FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

[x] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 1997

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from          to

Commission file number 1-7324

KANSAS GAS AND ELECTRIC COMPANY
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| KANSAS | 48-1093840 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

P.O. BOX 208
WICHITA, KANSAS 67201
(Address of Principal Executive Offices)

316/261-6611
(Registrant's telephone number, including area code)

Indicated by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class | Outstanding at July 30, 1997 |
|---|---|
| Common Stock (No par value) | 1,000 Shares |

Registrant meets the conditions of General Instruction H(1)(a) and (b) to Form 10-Q and is therefore filing this form with a reduced disclosure format.



KANSAS GAS AND ELECTRIC COMPANY
INDEX

KANSAS GAS AND ELECTRIC COMPANY
BALANCE SHEETS
(Dollars in Thousands)
(Unaudited)

| | June 30, 1997 | December 31, 1996 |
|---|---|---|
| ASSETS | | |
| UTILITY PLANT: | | |
| Electric plant in service | $3,507,286 | $3,487,213 |
| Less - Accumulated depreciation | 1,015,523 | 974,451 |
| | 2,491,763 | 2,512,762 |
| Construction work in progress | 38,143 | 33,197 |
| Nuclear fuel (net) | 43,998 | 38,461 |
| Net utility plant | 2,573,904 | 2,584,420 |
| INVESTMENTS AND OTHER PROPERTY: | | |
| Decommissioning trust | 34,638 | 33,041 |
| Other | 9,746 | 9,093 |
| | 44,384 | 42,134 |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | 35 | 44 |
| Accounts receivable and unbilled revenues (net) | 73,603 | 75,671 |
| Advances to parent company | 44,154 | 250,733 |
| Fossil fuel, at average cost | 13,710 | 13,459 |
| Materials and supplies, at average cost | 29,909 | 30,187 |
| Prepayments and other current assets | 34,037 | 16,991 |
| | 195,448 | 387,085 |
| DEFERRED CHARGES AND OTHER ASSETS: | | |
| Deferred future income taxes | 206,800 | 164,520 |
| Corporate-owned life insurance (net) | 10,863 | 10,341 |
| Regulatory assets | 110,913 | 122,388 |
| Other | 3,907 | 7,999 |
| | 332,483 | 305,248 |
| TOTAL ASSETS | $3,146,219 | $3,318,887 |
| CAPITALIZATION AND LIABILITIES | | |
| CAPITALIZATION (See Statements): | | |
| Common stock equity | $1,159,015 | $1,182,351 |
| Long-term debt (net) | 684,065 | 684,068 |
| | 1,843,080 | 1,866,419 |
| CURRENT LIABILITIES: | | |
| Short-term debt | 10,000 | 222,300 |
| Accounts payable | 70,931 | 48,819 |
| Accrued taxes | 37,012 | 35,358 |
| Accrued interest | 8,143 | 9,445 |
| Other | 6,940 | 6,726 |
| | 133,026 | 322,648 |
| DEFERRED CREDITS AND OTHER LIABILITIES: | | |
| Deferred income taxes | 784,389 | 753,511 |
| Deferred investment tax credits | 68,099 | 69,722 |
| Deferred gain from sale-leaseback | 227,693 | 233,060 |
| Other | 89,932 | 73,527 |
| | 1,170,113 | 1,129,820 |
| COMMITMENTS AND CONTINGENCIES (Note 2) | | |
| TOTAL CAPITALIZATION AND LIABILITIES | $3,146,219 | $3,318,887 |

The NOTES TO FINANCIAL STATEMENTS are an integral part of these statements.

KANSAS GAS AND ELECTRIC COMPANY
STATEMENTS OF INCOME
(Dollars in Thousands)
(Unaudited)

| | Three Months Ended June 30, 1997 | Three Months Ended June 30, 1996 |
|---|---|---|
| OPERATING REVENUES | $ 148,826 | $ 163,038 |
| OPERATING EXPENSES: | | |
| Fuel used for generation: | | |
| Fossil fuel | 16,355 | 21,828 |
| Nuclear fuel | 5,999 | 5,618 |
| Power purchased | 4,186 | 2,464 |
| Other operations | 37,857 | 38,307 |
| Maintenance | 14,405 | 15,439 |
| Depreciation and amortization | 24,183 | 23,494 |
| Amortization of phase-in revenues | 4,386 | 4,386 |
| Taxes: | | |
| Federal income | 5,864 | 7,592 |
| State income | 1,802 | 2,433 |
| General | 8,986 | 12,047 |
| Total operating expenses | 124,023 | 133,608 |
| OPERATING INCOME | 24,803 | 29,430 |
| OTHER INCOME AND DEDUCTIONS: | | |
| Corporate-owned life insurance (net) | (749) | (1,565) |
| Miscellaneous (net) | 783 | 556 |
| Income taxes (net) | 2,655 | 2,738 |
| Total other income and deductions | 2,689 | 1,729 |
| INCOME BEFORE INTEREST CHARGES | 27,492 | 31,159 |
| INTEREST CHARGES: | | |
| Long-term debt | 11,525 | 11,583 |
| Other | 999 | 2,694 |
| Allowance for borrowed funds used during construction (credit) | (524) | (371) |
| Total interest charges | 12,000 | 13,906 |
| NET INCOME | $ 15,492 | $ 17,253 |

The NOTES TO FINANCIAL STATEMENTS are an integral part of these statements.

