompanying graph.

Total operating revenues were unchanged in 1985 at $411 million. As shown in Table 4, increases in rates during the year were offset by slightly lower sales and lower fuel costs.

Total 1984 operating revenues were up 5% compared to 1983 as a result of greater sales to retail customers and two spring 1983 retail rate increases. Wholesale revenues, which provided 6% of total revenues for 1984, decreased 27% because of a drop in sales to municipalities.

Electric Operating Revenues

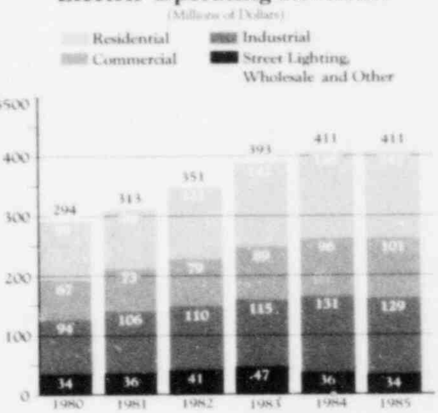


Table 3 **Sales and Customer Statistics**

	Increase or (Decrease) from Prior Year 1985		1984	
Electric Sales (M kWh)	**Electric Sales**	**Percent Change**	**Electric Sales**	**Percent Change**
Residential	(50,907)	(2.4)%	15,909	0.8%
Commercial	42,504	2.7	59,248	3.9
Industrial	(55,538)	(2.0)	295,640	12.0
Public Street & Highway Lighting	(6,426)	(10.2)	(2,049)	(3.1)
Retail Sales	(70,367)	(1.1)	368,748	6.0
Wholesale Sales	58,017	6.3	(188,708)	(16.9)
Total Sales	(12,350)	(0.2)%	180,040	2.5%
Customers (End of Year)	**Customers**	**Percent Change**	**Customers**	**Percent Change**
Residential	3,006	1.4%	3,691	1.7%
Commercial	353	1.8	299	1.5
Industrial	(32)	(0.7)	51	1.1
Public Street & Highway Lighting	25	3.6	35	5.3
Retail Customers	3,352	1.4	4,076	1.7
Wholesale Customers	(1)	(2.6)	(1)	(2.5)
Total Customers	3,351	1.4%	4,075	1.7%

Table 4 **Operating Revenues**

	Revenue Increase or (Decrease) (Dollars in Thousands) 1985 over 1984	1984 over 1983
Retail:		
Electric Sales	$(3,990)	$15,939
Fuel	(19,628)	(193)
Rate Increases	25,767	12,991
Other	(5,604)	150
Total Retail	(3,455)	28,887
Wholesale	3,488	(11,187)
Total Revenue	$ 33	$17,700

Table 5 **Retail Rate Increases Received, 1983-1985**

Date	Amount Granted *(Millions)*	Percent of Amount Requested	Percent Increase in Revenues	Allowed Return on Rate Base	Allowed Return on Common Equity
4/83	$15.2	32%	4.4%	11.52%	15.50%
5/83	18.9[a]	93	5.5	11.37	15.50
9/85	135.0[b]	[c]	36.7	11.99	15.50

[a] *Subject to refund.*
[b] *Subject to refund. This amount is the first year increase of a three year phase-in and is in addition to the $18.9 million granted subject to refund in 5/83.*
[c] *A total revenue increase of $169.6 million will be phased-in over three years. This reflects 45% of the Company's test year revenue deficiency.*

Operating Expenses

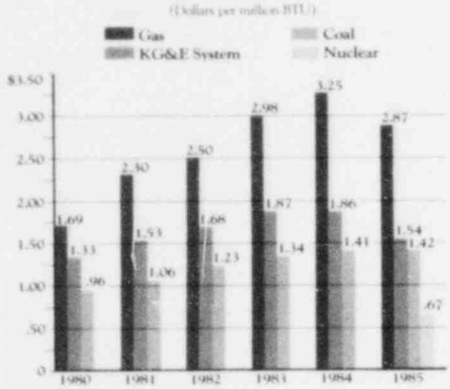
Fuel and Purchased Power

Fuel and purchased power costs comprised 60% of total operation and maintenance expenses in 1985 compared to 69% in 1984 and 70% in 1983. The lower cost of generating power with nuclear fuel during 1985 was a significant factor in the recent decline.

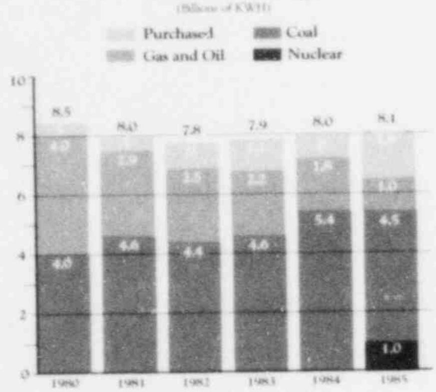
Management's Discussion and Analysis of Financial Condition and Results of Operations

Average fuel cost data and the sources of energy for the Company are detailed in the accompanying graphs.

Average Fuel Cost Data



Sources of Energy



Coal continued to be the main source of energy representing 69% of fuel usage on a Btu basis in 1985 compared to 75% in 1984 and 67% in 1983. Nuclear fueled generation comprised 15% of the fuel usage in 1985 even though Wolf Creek first began commercial operation in September. With the completion of Wolf Creek, both coal and gas usage declined during 1985.

The Company's average fuel cost per million Btu decreased 17% in 1985 compared to 1984. The use of nuclear fuel at an average cost of $.67 per million Btu contributed to the decline as well as decreased costs for oil and natural gas. The average cost per million Btu for natural gas was $2.87 in 1985 compared to $3.25 in 1984. The cost of coal for the Company was virtually unchanged with average cost of $1.42 per million Btu in 1985 compared to $1.41 in 1984.

Purchased power costs increased 66% in 1985. This increase resulted from the accounting treatment of all test power from Wolf Creek. During Wolf Creek testing all power generated by the plant was treated as purchased power.

In 1984 the Company purchased 27% less electricity than in the previous year, resulting in a 26% decrease in purchased power expense. This decline resulted primarily from the full-year availability of Jeffrey Energy Center (JEC) Unit 3, which began operation in mid-1983, and greater utilization of the La Cygne Unit 1.

Other Operating Expenses

Other operation expenses were up 22% in 1985 primarily because of Wolf Creek being in operation beginning in September, inflation, an increase in uncollectible customer accounts and increased administrative and general expenses. Other operation expenses increased 13% in 1984 from 1983 because of inflation, an increase in uncollectible customer accounts and increased administrative and general expenses relating to JEC and La Cygne plants.

Maintenance expenses were up 32% in 1985 over 1984 as a result of the scheduled overhauls of the La Cygne Unit 1 and JEC Unit 1 and the commercial operation of Wolf Creek.

Depreciation and taxes other than income taxes increased during 1985 because Wolf Creek was in commercial operation for three months during the year.

The Company's effective federal income tax rate and changes in income taxes for the last three years are detailed in Note 9 of Notes to Financial Statements.

Other Statement of Income Items

During the past three years, virtually all of the Company's reported earnings have resulted from non-cash adjustments to its income statement. These adjustments, called allowance for funds used during construction (AFC) were made because the KCC generally does not permit utilities to earn a cash return on investments until the assets begin providing service to customers. Instead, the Company recorded the cost of money associated with the investment as current earnings.

These earnings adjustments appear in the income statement as AFC-other and AFC-borrowed. AFC-other reflects the cost of equity funds invested in construction while AFC-borrowed represents the cost of debt which finances construction. These adjustments were made with the understanding that additions to income would be subsequently recovered through higher rates when the assets represented by the investment began service to customers.

For a discussion of phase-in revenues, see "Wolf Creek Rate Increase Order Issued September 27."

AFC net of tax and phase-in revenue, both non-cash components of earnings, were $95 million in 1985, $106 million in 1984 and $83 million in 1983 and represented 114%, 100% and 90%, respectively, of earnings applicable to common stock. AFC accruals ended for Wolf Creek in September and thus will provide minimal contribution to earnings in the future.

Interest on long-term debt increased 17% in 1985 and 33% in 1984, due to increased debt incurred to finance construction. Total interest charges-net increased 61% and 26% during the same years for similar reasons although the 1985 increase was magnified by the decline in the allowance for borrowed funds used during construction. With the completion of Wolf Creek this offset will decline sharply in subsequent years.

