

Washington Electric Cooperative, Inc.

FINANCIAL STATEMENTS

December 31, 2016

Washington Electric Cooperative, Inc.
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Kittell Branagan & Sargent

Certified Public Accountants

Vermont License #167

INDEPENDENT AUDITOR'S REPORT

The Board of Directors
Washington Electric Cooperative, Inc.
East Montpelier, Vermont

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, 2016 and 2015, and the related consolidated statements of operations, equities and cash flows for the years then ended, and the related notes to the consolidated 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 opinions on these consolidated financial statements based on our audit. 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. 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 opinions.

Opinions

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the respective financial position of Washington Electric Cooperative, Inc. as of December 31, 2016 and 2015, and the respective changes in its operations, equities and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Other Information

Our audit was conducted for the purpose of forming opinions on the consolidated financial statements that collectively comprise the Washington Electric Cooperative Inc.'s basic consolidated financial statements. The consolidating balance sheet and consolidating statements of operations are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The consolidating balance sheet and consolidating statements of operations are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic consolidated financial statements or to the basic consolidate financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating balance sheet and consolidating statements of operations are fairly stated in all material respects in relation to the basic consolidated financial statements as a whole.

The consolidating balance sheet and consolidating statements of operations have not been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated February 21, 2017 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 & Sylvest

Washington Electric Cooperative, Inc.

BALANCE SHEETS

December 31,

	<u>ASSETS</u>	
	<u>2016</u>	<u>2015</u>
ELECTRIC PLANT, at cost	\$ 77,281,918	\$ 75,532,498
Less accumulated depreciation	<u>(28,661,555)</u>	<u>(26,920,800)</u>
Electric plant in service, net	48,620,363	48,611,698
Construction work in progress	<u>1,788,613</u>	<u>347,040</u>
TOTAL ELECTRIC PLANT, net	<u>50,408,976</u>	<u>48,958,738</u>
CURRENT ASSETS		
Cash	654,021	726,524
Restricted cash	509,279	-
Receivables -		
Notes, less allowance for doubtful accounts of \$1,500 in 2016 and 2015	99	99
Accounts, less allowance for doubtful accounts of \$47,470 and \$30,500 in 2016 and 2015	1,245,394	1,263,847
Renewable energy certificate revenue	714,079	682,848
Miscellaneous	320,114	222,240
Unbilled revenue	766,094	621,245
Inventories	275,665	282,472
Prepaid corporate taxes	33,647	62,929
Prepaid expenses	<u>276,846</u>	<u>248,109</u>
TOTAL CURRENT ASSETS	<u>4,795,238</u>	<u>4,110,313</u>
OTHER ASSETS		
Other investments	7,567,514	6,786,914
Deferred charges	<u>1,196,475</u>	<u>1,414,368</u>
TOTAL OTHER ASSETS	<u>8,763,989</u>	<u>8,201,282</u>
TOTAL ASSETS	<u>\$ 63,968,203</u>	<u>\$ 61,270,333</u>

LIABILITIES AND EQUITY

	<u>2016</u>	<u>2015</u>
EQUITIES		
Memberships issued and subscribed	\$ 135,435	\$ 131,445
Patronage capital assignable	1,420,798	1,273,484
Patronage capital credits	21,834,028	20,972,691
Donated capital	<u>255,104</u>	<u>246,854</u>
NET EQUITY	<u>23,645,365</u>	<u>22,624,474</u>
LONG-TERM DEBT	<u>35,063,510</u>	<u>34,346,843</u>
CURRENT LIABILITIES		
Current portion of long-term debt	2,219,526	2,089,746
Accounts payable	1,463,848	1,036,402
Customer deposits	213,152	213,179
Other accrued expenses	796,774	766,322
Deferred renewable energy certificate revenue	<u>400,000</u>	<u>-</u>
TOTAL CURRENT LIABILITIES	<u>5,093,300</u>	<u>4,105,649</u>
DEFERRED CREDITS	<u>166,028</u>	<u>193,367</u>
TOTAL LIABILITIES AND EQUITY	<u>\$ 63,968,203</u>	<u>\$ 61,270,333</u>

See Accompanying Notes to Financial Statements

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

	<u>2016</u>	<u>2015</u>
OPERATING REVENUE		
Member revenue retail sales	\$ 13,798,558	\$ 13,735,844
Member revenue REC sales	2,685,294	2,917,628
Other	<u>467,311</u>	<u>464,859</u>
TOTAL OPERATING REVENUE	<u>16,951,163</u>	<u>17,118,331</u>
OPERATING EXPENSES		
Purchased power	4,113,662	4,439,913
Power generation	2,126,254	2,130,815
Transmission	87,104	95,708
Distribution:		
Operations, including vehicle depreciation expense of \$137,167 and \$164,220 in 2016 and 2015, respectively	1,765,405	1,766,347
Maintenance	2,147,093	1,998,454
Customer accounts	891,806	880,792
Administrative and general	1,463,892	1,428,489
Depreciation	2,287,887	2,234,331
Taxes	<u>155,928</u>	<u>154,449</u>
TOTAL OPERATING EXPENSES	<u>15,039,031</u>	<u>15,129,298</u>
MARGINS FROM OPERATIONS BEFORE INTEREST CHARGES	<u>1,912,132</u>	<u>1,989,033</u>
INTEREST CHARGES		
Interest on long-term debt	1,357,253	1,388,233
Other interest	<u>2,581</u>	<u>4,747</u>
TOTAL INTEREST CHARGES	<u>1,359,834</u>	<u>1,392,980</u>
MARGINS FROM OPERATIONS	<u>552,298</u>	<u>596,053</u>
OTHER INCOME (EXPENSE)		
Interest and dividend income	798,459	777,793
Other non-operating income	184,614	74,448
Other non-operating expense	(85,291)	(174,510)
Income taxes	<u>(29,282)</u>	<u>(300)</u>
TOTAL OTHER INCOME (EXPENSE)	<u>868,500</u>	<u>677,431</u>
NET MARGINS	<u>\$ 1,420,798</u>	<u>\$ 1,273,484</u>

