

**WASHINGTON ELECTRIC COOPERATIVE, INC.**

**FINANCIAL STATEMENTS  
DECEMBER 31, 2011 AND 2010  
AND  
INDEPENDENT AUDITOR'S REPORTS**

**WASHINGTON ELECTRIC COOPERATIVE, INC.**

**DECEMBER 31, 2011 AND 2010**

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**INDEPENDENT AUDITOR'S REPORT**

The Board of Directors  
Washington Electric Cooperative, Inc.

We have audited the accompanying consolidated balance sheets of Washington Electric Cooperative, Inc., and subsidiary, as of December 31, 2011 and 2010 and the related consolidated statements of operations, equities, and cash flows for the years then ended. These financial statements are the responsibility of the Cooperative's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Washington Electric Cooperative, Inc. as of December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards* we have also issued a report dated March 20, 2012, on our consideration of Washington Electric Cooperative Inc.'s internal control over financial reporting and on 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Montpelier, Vermont  
March 20, 2012

*Mudgett, Jennett &  
Krogh-Wisner, P.C.*

**WASHINGTON ELECTRIC COOPERATIVE, INC.**  
**BALANCE SHEETS**  
**DECEMBER 31, 2011 AND 2010**  
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<u>ASSETS</u>	<u>2011</u>	<u>2010</u>
Electric plant, at cost:		
Electric plant in service	\$ 67,250,506	\$ 65,366,026
Less accumulated depreciation	<u>21,224,577</u>	<u>20,032,169</u>
Net electric plant in service	46,025,929	45,333,857
Construction work in progress	<u>969,489</u>	<u>981,884</u>
 Net electric plant	 <u>46,995,418</u>	 <u>46,315,741</u>
Other assets:		
Restricted cash (Note 6)	-	338,180
Other investments (Note 2)	<u>5,545,977</u>	<u>5,322,559</u>
Total other assets	<u>5,545,977</u>	<u>5,660,739</u>
Current assets:		
Cash and cash equivalents	751,330	553,689
Receivables -		
Notes, less allowance for doubtful accounts		
of \$1,500 and \$2,000 in 2011 and 2010	99	107
Accounts, less allowance for doubtful accounts		
of \$23,500 and \$23,000 in 2011 and 2010	1,428,812	1,053,807
Renewable energy certificate revenue	533,578	641,068
Miscellaneous	433,415	152,876
Unbilled revenue	791,515	723,541
Inventories	239,936	260,445
Prepaid expenses	<u>207,955</u>	<u>115,200</u>
Total current assets	<u>4,386,640</u>	<u>3,500,733</u>
Deferred debits, net of amortization	<u>213,826</u>	<u>253,360</u>
 Total assets	 \$ <u>57,141,861</u>	 \$ <u>55,730,573</u>

The notes to financial statements are an integral part of these statements.

**WASHINGTON ELECTRIC COOPERATIVE, INC.**  
**BALANCE SHEETS**  
**DECEMBER 31, 2011 AND 2010**  
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<u>LIABILITIES AND EQUITIES</u>	<u>2011</u>	<u>2010</u>
Equities:		
Memberships issued and subscribed	\$ 116,145	\$ 112,865
Patronage capital assignable	832,315	743,563
Patronage capital credits	7,709,189	7,215,773
Donated capital	214,014	206,334
Contributions in aid of construction	<u>9,983,373</u>	<u>9,770,647</u>
Net equity	<u>18,855,036</u>	<u>18,049,182</u>
 Long-term debt, excluding current installments (Note 3)	 <u>34,722,783</u>	 <u>33,916,169</u>
 Current liabilities:		
Notes payable (Note 4)	-	316,827
Current installments of long-term debt (Note 3)	1,446,397	1,356,821
Accounts payable	1,076,567	696,469
Customer deposits	198,258	174,196
Accrued expenses	<u>600,933</u>	<u>608,580</u>
Total current liabilities	<u>3,322,155</u>	<u>3,152,893</u>
 Deferred credits	 <u>241,887</u>	 <u>612,329</u>
 Commitments and contingencies (Notes 4, 6, 7, 8, 9 and 10)		
 Total liabilities and equity	 \$ <u>57,141,861</u>	 \$ <u>55,730,573</u>

The notes to financial statements are an integral part of these statements.