"With the receipt of Wolf Creek revenue increases granted by the KCC, internal cash generation will improve in future years."

Net Income

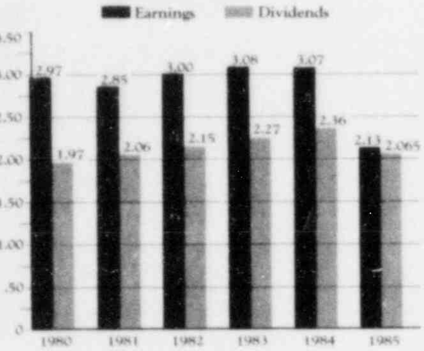
Net income decreased 20% in 1985 compared to 1984. The decrease can be attributed to the inadequate rate treatment received from the KCC and the loss of AFC when Wolf Creek began commercial operation in September. (See "Wolf Creek Rate Increase Order Issued

September 27" and "Other Statement of Income Items.") As a result of the foregoing, the Company anticipates net income in 1986 will be substantially lower than in 1985. However, with the receipt of Wolf Creek revenue increases granted by the KCC, internal cash generation will improve in future years.

Earnings and Dividends

Earnings per average share of common stock and common dividends paid are detailed for the 1980-1985 period in the accompanying graph.

Annual Common Stock Earnings per Share and Cash Dividends Paid



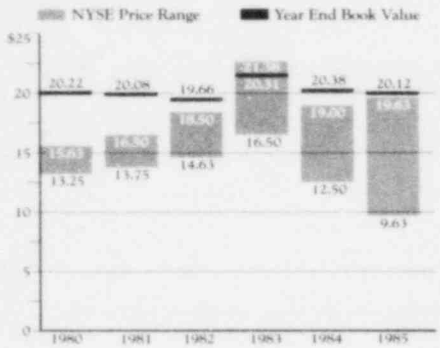
Earnings applicable to common stock were $83 million, a decrease of 22% from $106 million in 1984. The lower earnings per share can be attributed to the decline in AFC and an increase in average shares of common stock outstanding. Earnings for 1983 were $92.0 million or 14% less than 1984. In 1985 the Company's earned return on average common equity was 10.7% in comparison to 15.4% in 1984 and 15.8% in 1983.

Dividends paid on common stock in 1985 were $2.065 per share, a decrease of $.295 from 1984, reflecting the 50% reduction in the fourth quarter dividend. The dividend reduction for the fourth quarter came as a result of the unfavorable rate order received from the KCC. (See "Wolf Creek Rate Increase Order Issued September 27.") The rate increase granted was not adequate to maintain the common stock dividend at the prior level of $0.59 per share.

Details of the market price and book value of the Company's common stock are presented in the accompanying graph.

Market Price and Book Value of Common Stock

(In Dollars)



Impact of Inflation and Changing Prices

Inflation had a continuing impact on the Company's operations. A discussion of its effects is included in Note 13 of the Notes to Financial Statements.

Other Matters

In September 1985, a stockholder derivative suit was brought in the U.S. District Court for the District of Kansas, against the Company's directors alleging that the directors mismanaged and wasted the assets of the Company in the construction of Wolf Creek. The defendants have filed a motion to dismiss the complaint for the plaintiff's failure to make a demand upon the Board of Directors prior to bringing the suit. The motion is still pending.

In February 1986, the City of Wichita, Kansas passed a resolution directing that a study be conducted to determine the feasibility of the City, either singly or in cooperation with a group of municipalities served by the Company, acquiring all or a part of the Company's facilities providing electric and street lighting services to the City. While the Company has determined that an appropriate proposal for the purchase of its Wichita street lighting facilities would be in its interest, it does not believe a purchase of any portion of its other facilities would be.

For further information with respect to other matters, see Note 10 of Notes to Financial Statements.

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For a copy of KG&E's "Financial and Statistical Report 1975-1985" or other information, contact the stockholder records or investor relations departments as indicated on the back page of this report.

Efficient mobilization of resources is critical to prompt restoration of service when storms hit.

STATEMENTS OF INCOME

For the Years Ended December 31

	1985	1984	1983
		(Thousands of Dollars)	
Operating Revenues (Note 2)	$ 410,786	$ 410,753	$ 393,053
Operating Expenses:			
Fossil fuel	102,696	148,959	139,339
Nuclear fuel	7,169	—	—
Purchased power — net	30,180	18,221	24,541
Other operation	59,314	48,573	43,050
Maintenance	34,540	26,108	27,871
Total operation and maintenance	233,899	241,861	234,801
Depreciation	44,543	32,433	29,919
Taxes other than incomes taxes	19,246	16,063	15,078
Current income taxes (Note 9)	—	(1,493)	2,910
Deferred income taxes (Note 9)	36,095	42,517	36,993
Total operating expenses	333,783	331,381	319,701
Operating Income	77,003	79,372	73,352
Other Income and Deductions:			
Allowance for other funds used during construction	62,652	78,345	63,068
Equity in earnings of subsidiary companies (Note 7)	1,353	1,603	1,400
Phase-in revenue — net of tax (Note 2)	8,770	—	—
Miscellaneous — net	3,956	2,299	659
Income taxes — net (Note 9)	4,820	(1,993)	(1,061)
Total other income and deductions	81,551	80,254	64,066
Income before Interest Charges	158,554	159,626	137,418
Interest Charges:			
Interest on long-term debt	102,194	87,508	65,948
Other interest	3,742	5,372	3,031
Amortization of debt premium, discount and expense	1,239	729	768
Allowance for borrowed funds used during construction	(46,353)	(55,841)	(39,867)
Total interest charges — net	60,822	37,768	29,880
Net Income	97,732	121,858	107,538
Preferred Stock Dividends	14,355	15,363	15,511
Earnings Applicable to Common Stock	$ 83,377	$ 106,495	$ 92,027
Average Shares of Common Stock Outstanding	39,118,105	34,698,342	29,912,327
Earnings Per Share of Common Stock	$ 2.13	$ 3.07	$ 3.08

STATEMENTS OF RETAINED EARNINGS

For the Years Ended December 31

	1985	1984	1983
		(Thousands of Dollars)	
Balance at Beginning of the Year	$ 181,452	$ 157,810	$ 134,544
Net Income	97,732	121,858	107,538
Total	279,184	279,668	242,082
Deduct:			
Cash Dividends:			
Preferred Stock (at prescribed rates of each series — Note 5)	14,355	15.363	15,511
Common Stock — \$2.065 in 1985; \$2.36 in 1984; \$2.27 in 1983	80,426	82,723	68,572
Capital Stock Expense	67	130	189
Total	94,848	98,216	84,272
Balance at End of the Year	$ 184,336	$ 181,452	$ 157,810

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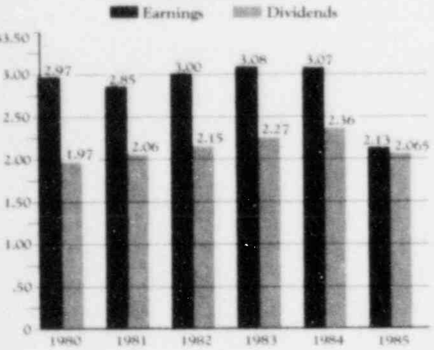

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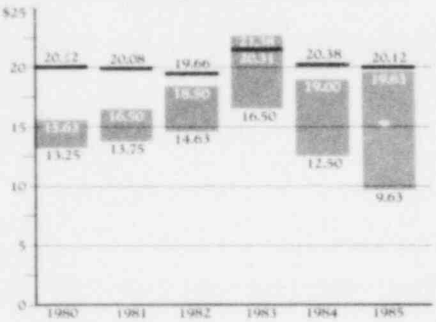