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	Donated Capital
BALANCE, at December 31, 2014	\$ 126,975	\$ 1,295,102	\$ 19,989,768	\$ 238,164
New memberships issued and subscribed for	13,160	-	-	-
Transfers to donated capital	(8,690)	-	-	8,690
Transfers to patronage capital credits	-	(1,295,102)	1,295,102	-
Patronage rebates	-	-	(312,179)	-
Net margins for the year	<u>-</u>	<u>1,273,484</u>	<u>-</u>	<u>-</u>
BALANCE, at December 31, 2015	131,445	1,273,484	20,972,691	246,854
New memberships issued and subscribed for	12,240	-	-	-
Transfers to donated capital	(8,250)	-	-	8,250
Transfers to patronage capital credits	-	(1,273,484)	1,273,484	-
Patronage rebates	-	-	(412,147)	-
Net margins for the year	<u>-</u>	<u>1,420,798</u>	<u>-</u>	<u>-</u>
BALANCE, at December 31, 2016	<u>\$ 135,435</u>	<u>\$ 1,420,798</u>	<u>\$ 21,834,028</u>	<u>\$ 255,104</u>

See Accompanying Notes to Financial Statements

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

	<u>2016</u>	<u>2015</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 1,420,798	\$ 1,273,484
Noncash expenses (income) included in earnings:		
Depreciation	2,425,054	2,398,551
Amortization of deferred charges	180,899	288,300
Gain on sale of assets	(114,758)	(4,764)
Loss on abandonment	-	85,377
Changes in assets and liabilities:		
Decrease (increase) in accounts receivable	(79,421)	209,124
Decrease (increase) in renewable energy certificate revenue receivable	(31,231)	146,947
Decrease (increase) in unbilled revenue	(144,849)	144,341
Decrease (increase) in inventories	6,807	(10,541)
Decrease (increase) in prepaid expenses	545	(183,708)
Decrease (increase) in deferred debits	(25,140)	122,322
Increase (decrease) in accounts payable	427,446	(64,762)
Increase (decrease) in customer deposits	(27)	18,501
Increase (decrease) in accrued expenses	30,452	73,623
Increase (decrease) in deferred credits	<u>372,661</u>	<u>21,374</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>4,469,236</u>	<u>4,518,169</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales of assets	128,000	11,500
Additions to electric plant in service and construction work in progress	(3,845,232)	(2,445,208)
Return of capital	32,897	35,030
Purchase of investments	<u>(813,497)</u>	<u>(65,500)</u>
NET CASH (USED) IN INVESTING ACTIVITIES	<u>(4,497,832)</u>	<u>(2,464,178)</u>

See Accompanying Notes to Financial Statements

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

	<u>2016</u>	<u>2015</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Memberships issued, net of refunds	12,240	13,160
Patronage rebates	(412,147)	(312,179)
Proceeds from short-term debt	61,000	1,045,725
Payments on short-term debt	(61,000)	(1,107,706)
Proceeds from long-term debt	2,962,366	800,000
Principal payments on long-term debt	<u>(2,097,087)</u>	<u>(2,052,501)</u>
NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES	<u>465,372</u>	<u>(1,613,501)</u>
NET INCREASE IN CASH	436,776	440,490
CASH - Beginning of Year	<u>726,524</u>	<u>286,034</u>
CASH - End of Year	<u>\$ 1,163,300</u>	<u>\$ 726,524</u>
 SUPPLEMENTARY CASH FLOW INFORMATION		
Cash paid during the year for interest	<u>\$ 1,353,526</u>	<u>\$ 1,386,839</u>

See Accompanying Notes to Financial Statements

Washington Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Washington Electric Cooperative, Inc. ("the Cooperative") is a vertically integrated utility with monopoly franchise rights granted by the state of Vermont to provide residential and commercial electric service in its franchise service territory. 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 non-stock 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).

Accounting Standards Codification 740, Income Taxes (formerly FASB Interpretation No. 48) 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, 2016, 2015, 2014 and 2013 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.

Washington Electric Cooperative, Inc.
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2016

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Listed below are the major classes of electric plant as of December 31:

	<u>2016</u>	<u>2015</u>
Intangible plant	\$ 609	\$ 609
Generation (hydro) plant	3,746,792	3,746,792
Generation (landfill gas) plant	12,250,749	12,275,937
Transmission plant	2,630,969	2,630,969
Distribution plant	53,062,936	51,499,264
General plant	<u>5,589,863</u>	<u>5,378,927</u>
	<u>\$ 77,281,918</u>	<u>\$ 75,532,498</u>

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.

Washington Electric Cooperative, Inc.
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2016

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 prior to 2013 were accounted for as a component of patrons' equity rather than as a reduction of electric plant in service. Beginning in January, 2013 the Cooperative began netting all contributions in aid of construction received from its members with the fixed assets placed in service for all new line construction. 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.

Deferred charges

The Cooperative established deferred charges for costs associated with the recovery of various expenses that are deferred and amortized over a specified number of years. These deferred charges are regulatory in nature and approved by the Board of Directors and Public Service Board and RUS.

NOTE 2 OTHER INVESTMENTS

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

	<u>2016</u>	<u>2015</u>
Investments in associated organizations:		
National Rural Utilities Cooperative Finance		
Corporation (CFC) membership	\$ 1,000	\$ 1,000
CFC capital term certificates	440,588	444,000
CFC patronage capital certificates	228,319	201,481
Cooperative Response Center (CRC)	10,000	10,000
CRC patronage capital certificates	1,946	1,166

Washington Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 2 OTHER INVESTMENTS (continued)

	<u>2016</u>	<u>2015</u>
National Information Solutions Cooperative patronage capital certificates	97,955	88,860
Patronage capital certificates - other Cooperatives	15,046	14,977
Rural Electric Vermont Association membership	497	497
	<u>795,351</u>	<u>761,981</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	2,817,270	2,488,490
Vermont Transco LLC - Class B membership units	3,585,600	3,167,150
	<u>6,772,163</u>	<u>6,024,933</u>
 TOTAL OTHER INVESTMENTS	 <u>\$ 7,567,514</u>	 <u>\$ 6,786,914</u>

NOTE 3 LONG-TERM DEBT

Long-term debt at December 31, 2016 and 2015 consists of the following:

	<u>2016</u>	<u>2015</u>
Mortgage notes payable, U.S. Department of Agriculture (RUS) 35-year terms at the following interest rates:		
4.125% mortgage notes, due January 2030	\$ 4,950,819	\$ 5,234,478
 Mortgage notes payable, National Rural Utilities Cooperative Finance Corporation (CFC), 35-year terms due between 2017 and 2031 at the following rates of interest:		
Fixed rate mortgage notes, 6.1% to 6.45% due quarterly, variable dates through July 1, 2028.	1,155,482	1,306,227
Fixed rate mortgage notes, 2.15% to 4.35% due annually, through June 30, 2031.	12,035,824	12,915,526
Fixed rate mortgage note, 3.0% due annually matures June 30, 2023.	1,183,529	1,346,054
	<u>14,374,835</u>	<u>15,567,807</u>