KANSAS GAS AND ELECTRIC COMPANY
STATEMENTS OF INCOME
(Dollars in Thousands)
(Unaudited)

| | Six Months Ended June 30, 1997 | 1996 |
|---|---|---|
| OPERATING REVENUES | $ 292,617 | $ 308,072 |
| OPERATING EXPENSES: | | |
| Fuel used for generation: | | |
| Fossil fuel | 33,122 | 43,980 |
| Nuclear fuel | 12,290 | 7,375 |
| Power purchased | 7,352 | 6,824 |
| Other operations | 71,760 | 69,676 |
| Maintenance | 27,166 | 27,338 |
| Depreciation and amortization | 48,720 | 46,862 |
| Amortization of phase-in revenues | 8,772 | 8,772 |
| Taxes: | | |
| Federal income | 11,663 | 12,672 |
| State income | 3,518 | 3,992 |
| General | 20,356 | 24,088 |
| Total operating expenses | 244,719 | 251,579 |
| OPERATING INCOME | 47,898 | 56,493 |
| OTHER INCOME AND DEDUCTIONS: | | |
| Corporate-owned life insurance (net) | (3,469) | (3,749) |
| Miscellaneous (net) | 1,341 | 1,571 |
| Income taxes (net) | 5,454 | 5,327 |
| Total other income and deductions | 3,326 | 3,149 |
| INCOME BEFORE INTEREST CHARGES | 51,224 | 59,642 |
| INTEREST CHARGES: | | |
| Long-term debt | 23,007 | 23,299 |
| Other | 2,556 | 4,369 |
| Allowance for borrowed funds used during construction (credit) | (1,003) | (979) |
| Total interest charges | 24,560 | 26,689 |
| NET INCOME | $ 26,664 | $ 32,953 |

The NOTES TO FINANCIAL STATEMENTS are an integral part of these statements.

KANSAS GAS AND ELECTRIC COMPANY
STATEMENTS OF INCOME
(Dollars in Thousands)
(Unaudited)

| | Twelve Months Ended June 30, 1997 | 1996 |
|---|---|---|
| OPERATING REVENUES | $ 639,115 | $ 648,636 |
| OPERATING EXPENSES: | | |
| Fuel used for generation: | | |
| Fossil fuel | 80,966 | 87,176 |
| Nuclear fuel | 24,877 | 17,036 |
| Power purchased | 12,011 | 10,195 |
| Other operations | 136,804 | 125,353 |
| Maintenance | 48,771 | 50,768 |
| Depreciation and amortization | 98,167 | 89,872 |
| Amortization of phase-in revenues | 17,544 | 17,545 |
| Taxes: | | |
| Federal income | 35,147 | 47,707 |
| State income | 9,981 | 12,567 |
| General | 42,451 | 46,943 |
| Total operating expenses | 506,719 | 505,162 |
| OPERATING INCOME | 132,396 | 143,474 |
| OTHER INCOME AND DEDUCTIONS: | | |
| Corporate-owned life insurance (net) | (1,969) | (2,880) |
| Miscellaneous (net) | 3,167 | 3,625 |
| Income taxes (net) | 10,480 | 13,271 |
| Total other income and deductions | 11,678 | 14,016 |
| INCOME BEFORE INTEREST CHARGES | 144,074 | 157,490 |
| INTEREST CHARGES: | | |
| Long-term debt | 46,012 | 46,821 |
| Other | 9,945 | 6,947 |
| Allowance for borrowed funds used during construction (credit) | (1,868) | (2,665) |
| Total interest charges | 54,089 | 51,103 |
| NET INCOME | $ 89,985 | $ 106,387 |

The NOTES TO FINANCIAL STATEMENTS are an integral part of these statements.

KANSAS GAS AND ELECTRIC COMPANY
STATEMENTS OF CASH FLOWS
(Dollars in Thousands)
(Unaudited)

| | Six Months Ended June 30, 1997 | Six Months Ended June 30, 1996 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | $ 26,664 | $ 32,953 |
| Depreciation and amortization | 48,720 | 46,862 |
| Amortization of nuclear fuel | 9,803 | 5,602 |
| Amortization of phase-in revenues | 8,772 | 8,772 |
| Corporate-owned life insurance | (13,930) | (12,593) |
| Amortization of gain from sale-leaseback | (5,367) | (4,820) |
| Changes in working capital items: | | |
| Accounts receivable and unbilled revenues (net) | 2,068 | (5,162) |
| Fossil fuel | (251) | 2,627 |
| Accounts payable | 22,112 | 7,695 |
| Interest and taxes accrued | 352 | 2,868 |
| Other | (16,047) | 10,076 |
| Changes in other assets and liabilities | (5,349) | (39,894) |
| Net cash flows from operating activities | 77,547 | 54,986 |
| CASH FLOWS USED IN INVESTING ACTIVITIES: | | |
| Additions to utility plant | 46,221 | 31,314 |
| Corporate-owned life insurance policies | 24,557 | 22,468 |
| Death proceeds of corporate-owned life insurance policies | (1,810) | - |
| Net cash flows used in investing activities | 68,968 | 53,782 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Short-term debt (net) | (212,300) | 200,000 |
| Advances to parent company (net) | 206,579 | (179,355) |
| Bonds retired | (65) | (16,135) |
| Borrowings against life insurance policies | 47,782 | 44,321 |
| Repayments of borrowings against life insurance policies | (584) | - |
| Dividends to parent company | (50,000) | (50,000) |
| Net cash flows from (used in) financing activities | (8,588) | (1,169) |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | (9) | 35 |
| CASH AND CASH EQUIVALENTS: | | |
| BEGINNING OF PERIOD | 44 | 53 |
| END OF PERIOD | $ 35 | $ 88 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION | | |
| CASH PAID FOR: | | |
| Interest on financing activities (net of amount capitalized) | $ 54,342 | $ 50,652 |
| Income taxes | 20,100 | 17,600 |

The NOTES TO FINANCIAL STATEMENTS are an integral part of these statements.

