

WASHINGTON ELECTRIC COOPERATIVE, INC.

**FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009
AND
INDEPENDENT AUDITOR'S REPORTS**

WASHINGTON ELECTRIC COOPERATIVE, INC.

DECEMBER 31, 2010 AND 2009

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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, 2010 and 2009 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, 2010 and 2009, 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 16, 2011, on our consideration of Washington Electric Cooperative Inc.'s internal control over financial reporting and 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 16, 2011

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

WASHINGTON ELECTRIC COOPERATIVE, INC.
BALANCE SHEETS
DECEMBER 31, 2010 AND 2009
(Page 1 of 2)

<u>ASSETS</u>	<u>2010</u>	<u>2009</u>
Electric plant, at cost:		
Electric plant in service	\$ 65,366,026	\$ 63,296,613
Less accumulated depreciation	<u>20,032,169</u>	<u>18,546,103</u>
Net electric plant in service	45,333,857	44,750,510
Construction work in progress	<u>981,884</u>	<u>1,188,225</u>
Net electric plant	<u>46,315,741</u>	<u>45,938,735</u>
Other assets:		
Restricted cash (Note 6)	338,180	1,907,470
Other investments (Note 2)	<u>5,322,559</u>	<u>4,681,074</u>
Total other assets	<u>5,660,739</u>	<u>6,588,544</u>
Current assets:		
Cash and cash equivalents	553,689	329,570
Receivables -		
Notes, less allowance for doubtful accounts of \$2,000 and \$3,000 in 2010 and 2009	107	1,941
Accounts, less allowance for doubtful accounts of \$23,000 and \$22,000 in 2010 and 2009	1,053,807	855,104
Renewable energy certificate revenue	641,068	1,341,469
Miscellaneous	152,876	114,984
Unbilled revenue	723,541	704,051
Inventories	260,445	304,823
Prepaid expenses	<u>115,200</u>	<u>86,772</u>
Total current assets	<u>3,500,733</u>	<u>3,738,714</u>
Deferred debits, net of amortization	<u>253,360</u>	<u>306,721</u>
Total assets	\$ <u>55,730,573</u>	\$ <u>56,572,714</u>

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

WASHINGTON ELECTRIC COOPERATIVE, INC.
BALANCE SHEETS
DECEMBER 31, 2010 AND 2009
(Page 2 of 2)

	<u>2010</u>	<u>2009</u>
<u>LIABILITIES AND EQUITIES</u>		
Equities:		
Memberships issued and subscribed	\$ 112,865	\$ 108,455
Patronage capital assignable	743,563	654,169
Patronage capital credits	7,215,773	6,821,356
Donated capital	206,334	199,004
Contributions in aid of construction	<u>9,770,647</u>	<u>9,484,262</u>
Net equity	<u>18,049,182</u>	<u>17,267,246</u>
 Long-term debt, excluding current installments (Note 3)	 <u>33,916,169</u>	 <u>32,607,066</u>
Current liabilities:		
Notes payable (Note 4)	316,827	1,378,054
Current installments of long-term debt (Note 3)	1,356,821	1,082,346
Accounts payable	696,469	656,679
Coventry construction accounts payable	-	616,064
Customer deposits	174,196	170,017
Accrued expenses	<u>608,580</u>	<u>504,097</u>
Total current liabilities	<u>3,152,893</u>	<u>4,407,257</u>
 Deferred credits	 <u>612,329</u>	 <u>2,291,145</u>
 Commitments and contingencies (Notes 4, 6, 7, 8, 9 and 10)		
 Total liabilities and equity	 \$ <u>55,730,573</u>	 \$ <u>56,572,714</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, 2010 AND 2009

	<u>2010</u>	<u>2009</u>
OPERATING REVENUE	\$ <u>14,540,934</u>	\$ <u>13,616,575</u>
OPERATING EXPENSES:		
Purchased power	3,372,614	3,180,956
Power generation	1,427,777	1,256,433
Transmission	29,916	22,480
Distribution -		
Operations	1,390,659	1,352,970
Maintenance	1,567,991	1,459,832
Customer accounts	861,394	850,099
Administrative and general	1,442,217	1,345,615
Depreciation	2,197,625	2,022,779
Taxes	336,697	412,454
Other items, net	<u>63,274</u>	<u>63,274</u>
Total operating expenses	<u>12,690,164</u>	<u>11,966,892</u>
 Margins from operations before interest charges	 <u>1,850,770</u>	 <u>1,649,683</u>
INTEREST CHARGES:		
Interest on long-term debt	1,607,057	1,463,722
Other interest	<u>38,137</u>	<u>23,572</u>
Total interest charges	<u>1,645,194</u>	<u>1,487,294</u>
 Margins from operations	 <u>205,576</u>	 <u>162,389</u>
OTHER INCOME (EXPENSE):		
Interest and dividend income	519,853	445,752
Other nonoperating income	38,676	72,222
Other nonoperating expense	(19,653)	(26,066)
Income taxes	<u>(889)</u>	<u>(128)</u>
Total other income	<u>537,987</u>	<u>491,780</u>
 Net margins	 \$ <u>743,563</u>	 \$ <u>654,169</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, 2010 AND 2009

