Washington Electric Cooperative, Inc.

FINANCIAL STATEMENTS

December 31, 2012

Washington Electric Cooperative, Inc.
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December 31, 2012

KBS
Kittell Branagan & Sargent
*Certified Public Accountants*
Vermont License # 167

# INDEPENDENT AUDITOR'S REPORT

The Board of Directors
Washington Electric Cooperative, Inc.

## Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Washington Electric Cooperative, Inc. (a non-profit corporation), which comprise the consolidated statement of financial position as of December 31, 2012 and 2011, and the related consolidated statements of operations, equities and cash flows for the years then ended, and the related notes to the financial statements.

### *Management's Responsibility for the Financial Statements*

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

### *Auditor's Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

### *Opinion*

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Washington Electric Cooperative, Inc. as of December 31, 2012 and 2011, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

To the Board of Directors
Washington Electric Cooperative, Inc.
continued

*Other Matters*
The consolidated financial statements of Washington Electric Cooperative, Inc. as of December 31, 2011, were audited by other auditors whose report dated March 20, 2012 expressed an unmodified opinion on those consolidated financial statements.

*Other Information*
Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The schedule of expenditures of federal awards, as required by Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

**Other Reporting Required by *Government Auditing Standards***
In accordance with *Government Auditing Standards*, we have also issued our report dated March 2, 2013 on our consideration of Washington Electric Cooperative, Inc.'s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Washington Electric Cooperative, Inc.'s internal control over financial reporting and compliance.

Kittell Branagan + Sargent

St. Albans, Vermont
March 2, 2013

Washington Electric Cooperative, Inc.
BALANCE SHEETS
December 31,

## ASSETS

| | 2012 | 2011 |
|---|---|---|
| ELECTRIC PLANT, at cost | $ 70,025,431 | $ 67,250,506 |
| Less accumulated depreciation | (22,490,696) | (21,224,577) |
| Electric plant in service, net | 47,534,735 | 46,025,929 |
| Construction work in progress | 1,072,809 | 969,489 |
| TOTAL ELECTRIC PLANT, net | 48,607,544 | 46,995,418 |
| CURRENT ASSETS | | |
| Cash | 711,228 | 751,330 |
| Receivables - | | |
| Notes, less allowance for doubtful accounts of $1,500 and $1,500 in 2012 and 2011 | 99 | 99 |
| Accounts, less allowance for doubtful accounts of $25,500 and $23,500 in 2012 and 2011 | 1,263,483 | 1,428,812 |
| Renewable energy certificate revenue | 742,171 | 533,578 |
| Miscellaneous | 319,586 | 433,415 |
| Unbilled revenue | 788,296 | 791,515 |
| Inventories | 265,649 | 239,936 |
| Prepaid expenses | 91,458 | 207,955 |
| TOTAL CURRENT ASSETS | 4,181,970 | 4,386,640 |
| OTHER ASSETS | | |
| Other investments | 5,901,731 | 5,545,977 |
| Deferred charges | 478,447 | 213,826 |
| TOTAL OTHER ASSETS | 6,380,178 | 5,759,803 |
| TOTAL ASSETS | $ 59,169,692 | $ 57,141,861 |

## LIABILITIES AND EQUITY

| | 2012 | 2011 |
|---|---|---|
| EQUITIES | | |
| Memberships issued and subscribed | $ 120,060 | $ 116,145 |
| Patronage capital assignable | 893,293 | 832,315 |
| Patronage capital credits | 8,284,160 | 7,709,189 |
| Donated capital | 221,979 | 214,014 |
| Contributions in aid of construction | 10,303,634 | 9,983,373 |
| NET EQUITY | 19,823,126 | 18,855,036 |
| LONG-TERM DEBT | 34,565,309 | 34,722,783 |
| CURRENT LIABILITIES | | |
| Current portion of long-term debt | 2,009,900 | 1,446,397 |
| CFC line of credit | 913,130 | - |
| Accounts payable | 852,268 | 1,076,567 |
| Customer deposits | 215,696 | 198,258 |
| Other accrued expenses | 632,644 | 600,933 |
| TOTAL CURRENT LIABILITIES | 4,623,638 | 3,322,155 |
| DEFERRED CREDITS | 157,619 | 241,887 |
| TOTAL LIABILITIES AND EQUITY | $ 59,169,692 | $ 57,141,861 |

See Accompanying Notes to Financial Statements

Washington Electric Cooperative, Inc.

STATEMENTS OF OPERATIONS

For the Years Ended December 31,

| | 2012 | 2011 |
|---|---|---|
| OPERATING REVENUE | $ 15,367,726 | $ 14,847,197 |
| OPERATING EXPENSES | | |
| Purchased power | 3,713,419 | 3,661,779 |
| Power generation | 1,527,930 | 1,514,780 |
| Transmission | 33,839 | 46,039 |
| Distribution: | | |
| Operations | 1,422,784 | 1,503,620 |
| Maintenance | 1,729,403 | 1,607,948 |
| Customer accounts | 927,780 | 899,883 |
| Administrative and general | 1,467,668 | 1,419,115 |
| Depreciation | 2,207,451 | 2,141,681 |
| Taxes | 332,878 | 341,240 |
| Other deductions, net | 21,658 | (144,806) |
| TOTAL OPERATING EXPENSES | 13,384,810 | 12,991,279 |
| MARGINS FROM OPERATIONS BEFORE INTEREST CHARGES | 1,982,916 | 1,855,918 |
| INTEREST CHARGES | | |
| Interest on long-term debt | 1,619,999 | 1,642,965 |
| Other interest | 9,983 | 8,244 |
| TOTAL INTEREST CHARGES | 1,629,982 | 1,651,209 |
| MARGINS FROM OPERATIONS | 352,934 | 204,709 |
| OTHER INCOME (EXPENSE) | | |
| Interest and dividend income | 594,979 | 591,837 |
| Other non-operating income | 32,625 | 52,391 |
| Other non-operating expense | (86,995) | (16,372) |
| Income taxes | (250) | (250) |
| TOTAL OTHER INCOME (EXPENSE) | 540,359 | 627,606 |
| NET MARGINS | $ 893,293 | $ 832,315 |