KANSAS GAS AND ELECTRIC COMPANY
STATEMENTS OF CASH FLOWS
(Dollars in Thousands)
(Unaudited)

| | Twelve Months Ended June 30, 1997 | Twelve Months Ended June 30, 1996 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | $ 89,985 | $ 106,387 |
| Depreciation and amortization | 98,167 | 89,872 |
| Amortization of nuclear fuel | 19,886 | 12,862 |
| Amortization of phase-in revenues | 17,544 | 17,545 |
| Corporate-owned life insurance | (31,050) | (32,476) |
| Amortization of gain from sale-leaseback | (10,187) | (9,639) |
| Changes in working capital items: | | |
| Accounts receivable and unbilled revenues (net) | 8,049 | (13,672) |
| Fossil fuel | 1,185 | 1,714 |
| Accounts payable | 12,453 | 3,552 |
| Interest and taxes accrued | 16,618 | (2,770) |
| Other | (21,702) | 20,977 |
| Changes in other assets and liabilities | 24,773 | (19,867) |
| Net cash flows from operating activities | 225,721 | 174,485 |
| CASH FLOWS USED IN INVESTING ACTIVITIES: | | |
| Additions to utility plant | 83,539 | 84,696 |
| Corporate-owned life insurance policies | 27,736 | 27,176 |
| Death proceeds of corporate-owned life insurance | (11,255) | (10,333) |
| Net cash flows used in investing activities | 100,020 | 101,539 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Short-term debt (net) | (240,000) | 225,000 |
| Advances to parent company (net) | 170,149 | (122,399) |
| Bonds retired | (65) | (16,135) |
| Borrowings against life insurance policies | 49,439 | 45,789 |
| Repayment of borrowings against life insurance policies | (5,277) | (5,185) |
| Dividends to parent company | (100,000) | (200,000) |
| Net cash flows from (used in) financing activities | (125,754) | (72,930) |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | (53) | 16 |
| CASH AND CASH EQUIVALENTS: | | |
| BEGINNING OF PERIOD | 88 | 72 |
| END OF PERIOD | $ 35 | $ 88 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION | | |
| CASH PAID FOR: | | |
| Interest on financing activities (net of amount capitalized) | $ 82,402 | $ 73,651 |
| Income taxes | 34,600 | 41,660 |

The NOTES TO FINANCIAL STATEMENTS are an integral part of these statements.

KANSAS GAS AND ELECTRIC COMPANY
STATEMENTS OF CAPITALIZATION
(Dollars in Thousands)
(Unaudited)

| | | | | June 30, 1997 | | December 31, 1996 | |
|---|---|---|---|---|---|---|---|
| COMMON STOCK EQUITY (see Statements): | | | | | | | |
| Common stock, without par value, authorized and issued 1,000 shares. . . . . . . . . . . . . . . . . . . . . . . . . . | | | | $1,065,634 | | $1,065,634 | |
| Retained earnings . . . . . . . . . . . . . . . . . . . . . . . . . | | | | 93,381 | | 116,717 | |
| Total common stock equity . . . . . . . . . . . . . . . . . . . | | | | 1,159,015 | 63% | 1,182,351 | 63% |
| LONG-TERM DEBT: | | | | | | | |
| First Mortgage Bonds: | | | | | | | |
| Series | Due | 1997 | 1996 | | | | |
| 7.6% | 2003 | 135,000 | 135,000 | | | | |
| 6-1/2% | 2005 | 65,000 | 65,000 | | | | |
| 6.20% | 2006 | 100,000 | 100,000 | | | | |
| | | | | 300,000 | | 300,000 | |
| Pollution Control Bonds: | | | | | | | |
| 5.10% | 2023 | 13,757 | 13,822 | | | | |
| Variable (a) | 2027 | 21,940 | 21,940 | | | | |
| 7.0% | 2031 | 327,500 | 327,500 | | | | |
| Variable (a) | 2032 | 14,500 | 14,500 | | | | |
| Variable (a) | 2032 | 10,000 | 10,000 | | | | |
| | | | | 387,697 | | 387,762 | |
| Total bonds. . . . . . . . . . . . . . . . . . . . . . . . | | | | 687,697 | | 687,762 | |
| Less: | | | | | | | |
| Unamortized premium and discount (net). . . . . . . . . . . | | | | 3,632 | | 3,694 | |
| Total long-term debt . . . . . . . . . . . . . . . . . . . | | | | 684,065 | 37% | 684,068 | 37% |
| TOTAL CAPITALIZATION. . . . . . . . . . . . . . . . . . . . . . . . | | | | $1,843,080 | 100% | $1,866,419 | 100% |

(a) Market-Adjusted Tax Exempt Securities (MATES). As of June 30, 1997, the rate on these bonds ranged from 3.75% to 4.15%.

The NOTES TO FINANCIAL STATEMENTS are an integral part of these statements.