**WASHINGTON ELECTRIC COOPERATIVE, INC.**  
**STATEMENTS OF OPERATIONS**  
**FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010**

	<u>2011</u>	<u>2010</u>
OPERATING REVENUE	\$ <u>14,847,197</u>	\$ <u>14,540,934</u>
OPERATING EXPENSES:		
Purchased power	3,661,779	3,372,614
Power generation	1,514,780	1,427,777
Transmission	46,039	29,916
Distribution -		
Operations	1,503,620	1,390,659
Maintenance	1,607,948	1,567,991
Customer accounts	899,883	861,394
Administrative and general	1,419,115	1,442,217
Depreciation	2,141,681	2,197,625
Taxes	341,240	336,697
Other items, net, including amortization of regulatory credits	<u>(144,806)</u>	<u>63,274</u>
Total operating expenses	<u>12,991,279</u>	<u>12,690,164</u>
 Margins from operations before interest charges	 <u>1,855,918</u>	 <u>1,850,770</u>
INTEREST CHARGES:		
Interest on long-term debt	1,642,965	1,607,057
Other interest	<u>8,244</u>	<u>38,137</u>
Total interest charges	<u>1,651,209</u>	<u>1,645,194</u>
 Margins from operations	 <u>204,709</u>	 <u>205,576</u>
OTHER INCOME (EXPENSE):		
Interest and dividend income	591,837	519,853
Other nonoperating income	52,391	38,676
Other nonoperating expense	(16,372)	(19,653)
Income taxes	<u>(250)</u>	<u>(889)</u>
Total other income	<u>627,606</u>	<u>537,987</u>
 Net margins	 <u>\$ 832,315</u>	 <u>\$ 743,563</u>

The notes to financial statements are an integral part of these statements.

**WASHINGTON ELECTRIC COOPERATIVE, INC.**  
**STATEMENTS OF EQUITIES**  
**FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010**

	Memberships Issued and Subscribed	Patronage Capital Assignable	Other Equities		Contributions in Aid of Construction
			Patronage Capital Credits	Donated Capital	
BALANCE, December 31, 2009	\$ 108,455	\$ 654,169	\$ 6,821,356	\$ 199,004	\$ 9,484,262
New memberships issued or subscribed for	11,740	-	-	-	-
Transfers to donated capital	(7,330)	-	-	7,330	-
Transfers to patronage capital credits	-	(654,169)	654,169	-	-
Patronage rebates	-	-	(259,752)	-	-
Net margins for the year	-	743,563	-	-	-
New contributions in aid of construction, net	-	-	-	-	286,385
BALANCE, December 31, 2010	112,865	743,563	7,215,773	206,334	9,770,647
New memberships issued or 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 construction, net	-	-	-	-	212,726
BALANCE, December 31, 2011	\$ 116,145	\$ 832,315	\$ 7,709,189	\$ 214,014	\$ 9,983,373

The notes to financial statements are an integral part of these statements.

**WASHINGTON ELECTRIC COOPERATIVE, INC.**  
**STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010**  
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	<u>2011</u>	<u>2010</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net margins	\$ 832,315	\$ 743,563
Noncash items included in earnings -		
Depreciation	2,141,681	2,197,625
Deferred revenue recognized	(338,180)	(1,735,000)
Amortization of deferred charges	36,237	36,237
Amortization of deferred regulatory credits	(166,464)	-
Restricted cash interest income	-	(1,690)
Changes in assets and liabilities -		
Decrease (increase) in accounts receivable	(655,544)	(236,595)
Decrease (increase) in renewable energy certificate revenue receivable	107,490	700,401
Decrease (increase) in unbilled revenue	(67,974)	(19,490)
Decrease (increase) in inventories	20,509	44,378
Decrease (increase) in prepaid expenses	(92,755)	(28,428)
Decrease (increase) in deferred debits	(13,819)	-
Increase (decrease) in accounts payable	380,098	(576,274)
Increase (decrease) in customer deposits	24,062	4,179
Increase (decrease) in accrued expenses	(7,647)	104,483
Increase (decrease) in deferred credits	<u>134,202</u>	<u>56,184</u>
Net cash provided by operating activities	<u>2,334,211</u>	<u>1,289,573</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Retirement of notes receivable	8	1,834
Investment in CD over 3 months	(250,000)	-
Additions by construction work in progress	(2,418,374)	(2,378,794)
Additions to electric plant in service	(449,903)	(335,509)
Retirements of electric plant in service	(193,706)	(217,753)
Return of capital	53,870	55,289
Purchase of investments	<u>(27,288)</u>	<u>(696,774)</u>
Net cash used in investing activities	<u>(3,285,393)</u>	<u>(3,571,707)</u>