Washington Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 3 LONG-TERM DEBT (continued)

	<u>2016</u>	<u>2015</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.	527,699	603,085
CFC Clean Renewable Energy Bond, nominal interest rate 3.70% effective interest rate 0.859%, with an annual debt service net of tax credits in 2017 of \$115,926 Due September 2031.	<u>1,712,366</u>	<u>-</u>
	<u>2,240,065</u>	<u>603,085</u>
Mortgage notes payable, Federal Financing Bank (FFB) at the following due dates and rates of interest (unadvanced loan funds as of December 31, 2016 and 2015 were \$0 and \$1,250,000, respectively):		
4.366% advances, matures December 31, 2033	2,317,174	2,453,478
4.472% advances, matures December 31, 2043	2,416,091	2,505,576
4.272% advances, matures December 31, 2043	978,545	1,014,788
3.707% advances, matures December 31, 2043	680,727	705,940
3.328% advances, matures December 31, 2043	522,000	541,333
4.193% advances, matures December 31, 2043	558,962	579,664
3.999% advances, matures December 31, 2043	1,029,768	1,067,907
3.134% advances, matures December 31, 2043	312,279	323,845
2.281% advances, matures December 31, 2046	454,545	469,697
2.418% advances, matures December 31, 2046	727,273	751,515
2.625% advances, matures December 31, 2046	454,545	469,697
2.633% advances, matures December 31, 2046	818,182	845,455
3.411% advances, matures December 31, 2046	909,091	939,394
3.258% advances, matures December 31, 2046	763,351	778,279
2.797% advances, matures December 31, 2046	817,141	834,514
2.655% advances, matures December 31, 2046	782,927	800,000
2.399% advances, matures December 31, 2046	247,202	-
2.044% advances, matures December 31, 2046	796,209	-
2.943% advances, matures December 31, 2046	200,000	-
	<u>15,786,012</u>	<u>15,081,082</u>

Washington Electric Cooperative, Inc.
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2016

NOTE 3 LONG-TERM DEBT (continued)

	<u>2016</u>	<u>2015</u>
Total long-term debt before unamortized debt issuance costs	<u>37,351,731</u>	<u>36,486,452</u>
Unamortized debt issuance costs	<u>(68,695)</u>	<u>(49,863)</u>
Total long-term debt	37,283,036	36,436,589
Less current installments:	<u>(2,219,526)</u>	<u>(2,089,746)</u>
Long-term debt, excluding current installments	<u>\$ 35,063,510</u>	<u>\$ 34,346,843</u>

The 2012-2015 Construction Work Plan (CWP) loan from the Federal Financing Bank (FFB) in the amount of \$7.4 million was fully drawn in December 2016. In March 2014, the Cooperative's Board of Directors approved the 2014-2017 CWP. In August 2014, the Cooperative's Board of Directors authorized the submission of the financing application to RUS for an FFB loan in the amount of \$7,141,000 to finance its 2014-2017 CWP. On June 2, 2015, the Cooperative signed the loan documents. For this loan the first principal payment is due June 30, 2017. The last day for an advance is April 1, 2020.

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.

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, 2016:

2017	\$ 2,219,526
2018	2,256,545
2019	2,256,895
2020	2,280,360
2021	2,290,727
Thereafter	<u>26,047,678</u>
	<u>\$ 37,351,731</u>

Washington Electric Cooperative, Inc.
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2016

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 1.25 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 1.10 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 2016 and 2015.

Under the terms of the loan agreements 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 2016 and 2015.

NOTE 4 CHANGE IN ACCOUNTING PRINCIPAL – RETROSPECTIVE APPLICATION

On January 1, 2016, Washington Electric Cooperative Inc. changed its method of accounting for debt issue costs to conform with ASU 2015-03, effective for fiscal years beginning after December 15, 2015. The change was adopted retroactively. Under the new accounting method, the entity must now report their debt costs net of debt issue costs, increase the effective interest rate. As a result, the cumulative effect of applying the method, the following amounts increased/(decreased):

	<u>2016</u>	<u>2015</u>
Deferred Charges	\$ <u>(68,695)</u>	\$ <u>(49,863)</u>
Long-Term Debt	\$ <u>(68,695)</u>	\$ <u>(49,863)</u>

NOTE 5 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 12, 2017. 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, 2016 was 2.5%. The available balance on the note was \$2,600,000 at year end.

NOTE 6 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.

Washington Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 6 PENSION PLAN (continued)

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 Cooperative's contributions to the RS Plan in 2016 and 2015 represented less than 5 percent of the total contributions made to the RS plan by all participating employers. WEC made contributions to the RS Plan of \$523,040 in 2016 and \$496,137 in 2015. There have been no significant changes that affect the comparability of 2016 and 2015 contributions. Pension expense for the prior service costs was \$8,172 in 2016 and 2015.

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, the RS Plan was over 80 percent funded on January 1, 2016 and over 80 percent funded on January 1, 2015 based on the PPA funding target and PPA actuarial value of assets on those dates.

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.

At the December 2012 meeting of the I&FS Committee of the NRECA Board of Directors, the Committee approved an option to allow participating cooperatives in the RS Plan to make a contribution prepayment and reduce future required contributions. The prepayment amount is a cooperative's share, as of January 1, 2013, of future contributions required to fund the RS Plan's unfunded value of benefits earned to date using RS Plan actuarial valuation assumptions. The prepayment amount will typically equal approximately 2.5 times a cooperative's annual RS Plan required contribution as of January 1, 2013. After making the prepayment, for most cooperatives the billing rate is reduced by approximately 25%, retroactive to January 1, 2013. The 25% differential in billing rates is expected to continue for approximately 15 years. However, changes in interest rates, asset returns and other plan experience different from expected, plan assumption changes and other factors may have an impact on the amount and duration of the differential in billing rates. The prepayment, which is included in deferred charges on the balance sheet, was made by the Cooperative during 2013 for \$1,694,453 and is being amortized over a 13 year period. On June 28, 2013, the Vermont Public Service Board authorized the financing of the pension prepayment in Docket #8062.

Washington Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 7 COMMITMENTS AND CONTINGENCIES

Rate Increase & Revenue Deferral Request

The Cooperative filed with the Vermont Public Service Board (PSB) in November 2016 for an across the board increase in its retail rates in the amount of 6.52%. Docket No. 8877 was opened by the PSB and a decision is expected to be reached in early 2017. The Cooperative is allowed to increase its rates 45 days after the filing, and therefore new rates went into effect as a temporary surcharge on January 1, 2017 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. On February 6, 2017, the Cooperative filed for a modification to the existing rate increase filing, seeking an Accounting Order to defer \$400,000 in REC Revenues from 2016 into 2017 that are in excess of what is needed to meet lender ratio requirements. Coupled with this request, WEC would agree to reduce the current rate increase to 5.95%. In the event the final order approves the amended filing, the Cooperative will refund to members excess amounts collected.