KANSAS GAS AND ELECTRIC COMPANY
STATEMENTS OF COMMON STOCK EQUITY
(Dollars in Thousands)
(Unaudited)

| | Common Stock | Retained Earnings |
|---|---|---|
| BALANCE DECEMBER 31, 1994, 1,000 shares. . . . . . . | $1,065,634 | $ 159,570 |
| Net income . . . . . . . . . . . . . . . . . . . . . . . | | 110,873 |
| Dividend to parent company . . . . . . . . . . . . . . | | (150,000) |
| BALANCE DECEMBER 31, 1995, 1,000 shares. . . . . . . | 1,065,634 | 120,443 |
| Net income . . . . . . . . . . . . . . . . . . . . . . . | | 96,274 |
| Dividend to parent company . . . . . . . . . . . . . . | | (100,000) |
| BALANCE DECEMBER 31, 1996, 1,000 shares. . . . . . . | 1,065,634 | 116,717 |
| Net Income . . . . . . . . . . . . . . . . . . . . . . . | | 26,664 |
| Dividend to parent company . . . . . . . . . . . . . . | | (50,000) |
| BALANCE JUNE 30, 1997, 1,000 shares. . . . . . . . . | $1,065,634 | $ 93,381 |

The NOTES TO FINANCIAL STATEMENTS are an integral part of these statements.

KANSAS GAS AND ELECTRIC COMPANY
NOTES TO FINANCIAL STATEMENTS
(Unaudited)

1. ACCOUNTING POLICIES AND OTHER INFORMATION

General: Kansas Gas and Electric Company (the company) is a rate regulated electric utility and wholly-owned subsidiary of Western Resources, Inc. (Western Resources). The company is engaged in the production, purchase, transmission, distribution, and sale of electricity. The company serves approximately 277,000 electric customers in southeastern Kansas. At December 31, 1996, the company had no employees. All employees are provided by the company's parent, Western Resources which allocates costs related to the employees of the company.

The company owns 47% of the Wolf Creek Nuclear Operating Corporation (WCNOC), the operating company for the Wolf Creek Generating Station (Wolf Creek). The company records in its financial statements its proportionate share of all transactions of WCNOC as it does other jointly-owned facilities.

The company prepares its financial statements in conformity with generally accepted accounting principles as applied to regulated public utilities. The accounting and rates of the company are subject to requirements of the Kansas Corporation Commission (KCC) and the Federal Energy Regulatory Commission. The financial statements require management to make estimates and assumptions that affect the reported amounts of assets and liabilities, to disclose contingent assets and liabilities at the balance sheet date, and to report amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The company currently applies accounting standards that recognize the economic effects of rate regulation Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation", (SFAS 71) and, accordingly, has recorded regulatory assets and liabilities related to its generation, transmission and distribution operations. In 1996, the KCC initiated a generic docket to study electric restructuring issues. A retail wheeling task force has been created by the Kansas Legislature to study competitive trends in retail electric services. During the 1997 session of the Kansas Legislature, bills were introduced to increase competition in the electric industry. Among the matters under consideration is the recovery by utilities of costs in excess of competitive cost levels. There can be no assurance at this time that such costs will be recoverable if open competition is initiated in the electric utility market. In the event the company determines that it no longer meets the criteria for SFAS 71, the accounting impact would be an extraordinary non-cash charge to operations of an amount that would be material. Criteria that give rise to the discontinuance of SFAS 71 include, (1) increasing competition that restricts the company's ability to establish prices to recover specific costs, and (2) a significant change in the manner in which rates are set by regulators from a cost-based regulation to another form of regulation. The company periodically reviews these criteria to ensure the continuing application of SFAS 71 is appropriate. Based on current evaluation of the various factors and conditions that are expected to impact future cost recovery, the company believes that its net regulatory assets are probable of future recovery. Any regulatory changes that would require the company to discontinue SFAS 71 based upon competitive or other events may significantly impact the valuation of the company's net regulatory assets and its utility plant investments, particularly the Wolf Creek facility. At this time, the effect of competition and the amount of regulatory assets which could be recovered in such an environment cannot be predicted. See Note 3 for further discussion on regulatory assets.

Environmental Remediation: Effective January 1, 1997, the company adopted the provisions of Statement of Position (SOP) 96-1, "Environmental Remediation Liabilities". This statement provides authoritative guidance for recognition, measurement, display, and disclosure of environmental remediation liabilities in financial statements. The company's best current estimate of the most likely range of environmental costs to be incurred per site based upon limited current information presently available is approximately $100,000 to $10 million. It should be noted that additional information and testing could result in costs significantly below or in excess of the amounts noted above to be incurred. The KCC has permitted another Kansas utility to recover its remediation costs through rates. To the extent that such remediation costs are not recovered through rates, the costs could be material to the company's financial position or results of operations, depending on the degree of remediation required and number of years over which the remediation must be completed.

Cash Surrender Value of Life Insurance Contracts: The following amounts related to corporate-owned life insurance contracts (COLI) are recorded in Corporate-owned Life Insurance (net) on the balance sheets:

| | June 30, 1997 | December 31, 1996 |
|---|---|---|
| | (Dollars in Millions) | |
| Cash surrender value of contracts.(1). . | $452.3 | $404.6 |
| Borrowings against contracts . . . . . . | (441.4) | (394.3) |
| COLI (net) . . . . . . . . . . . . . | $ 10.9 | $ 10.3 |

(1) Cash surrender value of contracts as presented represents the value of the policies as of the end of the respective policy years and not as of June 30, 1997 and December 31, 1996.

Income is recorded for increases in cash surrender value and net death proceeds. Interest expense is recognized for COLI borrowings. The net income generated from COLI contracts, including the tax benefit of the interest deductions and premium expenses, are recorded as Corporate-owned Life Insurance (net) on the Statements of Income. The income from increases in cash surrender value and net death proceeds was $6.7 million, $10.9 million, and $26.1 million for the three, six and twelve months ended June 30, 1997, respectively, compared to $5.4 million, $10.2 million and $24.7 million for the three, six and twelve months ended 1996, respectively. The interest expense deduction taken was $7.4 million, $14.4 million and $28.1 million for the three, six and twelve months ended June 30, 1997, respectively, compared to $7.0 million, $13.9 million and $27.6 million for the three, six and twelve months ended June 30, 1996, respectively.