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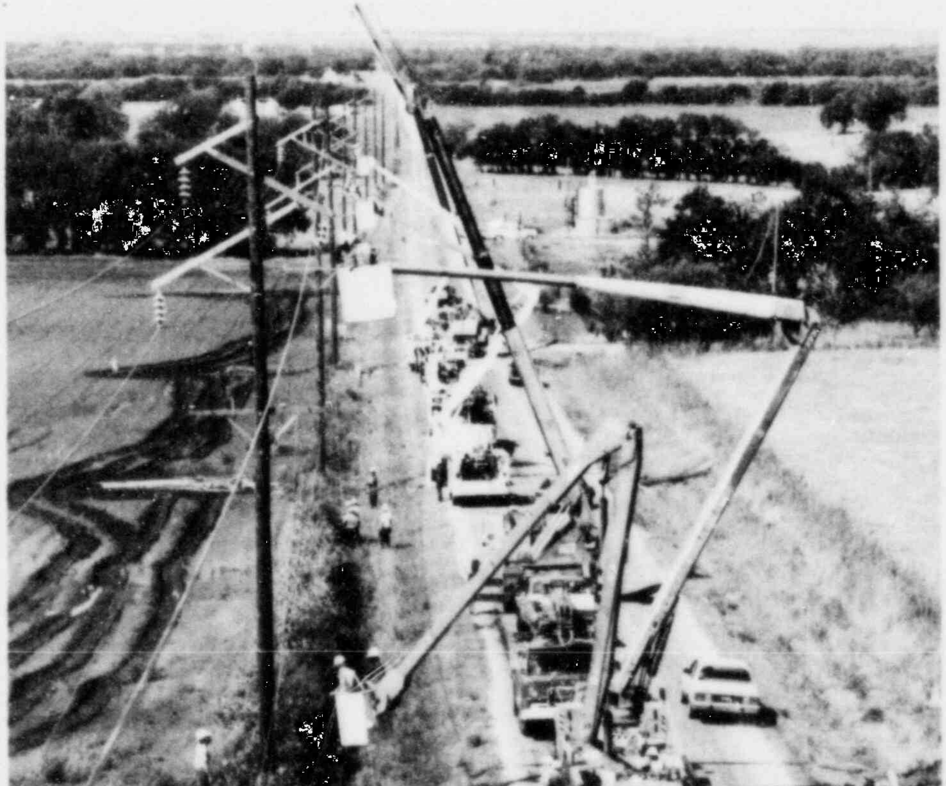

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Balance at End of the Year	$ 184,336	$ 181,452	$ 157,810

See notes to financial statements.

BALANCE SHEETS DECEMBER 31, 1985 and 1984

	1985		1984	
	(Thousands of Dollars)			
ASSETS				
Electric Plant - at original cost (Note 6):				
Plant in service	$2,418,957		$1,009,838	
Less accumulated depreciation	320,880		293,683	
Net plant in service	2,098,077		716,155	
Construction work in progress	9,725		1,248,322	
Electric plant held for future use — net	6,414		2,871	
Nuclear fuel — net	17,831		21,665	
Total electric plant — net	2,132,047		1,989,013	
Other Property and Investments:				
Investment in subsidiary companies (Note 7)	13,504		13,589	
Special interest accounts — adjustable rate series (Note 6)	20,918		22,356	
Other	555		191	
Total other property and investments	34,977		36,136	
Current Assets:				
Cash	3,350		1,355	
Temporary cash investments (Note 6)	74,000		39,000	
Accounts receivable — net	19,511		32,022	
Fossil fuel — at average cost (Note 6)	26,545		26,822	
Materials and supplies — at average cost	14,607		9,340	
Prepayments and other current assets	2,762		769	
Total current assets	140,775		109,308	
Deferred Debits:				
Unamortized debt expense	9,546		8,662	
Phase-in revenue requirements (Note 2)	8,770		—	
Other	22,088		7,439	
Total deferred debits	40,404		16,101	
Total	$2,348,203		$2,150,558	
CAPITALIZATION AND LIABILITIES				
Capitalization:				
Common stock, without par value, authorized 50,000,000 shares; outstanding 40,464,810 and 36,524,434 shares, respectively (Note 4)	$ 628,298	31.4%	$ 561,106	29.9%
Retained earnings (Note 6)	184,336	9.2	181,452	9.7
Other paid-in capital (Note 4)	1,661	0.1	1,661	0.1
Common stock equity	814,295	40.7	744,219	39.7
Preferred stock — redemption not required (Note 5)	63,701	3.2	63,701	3.4
Preferred stock — redemption required (Note 5)	76,000	3.8	78,000	4.1
Long-term debt (Note 6)	1,047,420	52.3	991,004	52.8
Total capitalization	2,001,416	100.0%	1,876,924	100.0%
Current Liabilities:				
Short-term borrowings (Note 3)	—		13,000	
Securities due within one year (Notes 5 and 6)	110,100		25,000	
Accounts payable	46,371		65,313	
Customers' deposits	2,831		2,471	
Taxes accrued	14,503		11,117	
Interest accrued	27,067		22,998	
Total current liabilities	200,872		139,899	
Deferred Credits:				
Accumulated deferred income taxes (Note 9)	120,123		96,669	
Accumulated deferred investment tax credit (Note 9)	21,747		32,724	
Customers' advances for construction	2,581		2,540	
Other	1,464		1,802	
Total deferred credits	145,915		133,735	
Commitments and Contingencies (Notes 2 and 10)				
Total	$2,348,203		$2,150,558	

See notes to financial statements.

Kansas Gas and Electric Company

STATEMENTS OF CHANGES IN FINANCIAL POSITION

For the Years Ended December 31

	1985	1984	1983
		(Thousands of Dollars)	
Sources of Funds			
From Operations:			
Net income	$ 97,732	$ 121,858	$ 107,538
Non-cash charges (credits) to net income:			
Depreciation	44,543	32,433	29,919
Amortization of nuclear fuel	6,118	—	—
Displacement power cost	13,747	—	—
Deferred income taxes — net	32,327	40,435	32,741
Deferred investment tax credit	(1,052)	2,082	4,252
Allowance for funds used during construction (AFC)	(109,005)	(134,186)	(102,935)
Phase-in revenue — net	(8,770)	—	—
Other — net	1,239	729	768
From operations	76,879	63,351	72,283
From External Sources:			
First Mortgage Bonds	30,000	150,000	—
Other long-term debt	148,300	98,000	157,000
Other long-term agreements	720	525	—
Total debt	179,020	248,525	157,000
Common Stock	67,192	76,701	100,624
Trustee investment fund — net	17,156	(8,258)	(32,258)
From external sources	263,368	316,968	225,366
Other — net	(8,425)	(3,320)	(3,682)
Total Sources of Funds	$ 331,822	$ 376,999	$ 293,967
Application of Funds			
Gross plant additions	$ 212,440	$ 364,823	$ 262,520
Less AFC charged to construction	85,993	106,464	83,143
Net construction expenditures	126,447	258,359	179,377
Dividends	94,781	98,086	84,083
Securities redemptions	55,000	2,073	51,283
Increase (decrease) in working capital	55,594	18,481	(20,776)
Total Application of Funds	$ 331,822	$ 376,999	$ 293,967
Summary of Changes in Working Capital: (other than securities due within one year):			
Cash	$ 1,995	$ (562)	$ (5,507)
Temporary cash investments	35,000	39,000	(4,700)
Accounts receiveable	(12,511)	(10,452)	18,439
Other current assets	6,983	(391)	2,554
Accounts payable	18,942	3,965	(24,014)
Accrued liabilities	(7,455)	(8,669)	(2,324)
Short-term debt	13,000	(4,000)	(9,000)
Other current liabilities	(360)	(410)	3,776
Net Change in Working Capital	$ 55,594	$ 18,481	$ (20,776)

Note: The 1984 and 1983 format has been changed from Statements of Sources of Funds for Construction.

See Notes to Financial Statements.

NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies:

System of Accounts — The Company is subject to the jurisdiction of the State Corporate Commission of the State of Kansas (KCC) and the Federal Energy Regulatory Commission (FERC) and maintains its accounts in accordance with the uniform system of accounts prescribed by these regulatory commissions. As a regulated utility, the accounting principles applied by the Company differ in certain respects from those applied by non-regulated business.

Electric Plant — The Company performs a portion of its construction work and capitalizes general overhead and engineering expenses related to construction projects and credits the projects for the value of energy generated during testing. Maintenance and repairs of property and replacements and renewals of items determined to be less than units of property are charged to operating expenses. The cost of units of property replaced or renewed, plus removal costs, less salvage, is charged to accumulated depreciation, and the cost of related replacements and renewals is added to electric plant. Betterments are charged to electric plant.