Integrated Resource Plan

Pursuant to 30 V.S.A. §218c each Vermont regulated electric utility is required to prepare and implement a least cost integrated plan (also called an integrated resource plan or IRP) for provision of energy services to its Vermont customers. The Comprehensive Energy Plan and Public Service Board ("PSB" or "Board") Orders outline requirements that a distribution utility's complete IRP should meet in order to obtain the DPS's and Board's approval. The IRP process and the implementation of each Vermont utility's approved plan are intended to meet the public's need for energy services, after safety concerns are addressed, at the lowest present value life cycle cost, including environmental and economic costs, through a strategy combining investments and expenditures on energy supply, transmission and distribution capacity, transmission and distribution efficiency, and comprehensive energy efficiency programs. (30 V.S.A. §218c). The cost and benefit factors to be considered include both direct monetary costs and benefits, and indirect impacts such as environmental and other societal effects. The timing for filing a utility's IRP is based on a three year statutory requirement.

The IRP projects the Cooperative's load, power supply requirements and electrical infrastructure needs. It is used to identify committed and preferred resource options for the future, including demand-side management resources and renewable sources of power such as increased Coventry Project power and Sheffield wind power. The IRP also includes information relative to WEC's transmission and distribution planning. It identifies where investments and upgrade work are needed on the WEC electric system for delivery of power to its members. The 2005 IRP supported the need for the Coventry (Methane Generation) Project, discussed below, which came online in July 2005.

The Cooperative filed an updated 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.

WEC filed a new IRP on December 6, 2013 and an amended IRP on March 21, 2014 to comply with a memorandum of understanding reached with the DPS. WEC's 2014 IRP was approved by the PSB in December 2014. In the IRP, WEC demonstrated that it is projected to have sufficient sources of power from contracts and owned generation to meet its projected power supply needs for the next 20 years. WEC also noted that it is well positioned to meet various renewable energy goals and targets which are outlined in the State's Comprehensive Energy Plan, based on its current resource mix. WEC's next IRP is due March 31, 2017. Work is underway on this effort including analysis, report writing, and communicating report contents with the WEC Board of Directors.

Washington Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 7 COMMITMENTS AND CONTINGENCIES (continued)

Energy Efficiency Utility

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" in coordination with 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, 2016 and 2015 the total collected from the Cooperative's members was approximately \$861,895 and \$802,327, respectively. This amount is forwarded to a fiscal agent selected by the PSB and is not revenue to the Cooperative.

Power Contracts

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 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. The contract went into effect in November 2016 and all power is being transferred to VEC. WEC does not project to have a need to take power from the contract in the upcoming year. Therefore, WEC will bill VEC for the power which effectively negates its use to serve WEC load in WEC's power supply mix.

Net Metering Act 99

The Vermont legislature passed sweeping changes to net metering laws through Act 99 in 2014. As part of the legislation, the PSB issued a draft rule in 2016 requiring all Vermont electric utilities to issue new net metering tariffs. The tariff changes affect existing net metering systems and new systems installed after January 1, 2017. The PSB issued an order in August 2016 summarizing changes to the net metering program as a result of the legislative directive from Act 99. WEC filed its Net Metering tariff in October 2016 to comply with the new net metering rules. It amended this filing in January 2017 based on feedback from the PSB to WEC's October filing. In its tariff WEC converted its Grid Service Fee plan participants (those members with net metered generation installed after July 2014) to its Legacy plan structure to comply with the PSB rule making. After 10 years of operation, all pre-existing system (those installed prior to January 1, 2017) will be paid the statewide blended rate per the new PSB rules. Prior to this 10 year anniversary they will be paid at WEC's highest energy block rate in its retail rate design.

WEC currently has 255 members totaling 1,661 kW of generation capacity signed up under the existing net metering programs, which represents approximately 11% of WEC's 2016 retail peak load level. The amount of energy produced from net metered systems equals roughly 2.6% of WEC's 2016 annual retail sales.

Washington Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 7 COMMITMENTS AND CONTINGENCIES (continued)

Renewable Energy Standard Act 56

Act 56 of 2015 created a Renewable Energy Standard (RES) for Vermont electric utilities that requires renewable energy totaling 55% of retail electric sales in 2017, with that requirement growing 4% every three years to 75% in 2032 (Tier 1). Of these renewable resources, some (1% of retail sales in 2017, growing to 10% in 2032) are required to be new, small, distributed generators connected to Vermont's distribution grid (Tier 2). The Act also requires utilities to assist their customers in reducing fossil fuel consumption from non-electric related use (Tier 3).

WEC maintains a portfolio that is 100% renewable and therefore it has met the RES 55% renewable goals for 2017 (Tier 1). More significantly, WEC has already exceeded the state goal of 75% renewable by 2032 with its existing (2016) mix of energy sources. WEC is a leader in renewable energy and one of only a few utilities in the nation that can boast a 100% renewable power supply mix. Therefore, WEC does not need to change or plan for new sources of power to meet the State's RES Tier 1 requirement.

In March 2016, WEC petitioned the PSB in Docket 8550 for a determination that it qualifies as a retail electricity provider meeting the conditions in 30 VSA 8005 (b)(1)(A) which allows it to satisfy the distributed generation requirement of Tier 2 by accepting net metering systems within its service territory. The PSB approved this petition and WEC was granted the determination that it qualified as a 100% renewable retail electric provider (Docket 8714).

As noted above, Tier 2 requires electric providers to have distributive renewable generation comprising at least one percent of its annual retail sales for the year beginning January 1, 2017. WEC's renewable determination by the Board enables WEC to satisfy Tier 2 requirements by accepting net metering systems within its service territory. Therefore, WEC is not exempt from offering net metering as a renewable energy provider. Rather, it must offer net metering, but its members are not required to achieve the annual energy targets set forth in Tier 2; WEC is relieved of the requirement to provide that 1% of its annual sales are provided by new net metering due to its 100% renewable status. Currently WEC has 1,661 kW of distributed generation system installed in its service territory. This equates to an amount of energy produced from net metered systems of roughly 2.6% of WEC's 2016 annual retail sales.