The notes to financial statements are an integral part of these statements.



**WASHINGTON ELECTRIC COOPERATIVE, INC.**  
**STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010**

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	<u>2011</u>	<u>2010</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Contributions in aid of construction (CIAOC)	212,726	286,385
CIAOC from the American Recovery and Reinvestment Act Grant	211,774	374,549
CIAOC from FEMA Grants	45,967	-
Memberships issued, net of refunds	10,960	11,740
Patronage rebates	(250,147)	(259,752)
Release of restricted cash	338,180	1,770,980
Deposits in restricted cash	-	(200,000)
Proceeds from short-term debt	1,057,364	3,210,380
Payments on short-term debt	(1,374,191)	(4,271,607)
Proceeds from long-term debt	2,281,000	2,666,000
Principal payments on long-term debt	<u>(1,384,810)</u>	<u>(1,082,422)</u>
Net cash provided by financing activities	<u>1,148,823</u>	<u>2,506,253</u>
Net increase (decrease) in cash and cash equivalents	197,641	224,119
CASH AND CASH EQUIVALENTS, beginning of year	<u>553,689</u>	<u>329,570</u>
CASH AND CASH EQUIVALENTS, end of year	\$ <u>751,330</u>	\$ <u>553,689</u>

**SUPPLEMENTAL CASH FLOW INFORMATION**

Cash paid during the year for interest	\$ <u>1,651,209</u>	\$ <u>1,607,085</u>
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The notes to financial statements are an integral part of these statements.

**WASHINGTON ELECTRIC COOPERATIVE, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011 AND 2010**

**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, 2010, 2009 and 2008 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, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Intangible plant	\$ 609	\$ 609
Generation (hydro) plant	3,745,461	3,731,366
Generation (landfill gas) plant	12,551,623	12,549,518
Transmission plant	2,286,713	2,276,423
Distribution plant	44,432,749	42,442,716
General plant	<u>4,233,351</u>	<u>4,365,394</u>
	<u>\$ 67,250,506</u>	<u>\$ 65,366,026</u>

**WASHINGTON ELECTRIC COOPERATIVE, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011 AND 2010**

**1. Summary of significant accounting policies (continued):**

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:

	<u>Life in Years</u>	<u>Composite Rate</u>
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 are accounted for as a component of patrons' equity rather than as a reduction of electric plant in service. 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.

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.

**WASHINGTON ELECTRIC COOPERATIVE, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011 AND 2010**

**2. Other investments:**

Other investments include the following, at cost, at December 31, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Investments in associated organizations:		
National Rural Utilities Cooperative Finance Corporation (CFC) membership	\$ 1,000	\$ 1,000
CFC capital term certificates	455,685	458,174
CFC patronage capital certificates	121,108	113,820
NISC patronage capital certificates	59,515	52,437
Patronage capital certificates - other cooperatives	15,061	10,656
Rural Electric Vermont Association membership	497	497
	<u>652,866</u>	<u>636,584</u>
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	1,845,950	1,845,950
Vermont Transco LLC - Class B membership units	2,349,380	2,349,380
CD 6 month maturity	250,000	-
Central Vermont Memorial Civic Center - rural economic development loan	78,488	121,352
	<u>4,893,111</u>	<u>4,685,975</u>
	<u>\$ 5,545,977</u>	<u>\$ 5,322,559</u>