Nuclear Fuel — The cost of nuclear fuel in process of refinement, conversion, enrichment, and fabrication is recorded as an asset at original cost and is charged to expense based upon the quantity of heat produced for the generation of electricity. Under the Nuclear Waste Policy Act of 1982, the U.S. Department of Energy (DOE) is responsible for the ultimate storage and disposal of spent nuclear fuel removed from nuclear reactors. Under a contract with the DOE for disposal of spent nuclear fuel, the Company pays a quarterly fee to the DOE of 1 mill per kilowatthour on net nuclear generation.

The accumulated amortization of nuclear fuel was $6.1 million at December 31, 1985.

Decommissioning Costs — Wolf Creek Generating Station (Wolf Creek), a nuclear plant, was placed in service September 1985. The Company's share of the cost to take Wolf Creek out of service in the future is estimated by the KCC to be $65.8 million. This amount, to be accrued over 30 years, is charged to operating expense and subsequently collected from customers. The monies are to be transferred to an external trust fund quarterly.

Allowance for Funds Used During Construction — Allowance for funds used during construction (AFC), a noncash item, is defined in the applicable regulatory system of accounts as the net cost during the period of construction of borrowed funds used for construction purposes, including nuclear fuel, and a reasonable rate on other funds when so used. This allowance has been added to all major construction projects with semi-annual compounding. The annual average net AFC rate (net of income taxes) for 1985, 1984 and 1983 was 9.38%, 9.72% and 9.81%, respectively.

Depreciation — For financial reporting purposes, the Company uses the straight-line method to depreciate the original cost of property over its estimated remaining service life, as determined by independent engineers. The provision for depreciation stated as a percent of original cost of depreciable property was 3.4% for 1985 and 1984 and 3.3% for 1983.

Income Taxes — In the calculation of income taxes, the Company (i) uses liberalized depreciation for additions for 1973 through 1980 and ACRS beginning in 1981, and (ii) utilizes other tax benefits as permitted by the Internal Revenue Code, consisting principally of differences in straight-line depreciation and the deduction currently for interest and taxes capitalized for book purposes. Deferred taxes are provided for such items as approved by the appropriate regulatory commission and as required by the Internal Revenue Code. In connection with an order from the KCC, AFC is recorded in Electric Plant on a net basis with an amount equivalent to the income tax effect on the borrowed funds portion of the AFC charged to deferred taxes under operating expenses and credited to AFC.

The Company defers and amortizes the investment tax credit over the life of the applicable property, in accordance with an order of the KCC.

Revenues — Operating revenues and accounts receivable include amounts actually billed for services rendered and fuel adjustment clause variances.

Fuel Adjustment Clause Revenue — The Company's rate schedules include a fuel adjustment clause which permits current recoveries of fuel costs on an estimated basis. The variances between actual and estimate are adjusted through the fuel adjustment clause two months after they are recorded.

2. Rate Matters:

In connection with the start of commercial operation of Wolf Creek in 1985, the KCC granted the Company, effective October 3, 1985, a $166.7 million interim rate increase (which was later amended to $169.6 million) subject to refund or adjustment. With respect to the Company's investment in Wolf Creek amounting to $1,327 million (excluding an additional $61 million investment in Wolf Creek not subject to the rate order), the KCC generally determined the amount of the increase granted based on the following amounts of cost recovery through depreciation and rates of return:

Investment In Wolf Creek	Kansas Jurisdictional	Amount of Cost Recovery	Rate of Return
	(Millions of Dollars)		
$266	$260	$260	11.995%
421	411	411	6.0
512	499	499	—
128	125	—	—

The rate increase of $169.6 million is to be phased in over three years in the amounts of $135, $20 and $14.6 million in years one through three, respectively. Revenues recorded but not currently billed under the phase-in plan, plus a return of 11.995% on such amounts, will be collected in years four through eight via an additional rate increase in those years

The rate order did not result in any adjustment to the carrying value of Wolf Creek under generally accepted accounting principles.

The statements of income for the years ended December 31, 1985, 1984 and 1983 include approximately $39.9, $19.7 and $11.3 million of revenues, respectively, which are currently subject to refund or adjustment. Management does not believe any significant amount of such revenues will be refunded or adjusted.

See Note 10 for Committments and Contingencies.

3. Short-Term Borrowings:

At December 31, 1985 and 1984, the Company had bank credit arrangements in the amount of $91 million. The Company draws upon these sources to meet short-term cash requirements. Interest costs are based upon daily average outstanding loan balances. The maximum amounts outstanding during 1985 and 1984 were $69 million on April 9, 1985 and $66.5 million on March 2, 1984. The weighted average interest rate, including fees, was 10.3% for 1985 and 12.0% for 1984.

4. Common Stock and Other Paid-in Capital:

Changes in Common Stock were as follows:

	Shares		Amount
	Authorized	**Outstanding**	*(Thousands of Dollars)*
Balance January 1, 1983	35,000,000	26,412,589	$383,781
Additional shares sold		4,000,000	76,828
Employee Stock Purchase Plan, Employee Stock Ownership Plan and Dividend Reinvestment Plan		1,259,377	23,796
Additional shares authorized	15,000,000		
Balance December 31, 1983	50,000,000	31,671,966	484,405
Additional shares sold		3,000,000	49,255
Employee Stock Purchase Plan, Employee Stock Ownership Plan and Dividend Reinvestment Plan		1,852,468	27,446
Balance December 31, 1984	50,000,000	36,524,434	561,106
Additional shares sold		2,000,000	38,620
Employee Stock Purchase Plan, Employee Stock Ownership Plan and Dividend Reinvestment Plan		1,940,376	28,572
Balance December 31, 1985	50,000,000	40,464,810	$628,298

The Other Paid-in Capital represents the cumulative gain on the reacquired preferred stock and premium on initial sale of preferred stock.

In April 1985, the Company issued 2 million shares of common stock at $19.31 per share. Book value per share decreased from $20.65 to $20.58, a 0.3% dilutive effect.

Common stock issues under the Dividend Reinvestment Plan, Employee Stock Purchase Plan and Employee Stock Ownership Plan on a monthly basis do not materially affect book value per share.

5. Cumulative Preferred Stock:

	December 31,		
	1985	1984	Call Price
	(Thousands of Dollars)		*(At December 31, 1985)*
Redemption not required — except at the Company's option:			
4½%, $100 par value; authorized and outstanding 82,011 shares	**$ 8,201**	$ 8,201	$110.00
Serial, $100 par value; authorized 255,000 shares:			
4.28% series, outstanding 45,000 shares	**4,500**	4,500	101.00
4.32% series, outstanding 60,000 shares	**6,000**	6,000	101.64
7.44% series, outstanding 150,000 shares	**15,000**	15,000	104.95
Serial, without par value (Note):			
$8.66 series, outstanding 300,000 shares	**30,000**	30,000	106.50
Total	**$63,701**	$63,701	
Redemption required:			
Serial, without par value (Note):			
$2.42 series, outstanding 520,000 shares	**$13,000**	$13,000	$ 26.20
$8.125 series, outstanding 100,000 shares	**10,000**	10,000	106.67
$8.00 series, 150,000 shares	**—**	15,000	
$8.25 series, outstanding 100,000 shares	**10,000**	10,000	102.75
$15.50 series, outstanding 300,000 shares	**30,000**	30,000	107.75
$13.25 series, outstanding 150,000 shares	**15,000**	15,000	none
Subtotal	**78,000**	93,000	
Less: Securities due within one year	**2,000**	15,000	
Total	**$76,000**	$78,000	

Note: Serial Preferred Stock, without par value, has 6,000,000 shares authorized.

The $13.25 Series Serial Preferred Stock may be redeemed on and after October 1, 1987 at $100 plus unpaid accumulated dividends, if any. The dividend rate on the $13.25 Series will be $13.25 through September 30, 1987. From October 1, 1987 through September 30, 1992, the rate will be determined by a formula which is based on an average prime interest rate in the year ending September 30, 1987.