Tier 3 or what has been referred to as the energy transformation Tier, focuses on efforts that switch members away from fossil fuels in transportation and heating use to non-fossil fuel. All utilities were required to create a plan to meet their Tier 3 obligations. WEC's Annual Plan addresses its strategy to meet Tier 3 compliance obligation for 2017 and has been filed with the PSB. WEC will offer a suite of energy transformation measures that have been screened and vetted through the Technical Advisory Group (TAG) screening process. However, a fundamental component of WEC's plan is to emphasize and match TAG screened measures with heightened weatherization efforts.

Washington Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 7 COMMITMENTS AND CONTINGENCIES (continued)

Implementation of the projects described in WEC's Annual Plan will be closely coordinated with Vermont Energy Investment Corporation (VEIC) as the administrator of Efficiency Vermont, the statewide energy efficiency utility (EEU). In addition, coordination of data collection, management, reporting, and evaluation and verification activities will be maximized to the extent possible with protocols and schedules already in place for WEC and Efficiency Vermont. In cases where entities other than VEIC and its subcontractors deliver WEC Tier 3 programs and services independently, WEC will ensure coordination of data collection and reporting to provide a single deliverable to regulators. WEC's plan includes the coordinated use of member and supply-side incentives, standards for measuring performance, and methods to allocate savings and reductions in fossil fuel consumption and greenhouse gas emissions among VEIC and WEC with a strong emphasis on weatherization. The foundation of WEC's Tier 3 program is found in statute, V.S.A. Title 10 § 581. Vermont has an aggressive policy goal of weatherizing 80,000 existing residences by 2020; WEC's Tier 3 program is, in part, intended to assist members to reduce the fossil fuels used today, as well as increase comfort and indoor air quality through comprehensive thermal energy improvements.

Vermont's RES establishes a required amount for Tier 3 compliance of 2% of a utility's annual retail sales in 2017, increasing by two-thirds of a percent each year and reaching 12% in 2032. WEC's first year compliance target is 1,394 MWH. Adding a ten percent buffer to this estimate for planning purposes gives WEC a year one target of 1,533 MWH. The "maximum investment" (alternate compliance payment/ACP) represents the Co-op's internal maximum potential investment to achieve a particular goal of fossil fuel reduction among its members. With a first year budget of \$48,000, this equates to a cost equivalent of 3.4¢ per kWh (compared to the ACP of 6¢ per kWh).

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.

NOTE 8 COMMITMENTS AND CONTINGENCIES - POWER SUPPLY

Coventry Methane Generation Project

The Cooperative owns and CCEC 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 nameplate 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.

Washington Electric Cooperative, Inc.
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2016

NOTE 8 COMMITMENTS AND CONTINGENCIES - POWER SUPPLY (continued)

The summary of project costs and outstanding notes payable as of December 31, 2016 are:

	<u>Plant Cost</u>	<u>Note Balance</u>
Phase 1 - Initial Construction, Engines 1-3	\$ 8,502,732	\$ 4,950,819
Phase 2 - Engine 4	1,238,397	527,699
Phase 3 - Engine 5 plus building modifications	4,133,419	2,317,174
Systems Upgrades financed with general funds	288,186	-
	<u>\$ 14,162,734</u>	<u>\$ 7,795,692</u>

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

Of the \$14,162,734 plant cost, \$12,174,953 is capitalized to generation plant with the balance included in transmission plant.

In 2016 the Coventry Project provided approximately 66% of the Cooperative's total power supply output which made up 69% of the Cooperative's load requirements as measured by the Independent System Operator of New England (ISO-NE).

In 2016, WEC added a new gas scrubbing system and related upgrades at the plant, referred to as a Siloxane Removal System (SRS). WEC filed for a Certificate of Public Good (CPG) for this work with the PSB pursuant to 30 V.S.A. § 248(j). The Board issued an order in Docket 8721 approving the project in May 2016. Subsequent to receiving permission to build the project, WEC filed with the PSB for permission pursuant to 30 V.S.A. § 108 for approval to finance the project in the amount of \$1,712,366 using United States Department of Treasury's New Clean Renewable Energy Bonds (NCREB). The Board approved financing in August 2016. The SRS is intended to remove siloxanes, which reduces the concentration of contaminants in the landfill gas. The buildup of siloxane compounds within the engines causes destructive detonation and inefficient operation of the engines causing additional maintenance and engine downtime. The removal of the siloxane compounds will improve engine availability and increase electricity production. The amount listed under Restricted Cash on the Balance Sheet is associated with the CREBs financing for the SRS project. In accordance with the CREBs financing requirements, this restricted cash is committed to the SRS project. The project has been successfully installed and is operating as of January 2017. Final payment on the project is expected to be made in March 2017.

Washington Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 8 COMMITMENTS AND CONTINGENCIES - POWER SUPPLY (continued)

CCEC has a Landfill Gas Project Agreement with Innovative Energy Systems, Inc. (IES), (a subsidiary of Aria Energy with corporate headquarters in Novi, Michigan). WEC and IES entered a revised O&M contract which was signed in December 2016. The new contract assures continuity of operations at the plant. The contract term is for 15 years, from May 2015 through May 2029. As part of the negotiations to extend operation and maintenance (O&M) services with Aria and due to unexpected higher maintenance costs currently experienced at the plant, CCEC began to pay increased fees for O&M services effective May 2015. The new agreement codifies this arrangement. Services provided by Aria include day-to-day management, operation, maintenance, plant repair, monitoring and adjustment of the gas collection system. At December 31, 2016 and 2015 the amount included in expense was \$1,480,147 and \$1,540,677, respectively.

Wrightsville Hydro

The Cooperative also owns and operates the Wrightsville Hydroelectric Generation Station in Montpelier, Vermont, a largely run-of-the-river project that has a nameplate capacity of 1,000 kW, though it provides significantly less average output because it is dependent on precipitation and weather conditions during the year. Operating costs were \$131,518 and \$101,559 at December 31, 2016 and 2015, respectively. Fixed costs were \$93,645 and \$93,445 over that same period, respectively. All debt associated with this station has been paid in full as of December 31, 2014.

In March 2016, WEC successfully converted the hydro unit's status at the ISO-NE from a generator to a load reducer. As a load reducer the production from Wrightsville goes directly toward lowering WEC's load with the ISO-NE. The unit is no longer seen by the ISO-NE as a generator and is instead used to reduce WEC's load obligation. This change saves WEC in ancillary market costs, capacity costs, reserves and many other expenses assessed to load by the ISO-NE. We continue to record generation monthly for internal tracking and adjust load internally as if the generator were not a load reducer. This allows us to measure and track WEC's total member load for planning purposes.