	<u>Memberships</u> Issued and <u>Subscribed</u>	<u>Patronage</u> Capital <u>Assignable</u>	<u>Patronage</u> Capital <u>Credits</u>	<u>Other Equities</u> Donated <u>Capital</u>	<u>Contributions</u> in Aid of <u>Construction</u>
BALANCE, December 31, 2008	\$ 106,530	\$ 615,254	\$ 6,455,940	\$ 189,909	\$ 9,260,560
New memberships issued or subscribed for	11,020	-	-	-	-
Transfers to donated capital	(9,095)	-	-	9,095	-
Transfers to patronage capital credits	-	(615,254)	615,254	-	-
Patronage rebates	-	-	(249,838)	-	-
Net margins for the year	-	654,169	-	-	-
New contributions in aid of construction, net	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>223,702</u>
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	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>286,385</u>
BALANCE, December 31, 2010	\$ <u>112,865</u>	\$ <u>743,563</u>	\$ <u>7,215,773</u>	\$ <u>206,334</u>	\$ <u>9,770,647</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, 2010 AND 2009
(Page 1 of 2)

	<u>2010</u>	<u>2009</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net margins	\$ 743,563	\$ 654,169
Noncash items included in earnings -		
Depreciation	2,197,625	2,022,779
Deferred revenue recognized	(1,735,000)	-
Amortization of deferred charges	36,237	36,237
Loss (Gain) on disposal of assets	-	(36,382)
Restricted cash interest income	(1,690)	(14,035)
Changes in assets and liabilities -		
Decrease (increase) in accounts receivable	(236,595)	128,755
Decrease (increase) in renewable energy certificate revenue receivable	700,401	(44,663)
Decrease (increase) in unbilled revenue	(19,490)	(23,358)
Decrease (increase) in inventories	44,378	(39,876)
Decrease (increase) in prepaid expenses	(28,428)	(8,751)
Decrease (increase) in deferred debits	-	(4,595)
Increase (decrease) in accounts payable	(576,274)	429,344
Increase (decrease) in customer deposits	4,179	11,676
Increase (decrease) in accrued expenses	104,483	21,161
Increase (decrease) in deferred credits	<u>56,184</u>	<u>218,763</u>
Net cash provided by operating activities	<u>1,289,573</u>	<u>3,351,224</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Retirement of notes receivable	1,834	1,758
Proceeds from sale of assets	-	37,798
Additions by construction work in progress	(2,378,794)	(5,514,944)
Additions to electric plant in service	(335,509)	(531,680)
Retirements of electric plant in service	(217,753)	(156,328)
Return of capital	55,289	54,457
Purchase of investments	<u>(696,774)</u>	<u>(694,992)</u>
Net cash used in investing activities	<u>(3,571,707)</u>	<u>(6,803,931)</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, 2010 AND 2009
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	<u>2010</u>	<u>2009</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Contributions in aid of construction (CIAOC)	286,385	223,702
CIAOC from the American Recovery and Reinvestment Act Grant	374,549	-
Memberships issued, net of refunds	11,740	11,020
Patronage rebates	(259,752)	(249,838)
Release of restricted cash	1,770,980	-
Deposits in restricted cash	(200,000)	(1,750,000)
Proceeds from short-term debt	3,210,380	2,730,666
Payments on short-term debt	(4,271,607)	(2,428,170)
Proceeds from Coventry financing	-	2,859,000
Proceeds from long-term debt	2,666,000	2,953,000
Principal payments on long-term debt	<u>(1,082,422)</u>	<u>(1,082,811)</u>
Net cash provided by financing activities	<u>2,506,253</u>	<u>3,266,569</u>
 Net increase (decrease) in cash and cash equivalents	 224,119	 (186,138)
 CASH AND CASH EQUIVALENTS, beginning of year	 <u>329,570</u>	 <u>515,708</u>
 CASH AND CASH EQUIVALENTS, end of year	 \$ <u>553,689</u>	 \$ <u>329,570</u>

SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid during the year for interest	\$ <u>1,607,085</u>	\$ <u>1,487,294</u>
Long-term financing payments of Coventry lines of credit	\$ <u>-</u>	\$ <u>2,847,000</u>

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

WASHINGTON ELECTRIC COOPERATIVE, INC.
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009

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 financial statements.