See Accompanying Notes to Financial Statements

Washington Electric Cooperative, Inc.
STATEMENTS OF EQUITIES
For the Years Ended December 31,

| | Memberships Issued and Subscribed | Patronage Capital Assignable | Other Equities: Patronage Capital Credits | Other Equities: Donated Capital | In Aid of Construction |
|---|---|---|---|---|---|
| BALANCE, at December 31, 2010 | $ 112,865 | $ 743,563 | $ 7,215,773 | $ 206,334 | $ 9,770,647 |
| New memberships issued and subscribed for | 10,960 | - | - | - | - |
| Transfers to donated capital | (7,680) | - | - | 7,680 | - |
| Transfers to patronage capital credits | - | (743,563) | 743,563 | - | - |
| Patronage rebates | - | - | (250,147) | - | - |
| Net margins for the year | - | 832,315 | - | - | - |
| New contributions in aid of constructio | - | - | - | - | 212,726 |
| BALANCE, at December 31, 2011 | 116,145 | 832,315 | 7,709,189 | 214,014 | 9,983,373 |
| New memberships issued and subscribed for | 11,880 | - | - | - | - |
| Transfers to donated capital | (7,965) | - | - | 7,965 | - |
| Transfers to patronage capital credits | - | (832,315) | 832,315 | - | - |
| Patronage rebates | - | - | (257,344) | - | - |
| Net margins for the year | - | 893,293 | - | - | - |
| New contributions in aid of constructio | - | - | - | - | 320,261 |
| BALANCE, at December 31, 2012 | $ 120,060 | $ 893,293 | $ 8,284,160 | $ 221,979 | $ 10,303,634 |

See Accompanying Notes to Financial Statements

Washington Electric Cooperative, Inc.
STATEMENTS OF CASH FLOWS
For the Years Ended December 31,

| | | 2012 | | 2011 |
|---|---|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | | |
| Net income | $ | 893,293 | $ | 832,315 |
| Noncash expenses (income) included in earnings: | | | | |
| Depreciation | | 2,207,451 | | 2,141,681 |
| Deferred revenue recognized | | - | | (338,180) |
| Amortization of deferred charges | | 110,955 | | 36,237 |
| Amortization of deferred regulatory credits | | - | | (166,464) |
| Changes in assets and liabilities: | | | | |
| Decrease (increase) in accounts receivable | | 279,158 | | (655,544) |
| Decrease (increase) in renewable energy certificate revenue receivable | | (208,593) | | 107,490 |
| Decrease (increase) in unbilled revenue | | 3,219 | | (67,974) |
| Decrease (increase) in inventories | | (25,713) | | 20,509 |
| Decrease (increase) in prepaid expenses | | 116,497 | | (92,755) |
| Decrease (increase) in deferred debits | | (380,845) | | (13,819) |
| Increase (decrease) in accounts payable | | (224,299) | | 380,098 |
| Increase (decrease) in customer deposits | | 17,438 | | 24,062 |
| Increase (decrease) in accrued expenses | | 31,711 | | (7,647) |
| Increase (decrease) in deferred credits | | (84,268) | | 134,202 |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | | 2,736,004 | | 2,334,211 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | | |
| Retirement of notes receivable | | - | | 8 |
| Investment in CD over 3 months | | 250,000 | | (250,000) |
| Additions by construction work in progress | | (2,970,700) | | (2,418,374) |
| Additions to electric plant in service | | (2,204,905) | | (449,903) |
| Retirement of electric plant in service | | 158,129 | | (193,706) |
| Return of capital | | 52,168 | | 53,870 |
| Purchase of investments | | (657,922) | | (27,288) |
| NET CASH (USED) IN INVESTING ACTIVITIES | | (5,373,230) | | (3,285,393) |

See Accompanying Notes to Financial Statements

Washington Electric Cooperative, Inc.
STATEMENTS OF CASH FLOWS
For the Years Ended December 31,

| | 2012 | 2011 |
|---|---|---|
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Contributions in aid of construction | 320,261 | 212,726 |
| CIAOC from the American Recovery and Reinvestment Act Grant | 1,199,317 | 211,774 |
| CIAOC from FEMA Grants | 3,852 | 45,967 |
| Memberships issued, net of refunds | 11,880 | 10,960 |
| Patronage rebates | (257,344) | (250,147) |
| Release of restricted cash | - | 338,180 |
| Proceeds from short-term debt | 3,750,628 | 1,057,364 |
| Payments on short-term debt | (2,837,499) | (1,374,191) |
| Proceeds from long-term debt | 1,800,000 | 2,281,000 |
| Principal payments on long-term deb | (1,393,971) | (1,384,810) |
| NET CASH PROVIDED BY FINANCING ACTIVITIES | 2,597,124 | 1,148,823 |
| NET INCREASE (DECREASE) IN CASH | (40,102) | 197,641 |
| CASH - Beginning of Year | 751,330 | 553,689 |
| CASH - End of Year | $ 711,228 | $ 751,330 |
| SUPPLEMENTARY CASH FLOW INFORMATION | | |
| Cash paid during the year for interest | $ 1,629,982 | $ 1,651,209 |

See Accompanying Notes to Financial Statements

## NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Washington Electric Cooperative, Inc. ("the Cooperative") provides residential and commercial electrical service to its patrons. Operating revenue is generated from sales of electric power and related activity to the Cooperative's patrons located primarily within the State of Vermont.

Regulatory jurisdictions

The Cooperative is under the jurisdiction of the Federal Energy Regulatory Commission (FERC), the Rural Utilities Service (RUS), formerly known as the Rural Electrification Administration (REA), the Public Service Board of Vermont (PSB), and the Vermont Department of Public Service (DPS). The PSB has the primary responsibility for regulating the Cooperative's rates. The Cooperative utilizes the Uniform System of Accounts established by the RUS, except where the PSB has prescribed other treatment.

Corporate structure and income taxes

The Cooperative is a nonprofit and nonstock membership corporation organized under provisions of the Electric Cooperative Act of Vermont. The Cooperative is an organization described in Section 501(c)(12) of the Internal Revenue Code, and has been recognized by the Internal Revenue Service as an organization exempt from taxes on related income under Section 501(a).

Effective January 1, 2009, the Cooperative adopted the guidance on uncertain tax positions in the Financial Accounting Standards Board (FASB) Accounting Standards Codification 740, Income Taxes (formerly FASB Interpretation No. 48) that requires the Cooperative to evaluate its income tax positions to determine if there are any positions that would require any adjustments to the financial statements. The Cooperative has determined that it has no uncertain income tax positions that need to be recorded or reported in the financial statements.

In July 2003, the Board of Directors authorized the creation of, and a $5,000 investment in, the Coventry Clean Energy Corporation (CCEC), a wholly-owned subsidiary. CCEC is a for profit corporation. Since its operations began in 2006, CCEC financial statements have been consolidated with the Cooperative's financial statements.

The tax years ending December 31, 2012, 2011, 2010 and 2009 are still open to audit for both federal and state purposes.

Consolidation policy

The consolidated financial statements include the accounts of the Cooperative and CCEC. All intercompany accounts and transactions are eliminated in consolidation.