The Wrightsville Hydro facility was issued a 40-year license by the Federal Energy Regulatory Commission (FERC) on November 23, 1982 (FERC No. 5124 also known as North Branch No. 3 Hydroelectric Project). At the time of the license, the Project was owned by the Montpelier Hydroelectric Company; it was later transferred to the Washington Electric Cooperative, Inc. (WEC) on June 30, 1983. The current license expires on October 31, 2022. As a result, WEC must file its Notice of Intent (NOI) and Pre-Application Document (PAD) between May 1, 2017 and October 31, 2017).

WEC is exploring and researching the requirements and options to renew the license. A preliminary meeting was held with Vermont Agency of Natural Resources (VANR). WEC is discussing plans and FERC requirements with technical experts to help guide WEC through the process. Based on initial discussions with and information from FERC and VANR, the license renewal process will be complex and entail many requirements and studies.

Following an initial meeting with VANR in December 2016, which was held to identify potential studies required to license the project, the state noted that they will likely request at least four studies.

Washington Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 8 COMMITMENTS AND CONTINGENCIES - POWER SUPPLY (continued)

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") and is now part of SunEdison, 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 10% of WEC's total power supply in 2016 and served roughly 11% of WEC's load needs.

WEC is a counterparty to a Purchase Power Agreement (as amended) with Vermont Wind, LLC. This contract was sold or assigned to TerraForm Power, Inc. (TERP) which is a subsidiary or yieldco of SunEdison Inc. In April 2016 TerraForm Power, Inc.'s parent company, SunEdison, Inc., filed for bankruptcy protection. TerraForm Power continues to perform as agreed under the PPA, however, WEC was concerned about the risk that TerraForm could fail to perform due to the bankruptcy and the potential adverse impact it may have on TERP's capability to meet its financial commitments under the Power Purchase Agreement.

WEC retained outside assistance to analyze TERP's current financial condition and its longer term financial viability to perform under the PPA, and to assess TERP's capacity to provide financial security in the event WEC seeks to proceed with a performance guarantee request. Based on a review of financial data, the consultant reported that "WEC faces a de-minimis risk of a TERP PPA default arising as a result of the SunEdison bankruptcy". The consultant's opinion is that large sophisticated investors see value in TerraForm and are buying large blocks of the Class A stock and are trying to buy SunEdison's Class B controlling shares that will be let for bid soon. TERP's stock price continues to rise and it continues to perform under the terms of the contract. WEC will continue to monitor the situation and stay apprised of TERP's financial condition.

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 14% of WEC's total power supply in 2016 and served roughly 14% 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. With the end of the HQ Vermont Joint Owners contract, WEC replaced the power with a new contract from HQ.

Washington Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 8 COMMITMENTS AND CONTINGENCIES - POWER SUPPLY (continued)

WEC, along with other Vermont utilities, petitioned the Vermont Public Service Board in 2010 in Docket 7670 to approve various agreements related to obtaining power from H.Q. Energy Services (US) Inc. through a Purchase Power Agreement (HQUS PPA). WEC is participating as a buyer of power under the Vermont Public Power Supply Authority (VPPSA), through a sub-allocation arrangement. WEC will be allocated energy products from the HQUS PPA through VPPSA in the amount of 4 MW from November 1, 2016 through October 31, 2038.

The energy from this contract will be delivered 7 days a week from hour ending 08:00 to hour ending 23:00 on a firm basis through an Internal Bilateral Transaction (IBT) settled through the ISO-NE markets. There is no capacity accompanying the energy, but environmental attributes will be delivered with a minimum guarantee that 90% of the power will come from hydro resources.

WEC has a contract entitlement from this resource of up to 4 MW. Currently WEC assigns this power to Vermont Electric Cooperative (VEC) through a sleeve arrangement. Starting on November 1, 2016, WEC is contractually required to take back this power to meet its load if its other committed resources are insufficient. The amount of power WEC must take is specified by a formulaic process in the sleeve agreement. This agreement states:

- WEC must begin to take power back from VEC with a one year notice period if its coverage ratio falls below 97% over the preceding prior 12 month period.
- The amount of power WEC takes back is defined by formula which includes a coverage band tied to the amount of power needed to bring WEC's coverage ratio to 100%.
- Once WEC takes power back, it must retain that power through the end of the contract term in 2038.
- WEC can temporarily take back power in the event of an unplanned outage from an existing resource.

Twelve months after the month the coverage ratio falls below 97%, WEC will begin to take back power up to the amount of the energy deficit for the current month, provided the desired amount of energy falls between the coverage ratio limits. If it falls outside these limits, then the amount WEC will take reflects the coverage band lower or upper bound. Once WEC takes back a certain amount of power, that amount will remain in the WEC resource portfolio.

Highgate Converter Station (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. The total costs were \$8,576 and \$8,034 at December 31, 2016 and 2015, respectively. These amounts are included in the total cost above for the Schedule B take or pay costs.

Washington Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 8 COMMITMENTS AND CONTINGENCIES – POWER SUPPLY (continued)

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 \$377,140 in 2016 and \$393,324 in 2015. The Cooperative's costs are expected to decrease moderately through time for VEPPI resources as contracts expire. The contract for the largest VEPPI unit (Ryegate), which accounts for roughly half of the VEPPI power, expired in October 2012. However in 2011 lawmakers through Act 471 mandated the establishment of a standard offer price for certain baseload renewable power. In an Order dated October 29, 2012, the PSB established a standard-offer price schedule for baseload renewable power (Ryegate biomass facility) that is represented by a levelized price of \$0.10 per kWh and that included a fuel pass-through mechanism, by which the price will be adjusted to reflect changes in Ryegate's fuel costs. The new contract began November 2012 at the termination of Ryegate's Rule 4.100 contract. The new contract for Ryegate is in effect for ten years from November 2012 through October 2022. WEC is currently being allocated roughly 1.3% 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.

GMP System Power Rate W

WEC is provided a small portion of power to serve its Jones Brook circuit from GMP, purchased under GMP FERC-administered Wholesale Rate W tariff. The billing is determined monthly and is based on WEC load metered at GMP's Berlin substation. In August 2016, WEC successfully converted this load from a wholesale energy supply rate that was charging a premium to serve the load to a transmission rate under GMP's Open Access Transmission Tariff. The result of this change in tariff is a savings to the Coop.

Standard Offer Resources

Standard Offer is a feed-in like tariff program for developers, available under the auspices of the PSB, and authorized by the Vermont legislature, through various PSB dockets (#7523 and #7533). The Cooperative has one such Standard Offer facility on its distribution system, a 2.1 MW photovoltaic (PV) project in Williamstown. WEC does not take power from this facility. Another 2.2 MW photovoltaic project was approved by the PSB and is now interconnected to the Cooperative's sub-transmission line in Coventry. WEC plans to institute an Open Access Transmission Tariff for wheeling power from projects connected to its sub-transmission lines to the VELCO grid and to charge for that service.