The following preferred stock may not be redeemed prior to the date shown below through the use, directly or indirectly, of the proceeds of indebtedness or of the issuance of stock of equal or prior rank, at an effective cost to the Company of less than the amount shown (except in the case of the $8.25 Series for sinking fund purposes):

Series	Date	Effective Cost
$15.50	March 1, 1986	15.50 %
$8.125	April 1, 1988	8.125%
$8.25	July 1, 1989	8.25 %

The mandatory sinking fund or redemption obligations for the various Series are:

	Period		Annual
Series	Commencing	Completion	Number of Shares
$2.42	April 1, 1980	April 1, 1999	40,000
$8.125	April 1, 1989	April 1, 2018	3,333
$8.25	July 1, 1986	—	20,000
	July 1, 1987	—	50,000
	July 1, 1988	—	15,000
	July 1, 1989	—	15,000
$15.50	April 1, 1987	April 1, 1991	60,000
$13.25	October 1, 1988	October 1, 1992	30,000

Amounts related to shares to be redeemed within the next year have been shown as a current liability. Purchases of the $2.42 and $8.125 Series in excess of the minimum can be used to satisfy future minimum requirements.

All sinking fund redemptions will be made at $100 per share (except for the $2.42 Series at $25 per share) plus unpaid accumulated dividends.

The embedded cost of preferred stock was 10.06% for 1985 and 9.86% for 1984 and 1983.

6. Long-Term Debt:

	December 31, 1985	December 31, 1984
	(Thousands of Dollars)	
First Mortgage Bonds:		
3⅜% series, due 1985	$ —	$ 10,000
3⅜% series, due 1986	7,000	7,000
16% series, due 1986-1996	25,000	25,000
10⅞% series, due 1987	30,000	—
16¼% series, due 1987	—	30,000
14⅞% series, due 1987-1991	30,000	30,000
13½% series, due 1989	100,000	100,000
4⅝% series, due 1991	7,000	7,000
14.05% series, due 1991	30,000	30,000
14⅛% series, due 1991	20,000	20,000
5⅝% series, due 1996	16,000	16,000
8½% series, due 2000	35,000	35,000
8⅛% series, due 2001	35,000	35,000
7⅜% series, due 2002	25,000	25,000
6.8% series, due 2004	14,500	14,500
9⅝% series, due 2005	$ 40,000	$ 40,000
8⅜% series, due 2006	25,000	25,000
5⅞% series, due 2007	21,940	21,940
6% series, due 2007	10,000	10,000
8½% series, due 2007	25,000	25,000
8⅞% series, due 2008	30,000	30,000
Total First Mortgage Bonds	526,440	536,440
Other Long-Term Debt:		
Pollution control revenue bonds:		
5¾% series, due 2003	15,000	15,000
Adjustable rate series, due 1986	70,000	70,000
Adjustable rate series, due 2013	87,000	87,000
Adjustable rate series, due 2013	63,000	—
Adjustable rate series, due 2014	98,000	98,000
Adjustable rate series, due 2015	79,500	—
Securities held by Trustee-adjustable rate series	(2,815)	(18,533)
16¾% promissory note, due 1989	39,400	39,400
Credit agreement, due 1986	28,800	50,000
Revolving bank loan, due 1990	100,000	50,000
Revolving bank loan, due 1991	50,000	50,000
Bankers acceptance agreement, due 1986	—	23,000
Other long-term agreements	1,245	714
Unamortized premium and discount — net	(50)	(17)
Total Other Long-Term Debt	629,080	464,564
Subtotal	1,155,520	1,001,004
Less: Securities due within one year	108,100	10,000
Total	$1,047,420	$ 991,004

Required redemptions and sinking fund payments for 1986 through 1990 amount to $108.1, $38.3, $20.8, $160.2 and $120.8 million, respectively. The redemption requirements for 1989 and 1990 would be increased by the amounts of the $87 and $98 and $79.5 million adjustable rate series, respectively, in the event that the irrevocable letter of credit agreements are not extended or other arrangements for collateral are not made.

First Mortgage Bonds may be issued in additional amounts, limited by property, earnings and other provisions of the Company's Mortgage dated as of April 1, 1940, as supplemented. Electric plant is subject to the lien of the Mortgage except for transportation equipment.

The 6.8% series, due 2004, and the 5⅞% and 6% series due 2007 are pledged as collateral for Pollution Control Revenue Bonds issued by Kansas municipalities.

Proceeds of the $63 million adjustable rate series, due 2013, were placed in a trust account to be used together with investment earnings from such proceeds, to retire the $70 million adjustable rate series in June 1986. Proceeds of the remaining four adjustable rate series were used to refund certain First Mortgage Bonds initially pledged as collateral for Pollution Control Revenue Bonds issued by Kansas municipalities, pay costs incurred on existing pollution control facilities, and establish special interest accounts with the trustee which are pledged for debt service. The balances were deposited with the trustee and invested pending construction of additional pollution control facilities. The letter of credit agreements with respect to such series permit extensions on an annual basis upon mutual agreement of the banks and the Company. The variable interest rate is determined on the basis of prevailing market rates for debt instruments of like tenor and quality. The following information is applicable to these issues:

Description	Letter of Credit Expiration Date	Weighted Average Net Interest Rate 1985	1984
Series due 1986 $70 million	June 18, 1986	5.8%	6.3%
Series due 2013 $87 million	December 2, 1989	5.8%	6.0%
Series due 2014 $98 million	November 3, 1989	6.2%	6.5%
Series due 2015 $79.5 million	August 15, 1992	6.2%	—
Series due 2013 $63 million	December 17, 1990	7.6%	—

Long-term debt has been reduced by funds (plus accrued earnings) held by trustees for future construction expenditures. The construction fund investment will be withdrawn upon incurrence of qualified expenditures.

The special interest accounts are invested and used for interest payments and subsequently replenished up to the original account balances of $22.245 million.

The 16¼% promissory note due May 1, 1989, was issued to a wholly-owned finance subsidiary, Kansas Gas and Electric International Finance N.V. which is accounted for on the equity method. This note was issued in exchange for proceeds of $39.4 million initially received by this subsidiary in connection with its issuance of $40 million of guaranteed notes in the Eurodollar market. The Company has also issued First Mortgage Bonds 15¼% series due May 1, 1989, in the amount of $40 million, to a trustee to be held on a standby basis as ultimate collateral for the guaranteed notes issued by the subsidiary.

The credit agreement, which expires on July 8, 1986, enables the Company to sell up to $50 million in commercial paper supported by a bank letter of credit or obtain certain revolving credit loans. The weighted average interest rate, including fees, was 8.9% for 1985 and 11.2% for 1984.

The Company has two revolving bank loans. One loan, due 1990, for up to $100 million is comprised of a revolving credit loan until September 1, 1986, followed by a four-year term loan. A second loan, due 1991, enables the Company to borrow up to $200 million on a revolving credit basis until May 31, 1987, followed by a four-year term loan. Both loans may be repaid at any time without penalty. The weighted average interest rate, including fees, was 9.3% for 1985 and 12.4% for 1984.

The bankers acceptance agreement is to expire February 28, 1986. The agreement enables the Company to borrow up to $25 million by collateralizing its coal and fuel oil inventories at rates based upon the banks' discount and acceptance charge. The weighted average interest rate, including fees, was 9.1% for 1985 and 11.4% for 1984.

A revolving underwriting facility agreement was entered into on December 19, 1984 and expires July 1, 1988. This agreement enables the Company to sell promissory notes or borrow from international banks in an aggregate amount of up to $100 million. The Company did not utilize this agreement in 1984 or 1985.

The embedded cost of long-term debt for 1985, 1984 and 1983 was 9.07%, 9.80% and 9.45%, respectively.

7. Finance Subsidiary:

Kansas Gas and Electric International Finance N.V. is a wholly-owned offshore finance subsidiary with an original capital investment of $13.5 million. The subsidiary was formed to permit the Company to secure Eurodollar funds (See Note 6).

8. Retirement Plan:

The Company has a non-contributory retirement plan for all employees. The total cost for the years 1985, 1984 and 1983 was $3.7, $3.1 and $2.2, respectively, including amortization of unfunded past service cost over 30 years. Of these amounts, $2.0, $2.2 and $1.3 million, respectively, were included in plant construction costs. The Company's policy is to fund pension costs accrued currently.

Actuarial Present Value of Benefits at a 7.5% Assumed Rate of Return	November 30, 1984
Vested participants	$39.7 million
Non-vested participants	4.1 million
Total	$43.8 million
Market value of net assets available for benefits	$55.0 million

The above data is as of the latest actuarial evaluation.