Electric plant and retirements

Electric plant is stated at cost. The cost of additions to electric plant includes contracted work, direct labor and materials, and allocable overheads. Listed below are the major classes of electric plant as of December 31,:

| | 2012 | 2011 |
|---|---|---|
| Intangible plant | $ 609 | $ 609 |
| Generation (hydro) plant | 3,746,556 | 3,745,461 |
| Generation (landfill gas) plant | 12,551,623 | 12,551,623 |
| Transmission plant | 2,286,713 | 2,286,713 |

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

| | 2012 | 2011 |
|---|---|---|
| Distribution plant | 46,116,286 | 44,432,749 |
| General plant | 5,323,644 | 4,233,351 |
| | $ 70,025,431 | $ 67,250,506 |

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Depreciation and plant retirement

The Cooperative follows the policy of charging to operating expenses annual amounts of depreciation which allocate the cost of the electric plant over its estimated useful life. The Cooperative employs the straight-line and straight-line composite methods for determining the annual charge for depreciation. The estimated useful lives and rates for electric plant are as follows:

| | Life in Years | Composite Rate |
|---|---|---|
| Generation plant | 20-50 | 2-5% |
| Transmission plant | 35 | 2.748% |
| Distribution plant | 35 | 2.796% |
| Buildings and structures | 10-50 | 2.50% |
| Transportation equipment | 4-10 | 10-25% |
| General plant | 5-15 | 6-20% |

Maintenance and repairs are charged to expense as incurred. When assets are retired or otherwise disposed of, the costs are removed from plant, and such costs, plus removal costs, less salvage, are charged to accumulated depreciation.

Amortization

The Cooperative follows the policy of charging to operating expenses annual amounts of amortization which allocate the cost of various deferred charges over periods established by management for rate-making purposes. The Cooperative employs the straight-line method for determining the annual charge for amortization.

Cash and cash equivalents

The Cooperative considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Inventories

Inventories are stated at the lower of average cost or market, determined by the first-in, first-out method.

Contributions in aid of construction

As explained above, the Cooperative follows RUS accounting guidelines, except as otherwise allowed or prescribed by its state regulator, the PSB. In accordance with state regulatory requirements, contributions in aid of construction were accounted for as a component of patrons' equity rather than as a reduction of electric plant in service prior to 2013. All contributions in aid of construction come from patrons of the Cooperative. The Cooperative is allowed to recover its gross investment in plant in its rates.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Use of estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities. These estimates are made at the date of the financial statements and are based on the reported amounts of revenues and expenses during the reporting period, and other factors. Actual results could differ from those estimates.

Revenue recognition

The Cooperative recognizes revenue for electric service in the month that service is rendered. The amount shown as unbilled revenue represents an estimate of the amounts used from the last meter reading through the end of the year.

Investments

Investments are recorded at cost. Because these investments are not publicly traded, market values are not readily determinable.

NOTE 2 OTHER INVESTMENTS

Other investments include the following, at cost, at December 31,:

| | 2012 | 2011 |
|---|---|---|
| Investments in associated organizations: | | |
| National Rural Utilties Cooperative Finance Corporation (CFC) membership | $ 1,000 | $ 1,000 |
| CFC capital term certificates | 453,034 | 455,685 |
| CFC patronage capital certificates | 126,029 | 121,108 |
| NISC patronage capital certificates | 64,911 | 59,515 |
| Patronage capital certificates - other Cooperatives | 15,003 | 15,061 |
| Rural Electric Vermont Association membership | 497 | 497 |
| | 660,474 | 652,866 |
| Other Investments | | |
| Vermont Electric Power Company - common stock, Class B | 265,600 | 265,600 |
| Vermont Electric Power Company - common stock, Class C | 101,900 | 101,900 |
| Vermont Electric Power Company - preferred stock, Class C | 1,793 | 1,793 |
| Vermont Transco LLC - Class A membership units | 2,128,000 | 1,845,950 |
| Vermont Transco LLC - Class B membership units | 2,708,340 | 2,349,380 |
| CD 6 month maturity | - | 250,000 |
| Central VT Memorial Civic Center - rural economic development loan | 35,624 | 78,488 |
| | 5,241,257 | 4,893,111 |
| TOTAL OTHER INVESTMENTS | $ 5,901,731 | $ 5,545,977 |

## NOTE 3 LONG-TERM DEBT

Long-term debt at December 31, 2012 and 2011 consists of the following:

| | 2012 | 2011 |
|---|---|---|
| Mortgage notes payable, U.S. Department of Agriculture (RUS) | | |
| 35-year terms at the following interest rates: | | |
| 5.0% mortgage notes | $ - | $ 16,276,977 |
| 4.125% mortgage notes | 6,017,094 | 6,257,186 |
| | 6,017,094 | 22,534,163 |
| Mortgage notes payable, National Rural Utilities Cooperative Finance Corporation (CFC), 35-year terms due between 2016 and 2031 at the following rates of interest: | | |
| Fixed rate mortgage notes, 5.8% to 6.45% due quarterly, variable dates through July 1, 2028 | 1,723,069 | 1,845,492 |
| Fixed rate mortgage notes, 1.95% to 4.35% due annually, through June 30, 2031 | 15,776,069 | - |
| | 17,499,138 | 1,845,492 |
| CFC Clean Renewable Energy Bond, nominal interest rate 0.400% effective interest rate 1.497%, quarterly payments of $17,304 from March 2008 through December 2023 | 829,242 | 904,628 |
| Mortgage notes payable, Federal Financing Bank (FFB) at the following due dates and rates of interest (unadvanced loan funds as of December 31, 2012 and 2011 were $5,600,000 and $0, respectively) | | |
| 4.287% to 8.335% advances, matures December 31, 2014 | 70,626 | 105,939 |
| 4.366% advances, matures December 31, 2033 | 2,862,391 | 2,998,696 |
| 4.472% advances, matures December 31, 2043 | 2,774,030 | 2,863,515 |
| 4.272% advances, matures December 31, 2043 | 1,123,515 | 1,159,758 |
| 3.707% advances, matures December 31, 2043 | 781,576 | 806,788 |
| 3.328% advances, matures December 31, 2043 | 599,333 | 618,666 |
| 4.193% advances, matures December 31, 2043 | 641,771 | 662,473 |
| 3.999% advances, matures December 31, 2043 | 1,182,326 | 1,220,465 |
| 3.134% advances, matures December 31, 2043 | 358,543 | 370,109 |
| 2.281% advances, matures December 31, 2043 | 500,000 | - |
| 2.418% advances, matures December 31, 2043 | 800,000 | - |
| 2.625% advances, matures December 31, 2043 | 500,000 | - |
| | 12,194,111 | 10,806,409 |

NOTE 3 LONG-TERM DEBT (continued)

| | 2012 | 2011 |
|---|---|---|
| Rural economic development loan, non-interest bearing, | | |
| U.S. Department of Agriculture (RUS) loan: | | |
| CVMCC - Payable in 168 monthly payments of $3,572 beginning November 1999 through October 2013 | 35,624 | 78,488 |
| | 36,575,209 | 36,169,180 |
| Less current installments | (2,009,900) | (1,446,397) |
| Long-term debt, excluding current installments | $ 34,565,309 | $ 34,722,783 |

The 2008-2011 Construction Work Plan (CWP) loan from the Federal Financing Bank (FFB) in the amount of $7.9 million was fully drawn in September 2011. In June 2011, the Cooperative's Board of Directors approved the 2012-2015 CWP authorizing its submittal to RUS together with a financing application for an FFB loan in the amount of $7.4 million. On February 21, 2012, the Cooperative signed the loan documents. For this loan the first principal payment is due March 31, 2014. The last day for an advance is January 17, 2017 and the final maturity date is December 31, 2046.