VELCO

The Cooperative has entered into contracts with the Vermont Electric Power Company, Inc. (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 in 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.

Washington Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 8 COMMITMENTS AND CONTINGENCIES – POWER SUPPLY (continued)

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 \$747,230 in Vermont Transco equity units in 2016. There were no equity calls in 2015. Over the next five years, Vermont Transco, LLC, anticipates additional collateral calls. The Cooperatives' estimated investment would be nearly \$1.3 million over this period

In 2012, the PSB approved the merger of Central Vermont Public Service (CVPS) and Green Mountain Power (GMP). 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.

Through its joint ownership in VELCO and under the Cooperative's participation in the 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, 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.

Washington Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 8 COMMITMENTS AND CONTINGENCIES – POWER SUPPLY (continued)

In 2016 the Cooperative's energy settlement load obligation with the ISO-NE was 76,762,851 kWh (this value represents the Cooperative's retail sales, distribution and transmission losses, unbilled accounts, and internal generation). To hedge its load obligation the Cooperative's power sources in 2016 totaled 81,087,128 kWh. The following table summarizes the Cooperative's sources of power:

	2016			2015	
	kWh	Percentage		kWh	Percentage
VDPS - NYPA	11,017,802	13.59 %		10,401,850	10.81 %
Hydro - Quebec	-	-		14,097,420	14.65 %
Small Power Producers & Ryegate	3,552,168	4.38 %		3,556,729	3.70 %
Wrightsville	2,228,396	2.75 %		2,569,597	2.67 %
GMP Rate W - Jones Brook	272,100	0.34 %		534,300	0.56 %
Coventry Clean Energy Corporation	53,156,651	65.55 %		56,325,531	58.53 %
Sheffield Wind	8,156,011	10.06 %		8,751,614	9.09 %
Market Purchases	<u>2,704,000</u>	<u>3.33 %</u>		-	-
	81,087,128	100.00 %		96,237,041	100.00 %
Load Obligation	<u>76,762,851</u>			<u>77,007,769</u>	
Excess Resources	<u><u>4,324,277</u></u>			<u><u>19,229,272</u></u>	

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 energy and other market products produced from a power plant. RECs are directly associated with the generation of electricity produced or purchased by the Cooperative from qualified resources, particularly the Coventry Project and the Sheffield wind project.

NOTE 9 RENEWABLE ENERGY CERTIFICATES

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. The Cooperative's Board has adopted a portfolio strategy for sale of RECs and RECs are being sold to multiple buyers for varying terms.

At December 31, 2016 and 2015 the Cooperative recorded REC revenue of \$3,085,294 and \$2,917,628, respectively. There was \$714,079 and \$682,848 in REC receivables at December 31, 2016 and 2015, respectively. WEC anticipates approval of the Accounting Order request to defer \$400,000 of 2016 REC revenues, and has recorded the regulatory liability in these financial statements.

Washington Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 9 RENEWABLE ENERGY CERTIFICATES (continued)

WEC sells Class 1 RECs from various resources in its power portfolio, and therefore renewability attributes of those resources (such as wind and landfill gas) are transferred to buyers. In order to restore the renewable quality of its portfolio, WEC purchases lower cost RECs in various Class 2 markets in New England. This allows WEC to retain and claim renewability of the power mix to serve WEC load. WEC only purchases the number of RECs it needs to meet its retail load. WEC has more Class 1 RECs to sell than are needed for load, and therefore WEC purchases fewer Class 2 RECs than it sells in the Class 1 markets.

NOTE 10 BANK DEPOSITS IN EXCESS OF INSURED LIMITS

At December 31, 2016 the Cooperative had cash balances of 1,202,244 of which \$523,342 is insured by FDIC, \$655,793 is insured by a repurchase agreement and \$23,109 is offset by debt. The Cooperative mitigates the exposure of uninsured cash 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.

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 replaced 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 and ending in December 2016. The amortization of the loss was \$74,900 in both 2016 and 2015.

NOTE 12 DECEMBER 2014 STORM COSTS

The Cooperative was impacted by an unprecedented winter storm in December 2014. Heavy wet snow loading brought down trees and power lines. The conditions caused widespread outages, and some of the Cooperative's members suffered from multi-day long interruptions in service. Restoration efforts took over 10 days. Permanent repairs continued into 2015.

The storm resulted in restoration costs impacting the income statement totaling \$640,837. The storm's impact on the state of Vermont was recognized by the Federal Emergency Management Agency (FEMA) as a national disaster and was declared eligible for public assistance on February 3, 2015. The Cooperative's FEMA reimbursement of eligible expenses is estimated to be 75% of the storm restoration expenses but only for two out of the four counties the Cooperative serves. The Cooperative recorded an estimated receivable of \$225,300 from FEMA. The Cooperative received \$365,529 from FEMA in 2015.

Washington Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 12 DECEMBER 2014 STORM COSTS (continued)

On January 27, 2015 the Vermont Public Service Board issued an accounting order allowing for the deferral of storm costs of up to \$526,067. The total amount deferred as of December 31, 2014, net of the receivable, is \$225,767 and is categorized as a deferred regulatory asset for future rate recovery and amortization. The funds received from FEMA in 2015 in excess of the estimated receivable were used to offset a portion of the deferral. The remaining \$85,537 balance of the deferral was amortized to the income statement in 2015.

NOTE 13 SUBSEQUENT EVENTS

In accordance with professional accounting standards, the Cooperative has evaluated subsequent events through February 21, 2017, which is the date the financial statements were available to be issued. All subsequent events requiring recognition as of December 31, 2016, have been incorporated into the financial statements herein.