9. Income Taxes:

The effective Federal income tax rates differ from the amounts computed by applying the Federal statutory rates to income before Federal income taxes. The reasons, with related percentage effects, are:

	1985	1984	1983
Statutory Federal income tax rate	46%	46%	46%
Add (Deduct) income tax effects of:			
Allowances for other funds used during construction	(23)	(23)	(20)
Phase-in revenue	(3)	—	—
Depreciation timing differences	1	1	1
Taxes and pensions capitalized	—	—	(1)
Amortization of investment tax credit	(1)	(1)	(1)
Other items-net (no one item makes up more than 2%)	2	—	—
Effective Federal income tax rate	22%	23%	25%

Income taxes as recorded in the Statements of Income are:

	1985	1984	1983
	(Thousands of Dollars)		
Operating expenses:			
Currently payable —			
Federal	$ —	$(1,749)	$ 1,796
State	—	256	1,114
Deferred — Federal	**32,408**	34,937	28,292
— State	**4,739**	5,498	4,449
Investment tax credit — net	**(1,052)**	2,082	4,252
Total	**36,095**	41,024	39,903
Other income and deductions:			
Currently payable —			
Federal	—	1,722	917
State	—	271	144
Deferred — Federal	**(4,164)**	—	—
— State	**(656)**	—	—
Total	**(4,820)**	1,993	1,061
Income tax expense — net	**$31,275**	$43,017	$40,964
Deferred income taxes consist of:			
Accelerated depreciation	**$43,257**	$11,006	$ 9,534
AFC - borrowed	**23,012**	27,722	19,792
Overheads capitalized — net	**4,118**	4,786	2,698
Net operating tax loss	**(33,705)**	—	—
Test energy for Wolf Creek — net	**(4,144)**	—	—
Other — net	**(211)**	(3,079)	717
Total	**$32,327**	$40,435	$32,741

At December 31, 1985, the Company has unused investment tax credits including those related to the Employee Stock Ownership Plan of approximately $124 million available for carryforward to future years. If not utilized, the remaining carryforward credits will expire in the years 1992 through 2000 in the amounts of $1, $14, $20, $16, $13, $17, $15, $20 and $8 million, respectively. Additionally, the Company has a loss carryforward of $76 million, which, if not used, will expire in the year 2000. This loss has been applied for accounting purposes in the calculation of the Company's 1985 deferred income tax provision.

The Company has not been allowed by the KCC to record deferred income taxes on certain items (primarily payroll and property taxes, pensions, and removal costs) prior to May 1983. The cumulative net amount of such timing differences for which deferred income taxes have not been provided is approximately $12 million as of December 31, 1985.

10. Commitments and Contingencies:

The construction budget (exclusive of nuclear fuel) for 1986 is approximately $35 million.

In January 1985, intervenors in operating license proceedings and others petitioned the U.S. Court of Appeals for the District of Columbia Circuit (Court of Appeals) to overturn a rule adopted by the NRC in 1984 which eliminated the financial qualifications of applicants as a matter for consideration when determining whether to issue an operating license for a nuclear generating facility. The Company and others have intervened in this case in support of the NRC's authority to adopt this rule. Oral arguments were heard by the Court of Appeals in October 1985; however, no decision has been made. The Company is not currently able to determine the impact, if any, this will have on the future operation of Wolf Creek; however, in the opinion of the Company the outcome would not have a material adverse affect on the Company.

In February 1986, a class action complaint was filed in the U.S. District Court for the District of Kansas against the Company, several current and prior directors and officers of the Company and others, alleging violation of Section 11 of the Securities Act of 1933 in connection with the sale of 2,000,000 shares of the Company's common stock in June 1983, at a price to the public of $19.625 per share. The complaint alleges that the prospectus for the sale of the shares was false and misleading because it failed to adequately describe material adverse facts and circumstances affecting the Company in connection with the construction of Wolf Creek and the Company's ability to recover through rates its investment in Wolf Creek. The Company has not yet filed a response to the complaint, but believes it to be without foundation.

Proposed Changes to Financial Accounting Standards Board Statement No. 71 — The accounting standard related specifically to public utilities and certain other regulated enterprises is promulgated by Financial Accounting Standards Board Statement No. 71 (FAS 71). The Financial Accounting Standards Board (Board) has issued an Exposure Draft proposing certain amendments to FAS 71. The amendments, if adopted, would become effective for fiscal years beginning after December 15, 1986 with retroactive application for prior transactions. The Exposure Draft proposes amendments to the accounting for: 1) the phase-in of rates associated with the costs of new generating plants, 2) abandonments of partially completed generating plants and 3) disallowances of costs associated with newly completed generating plants. The proposed amendments, if adopted in their present form, could have a significant adverse impact on the Company's financial statements due to the revisions proposed in the accounting treatment of plant costs. Under a literal interpretation of the proposed revisions, the Company's electric plant in service, common stock equity and book value could decrease 40%, 58% and 58%, respectively. In addition, the Company's retained earnings could be a deficit. However, until such time as the Board holds its scheduled public hearings on the Exposure Draft in June of 1986 and any amendments to FAS 71 are adopted, any determination of the specific impact such amendments may have on the Company are considered by management to be preliminary and subject to material change.

Nuclear Insurance — The Price-Anderson Act (Act) currently limits the public liability of an owner of a nuclear power plant to $650 million for a single nuclear incident. The Wolf Creek Owners' have purchased the maximum available private insurance of $160 million and the balance is provided by indemnity agreements with the Nuclear Regulatory Commission. The Wolf Creek Owners are jointly and severally subject to a retrospective assessment of up to $5 million ($2.35 million, Company's share) in the event there is a nuclear incident involving any of the nations' licensed reactors. There is a limitation of $10 million ($4.7 million, Company's share) in retrospective assessment in any one year. The Act is scheduled to expire in 1987 and Congress is considering several modifications to the Act. The Company is unable to predict the effect such actions may have on the Company's potential liability.

The Company carries property insurance in amounts of approximately $1 billion with a combination of the "nuclear insurance pools" and Nuclear Electric Insurance Limited (NEIL), which provides insurance coverage against property damage to nuclear generating facilities. The Company also carries additional insurance with NEIL to cover the costs of replacement power during prolonged outage of a nuclear unit. In the event of a claim by any member of NEIL under the above coverages, the Company may be subject to an assessment if losses exceed premiums, reserves and other NEIL resources. As of December 31, 1985, the maximum assessment to the Company is approximately $8 million.

See Note 2 for rate matters.

11. Joint Ownership of Utility Plants:

	Company's Ownership at December 31, 1985				
	In-Service Dates	Investment In Millions	Accum. Depr.	(MW)	Percent
La Cygne #1(a)	June 1973	$ 123	$50	343	50
La Cygne #2(a)	May 1977	118	38	315	50
Jeffrey #1(b)	July 1978	61	14	132	20
Jeffrey #2(b)	May 1980	60	11	134	20
Jeffrey #3(b)	May 1983	86	8	136	20
Wolf Creek #1(c)	Sept. 1985	1,390	15	530	47

(a) Jointly owned with Kansas City Power & Light Company.

(b) Jointly owned with The Kansas Power and Light Company, Central Telephone and Utilities Corp. and Missouri Public Service Company.

(c) Jointly owned with Kansas City Power & Light Company and Kansas Electric Power Cooperative, Inc.

Amounts and capacity represent the Company's share and are financed by the Company. The Company's share of operating expenses of plants in service are included in the operating expenses on the Statements of Income.

12. Quarterly Financial Statistics (Unaudited):

(Thousands of Dollars, except per share amounts)

	1985			
	4th Qtr.	3rd Qtr.	2nd Qtr.	1st Qtr.
Operating Revenues	$110,705	$115,608	$89,810	$94,663
Operating Income	19,716	26,567	13,499	17,221
Net Income	8,198	32,064	27,389	30,081
Earnings Applicable to Common Stock	4,681	28,547	23,872	26,277
Average Shares Outstanding	40,450	39,797	39,331	36,898
Earnings Per Share	$ 0.12	$ 0.72	$ 0.61	$ 0.71

	1984			
	4th Qtr.	3rd Qtr.	2nd Qtr.	1st Qtr.
Operating Revenues	$84,734	$131,588	$95,599	$98,832
Operating Income	14,409	30,207	16,955	17,801
Net Income	25,162	41,391	27,365	27,940
Earnings Applicable to Common Stock	21,344	37,576	23,500	24,075
Average Shares Outstanding	36,509	35,056	34,499	32,729
Earnings Per Share	$ 0.58	$ 1.07	$ 0.68	$ 0.74

These quarterly amounts are unaudited, but in the opinion of the Company, include all adjustments, consisting only of normal recurring accruals, necessary to a fair presentation thereof.