For FFB loans, the interest rate of an advance is determined at the time of the advance. At the time of the advance, the Cooperative can select, subject to RUS approval, either a short-term maturity date or a long-term maturity date. Payments on the advances are to be made quarterly.

Following PSB approval in November 2012, the Cooperative refinanced $15,776,069 of its RUS debt in December 2012 with a promissory note and loan agreement from CFC. The terms of the Loan provide for multiple advances with varying interest rates between 1.95% and 4.35%. The Cooperative estimates approximately $4,200,000 in interest expense savings over the 19 year refinance period ending June 2031.

The non-interest bearing rural economic development loan from the RUS to the Cooperative was used to partially finance the construction of the Central Vermont Memorial Civic Center (CVMCC) in the City of Montpelier. As security, the Cooperative received a 14-year note for $600,000 and first mortgages on real estate and leasehold estates from CVMCC, and four Irrevocable Letters of Credit from various banks as security for the loan.

All of the assets of the Cooperative are pledged as security under the above-mentioned notes.

The following is a schedule of required principal payments on long-term debt in subsequent fiscal years from December 31, 2012:

| | |
|---|---|
| 2013 | $ 2,009,900 |
| 2014 | 1,815,494 |
| 2015 | 1,807,031 |
| 2016 | 1,820,436 |
| 2017 | 1,817,436 |
| Thereafter | 27,304,912 |
| | $ 36,575,209 |

## NOTE 3 LONG-TERM DEBT (continued)

Loan covenants

Under the terms of the loan agreements, the Cooperative must maintain at least a times interest earned ratio (TIER) of 1.05 on the FFB debt, and 1.25 on the remaining long-term debt together with a debt service coverage (DSC) ratio of not less than 1.25, determined by averaging the two highest annual ratios during the three most recent calendar years. As required by the 1997 and subsequent RUS loan agreements, the Cooperative also must maintain an operating times interest earned ratio (OTIER) of 1.05 on the FFB debt and 1.10 on the remaining long-term debt together with an operating debt service coverage (ODSC) of 1.10, determined by averaging the two highest annual ratios during the three most recent calendar years. The Cooperative met these requirements in both 2012 and 2011.

Under the terms of the 2003 financing with CFC, the Cooperative must maintain a modified debt service coverage (MDSC) of not less than 1.35 determined by averaging the two highest annual ratios during the three most recent calendar years. The Cooperative met this requirement in 2012 and 2011.

## NOTE 4 SHORT-TERM DEBT

A line of credit agreement executed with CFC provides the Cooperative with a short-term loan in an amount up to $2,600,000. This short-term loan operates on a revolving basis for a period of twelve months to June 15, 2013. Interest rates on the advances are variable and not to exceed the prevailing bank prime rate as published in the Eastern edition of the *Wall Street Journal*, "Money Rates" column, plus one percent. The interest rate at December 31, 2012 was 2.9%. The available balance on the note was $1,686,870 at year end.

## NOTE 5 PENSION PLAN

All eligible employees of the Cooperative participate in the NRECA Retirement and Security Program, a defined benefit pension plan qualified under Section 401 and tax-exempt under Section 501(a) of the Internal Revenue Code. In this multi-employer plan, which is available to all member cooperatives of NRECA, the accumulated benefits and plan assets are not determined or allocated separately by individual employer. The plan sponsor’s Employer Identification Number is 53-0116145 and the Plan Number is 333.

A unique characteristic of multiemployer plans compared to a single employer plan is that all plan assets are available to pay benefits to any plan participant. Separate asset accounts are not maintained for participating employers. This means that assets contributed by one employer may be used to provide benefits to employees of other participating employers.

The Cooperatives contributions to the RS Plan in 2012 and 2011 represent less than 5 percent of the total contributions made to the plan by all participating employers. At December 31, 2012 and 2011 The Cooperative made contributions to the plan of $643,648 and $576,059, respectively. There have been no significant changes that affect the comparability of 2012 and 2011 contributions. Pension expense for the prior service costs was $14,580 in both 2012 and 2011.

In the RS Plan, a “zone status” determination is not required, and therefore not determined, under the Pension Protection Act (PPA) of 2006. In addition, the accumulated benefit obligations and plan assets are not determined or allocated separately by individual employer. In total, at January 1, 2012 and 2011, the Retirement Security Plan was between 65% and 80% funded, respectively, based on the PPA funding target and the actuarial value of assets at those dates.

NOTE 5 PENSION PLAN (continued)

Because the provisions of the PPA do not apply to the RS Plan, funding improvement plans and surcharges are not applicable. Future contribution requirements are determined each year as part of the actuarial valuation of the plan and may change as a result of plan experience.

NOTE 6 COMMITMENTS AND CONTINGENCIES

Regulatory matters

The Cooperative has provided a portfolio of member energy services since 1992, in part due to regulatory requirements and Vermont law requiring all utilities to develop and file Integrated Resource Plans (IRPs). The timing for filing a utility's IRP is based on a three year statutory requirement.

The IRP projects the Cooperative's load and power supply requirements, and identifies committed and preferred resource options for the future, including demand-side management resources and renewables such as increased Coventry Project power and Sheffield wind power. The 2005 IRP supported the need for the Coventry (Methane Generation) Project, discussed below, which came online in July 2005. The IRP also identified future power supply needs.

The Cooperative filed its most recent IRP on February 15, 2008. A stipulation regarding approval was entered with the DPS in August 2009; the plan and stipulation were approved by the PSB on December 13, 2012 in Docket No. 7432. In its Order, the PSB acknowledged its delay in approving the 2008 IRP and set December 6, 2013 as the filing date for the Cooperative's next IRP.

In 1999, the PSB ordered the establishment of the Energy Efficiency Utility (EEU), which began operating in February 2000 under the name "Efficiency Vermont" ("EVT"). Most efficiency services for commercial, industrial, residential and multi-family housing are now operated by the EEU and are no longer the responsibility of the Cooperative. The Cooperative continues to perform certain services associated with the "Residential New Construction Program" as a subcontractor to the EEU. Pursuant to an order from the PSB, all Vermont utilities collect a monthly surcharge called the Energy Efficiency Charge (EEC) from customers. For December 31, 2012 and 2011 the total collected from the Cooperative's members was approximately $630,699 and $617,788, respectively. This amount is forwarded to a fiscal agent selected by the PSB and is not revenue to the Cooperative.