**3. Long-term debt:**

Long-term debt at December 31, 2011 and 2010 consists of the following:

	<u>2011</u>	<u>2010</u>
Mortgage notes payable, U.S. Department of Agriculture (RUS), 35-year terms at the following rates of interest:		
5.0% mortgage notes	\$ 16,276,977	\$ 16,806,307
4.125% mortgage note	6,257,186	6,487,610
	<u>22,534,163</u>	<u>23,293,917</u>
Mortgage notes payable, CFC, 35-year terms due between 2016 and 2028 at the following rates of interest:		
Fixed rate mortgage notes, 6.1% to 6.45% due quarterly, variable dates through July 1, 2028	1,845,492	1,960,481
Fixed rate mortgage note, 4.85% due annually through December 31, 2011	-	21,974
	<u>1,845,492</u>	<u>1,982,455</u>

**WASHINGTON ELECTRIC COOPERATIVE, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011 AND 2010**

**3. Long-term debt (continued):**

	<u>2011</u>	<u>2010</u>
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	904,628	980,014
Mortgage notes payable, Federal Financing Bank (FFB), at the following due dates and rates of interest:		
4.287% to 8.335% advances, matures December 31, 2014	105,939	141,252
4.241% advances, matures December 31, 2033	2,998,696	3,135,000
4.347% advances, matures December 31, 2043	2,863,515	2,953,000
4.147% advances, matures December 31, 2043	1,159,758	1,196,000
3.582% advances, matures December 31, 2043	806,788	832,000
3.203% advances, matures December 31, 2043	618,666	638,000
4.068% advances, matures December 31, 2043	662,473	-
3.874% advances, matures December 31, 2043	1,220,465	-
3.009% advances, matures December 31, 2043	370,109	-
	<u>10,806,409</u>	<u>8,895,252</u>
Rural economic development, non-interest bearing, U.S. Department of Agriculture (RUS) loan:		
CVMCC, payable in 168 monthly payments of \$3,572 starting November 1999 through October 2013	78,488	121,352
	<u>36,169,180</u>	<u>35,272,990</u>
Less current installments	<u>(1,446,397)</u>	<u>(1,356,821)</u>
Long-term debt, excluding current installments	<u>\$ 34,722,783</u>	<u>\$ 33,916,169</u>

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. Subsequently 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.

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.

**WASHINGTON ELECTRIC COOPERATIVE, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011 AND 2010**

**3. Long-term debt (continued):**

The following is a schedule of required principal payments on long-term debt in subsequent fiscal years from December 31, 2011:

<u>Year ending December 31,</u>	
2012	\$ 1,446,397
2013	1,488,696
2014	1,501,738
2015	1,502,231
2016	1,541,027
Thereafter	<u>28,689,091</u>
	\$ <u>36,169,180</u>

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 2011 and 2010.

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 2011 and 2010.

**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, 2012. 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, 2011 was 3.2%. The available balance on the note was \$2,600,000 at year end.

**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. Contributions to the retirement plan from the Cooperative for the employees are recorded as pension expense. Pension expense was \$576,059 for 2011 and \$579,296 for 2010. Pension expense for the prior service costs was \$14,580 for 2011 and 2010.

**WASHINGTON ELECTRIC COOPERATIVE, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011 AND 2010**

**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 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 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 are still pending approval by the PSB in Docket No. 7432.

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. The total collected from the Cooperative's members was approximately \$617,788 in 2011 and \$525,437 in 2010. 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.

Rate Design

In September 2010, the Public Service Board approved a new rate design proposal which the Cooperative had filed in November 2009. Based on a Fully Allocated Cost of Service Study, the new rate reallocates costs among the different rate classes, and maintains but makes changes to the inclining rate structure for residential accounts that has been in place for many years. The rate design is revenue neutral and took effect in November 2010.