Market Prices and Dividend Rates of Common Stock:

	High/Low Market Price				Dividends	
Common-NYSE	1985		1984		1985	1984
First Quarter	19⅛	16⅞	19	15⅜	$.59	$.59
Second Quarter	19⅝	16¾	16	12½	.59	.59
Third Quarter	19⅛	10¼	17⅛	12⅞	.59	.59
Fourth Quarter	14⅞	9⅝	18⅜	16	.295	.59

The Company had 52,252 common stockholders as of December 31, 1985.

13. Supplementary Information to Disclose the Effects of Changing Prices — (Unaudited):

The estimates of the effect of inflation on the operation of the Company, as set forth below, were prepared on bases prescribed by the Financial Accounting Standards Board's Statement No. 33 (FAS 33), "Financial Reporting and Changing Prices" (as amended). This statement requires adjustments to historical costs to estimate the effects that specific prices (Current Cost) have had on the Company's results of operations. This data is not intended to serve as a substitute for earnings reported on a historical cost basis. It does offer some perspective of the approximate effects of inflation rather than a precise measurement of these effects.

Estimated property, plant and equipment (plant), primarily consisting of plant in service and construction work in progress, was determined for current cost by applying the Handy-Whitman Index of Public Utility Construction Costs to each major class of plant. Current cost is an estimate of the cost of currently replacing existing plant. The resulting adjusted data for plant is not indicative of the Company's future capital requirements because the actual replacement of existing plant will take place over many years and is not likely to be a reproduction of presently existing plant.

SUPPLEMENTAL STATEMENT OF INCOME ADJUSTED FOR CHANGING PRICES

For the Year Ended December 31, 1985

	Conventional Historical Cost	Current Cost Average 1985 Dollars
	(Thousands of Dollars)	
Operating revenues	$ 410,786	$ 410,786
Fuel	103,747	103,747
Purchased power	30,180	30,180
Depreciation	44,543	101,673
Amortization of nuclear fuel	6,118	6,168
Other operating and maintenance expense	113,100	113,100
Income tax expense — net	36,095	36,095
Interest expense — net	60,822	60,822
Other income and deductions — net	(81,551)	(81,551)
Subtotal	313,054	370,234
Income from operations (excluding reduction to net recoverable cost)	$ 97,732	$ 40,552
Increase in specific prices (current cost) of property, plant and equipment held during the year*		$ 76,007
Reduction to net recoverable cost		(20,162)
Effect of increase in general price level		(116,865)
Excess of increase in general price level over increase in specific prices after reduction to net recoverable cost		(61,020)
Gain from decline in purchasing power of net amounts owed		48,191
Net		$ (12,829)
Net assets at year-end at net recoverable cost		$ 801,362

**At December 31, 1985, current cost of utility plant net of accumulated depreciation was $3,241,960,000, while historical cost or net cost recoverable through depreciation was $2,132,047,000.*

The accumulated depreciation for current cost was developed by applying, for each major class of plant, the same percentage relationship that existed between gross plant and accumulated depreciation on a historical basis to the respective adjusted plant data.

Depreciation expense was determined by applying the Company's depreciation rates to the respective indexed plant amounts.

The regulatory process limits the Company to the recovery of the historical cost of service in its rates. Therefore, any excess of the value of plant under current cost must be reduced to the net recoverable cost, which is historical cost. The amount of this excess that accrued as a result of inflation in the current year must be reduced to net recoverable cost.

The Company, by holding assets such as receivables, prepayments, and inventory, suffers a loss of purchasing power during periods of inflation because the amount of cash received in the future for these items will purchase less. Conversely, by holding monetary liabilities, primarily long-term debt, the Company benefits because the payment in the future will be made with nominal dollars having less purchasing power. The Company has significant amounts of long-term debt outstanding which will be paid back in dollars having less purchasing power and, therefore, for purposes of these calculations, has a net gain from holding monetary liabilities in excess of monetary assets.

As allowed by FAS 33, items in the Income Statements, other than depreciation expense, were not adjusted. The cost of fuel used in electric production was not adjusted because the effect on earnings was not material due to the relatively short turnover period between the incurrence of these costs and their recovery through the fuel adjustment clause.

The regulatory process limits the amount of depreciation expense included in the Company's revenue allowance and limits utility plant in rate base to original cost. Such amounts produce cash flows which are inadequate to replace such property in the future or preserve the purchasing power of common equity capital previously invested. While this effect is partially mitigated by the benefit derived from holding long-term debt, the Company has a net purchasing power loss which is experienced by the common shareholder and can only be overcome as a result of adequate rate relief.

Kansas Gas and Electric Company

FIVE-YEAR COMPARISON OF SELECTED SUPPLEMENTARY FINANCIAL DATA ADJUSTED FOR EFFECTS OF CHANGING PRICES

For the Years Ended December 31

	1985	1984	1983	1982	1981
	(In Thousands of Average 1985 Dollars)				
Current cost information:					
Income from operations (excluding reduction to net recoverable cost)	$ 40,552	$ 83,412	$ 76,036	$ 52,704	$ 37,162
Income per common share (after dividend requirements on preferred and preference stock)	$ 0.67	$ 1.95	$ 1.99	$ 1.57	$ 1.67
Excess of increase in general price level over increase in specific prices after reduction to net recoverable cost	$(61,020)	$(30,634)	$(23,113)	$(14,335)	$ (76,772)
Net assets at year-end at net recoverable cost	$801,362	$760,023	$682,803	$572,095	$ 447,944
General information:					
Gain from decline in purchasing power of net amounts owed	$ 48,191	$ 45,003	$ 38,369	$ 36,380	$ 78,222
Cash dividends declared per common share	$ 2.065	$ 2.44	2.45	$ 2.40	$ 2.44
Market price per common share at year-end	$ 14.13	$ 17.87	$ 18.63	$ 20.48	$ 17.59
Average consumer price index	322.2	311.1	298.4	289.1	272.4

Auditors Opinion

To the Stockholders and the
Board of Directors of
Kansas Gas and Electric Company:

We have examined the balance sheets of Kansas Gas and Electric Company as of December 31, 1985 and 1984 and the related statements of income, of retained earnings, and of changes in financial position for each of the three years in the period ended December 31, 1985. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, such financial statements present fairly the financial position of the Company at December 31, 1985 and 1984 and the results of its operations and changes in its financial position for each of the three years in the period ended December 31, 1985, in conformity with generally accepted accounting principles applied on a consistent basis.

Kansas City, Missouri
February 11, 1986

Deloitte Haskins & Sells

Management Statement of Responsibility for Financial Statements

The management of Kansas Gas and Electric Company is responsible for the financial statements, notes thereto, and other information in this report. The accompanying financial statements have been prepared by management in accordance with generally accepted accounting principles consistently applied. The accounting system is in accordance with the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission and the State Corporation Commission of the State of Kansas.

The integrity of the accounting records is upheld by a comprehensive system of internal accounting controls, monitored on a regular basis by the internal audit staff of the Company. The system of internal control is complemented by a set of accounting policies and procedures which provide the necessary guidance needed to institute effective internal control.

The Board of Directors maintains its oversight responsibility through an Audit Committee, consisting of three outside directors. The Committee meets with Management, the Internal Auditors, and the Independent Auditors in connection with its review of matters relating to the Company's financial reporting; the Company's Internal Audit Program; the Company's system of internal accounting controls; and services of the Independent Auditors. The Committee meets with the auditors without management present in order to assure independent treatment of matters brought to its attention. The Committee also recommends to the Directors the selection of Independent Auditors.