Cash and Cash Equivalents: For purposes of the Statements of Cash Flows, cash and cash equivalents include cash on hand and highly liquid collateralized debt instruments purchased with maturities of three months or less.

## 2. COMMITMENTS AND CONTINGENCIES

Manufactured Gas Sites: The company has been associated with three former manufactured gas sites which may contain coal tar and other potentially harmful materials. The company and the Kansas Department of Health and Environment (KDHE) entered into a consent agreement governing all future work at the three sites. The terms of the consent agreement will allow the company to investigate these sites and set remediation priorities based upon the results of the investigations and risk analyses. The prioritized sites will be investigated over a ten year period. The agreement will allow the company to set mutual objectives with the KDHE in order to expedite effective response activities and to control costs and environmental impact. As of June 30, 1997, the costs incurred for site investigation and risk assessment have been minimal. Since the site investigations are preliminary, no formal agreement on costs to be incurred has been reached, and the minimum potential liability would not be material to the financial statements, an accrual for these environmental contingencies has not been reflected in the accompanying financial statements. To the extent that such remediation costs are not recovered through rates, the costs could be material to the company's financial position or results of operations depending on the degree of remediation and number of years over which the remediation must be completed.

Decommissioning: The company accrues decommissioning costs over the expected life of the Wolf Creek generating facility. The accrual is based on estimated unrecovered decommissioning costs which consider inflation over the remaining estimated life of the generating facility and are net of expected earnings on amounts recovered from customers and deposited in an external trust fund.

Approval of the 1996 Decommissioning Cost Study was received from the KCC on February 28, 1997. Based on the study, the company's share of these decommissioning costs, under the immediate dismantlement method, is estimated to be approximately $624 million during the period 2025 through 2033, or approximately $192 million in 1996 dollars. These costs were calculated using an assumed inflation rate of 3.6% over the remaining service life from 1996 of 29 years.

Decommissioning costs are currently being charged to operating expenses in accordance with the prior KCC orders. Electric rates charged to customers provide for recovery of these decommissioning costs over the life of Wolf Creek. Amounts expensed approximated $3.7 million in 1996 and will increase annually to $5.6 million in 2024. These expenses are deposited in an external trust fund. The average after tax expected return on trust assets is 5.7%. An updated funding schedule, on which the contributions are not materially different, was submitted to the KCC on March 10, 1997. Approval of this funding schedule is still pending with the KCC.

The company's investment in the decommissioning fund, including reinvested earnings approximated $34.6 million and $33.0 million at June 30, 1997 and December 31, 1996, respectively. Trust fund earnings accumulate in the fund balance and increase the recorded decommissioning liability. These amounts are reflected in Investments and Other Property, Decommissioning trust, and the related liability is included in Deferred Credits and Other Liabilities, Other, on the Balance Sheets.

The staff of the SEC has questioned certain current accounting practices used by nuclear electric generating station owners regarding the recognition, measurement, and classification of decommissioning costs for nuclear electric generating stations. In response to these questions, the Financial Accounting Standards Board is expected to issue new accounting standards for removal costs, including decommissioning, in 1998. If current electric utility industry accounting practices for such decommissioning costs are changed: (1) annual decommissioning expenses could increase, (2) the estimated present value of decommissioning costs could be recorded as a liability rather than as accumulated depreciation, and (3) trust fund income from the external decommissioning trusts could be reported as investment income rather than as a reduction to decommissioning expense. When revised accounting guidance is issued, the company will also have to evaluate its effect on accounting for removal costs of other long-lived assets. The company is not able to predict what effect such changes would have on results of operations, financial position, or related regulatory practices until the final issuance of revised accounting guidance, but such effect could be material.

The company carries premature decommissioning insurance which has several restrictions. One of these is that it can only be used if Wolf Creek incurs an accident exceeding $500 million in expenses to safely stabilize the reactor, to decontaminate the reactor and reactor station site in accordance with a plan approved by the Nuclear Regulatory Commission (NRC), and to pay for on-site property damages. This decommissioning insurance will only be available if the insurance funds are not needed to implement the NRC-approved plan for stabilization and decontamination.

Nuclear Insurance: The Price-Anderson Act limits the combined public liability of the owners of nuclear power plants to $8.9 billion for a single nuclear incident. If this liability limitation is insufficient, the U.S. Congress will consider taking whatever action is necessary to compensate the public for valid claims. The Wolf Creek owners (Owners) have purchased the maximum available private insurance of $200 million and the balance is provided by an assessment plan mandated by the NRC. Under this plan, the Owners are jointly and severally subject to a retrospective assessment of up to $79.3 million ($37.3 million, company's share) in the event there is a major nuclear incident involving any of the nation's licensed reactors. This assessment is subject to an inflation adjustment based on the Consumer Price Index and applicable premium taxes. There is a limitation of $10 million ($4.7 million, company's share) in retrospective assessments per incident, per year.

The Owners carry decontamination liability, premature decommissioning liability, and property damage insurance for Wolf Creek totaling approximately $2.8 billion ($1.3 billion, company's share). This insurance is provided by a combination of "nuclear insurance pools" ($500 million) and Nuclear Electric Insurance Limited (NEIL) ($2.3 billion). In the event of an accident, insurance proceeds must first be used for reactor stabilization and site decontamination. The company's share of any remaining proceeds can be used for property damage or premature decommissioning costs up to $1.3 billion (company's share). Premature decommissioning insurance cost recovery is the excess of funds previously collected for decommissioning (as discussed under "Decommissioning").