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**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 Request

The Cooperative filed a rate increase with the Vermont Public Service Board in November 2010 for an across the board increase in its retail rates in the amount of 23.81%. The request was investigated by the PSB in Docket No. 7691. This was the Cooperative's first rate increase in 11 years. The Cooperative is allowed to increase its rates 45 days after the filing, and therefore new rates went into effect on January 1, 2011 reflecting the increase. The revenue attributable to the rate increase was billed for separately until the PSB issued its final order on the rate increase. The PSB issued a Final Order in Docket No. 7691 in November 2011 approving an increase in rates of 19.44%. Since the final order decreased the requested rate increase, the Cooperative refunded to members the excess amounts collected.

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 and a decision is expected to be reached in early 2012. The Cooperative is allowed to increase its rates 45 days after the filing, and therefore new rates went into effect on January 1, 2012 reflecting the increase. The revenue attributable to the rate increase is billed for separately until the PSB issues its final order on the rate increase. In the event the final order decreases the requested rate increase, the Cooperative will refund to members excess amounts collected.

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. Employees were moved to temporary locations. Member services and administrative functions were not seriously disrupted. 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



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**6. Commitments and contingencies (continued):**

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 Board authorized a not-to-exceed total project cost of \$1.2 million. The principal contractor for the project is L.K. Rossi. The Cooperative was insured for flood damage including building repair and replacement of damaged equipment. It is estimated that the total project will cost approximately \$1 million with approximately a \$300,000 insurance reimbursement. The balance of the cost is expected to be financed by a combination of an amendment to the current CWP and general funds. The project is expected to be completed this spring.

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, 2011 are:

	<u>Plant Cost</u>	<u>Note Balance</u>
Phase 1 - Initial construction, Engines 1-3	\$ 8,502,732	\$ 6,257,186
Phase 2 - Engine 4	1,238,397	904,628
Phase 3 - Engine 5 plus building modifications	4,133,419	2,998,696
System Upgrades financed with general funds	<u>250,408</u>	<u>-</u>
	<u>\$ 14,124,956</u>	<u>\$ 10,160,510</u>

Of the \$14,124,956 plant cost, \$12,549,518 is capitalized to generation plant with the balance included in transmission plant.

In 2011 the Coventry Project provided approximately 59% 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). The Cooperative expects energy from the Coventry Project to increase going forward.

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

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**7. Commitments and contingencies - power supply (continued):**

and adjustment of the gas collection system. The contract is for nine years with an automatic renewal for eight years. Compensation to IES is at the rate of 2.3 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. The amount included in expense was \$1,169,245 for 2011 and \$1,118,403 for 2010.

Other power sources -

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 \$99,110 in 2011 and \$82,048 in 2010. Fixed costs were \$136,998 in 2011 and \$138,538 in 2010.

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, 2011, are as follows.

First 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.

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.

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.

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**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 \$1,135,437 in 2011 and \$1,115,187 in 2010.

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 2012.

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 2011, there was a net cost for the converter of \$2,591 while in 2010 there was a net credit of \$21,783. 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 \$565,902 in 2011 and \$566,868 in 2010. The Cooperative's costs are expected to increase moderately through time for VEPPI resources. 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. This docket is currently underway and an order is expected by mid 2012. The remaining Rule 4.100 contracts which are hydro based-resources are expected to expire fully by 2020.

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.

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**7. Commitments and contingencies - power supply (continued):**

Under collateral call arrangements associated with the Cooperative's ownership in VELCO and Vermont Transco LLC, the Cooperative purchased \$672,660 in Vermont Transco equity units in 2010. There were no equity calls in 2011.

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.

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 2011 the Cooperative's energy settlement load obligation with the ISO-NE was 77,293,943 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 2011 totaled 85,723,097 kWh. The following table summarizes the Cooperative's sources of power as follows:

	<u>2011</u>		<u>2010</u>	
	<u>KWH</u>	<u>Percentage</u>	<u>KWH</u>	<u>Percentage</u>
VDPS-NYPA	9,131,431	10.65%	8,945,249	10.87%
Hydro-Quebec	17,093,160	19.94%	17,339,180	21.06%
Small Power Producers	4,067,249	4.74%	4,254,697	5.17%
Wrightsville	2,363,827	2.76%	2,726,144	3.31%
GMP Rate W - Jones Brook	551,000	0.64%	570,100	0.69%
Coventry Clean Energy Corporation	50,280,800	58.65%	48,494,200	58.90%
Vermont Wind	2,235,630	2.61%	-	0.00%
	<u>85,723,097</u>	<u>100.00%</u>	<u>82,329,570</u>	<u>100.00%</u>
Load Obligation	<u>77,293,943</u>		<u>77,693,186</u>	
Excess Resources	<u>8,429,154</u>		<u>4,636,384</u>	

**WASHINGTON ELECTRIC COOPERATIVE, INC.**  
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**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. The Vermont Legislature is considering establishment of an RPS. This would require the Cooperative to retire rather than sell a portion of its RECs in future years.