Wichita, Kansas
February 11, 1986

E. D. Prothro
Controller and Assistant Secretary

COMPARATIVE ELECTRIC STATEMENTS

	1985	1984	1983	Annual Compound Growth Rate 5 Year	10 Year
Electric Operating Revenues *(Thousands)*:					
Residential	$ 147,183	$ 147,547	$ 142,029	8.2	13.3
Commercial	100,651	96,304	88,976	8.6	12.1
Industrial	129,313	131,080	115,413	6.7	13.0
Public street and highway lighting	4,241	4,305	4,080	11.1	12.5
Retail rates	381,388	379,236	350,498	7.8	12.9
Wholesale rates	23,873	25,294	41,390	(5.0)	7.6
Total sales of electricity	405,261	404,530	391,888	6.7	12.5
Other	5,525	6,223	1,165	39.6	20.1
Total electric operating revenues	$ 410,786	$ 410,753	$ 393,053	6.9	12.5
Sales in Kilowatthours *(Thousands)*:					
Residential	2,063,973	2,114,880	2,098,971	(1.0)	2.4
Commercial	1,629,227	1,586,723	1,527,475	2.0	3.1
Industrial	2,694,588	2,750,126	2,454,486	(.9)	1.7
Public street and highway lighting	56,817	63,243	65,292	(2.4)	(.3)
Retail rates	6,444,605	6,514,972	6,146,224	(.3)	2.2
Wholesale rates	983,983	925,966	1,114,674	(5.6)	.5
Total kilowatthours sold	7,428,588	7,440,938	7,260,898	(1.1)	2.0
Customers at End of Year:					
Residential	220,516	217,510	213,819	1.4	2.0
Commercial	20,206	19,853	19,554	1.0	.7
Industrial	4,542	4,574	4,523	3.0	6.0
Public street and highway lighting	715	690	655	8.1	8.4
Retail rates	245,979	242,627	238,551	1.5	2.0
Wholesale rates	38	39	40	(17.9)	(8.9)
Total electric customers	246,017	242,666	238,591	1.4	2.0
Residential:					
Average kilowatthours per customer	9,435	9,812	9,901	(2.5)	.3
Average revenue per customer	$672.85	$684.54	$669.96	6.6	11.0
Average revenue per kilowatthour	7.13¢	6.98¢	6.77¢	9.3	10.7
Kilowatthours Generated and Purchased *(Thousands)*:					
Generated *(net after station use)*	6,506,528	7,194,861	6,806,286	(3.9)	.5
Purchased	1,590,515	822,000	1,128,312	24.9	15.6
Total available	8,097,043	8,016,861	7,934,598	(.9)	2.1
Company use, line loss, etc.	668,455	575,923	673,700	.8	3.7
Total kilowatthours sold	7,428,588	7,440,938	7,260,898	(1.1)	2.0
Average BTU per Net Kilowatthour Generated	11,184	11,161	10,979	.5	.3
Average Fuel Cost per Million BTU	$1.54	$1.86	$1.87	3.0	10.2
Power Resources *(Megawatts)*					
Available capacity	2,097	2,099	2,160	.7	2.0
System peak responsibility	1,612	1,633	1,700	(1.4)	1.9
Reserve capacity	485	466	460	10.4	2.5
Utility Plant at Original Cost *(Thousands)*:					
Beginning of year	$ 2,282,696	$ 1,922,942	$ 1,668,929	15.9	16.9
Capital expenditures	212,440	364,823	262,520	3.7	9.2
Retirements	12,459	5,069	8,507	26.0	18.4
End of year	2,482,677	2,282,696	1,922,942	14.4	16.0
Accumulated depreciation	350,630	293,683	265,739	11.8	12.0
Net utility plant	$ 2,132,047	$ 1,989,013	$ 1,657,203	14.9	16.8
Employees at Year-end	2,513	2,277	2,016	10.0	6.9

Kansas Gas and Electric Company
P.O. Box 208
Wichita, Kansas 67201

Key Number 10

Address Correction Requested
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Bulk Rate
U.S. Postage
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Wichita, KS

DIRECTORS*

Frank J. Becker (1981)
(1,4) Chairman and Chief Executive Officer, Becker Corporation and First National Bank & Trust Co., El Dorado, KS

Glenn Biggs (1986)
(6) Vice Chairman of the Board, InterFirst Bank, San Antonio, TX

Howard Brenneman (1985)
President and Chief Executive Officer, Hesston Corporation, Hesston, KS

A. Dwight Button (1976)
(1,2,4) Retired Chairman of the Board, Fourth Financial Corp., Wichita

Wilson K. Cadman (1978)
([illegible]) Chairman of the Board and President of the Company, Wichita

C.T. Carter (1968)
(1,3) Retired Vice President, Pipeline Transportation, Atlantic Richfield Company, Independence, KS

C.Q. Chandler (1974)
(1,4,5) Chairman of the Board, First National Bank in Wichita

Robert T. Crain (1981)
(5) Crain Realty Company, Fort Scott, KS

Ralph P. Fiebach (1967)
Retired Chairman of the Board of the Company, Wichita

Ralph Foster (1970)
(4) Vice President - General Counsel of the Company, Wichita

Donald A. Johnston (1980)
(2,5) Corporate General Manager, Maupintour, Inc., Lawrence, KS

Russell W. Meyer, Jr. (1982)
(5) Chairman and Chief Executive Officer, Cessna Aircraft Company, Wichita

James J. Noone (1986)
(6) Attorney and Retired Administrative Judge for the District Court of Sedgwick County, Wichita

Terence J. Scanlon (1980)
(2,3,4) Investor and Developer, Wichita

Marjorie I. Setter (1980)
(4) President, Setter and Associates, Inc., Advertising and Public Relations, Wichita

Donald C. Slawson (1983)
(3) Chairman of the Board and President, Slawson Companies, Wichita

Dr. Newton Smith (1985)
Physician, Arkansas City, KS

Lawrence E. Walsh (1986)
(6) Attorney and Retired Federal District Court Judge, Oklahoma City, OK

***Year elected and committee assignments.**

Committees: *(1) Executive; (2) Compensation; (3) Audit; (4) Shareholder Relations; (5) Nominating; (6) Special Litigation*

OFFICERS

Wilson K. Cadman, 58*
Chairman of the Board and President

Kent R. Brown, 41*
Group Vice President

Richard M. Haden, 46*
Group Vice President

James S. Haines, Jr., 39*
Group Vice President

Robert L. Rives, 52*
Group Vice President

Ralph B. Foster, 57*
Vice President - General Counsel

Glenn L. Koester, 60*
Vice President - Nuclear

William B. Moore, 33
Vice President - Finance

E. D. Prothro, [illegible]
Controller and Assistant Secretary

Richard D. Terrill, 31
Secretary

W. R. Whitmer, 52
Treasurer

Verna L. Ridgeway, 58
Assistant Vice President - Consumer Affairs

Jack Skelton, 55
Assistant Controller

Michael A. Gayoso, 37
Assistant Controller

J. F. Klassen, 56
Assistant Treasurer

Joe R. Gibbens, 40
Assistant Secretary

**Policy Group member.*

STOCKHOLDER INFORMATION

Annual Meeting

The annual stockholders' meeting will be held May 21, 1986, at the Alexander Auditorium, Fine Arts Center, Friends University in Wichita. Proxies for this meeting will be solicited by the management. A proxy statement will be mailed to stockholders about April 15, 1986.

This report is prepared primarily for the information of company stockholders and is not transmitted in connection with the sale of any securities or offer to buy any securities.

Fiscal Agents

Preferred Stock: Transfer Agent — First National Bank in Wichita; Registrar — The Fourth National Bank and Trust Company, Wichita.

Common Stock: Transfer Agents — First National Bank in Wichita and First National Bank of Chicago; Registrars — The Fourth National Bank and Trust Company, Wichita, and First National Bank of Chicago. Listed N.Y.S.E. and P.S.E.; ticker symbol — KGE.

Bonds: Trustee, Registrar and Paying Agent — Morgan Guaranty Trust Company of New York.

Stockholder Records and Dividend Reinvestment

KG&E Stockholder Records
P.O. Box 208
Wichita, KS 67201
Phone: Kansas — Collect
(316) 261-6640
Outside Kansas —
1-800-527-2495, Ext. 6640

Other information
Vicki L. Ackerman
KG&E Investor Relations
P.O. Box 208
Wichita, KS 67201
Phone: Kansas — Collect
(316) 261-6929
Outside Kansas —
1-800-527-2495, Ext. 6929