The Cooperative, along with other Vermont utilities, petitioned the PSB in Docket No. 7670 to enter various agreements that will enable it to receive power from HQ Energy Services US (HQUS) beginning in November 2016. The agreements provide for delivery of primarily on-peak energy and associated environmental attributes seven days per week, 16 hours per day. There are no capacity credits or other ancillary market products included in the contract. The Cooperative will obtain up to 4.0 MW of power through the Vermont Public Power Supply Authority (VPPSA). In addition, the Cooperative has entered into an agreement with the Vermont Electric Cooperative (VEC) to transfer its portion of HQUS power to VEC until a need exists in the Cooperative's power supply portfolio. Proceedings in front of the PSB were underway in 2010 and through 2011. The PSB issued its decision in 2011 and approved WEC's participation in the various agreements that enable it to obtain HQUS power.

NOTE 6 COMMITMENTS AND CONTINGENCIES (continued)

Contributions in Aid of Construction. PSB Docket No. 7554

In 2009, the PSB opened Docket No. 7554 to consider whether or not to make regulatory changes in how electric cooperatives account for Contributions in Aid of Construction (CIAOC). In February 2011, the PSB issued a final order that requires the Cooperative to make changes in how it accounts for CIAOC beginning in 2013. This will result in changes in how CIAOC is currently accounted for, as described in Note 1, and it does rescind the previous PSB rulings on this matter. The Cooperative will follow generally accepted accounting principles effective January 1, 2013 which reduces fixed assets constructed by the contribution toward the construction. The CIAOC in equity will be allocated to active patrons as of December 31, 2013 based on their patronage for 2013.

Rate Increase

A rate increase, ultimately approved by the PSB at 19.44%, was included in rates beginning January 1, 2011.

The Cooperative filed a rate increase with the PSB in November 2011 for an across the board increase in its retail rates in the amount of 2.27%. Docket No. 7825 was opened by the PSB. The Cooperative is allowed to increase its rates 45 days after the filing and began collecting the increased revenue on January 1, 2012. The Department of Public Service investigated, but did not challenge, the amount of the increase, and the PSB approved the increase in an Order dated September 6, 2012. The Board’s Order also required that accounting changes related to payments by the Cooperative to its subsidiary, CCEC, be made in order to address a growing receivables balance. These changes were made effective January 1, 2012.

Risk Management

The Cooperative is exposed to various risks of loss related to torts; theft of, damage to and destruction of or misuse of assets; injuries to individuals; and natural disasters. In addition to a system of internal controls, the Cooperative manages these risks through commercial insurance packages purchased in the name of the Cooperative.

Office Building Renovations

In May 2011, the storm drain system behind the Cooperative's office building in East Montpelier was overwhelmed during a major storm. The resulting flooding and septic system back up did extensive damage to the building requiring major renovations of the interior. Since the Cooperative had already considered making changes to the building, the Board authorized a comprehensive renovation including restoration and repairs related to the flooding as well as other improvements to the building and drainage system. In recognition of the emergency nature of the situation, the Board of Directors authorized management to work with a committee including four directors that would proceed with design and the hiring of contractors. Black River Design was selected for design work and to help develop a project budget. The principal contractor for the project was L.K. Rossi. The Cooperative was insured for flood damage including building repair and replacement of damaged equipment. The total project cost approximately $1.3 million with approximately a $300,000 insurance reimbursement minus a $50,000 deductible. The balance of the cost is being financed by a combination of an amendment to the current CWP and general funds. The project was completed in the spring of 2012.

## NOTE 7 COMMITMENTS AND CONTINGENCIES - POWER SUPPLY

Coventry Methane Generation Project

The Cooperative owns and operates a generating facility powered by landfill gas at the Coventry Landfill in northern Vermont. The plant first began generating in July 2005 and was subsequently expanded in 2007 and 2009, to a present generating capacity of 8 MW. A set of contractual agreements was executed in 2003 between CCEC and New England Waste Services of Vermont, Inc. (NEWSVT), a wholly owned subsidiary of Casella Waste Systems, Inc. which owns the Coventry Landfill. These agreements codify the relationship of the parties.

The initial project was financed by an RUS loan. The 2007 expansion was financed by CFC under their implementation of the Clean Renewable Energy Bond Program (CREB). The 2009 expansion was financed by an RUS-guaranteed FFB loan and by reallocating funds in the 2008-2011 CWP from distribution projects to generation assets.

The summary of project costs and outstanding notes payable as of December 31, 2012 are:

| | Plant Cost | Note Balance |
|---|---|---|
| Phase 1 - Initial Construction, Engines 1-3 | $ 8,502,732 | $ 5,766,899 |
| Phase 2 - Engine 4 | 1,238,397 | 753,556 |
| Phase 3 - Engine 5 plus building modifications | 4,133,419 | 2,862,391 |
| Systems Upgrades financed with general funds | 250,408 | - |
| | $ 14,124,956 | $ 9,382,846 |

Costs for each phase have been capitalized to both generation and transmission plant, with the majority in generation.

Of the $14,124,956 plant cost, $12,551,623 is capitalized to generation plant with the balance included in transmission plant.

In 2012 the Coventry Project provided approximately 55% of the Cooperative's total power supply output which made up 65% of the Cooperative's load requirements as measured by the Independent System Operator of New England (ISO-NE).

CCEC has a Landfill Gas Project Agreement with Innovative Energy Systems, Inc. (IES), a New York corporation, to operate the Coventry Generating Facility. The contract was effective on July 1, 2007. Services provided by IES include day-to-day management, operation, maintenance, plant repair, monitoring and adjustment of the gas collection system. The contract is for nine years with a renewal option for eight years. Compensation to IES is at the rate of 2.38 cents per kWh of electricity produced monthly, which is adjusted for inflation each year by the GDP-IPD index, the gross domestic product implicit price deflator index. At December 31, 2012 and 2011 the amount included in expense was $1,191,488 and $1,169,245, respectively.

NOTE 7 COMMITMENTS AND CONTINGENCIES – POWER SUPPLY (continued)

Wrightsville Hydro

Besides the Coventry Project, the Cooperative also owns and operates the Wrightsville Hydroelectric Generation Station in Montpelier, Vermont, a largely run-of-the-river project that has a rated capacity of 933 kW, though it provides significantly less average output because it is dependent on precipitation and weather conditions during the year. Operating costs were $80,345 and $99,110 at December 31, 2012 and 2011, respectively. Fixed costs were $137,987 and $136,998 over that same period, respectively.