The tax years ending December 31, 2009, 2008 and 2007 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, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Intangible plant	\$ 609	\$ 609
Generation (hydro) plant	3,731,366	3,731,366
Generation (landfill gas) plant	12,549,518	12,544,674
Transmission plant	2,276,423	2,282,067
Distribution plant	42,442,716	40,525,438
General plant	<u>4,365,394</u>	<u>4,212,459</u>
	<u>\$ 65,366,026</u>	<u>\$ 63,296,613</u>

WASHINGTON ELECTRIC COOPERATIVE, INC.
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009

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, 2010 AND 2009

2. Other investments:

Other investments include the following, at cost, at December 31, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Investments in associated organizations:		
National Rural Utilities Cooperative Finance Corporation (CFC) membership	\$ 1,000	\$ 1,000
CFC capital term certificates	458,174	460,511
CFC patronage capital certificates	113,820	104,879
NISC patronage capital certificates	52,437	49,500
Patronage capital certificates - other Cooperatives	10,656	8,508
Rural Electric Vermont Association membership	497	497
	<u>636,584</u>	<u>624,895</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	1,549,980
Vermont Transco LLC - Class B membership units	2,349,380	1,972,690
Central VT Memorial Civic Center - rural economic develop. loan	121,352	164,216
	<u>4,685,975</u>	<u>4,056,179</u>
	<u>\$ 5,322,559</u>	<u>\$ 4,681,074</u>

3. Long-term debt:

Long-term debt at December 31, 2010 and 2009 consists of the following:

	<u>2010</u>	<u>2009</u>
Mortgage notes payable, U.S. Department of Agriculture (RUS), 35-year terms at the following interest rates:		
5.0% mortgage notes	\$ 16,806,307	\$ 17,309,910
4.125% mortgage note	6,487,610	6,708,750
	<u>23,293,917</u>	<u>24,018,660</u>
Mortgage notes payable, National Rural Utilities Cooperative Finance Corporation (CFC), 35-year terms due between 2011 and 2028 at the following rates of interest:		
Fixed rate mortgage notes, 5.8% to 6.45% due quarterly, variable dates through July 1, 2028	1,960,481	2,080,020
Fixed rate mortgage note, 4.85% due annually through December 31, 2011	21,974	106,551
	<u>1,982,455</u>	<u>2,186,571</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	<u>980,014</u>	<u>1,055,400</u>

WASHINGTON ELECTRIC COOPERATIVE, INC.
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009

3. Long-term debt (continued):

	<u>2010</u>	<u>2009</u>
Mortgage notes payable, Federal Financing Bank (FFB) - at the following due dates and rates of interest: (unadvanced loan funds as of December 31, 2010 and 2009 were \$2,281,000 and \$4,947,000, respectively)		
4.287% to 8.335% advances, matures December 31, 2014	141,252	176,565
4.366% advances, matures December 31, 2033	3,135,000	3,135,000
4.472% advances, matures December 31, 2043	2,953,000	2,953,000
4.272% advances, matures December 31, 2043	1,196,000	-
3.707% advances, matures December 31, 2043	832,000	-
3.328% advances, matures December 31, 2043	<u>638,000</u>	<u>-</u>
	<u>8,895,252</u>	<u>6,264,565</u>
Rural economic development loan, 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	<u>121,352</u>	<u>164,216</u>
	35,272,990	33,689,412
Less current installments	<u>(1,356,821)</u>	<u>(1,082,346)</u>
Long-term debt, excluding current installments	\$ <u>33,916,169</u>	\$ <u>32,607,066</u>

In January 2008, the Cooperative's Board of Directors approved the 2008-2011 Construction Work Plan (CWP) authorizing its submittal to RUS together with a financing application for a Federal Financing Bank (FFB) loan in the amount of \$7.9 million. On February 11, 2009, the Cooperative signed the loan documents. The 2008-2011 Work Plan had an available balance of \$2,281,000 at December 31, 2010. On March 10, 2011, the Cooperative received an advance of \$678,000 on this loan.

The Cooperative also signed on February 11, 2009 loan documents for the \$3.135 million FFB loan used to finance the Coventry fifth engine. The balance of this loan fund was fully drawn in June 2009.