The Owners also carry additional insurance with NEIL to cover costs of replacement power and other extra expenses incurred during a prolonged outage resulting from accidental property damage at Wolf Creek. If losses incurred at any of the nuclear plants insured under the NEIL policies exceed premiums, reserves, and other NEIL resources, the company may be subject to retrospective assessments under the current policies of approximately $8 million per year.

Although the company maintains various insurance policies to provide coverage for potential losses and liabilities resulting from an accident or an extended outage, the company's insurance coverage may not be adequate to cover the costs that could result from a catastrophic accident or extended outage at Wolf Creek. Any substantial losses not covered by insurance, to the extent not recoverable through rates, would have a material adverse effect on the company's financial condition and results of operations.

Clean Air Act: The Clean Air Act Amendments of 1990 (the Act) require a two-phase reduction in certain emissions. To meet the monitoring and reporting requirements under the acid rain program, the company has installed continuous monitoring and reporting equipment at a total cost of approximately $2.3 million as of December 31, 1996. The company does not expect material expenditures to be needed to meet Phase II sulfur dioxide requirements.

In the fourth quarter of 1996, the Environmental Protection Agency (EPA) issued new standards applying to NOx emissions from the company's effected coal units. Jeffrey Energy Center will require operational modifications and possible minor capital investments to modify the emission controls. The company will have until the year 2000 to comply.

Fuel Commitments: To supply a portion of the fuel requirements for its generating plants, the company has entered into various commitments to obtain nuclear fuel and coal. Some of these contracts contain provisions for price escalation and minimum purchase commitments. At December 31, 1996, WCNOC's nuclear fuel commitments (company's share) were approximately $15.4 million for uranium concentrates expiring at various times through 2001, $59.4 million for enrichment expiring at various times through 2003, and $70.3 million for fabrication through 2025. At December 31, 1996, the company's coal contract commitments in 1996 dollars under the remaining terms of the contracts were approximately $671 million. The largest coal contract expires in 2020, with the remaining coal contracts expiring at various times through 2013.

Energy Act: As part of the 1992 Energy Policy Act, a special assessment is being collected from utilities for a uranium enrichment decontamination and decommissioning fund. The company's portion of the assessment for Wolf Creek is approximately $7 million, payable over 15 years. Management expects such costs to be recovered through the ratemaking process.

## 3. RATE MATTERS AND REGULATION

Utility expenses and credits recognized as regulatory assets and liabilities on the Consolidated Balance Sheets are recognized in income as the related amounts are included in service rates and recovered from or refunded to customers in utility revenues. The company expects to recover the following regulatory assets in rates:

| | June 30, 1997 | December 31, 1996 |
| --- | --- | --- |
| | (Dollars in Thousands) | |
| Coal contract settlement costs | $ 10,848 | $ 11,655 |
| Deferred plant costs | 31,125 | 31,272 |
| Phase-in revenues | 17,545 | 26,317 |
| Debt issuance costs | 44,517 | 45,989 |
| Other regulatory assets | 6,878 | 7,155 |
| Total regulatory assets | $110,913 | $122,388 |

See Note 3 included in the company's 1996 Annual Report on Form 10-K for additional information regarding regulatory assets.

KCC Rate Proceedings: On May 23, 1996, the company implemented an $8.7 million electric rate reduction on an interim basis. On October 22, 1996, Western Resources, the company, the KCC Staff, the City of Wichita, and the Citizens Utility Ratepayer Board filed an agreement with the KCC whereby the company's retail electric rates would be reduced, subject to approval by the KCC. This agreement was approved on January 15, 1997. Under the agreement, on February 1, 1997, the company's rates were reduced by $36.3 million, and in addition, the May 1996 interim reduction became permanent. The company's rates will be reduced by another $10 million effective June 1, 1998, and again on June 1, 1999. Two one-time rebates of $5 million will be credited to customers of Western Resources in January 1998 and 1999. A portion of these rebates will be credited to the company's customers. The agreement also fixed annual savings from the 1992 merger with Western Resources at $40 million. This level of merger savings provides for complete recovery of and a return on the acquisition premium.

## 4. INCOME TAXES

Total income tax expense included in the Statements of Income reflects the Federal statutory rate of 35%. The Federal statutory rate produces effective income tax rates of 24.4% and 29.7% for the three month periods, 26.7% and 25.6% for the six month periods, and 27.8% and 30.6% for the twelve month periods ended June 30, 1997 and 1996, respectively. The effective income tax rates vary from the Federal statutory rate due to the permanent differences, including the amortization of investment tax credits, and accelerated amortization of certain deferred income taxes.

## 5. WESTERN RESOURCES AND KANSAS CITY POWER & LIGHT COMPANY MERGER AGREEMENT

On February 7, 1997, Kansas City Power & Light Company (KCPL) and Western Resources entered into an agreement whereby KCPL would be combined with Western Resources (KCPL Merger). The merger agreement provides for a tax-free, stock-for-stock transaction valued at approximately $2 billion. Under the terms of the agreement, KCPL shareholders will receive $32 of Western Resources common stock per KCPL share, subject to an exchange ratio collar of not less than 0.917 to no more than 1.100 common shares. Consummation of the KCPL Merger is subject to customary conditions including obtaining the approval of KCPL's and Western Resources' shareholders and various regulatory agencies. Western Resources expects to be able to close the KCPL Merger in the first half of 1998.