The remaining energy needs of the Cooperative are provided by other entities or generators through contractual obligations. A brief summary of the long-term financial obligations and the more significant sources of total energy, as of December 31, 2012, are as follows.

Sheffield Wind Project

In May 2005, the Cooperative executed an Advance Purchase Fee Agreement with wind developer UPC Wind Vermont, LLC (UPC), which subsequently became Vermont Wind, LLC ("Vermont Wind") for up to a 4 MW share of the output of its proposed 40 MW project in Sheffield. The PSB awarded UPC the required Certificate of Public Good for the project in August 2007. In January 2009, the Vermont Supreme Court unequivocally upheld the PSB Order. The contract was filed by Vermont Wind with the PSB in June 2009 and the PSB approved it, in Docket No. 7156, in August 2009. The Cooperative finalized a long-term Purchased Power Agreement with Vermont Wind in September 2009. Vermont Wind began construction in 2010 and the project reached its commercial operation date on October 19, 2011. WEC began receiving power generated from the wind project at that time. Sheffield Wind accounted for 9% of WEC's total power supply in 2012 and served roughly 11% of WEC's load needs.

NYPA

The Cooperative receives power from the Franklin D. Roosevelt-St. Lawrence and Niagara hydroelectric projects in New York, through the DPS, which contracts with the New York Power Authority (NYPA). NYPA power is currently being provided through the DPS under a long-term contract in which an extension was executed in 2007 for the St. Lawrence portion. The Cooperative anticipates no reductions in NYPA power supply going forward under the latest agreements, except when low water conditions exist. When low water conditions do exist, NYPA makes available replacement energy at a higher cost, but purchase of such replacement power is optional. The Niagara project, the largest provider of NYPA power to the Cooperative, was recently relicensed. This relatively low-cost resource is expected to continue to be available to the Cooperative's residential customers far into the future, though some related costs have increased in recent years, particularly transmission. NYPA accounted for 11% of WEC's total power supply in 2012 and served roughly 12% of WEC's load.

Hydro Quebec **-** On January 7, 1991, the PSB conditionally approved the Cooperative's purchase of 2.589 MW of Hydro-Quebec (HQ) Schedule B power for a term from September 23, 1995 through October 31, 2015. The Cooperative purchases this power as an assignee of rights under the Vermont Joint Owners' (VJO) contract with HQ. Under Vermont Statutes, a required vote of the membership took place at a special membership meeting on March 26, 1991, authorizing the Cooperative's participation in Schedules A and B of the HQ contract. Schedule A power terminated in 1995. The membership also voted to approve the transfer of the Cooperative's entitlement to any Schedule C power to the Village of Stowe Electric Department at that time.

NOTE 7 COMMITMENTS AND CONTINGENCIES – POWER SUPPLY (continued)

The remaining Schedule B power is must-take at a 75% annual capacity factor, subject to a limited number of annual options for adjustments by either party, all of which have been exercised at this point. If the power is not received by the Cooperative at the must-take level, then the Cooperative must pay a penalty equal to the difference between the must-take contract level and the actual level of contract power received. The Schedule B take or pay costs were $1,117,465 and $1,135,437 at December 31, 2012 and 2011, respectively.

The Cooperative contracted in 1996 for a sale of power to HQ, at Schedule B contract prices, and a purchase of the same amount of power from HQ at lower, market-based prices. This contract extended from November 1, 1995 to November 1, 1999, and has expired. However, under this sellback contract, HQ has the option, upon four years notice, of reducing its deliveries to the Cooperative by up to 30% for the duration of the Schedule B portion of the HQ contract. This option has remained unexercised, and the Cooperative does not expect HQ to exercise the option in 2013. HQ Schedule B accounted for 18% of WEC's total power supply in 2012 and served roughly 21% of WEC's load needs.

VPPSA

The Cooperative has agreed to pay the Vermont Public Power Supply Authority (VPPSA) for its proportionate share of VPPSA's costs and obligations associated with the Highgate Converter, a transmission facility which allows interconnection with the HQ electric system. This arrangement allows the Cooperative access to wheeling transfer capability over Highgate and allows the Cooperative to import its share of power from HQ for the VJO contract. The Cooperative continues to pay for the operating and maintenance expenses of the Highgate converter. In 2012, there was a net credit for the converter of $1,229 while in 2011 there was a net cost of $2,591. These amounts are included in the total cost above for the Schedule B take or pay costs.

Small Power Producers

Vermont PSB Rule 4.100 requires all electric utilities to purchase power from Vermont's non-utility small power producers, on the basis of prior year energy sales as a share of total Vermont utility energy sales. The state purchasing agent, currently the Vermont Electric Power Producers Inc. (VEPPI), administers the contracts and allocates costs to the Vermont utilities. This obligation, which for the Cooperative amounts to approximately 1% of the total small power producers' output, was $454,905 in 2012 and $565,902 in 2011. The Cooperative's costs are expected to increase moderately through time for VEPPI resources. The contract for the largest VEPPI unit (Ryegate) which accounts for roughly half of the VEPPI power was due to expire in October 2012. The Vermont PSB opened a docket (7782) to determine the rate to be charged to Vermont utilities upon the expiration of the existing Rule 4.100 contract. A new contract specifically covering Ryegate is expected to be finalized in 2013 and WEC is currently being allocated roughly 1% of the power from the Ryegate facility. The remaining Rule 4.100 contracts which are hydro based-resources are expected to expire fully by 2020.

NET METERING and Sustainably Priced Energy Enterprise Development (SPEED)

Since 1998, under Vermont's net metering statute, electric utilities must allow eligible forms of renewable energy generation "behind" the consumer/member's meter. Members must register with the PSB for installations of less than 10kw, or obtain a Certificate of Public Good (CPG) for capacity up to 500kw. The statute provides that a utility shall allow net metering up to 4% of its peak demand.

NOTE 7 COMMITMENTS AND CONTINGENCIES – POWER SUPPLY (continued)

The Cooperative’s net metering reached its 4% of peak demand during 2012. The Cooperative is evaluating the impact on its system to account for the revenue effect and costs incurred to compensate net metering members for “net excess generation”. At this time some 140 members with a nameplate capacity of 700 kw have registered or received CPG’s to inject power into the grid. In February 2013 the Cooperative notified the PSB of the fact that the 4% capacity level has been reached, and requested that the PSB take no immediate action.

SPEED is a feed in tariff programs for developers, available under the auspices of the PSB, and authorized by the legislature, through various PSB dockets (#7523 and #7533). The Cooperative has one such SPEED facility on its distribution system, a 2.1 MW photovoltaic (PV) project in Williamstown. WEC does not take power from this facility. Another proposed photovoltaic project which would be interconnected to the Cooperative’s subtransmission line in Coventry is pending before the PSB. WEC plans to institute Open Access Distribution Tariffs to wheel the power from these projects to the VELCO grid.