SUPPLEMENTARY INFORMATION

Washington Electric Cooperative Inc. and Affiliate
CONSOLIDATING BALANCE SHEETS
December 31, 2016

	<u>ASSETS</u>			
	<u>WEC</u>	<u>CCEC</u>	<u>Eliminations</u>	<u>Total</u>
ELECTRIC PLANT, at cost	\$ 76,719,648	\$ 562,270	\$ -	\$ 77,281,918
Less accumulated depreciation	<u>(28,342,040)</u>	<u>(319,515)</u>	-	<u>(28,661,555)</u>
Electric plant in service, net	48,377,608	242,755	-	48,620,363
Construction work in progress	<u>1,788,613</u>	-	-	<u>1,788,613</u>
TOTAL ELECTRIC PLANT, net	<u>50,166,221</u>	<u>242,755</u>	-	<u>50,408,976</u>
 CURRENT ASSETS				
Cash	632,741	21,280	-	654,021
Restricted cash	509,279	-	-	509,279
Receivables -				
Notes, less allowance for doubtful accounts of \$1,500 in 2016 and 2015	99	-	-	99
Accounts, less allowance for doubtful accounts of \$47,470 and \$30,500 in 2016 and 2015	1,413,232	108,024	(275,862)	1,245,394
Renewable energy certificate revenue	714,079	-	-	714,079
Miscellaneous	320,114	-	-	320,114
Unbilled revenue	766,094	-	-	766,094
Inventories	275,665	-	-	275,665
Prepaid corporate taxes	-	33,647	-	33,647
Prepaid expenses	<u>276,846</u>	-	-	<u>276,846</u>
TOTAL CURRENT ASSETS	<u>4,908,149</u>	<u>162,951</u>	<u>(275,862)</u>	<u>4,795,238</u>
 OTHER ASSETS				
Other investments	7,805,382	-	(237,868)	7,567,514
Deferred charges	<u>1,196,475</u>	-	-	<u>1,196,475</u>
TOTAL OTHER ASSETS	<u>9,001,857</u>	-	<u>(237,868)</u>	<u>8,763,989</u>
 TOTAL ASSETS	 <u>\$ 64,076,227</u>	 <u>\$ 405,706</u>	 <u>\$ (513,730)</u>	 <u>\$ 63,968,203</u>

LIABILITIES AND EQUITY

	<u>WEC</u>	<u>CCEC</u>	<u>Eliminations</u>	<u>Total</u>
EQUITIES				
Memberships issued and subscribed	\$ 135,435	\$ -	\$ -	\$ 135,435
Patronage capital assignable	1,420,798	92,892	(92,892)	1,420,798
Patronage capital credits	21,834,028	139,976	(139,976)	21,834,028
Donated capital	<u>255,104</u>	<u>5,000</u>	<u>(5,000)</u>	<u>255,104</u>
NET EQUITY	<u>23,645,365</u>	<u>237,868</u>	<u>(237,868)</u>	<u>23,645,365</u>
LONG-TERM DEBT	<u>35,063,510</u>	<u>-</u>	<u>-</u>	<u>35,063,510</u>
CURRENT LIABILITIES				
Current portion of long-term debt	2,219,526	-	-	2,219,526
Accounts payable	1,571,872	167,838	(275,862)	1,463,848
Customer deposits	213,152	-	-	213,152
Other accrued expenses	796,774	-	-	796,774
Deferred renewable energy certificate revenue	<u>400,000</u>	<u>-</u>	<u>-</u>	<u>400,000</u>
TOTAL CURRENT LIABILITIES	<u>5,201,324</u>	<u>167,838</u>	<u>(275,862)</u>	<u>5,093,300</u>
DEFERRED CREDITS	<u>166,028</u>	<u>-</u>	<u>-</u>	<u>166,028</u>
TOTAL LIABILITIES AND EQUITY	<u>\$ 64,076,227</u>	<u>\$ 405,706</u>	<u>\$ (513,730)</u>	<u>\$ 63,968,203</u>

See Accompanying Notes to Financial Statements

Washington Electric Cooperative Inc. and Affiliate
CONSOLIDATING STATEMENTS OF OPERATIONS
For the Year Ended December 31, 2016

	<u>WEC</u>	<u>CCEC</u>	<u>Eliminations</u>	<u>Total</u>
OPERATING REVENUE				
Member revenue retail sales	\$ 13,798,558	\$ 2,170,918	\$ (2,170,918)	\$ 13,798,558
Member revenue REC sales	2,685,294	-	-	2,685,294
Other	<u>503,257</u>	-	<u>(35,946)</u>	<u>467,311</u>
TOTAL OPERATING REVENUE	<u>16,987,109</u>	<u>2,170,918</u>	<u>(2,206,864)</u>	<u>16,951,163</u>
OPERATING EXPENSES				
Purchased power	6,284,580	-	(2,170,918)	4,113,662
Power generation	315,905	1,846,295	(35,946)	2,126,254
Transmission	87,104	-	-	87,104
Distribution:				
Operations, including vehicle depreciation expense of \$137,167 and \$164,220 in 2016 and 2015, respectively	1,765,405	-	-	1,765,405
Maintenance	2,147,093	-	-	2,147,093
Customer accounts	891,806	-	-	891,806
Administrative and general	1,320,316	143,576	-	1,463,892
Depreciation	2,229,014	58,873	-	2,287,887
Taxes	<u>155,928</u>	-	-	<u>155,928</u>
TOTAL OPERATING EXPENSES	<u>15,197,151</u>	<u>2,048,744</u>	<u>(2,206,864)</u>	<u>15,039,031</u>
MARGINS FROM OPERATIONS BEFORE INTEREST CHARGES	<u>1,789,958</u>	<u>122,174</u>	<u>-</u>	<u>1,912,132</u>
INTEREST CHARGES				
Interest on long-term debt	1,357,253	-	-	1,357,253
Other interest	<u>2,581</u>	-	-	<u>2,581</u>
TOTAL INTEREST CHARGES	<u>1,359,834</u>	<u>-</u>	<u>-</u>	<u>1,359,834</u>
MARGINS FROM OPERATIONS	<u>430,124</u>	<u>122,174</u>	<u>-</u>	<u>552,298</u>
OTHER INCOME (EXPENSE)				
Interest and dividend income	798,459	-	-	798,459
Other non-operating income	277,506	-	(92,892)	184,614
Other non-operating expense	(85,291)	-	-	(85,291)
Income taxes	<u>-</u>	<u>(29,282)</u>	<u>-</u>	<u>(29,282)</u>
TOTAL OTHER INCOME (EXPENSE)	<u>990,674</u>	<u>(29,282)</u>	<u>(92,892)</u>	<u>868,500</u>
NET MARGIN	<u>\$ 1,420,798</u>	<u>\$ 92,892</u>	<u>\$ (92,892)</u>	<u>\$ 1,420,798</u>

See Accompanying Notes to Financial Statements

ADDITIONAL REPORTS



Kittell Branagan & Sargent

Certified Public Accountants

Vermont License #167

Report 1

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, 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., which comprise the statement of financial position as of December 31, 2016, and the related statements of operations, equities, and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated February 21, 2017.

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 opinion 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.

Kittie Branagan + Sargent

St. Albans, Vermont
February 21, 2017