KCPL is a public utility company engaged in the generation, transmission, distribution, and sale of electricity to approximately 430,000 customers in western Missouri and eastern Kansas. KCPL, Western Resources, and the company have joint interests in certain electric generating assets, including Wolf Creek.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with Item 7 of the company's Annual Report on Form 10-K for 1996.

The following updates the information provided in the 1996 Form 10-K, and analyzes the changes in the results of operations between the three, six and twelve month periods ended June 30, 1997 and comparable periods of 1996.

Certain matters discussed in this Form 10-Q are "forward-looking statements" intended to qualify for the safe harbors from liability established by the Private Securities Litigation Reform Act of 1995. Such statements address future plans, objectives, expectations and events or conditions concerning various matters such as capital expenditures, earnings, litigation, rate and other regulatory matters, pending transactions, liquidity and capital resources, and accounting matters. Actual results in each case could differ materially from those currently anticipated in such statements, by reason of factors such as electric utility restructuring, including ongoing state and federal activities; future economic conditions; legislation; regulation; competition; and other circumstances affecting anticipated rates, revenues and costs.

## FINANCIAL CONDITION

General: The company had net income of $15.5 million and $26.7 million for the three and six months ended June 30, 1997 compared to $17.3 million and $33.0 million for the same periods in 1996, respectively. The decreases in net income were primarily due to the implementation of a $36.3 million rate reduction on February 1, 1997 and mild spring temperatures experienced within the company's service territory. See Note 3 of the Notes to Financial Statements for more information on the rate proceedings.

Net income for the twelve months ended June 30, 1997, of $90.0 million, decreased from net income of $106.4 million for the comparable period of 1996. The decrease was primarily attributable to mild spring temperatures, the $36.3 million rate reduction, and a May 1996 interim rate reduction of $8.7 million which became permanent on February 1, 1997.

Liquidity and Capital Resources: The company's liquidity is a function of its ongoing construction and maintenance program designed to improve facilities which provide electric service and meet future customer service requirements.

The company's short-term financing requirements are satisfied through short-term bank loans and uncommitted loan participation agreements. At June 30, 1997 short-term borrowing amounted to $10 million compared to $222.3 million at December 31, 1996.

In June 1997, the company increased its borrowings against the accumulated cash surrender values of corporate-owned life insurance policies by $45.1 million and received an additional $2.0 million from increased borrowings on Wolf Creek Nuclear Operating Company policies. Total 1997 COLI borrowings have amounted to $47.8 million.

## OPERATING RESULTS

The following discussion explains variances for the three, six and twelve months ended June 30, 1997, to the comparable periods of 1996.

Revenues: The company's revenues vary with levels of usage as a result of changing weather conditions during comparable periods and are sensitive to seasonal fluctuations between consecutive periods. Future electric revenues will continue to be affected by weather conditions, the electric rate reduction which was implemented on February 1, 1997, competing fuel sources, customer conservation efforts, wholesale demand, and the overall economy of the company's service area.

The following table reflects changes in electric sales for the three, six and twelve months ended June 30, 1997 from the comparable periods of 1996.

Increase (decrease) in electric sales volumes:

| | 3 Months Ended | 6 Months Ended | 12 Months Ended |
|---|---|---|---|
| Residential | (7.7)% | (4.8)% | (3.9)% |
| Commercial | (3.9)% | (1.3)% | 0.3 % |
| Industrial | (1.0)% | (3.0)% | (3.8)% |
| Total Retail | (3.7)% | (3.0)% | (2.8)% |
| | | | |
| Wholesale & Interchange | (22.4)% | 18.1% | 69.8% |
| Total electric sales | (8.5)% | 1.5% | 9.6% |

Revenues for the three and six months ended June 30, 1997, of $148.8 million and $292.6 million, decreased approximately nine and five percent from revenues of $163.0 million and $308.1 million for the comparable periods of 1996. Revenues decreased in all retail customer classes. These decreases are primarily due to the implementation of a $36.3 million rate reduction on February 1, 1997 and mild spring temperatures.

Revenues for the twelve months ended June 30, 1997, decreased approximately two percent to $639.1 million from revenues of $648.6 million for the comparable period of 1996. The decrease can be primarily attributed to the implementation of the above mentioned rate reduction and a May 1996 $8.7 million interim rate reduction which became permanent on February 1, 1997.

Partially offsetting the decrease in revenues for the six and twelve months ended June 30, 1997 were the increases in interchange sales due to the increased sales to power brokers as a result of the increase in competition within the wholesale market.

Operating Expenses: Total operating expenses decreased approximately seven and three percent for the three and six months ended June 30, 1997, respectively, compared to the same periods of 1996. The decreases were primarily due to decreased federal and state income taxes due to the decrease in net income.

Total operating expenses remain virtually unchanged for the twelve months ended June 30, 1997 compared to the same period of 1996. The increase in other operating expenses due to the increase in net generation as a result of increased sales to interchange customers was offset by the decreases in federal and state income taxes due to the decrease in net income.

Other Income and Deductions: Other income and deductions, net of taxes, increased for the three and six months ended June 30, 1997, compared to the same periods of 1996 due to the receipt of death benefit proceeds from COLI policies and the increase in cash surrender values of COLI policies.

Other income and deductions, net of taxes, decreased for the twelve months ended June 30, 1997, compared to the same period of 1996 due to lower income tax credits.

Interest Expense: Interest expense decreased approximately fourteen and eight percent for the three and six months ended June 30, 1997, respectively, compared to the same periods of 1996. The decreases can be attributed to the decrease in short-term debt during the first six months of 1997.