VELCO

The Cooperative has entered into contracts with the Vermont Electric Power Corporation (VELCO), which operates Vermont's bulk transmission system, to participate in Phase I of the Hydro-Quebec Interconnection, a 450 kV HVDC transmission line directly connecting the HQ electric system with the New England Power Pool. Under these agreements, the Cooperative provided capital for the cost of construction through purchase of VELCO Class C preferred stock, and will provide support for the operation of its 0.1133% (.782 MW) interest of the line. The Cooperative is currently leasing this capacity to the Village of Stowe so that the Village can receive Hydro-Quebec/VJO Schedule C Purchased Power.

Vermont Transco LLC was officially established on June 30, 2006. Vermont Transco LLC is a limited liability company formed by VELCO and Vermont's distribution company owners, including the Cooperative. Vermont Transco LLC is now the owner of Vermont's high-voltage electric transmission system. VELCO is the manager of the LLC and, in that capacity, operates and maintains Vermont's electric transmission system, as it has for over fifty years.

Under collateral call arrangements associated with the Cooperative's ownership in VELCO and Vermont Transco LLC, the Cooperative purchased $641,010 in Vermont Transco equity units in 2012. There were no equity calls in 2011.

In 2012 the PSB approved the merger of Central Vermont Public Service and Green Mountain Power. As part of its approval, the PSB ordered changes in the governance structure of VELCO to assure that the merged company would not control a majority of seats on its board. Consumer-owned utilities now appoint two additional independent directors, and a separate process was established for the appointment of three independent “public good” directors.

ISO-NE

The Cooperative, like all other utilities in New England, relies upon the ISO-NE, operator of the New England regional bulk transmission system, to dispatch generation and settle load obligations in the New England power markets. The Cooperative relies upon the ISO-NE to maintain reliability of the bulk power system and to administer the electricity markets within New England.

NOTE 7 COMMITMENTS AND CONTINGENCIES – POWER SUPPLY (continued)

Through its joint ownership in VELCO and under the Cooperative's Central Dispatch Agreement (CDA) with the Vermont Public Power Supply Authority (VPPSA), the Cooperative is a member of the New England Power Pool (NEPOOL). The Cooperative's power supply resources are combined in the CDA with other VPPSA participants, and settled as one entity with ISO-NE. The CDA is intended to provide pooling savings to its members by taking advantage of economies of scale through sharing staff resources through VPPSA and load diversity, where under the CDA supply sources and loads of all of its participants are aggregated into a single entity for the purpose of ISO-NE settlement calculations. The Cooperative became a member of the CDA effective July 1, 1998. The Cooperative can withdraw from the arrangement on a short-term notice (30 days including any additional time required by ISO-NE to reflect such a change).

Over the past decade, the ISO-NE market structure has continued to evolve. Spot markets for energy, capacity and ancillary power products were developed, upon which New England utilities such as the Cooperative depend to achieve reliability of the bulk power system. In recent years, significant investments in transmission in the ISO-NE region have contributed to increased power costs for the Cooperative and other utilities.

In 2012 the Cooperative's energy settlement load obligation with the ISO-NE was 76,532,664 kWh (this value represents the Cooperative's retail sales, distribution and transmission losses, and uncollected accounts). To hedge its load obligation the Cooperative's power sources in 2012 totaled 89,414,586 kWh. The following table summarizes the Cooperative's sources of power as follows:

| | 2012 | | 2011 | |
|---|---|---|---|---|
| | KWH | Percentage | KWH | Percentage |
| VDPS - NYPA | 9,775,599 | 10.93% | 9,131,431 | 10.65% |
| Hydro - Quebec | 16,079,870 | 17.98% | 17,093,160 | 19.94% |
| Small Power Producers & Ryegate | 2,758,164 | 3.08% | 4,067,249 | 4.74% |
| Wrightsville | 2,791,902 | 3.12% | 2,363,827 | 2.76% |
| GMP Rate W - Jones Brook | 530,900 | 0.59% | 551,000 | 0.64% |
| Coventry Clean Energy Corporation | 49,394,000 | 55.24% | 50,280,800 | 58.65% |
| Vermont Wind | 8,084,151 | 9.04% | 2,235,630 | 2.61% |
| | 89,414,586 | 100.00% | 85,723,097 | 100.00% |
| Load Obligation | 76,532,664 | | 77,293,943 | |
| Excess Resources | 12,881,922 | | 8,429,154 | |

GMP Subtransmission Tariff

Following the approval by the PSB and the Federal Energy Regulatory Commission (FERC) of the merger of CVPS and GMP, the merged company filed an updated subtransmission tariff with FERC affecting all wholesale customers including the Cooperative. Seven of the Cooperative's eight substations are served by GMP. The new tariff increases subtransmission costs by over 80% with the full impact phased in over a period of almost five years. The Cooperative has intervened in the FERC case along with two other Vermont utilities, and seeks to lessen the total impact of the increase and its implementation. The parties have been engaged in settlement discussions. The outcome of these discussions or of the litigation before FERC is not known at this time.

## NOTE 8 RENEWABLE ENERGY CERTIFICATES

Beginning in 2004, bilateral and settlement markets for Renewable Energy Certificates (RECs) began operating in the ISO-New England region as a result of renewable portfolio standards (RPS) legislation passed in a number of New England states. The markets allow for the renewable attributes of a generation source to be sold separately from the energy itself. RECs are directly associated with the generation of electricity produced or purchased by the Cooperative from qualified resources, particularly the Coventry Project and Vermont Wind’s Sheffield wind project, which began operation in October 2011. The Vermont Legislature may at some point establish an RPS. This would require the Cooperative to retire rather than sell a portion of its RECs in future years.

The Cooperative records proceeds from the sale of RECs in operating revenues. Proceeds for RECs sold are received in subsequent quarters due to the lag time required by the NEPOOL Generation Information System (GIS) and RECs market administrator to accurately account for the RECs generated. In 2011, the Cooperative’s Board adopted a portfolio strategy for sale of RECs for 2012 and beyond, and is selling RECs to multiple buyers for varying terms.

At December 31, 2012 and 2011 the Cooperative recorded REC revenue of $1,656,757 and $1,361,522, respectively. There was $742,171 and $533,578 in REC receivables at December 31, 2012 and 2011, respectively.

## NOTE 9 BANK DEPOSITS IN EXCESS OF INSURED LIMITS

At December 31, 2012 the Cooperative had uninsured exposure of approximately $688,895 in its cash accounts. The Cooperative mitigates this exposure through the use of repurchase agreements with an area bank. The bank utilizes a sweep account arrangement. The target balance is $2,500. Amounts in excess of this are swept into the repurchase account whereby the bank invests the excess in U.S. Government Securities. These underlying U.S. Government Securities serve as collateral for the Cooperative based on this agreement. The balance held in the repurchase account at December 31, 2012 was approximately $688,895.