In 2007, the Cooperative and Cape Light Compact of Massachusetts entered into a contract for the sale of RECs associated with the Coventry facility for the years 2008-2011. The Cooperative records proceeds from the sale of RECs available from its Coventry Landfill Gas project 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.

The Cooperative sold \$955,322 in 2011 and \$1,304,017 in 2010 in RECs associated with the Coventry facility. There was \$533,578 and \$641,068 in REC receivables at December 31, 2011 and December 31, 2010 respectively.

The Cooperative and Cape Light Compact contract contained a provision that allowed the contract price to be reset in 2010 and/or 2011 if market prices for RECs fell below a specified amount. In 2010 and 2011, the contract price was reset due to a significant drop in REC market prices.

Beginning in October 2011, the Cooperative began receiving the RECs associated with its share of the output of Vermont Wind's project in Sheffield. The Cooperative also sold \$68,020 in 2011 in RECs associated with VT Wind. The Cooperative has also filed an application for "low impact hydro" designation from the Low Impact Hydro Institute, which if approved, may create value for RECs from the Wrightsville facility. In 2011, the Cooperative's Board adopted a portfolio strategy for sale of RECs for 2012 and beyond, and will be selling RECs to multiple buyers for varying terms.

The Cooperative received RUS approval and an Accounting Order from the PSB in 2005 for a Rate Stabilization Plan. The plan allows the Cooperative to annually defer REC revenue from 2004 through 2009 in excess of what is needed to meet its lenders' requirements. The Cooperative used \$338,180 in 2011 and \$1,735,000 in 2010 in previously deferred revenues to cover lender requirements. At December 31, 2011 the balance in this restricted account was zero.

**9. Bank deposits in excess of insured limits:**

At December 31, 2011, the Cooperative had an uninsured/uncollateralized exposure of approximately \$339,109 in its cash accounts. In 2009, the Cooperative adopted a policy specific to the Deferred Revenue Investments which stated investments will be based on a portfolio approach with the majority of the investments being held in secure options, not necessarily FDIC or NCUSIF insured accounts. The National Rural Utilities Cooperative Finance Corporation (NRUCFC) Commercial Paper was deemed as one such secure investment. The balance in NRUCFC's Commercial Paper at December 31, 2011 was approximately \$339,005.

**WASHINGTON ELECTRIC COOPERATIVE, INC.**  
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**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 share of the award is \$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 Automatic Meter Infrastructure (AMI) proposal. The Cooperative included AMI deployment in its current CWP, financing for which was approved by the PSB in 2011. The Cooperative has submitted its AMI Plan for approval to the PSB, which is expected in early 2012, and expects to complete deployment by early 2013.

**INDEPENDENT AUDITOR'S 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 the consolidated financial statements of the Washington Electric Cooperative, Inc. (the Cooperative) as of and for the year ended December 31, 2011, and have issued our report thereon dated March 20, 2012. We conducted our audit 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.

**Internal Control Over Financial Reporting**

Management of the Cooperative is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Cooperative's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Cooperative's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Cooperative's internal control over financial reporting.

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 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.

Our consideration of internal control over financial reporting 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 financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Cooperative's consolidated financial statements are free of 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*.

We noted certain matters that we reported to management of the Cooperative in a separate letter dated March 20, 2012.

This report is intended solely for the information and use of the Board of Directors and management of Washington Electric Cooperative, the Rural Utilities Service, and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties.

Montpelier, Vermont  
March 20, 2012

*Mudgett, Bennett &  
Krogh-Winner, P.C.*