Interest expense increased approximately six percent for the twelve months ended June 30, 1997, compared to the same period of 1996. The increase resulted primarily from the higher short-term debt balances during 1997 as compared to 1996.

## OTHER INFORMATION

Merger Implementation: In accordance with the KCC Merger order, amortization of the acquisition adjustment commenced in August 1995. The amortization will amount to approximately $20 million (pre-tax) per year for 40 years. Western Resources and the company (combined companies) can recover the amortization of the acquisition adjustment through cost savings under a sharing mechanism approved by the KCC.

KANSAS GAS AND ELECTRIC COMPANY
Part II Other Information

Item 4. Submission of Matters to a Vote of Security Holders

Information required by Item 4 is omitted pursuant to General Instruction H(2)(b) to Form 10-Q.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

Exhibit 12 - Computation of Ratio of Earnings to Fixed Charges for 12 Months Ended June 30, 1997 (filed electronically)

Exhibit 27 - Financial Data Schedule (filed electronically)

(b) Reports on Form 8-K:

None

## SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

KANSAS GAS AND ELECTRIC COMPANY

Date July 30, 1997

By /s/ Richard D. Terrill
Richard D. Terrill
Secretary, Treasurer and
General Counsel

Exhibit 12

KANSAS GAS AND ELECTRIC COMPANY
Computations of Ratio of Earnings to Fixed Charges and
Computation of Ratio of Earnings to Combined Fixed Charges
and Preferred and Preference Dividend Requirements
(Dollars in Thousands)

| | Unaudited Twelve Months Ended June 30, 1997 | 1996 | 1995 | 1994 | 1993 |
|---|---|---|---|---|---|
| Net Income. . . . . . . . . . . . . | $ 89,985 | $ 96,274 | $110,873 | $104,526 | $108,103 |
| Taxes on Income . . . . . . . . . . | 34,648 | 36,258 | 51,787 | 55,349 | 46,896 |
| Net Income Plus Taxes. . . . . | 124,633 | 132,532 | 162,660 | 159,875 | 154,999 |
| Fixed Charges: | | | | | |
| Interest on Long-Term Debt. . . . | 46,012 | 46,304 | 47,073 | 47,827 | 53,908 |
| Interest on Other Indebtedness. . | 9,945 | 11,758 | 5,190 | 5,183 | 6,075 |
| Interest on Corporate-owned Life Insurance Borrowings . . . | 28,084 | 27,636 | 25,357 | 20,990 | 11,865 |
| Interest Applicable to Rentals. . | 25,501 | 25,539 | 25,375 | 25,096 | 24,967 |
| Total Fixed Charges . . . . . | 109,542 | 111,237 | 102,995 | 99,096 | 96,815 |
| Earnings (1). . . . . . . . . . . . | $234,175 | $243,769 | $265,655 | $258,971 | $251,814 |
| Ratio of Earnings to Fixed Charges. | 2.14 | 2.19 | 2.58 | 2.61 | 2.60 |

| | Pro Forma 1992 (2) | 1992 April 1 to Dec. 31 (Successor) | 1992 January 1 to March 31 (Predecessor) |
|---|---|---|---|
| Net Income. . . . . . . . . . . . . | $ 77,981 | $ 71,941 | $ 6,040 |
| Taxes on Income . . . . . . . . . . | 20,378 | 23,551 | (3,173) |
| Net Income Plus Taxes. . . . . | 98,359 | 95,492 | 2,867 |
| Fixed Charges: | | | |
| Interest on Long-Term Debt. . . . | 57,862 | 42,889 | 14,973 |
| Interest on Other Indebtedness. . | 15,121 | 11,777 | 3,344 |
| Interest on Corporate-owned Life Insurance Borrowings . . . | 7,155 | 5,294 | 1,861 |
| Interest Applicable to Rentals. . | 30,212 | 22,133 | 8,079 |
| Total Fixed Charges . . . . . | 110,350 | 82,093 | 28,257 |
| Earnings (1). . . . . . . . . . . . | $208,709 | $177,585 | $ 31,124 |
| Ratio of Earnings to Fixed Charges. | 1.89 | 2.16 | 1.10 |

(1) Earnings are deemed to consist of net income to which has been added income taxes (including net deferred investment tax credit) and fixed charges. Fixed charges consist of all interest on indebtedness, amortization of debt discount and expense, and the portion of rental expense which represents an interest factor.

(2) The pro forma information for the year ended December 31, 1992 was derived by combining the historical information of the three month period ended March 31, 1992 (Predecessor) and the nine month period ended December 31, 1992 (Successor). No purchase accounting adjustments were made for periods prior to the Merger in determining pro forma amounts because such adjustments would be immaterial. (See Note 1 of Notes to Financial Statements)

UT

THIS SCHEDULE CONTAINS FINANCIAL INFORMATION EXTRACTED FROM THE BALANCE SHEET AT JUNE 30, 1997 AND THE STATEMENT OF INCOME AND THE STATEMENT OF CASH FLOWS FOR THE SIX MONTHS ENDED JUNE 30, 1997 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

1,000

6-MOS
DEC-31-1997
JUN-30-1997
PER-BOOK
2,573,904
44,384
195,448
332,483
0
3,146,219
1,065,634
0
93,381
1,159,015
0
0
684,065
10,000
0
0
0
0
0
0
1,293,139
3,146,219
292,617
9,727
229,538
244,719
47,898
3,326
51,224
24,560
26,664
0
26,664
0
23,007
77,547
0
0