## NOTE 10 AMERICAN RECOVERY AND REINVESTMENT ACT (ARRA)

The Cooperative, along with other Vermont electric distribution utilities, and the state's transmission provider, Vermont Electric Power Company (VELCO), applied for and were awarded a Smart Grid Investment Grant (SGIG) from the Department of Energy (DOE) in December 2009. The total award is for $68.9 million dollars state-wide; the distribution utilities and VELCO are obligated to match the award amount; the total state-wide project amount is $137.8 million dollars. The Cooperative's original share of the award was $969,356, which will obligate the Cooperative to provide matching funds from its Construction Work Plan in an equal amount over a period of three years. In January 2011 the Cooperative was notified that up to an additional $1,000,000 in ARRA grant funding would be made available to the Cooperative to implement its Automated Meter Infrastructure (AMI) proposal. In 2012 the Cooperative was notified that an additional $250,000 was available for its AMI project. The Cooperative included AMI deployment in its current CWP, financing for which was approved by the PSB in 2011. The Cooperative submitted its AMI Plan for approval to the PSB, which approved the plan in early 2012. The Cooperative expects to complete deployment by early 2013.

## NOTE 11 AMORTIZATION OF STRANDED METER COSTS

In 2012, the Cooperative had a net loss on the early retirement of its meters in the amount of $373,587. This loss was due to the fact that the Cooperative began replacing all of its existing meters with an Advanced Metering Infrastructure (AMI), and the old meters were not fully depreciated. The Cooperative received approval from RUS to amortize this loss over a five year period starting in 2012. The amortization of the loss was $74,717 in 2012.

## NOTE 12 SUBSEQUENT EVENTS

In accordance with professional accounting standards, the Cooperative has evaluated subsequent events through March 2, 2013, which is the date the financial statements were available to be issued. All subsequent events requiring recognition as of December 31, 2012, have been incorporated into the financial statements herein.

Washington Electric Cooperative, Inc.

ADDITIONAL REPORTS REQUIRED BY
THE SINGLE AUDIT ACT

December 31, 2012

Washington Electric Cooperative, Inc.
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended December 31, 2012

| Federal Grantor/ Pass-through Grantor/ Program Title | Grantor Pass-through Number | Federal CFDA Number | Expended |
|---|---|---|---|
| US DEPARTMENT OF ENERGY, | | | |
| Passed through Vermont Transco, LLC: | | | |
| Electricity Delivery and Energy Reliability, Research, Development and Analysis (ARRA) | DE-OE0000315 | 81.122 | $ 1,208,117 |
| TOTAL | | | $ 1,208,117 |

The Schedule of Expenditures of Federal Awards was prepared using the significant accounting policies outlined in Note 1 to the basic financial statements.

Kittell Branagan & Sargent
*Certified Public Accountants*
Vermont License # 167

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Board of Directors
Washington Electric Cooperative, Inc.

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Washington Electric Cooperative, Inc., as of and for the year ended December 31, 2012, and the related statement of operations, equities and cash flows for the year then ended and notes to the financial statements, which collectively comprise Washington Electric Cooperative, Inc.'s basic consolidated financial statements, and have issued our report thereon dated March 2, 2013.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the consolidated financial statements, we considered Washington Electric Cooperative, Inc.'s internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of Washington Electric Cooperative, Inc.'s internal control. Accordingly, we do not express an opinion on the effectiveness of Washington Electric Cooperative, Inc.'s internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether Washington Electric Cooperative, Inc.'s consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

**Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Kittell Branagan & Sargent

St. Albans, Vermont
March 2, 2013

KBS
Kittell Branagan & Sargent
*Certified Public Accountants*
Vermont License # 167

# REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM; REPORT ON INTERNAL CONTROL OVER COMPLIANCE; AND REPORT ON THE SCHEDULE OF FEDERAL AWARDS REQUIRED BY OMB CIRCULAR A-133

To the Board of Trustees of
Washington Electric Cooperative, Inc.

**Report on Compliance for Each Major Federal Program**

We have audited Washington Electric Cooperative, Inc.'s compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Washington Electric Cooperative, Inc.'s major federal programs for the year ended December 31, 2012. Washington Electric Cooperative, Inc.'s major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

*Management's Responsibility*
Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

*Auditor's Responsibility*
Our responsibility is to express an opinion on compliance for each of Washington Electric Cooperative, Inc.'s major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Washington Electric Cooperative, Inc.'s compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of Washington Electric Cooperative, Inc.'s compliance.

*Opinion on Each Major Federal Program*
In our opinion, Washington Electric Cooperative, Inc. complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2012.

To the Board of Trustees of
Washington Electric Cooperative, Inc.
Report 3, continued

**Report on Internal Control Over Compliance**

Management of Washington Electric Cooperative, Inc. is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Washington Electric Cooperative, Inc.'s internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Washington Electric Cooperative, Inc.'s internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

**Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133**

We have audited the consolidated financial statements of Washington Electric Cooperative, Inc. as of and for the year ended December 31, 2012, and have issued our report thereon dated March 2, 2013, which contained an unmodified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditure of federal awards is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Kittell Branagan & Sargent

St. Albans, Vermont
March 2, 2013

Washington Electric Cooperative, Inc.
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
December 31, 2012

A. SUMMARY OF AUDIT RESULTS

1. The auditor's report expresses an unqualified opinion on the consolidated financial statements of Washington Electric Cooperative, Inc..

2. There were no significant deficiencies disclosed during the audit of the consolidated financial statements.

3. No instances of noncompliance material to the consolidated financial statements of Washington Electric Cooperative, Inc. were disclosed during the audit.

4. There were no significant deficiencies disclosed during the audit of the major federal award programs.

5. The auditor's report on compliance for the major federal award programs for Washington Electric Cooperative, Inc. expresses an unqualified opinion.

6. There were no audit findings relative to the major federal award programs for Washington Electric Cooperative, Inc.

7. The program tested as a major program was CFDA #81.122 Electricity Delivery and Energy Reliability, Research, Development and Analysis (ARRA) .

8. The threshold for distinguishing Types A and B programs was $300,000.

9. Washington Electric Cooperative, Inc. was not determined to be a low-risk auditee. Since Washington Electric Cooperative, Inc. was not required to have an A-133 audit in 2011 or 2010, it cannot be classified as "Low Risk" for this purpose.

B. FINDINGS – FINANCIAL STATEMENTS AUDIT

- There were no findings related to the consolidated financial statements audit.

C. FINDINGS AND QUESTIONED COSTS – MAJOR FEDERAL AWARD PROGRAMS AUDIT

- There were no findings or questioned costs related to the major federal award programs.