For both 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 CWP loan must be fully paid by December 31, 2043. The Coventry fifth engine loan must be fully paid by December 31, 2033.

On February 8, 2008, the Cooperative received proceeds from the Cooperative Finance Corporation (CFC) issuance of CFC Clean Renewable Energy Bonds (CREBs) for the purpose of financing the cost of installing a fourth engine at the Coventry Generation Plant. The long-term financing note payable of \$1,206,171 net of deferred debit bond costs of \$98,698 was used to pay off the balance of the Coventry fourth engine line of credit on February 12, 2008. The loan is payable to CFC in quarterly level payments from March 2008 through December 2023. The nominal interest rate on the bonds is 0.400% and the effective interest rate is 1.494% per year. The bond costs are amortized over the life of the loan.

In November 1999, the Cooperative obtained a non-interest bearing rural economic development loan from the RUS 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.

WASHINGTON ELECTRIC COOPERATIVE, INC.
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009

3. Long-term debt (continued):

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, 2010:

<u>Year ending December 31,</u>	
2011	\$ 1,356,821
2012	1,375,988
2013	1,418,288
2014	1,431,330
2015	1,431,335
Thereafter	<u>28,259,228</u>
	<u>\$ 35,272,990</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 2010 and 2009.

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 2010 and 2009.

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 16, 2011. 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, 2010 was 4.95%. The available balance on the note was \$2,283,173 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 \$579,296 for 2010 and \$396,523 for 2009. Pension expense for the prior service costs was \$14,580 for 2010 and 2009.

WASHINGTON ELECTRIC COOPERATIVE, INC.
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009

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 Cooperative filed its first IRP in January 1992. As a result of PSB Docket 6290, a new IRP methodology and format was created for all utilities. The Cooperative filed its second IRP with the PSB in October 2003, and approval of the IRP under Docket 6896 was received in June 2005. The 2005 IRP supported the need for the Coventry (Methane Generation) Project, discussed below, which came on-line 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 7432.

In 1999, the Public Service Board 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. In 2003, the "Residential New Construction Program," that had previously been part of the Cooperative's portfolio of services, became the responsibility of the EEU. The Cooperative continues to perform certain services associated with this 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 \$525,437 in 2010 and \$450,338 in 2009. 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 7670 to enter various agreements that will enable it to receive an initial 2.4 MW of power from HQ Energy Services US (HQUS) beginning in November, 2016. The agreements provide for delivery of on-peak energy and associated environmental attributes seven days per week. There are no capacity credits or other ancillary market products included in the contract. The Cooperative intends to obtain its portion of power through the Vermont Public Power Supply Authority (VPPSA). The Cooperative has the ability to increase its block of power from 2.4 MW up to 4.0 MW in the event that not all of the VPPSA participants take their full allocations. In addition, the Cooperative plans to enter 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 the Cooperative expects the PSB to issue its decision in 2011.

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.

WASHINGTON ELECTRIC COOPERATIVE, INC.
NOTES TO FINANCIAL STATEMENTS
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6. Commitments and contingencies (continued):

Contributions in Aid of Construction, PSB Docket No. 7554

In 2009, the Public Service Board 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 Public Service Board 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 Practices 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 at 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%. This is the Cooperative's first rate increase in 11 years and it has been actively communicating with members about the need for a rate increase. 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 is billed for separately until the PSB issues its final order on the rate increase. The Department of Public Service reviewed the filing and has recommended an investigation of the increase. Docket 7691 was opened by the PSB and a decision is expected to be reached by September 2011. 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. The Cooperative manages these risks through commercial insurance packages purchased in the name of the Cooperative.

7. Commitments and contingencies - power supply:

Proposed 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 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 it is projected that the project will begin generating by the end of 2011.

WASHINGTON ELECTRIC COOPERATIVE, INC.
NOTES TO FINANCIAL STATEMENTS
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7. Commitments and contingencies - power supply (continued):

Coventry Methane Generation Project

The Cooperative owns and operates a generating facility powered by landfill gas at the Coventry Landfill in northern Vermont. A set of contractual agreements was executed in October 2003 between a wholly-owned special purpose subsidiary of the Cooperative, the Coventry Clean Energy Corporation (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 related to a generation facility at the Coventry Landfill, now owned and operated by CCEC. Briefly, these agreements provided that: (1) the Cooperative would finance and build the generation and transmission facilities; (2) CCEC would buy the gas collection system from NEWSVT; (3) CCEC would operate the generation facility and transmission interconnection after leasing them from the Cooperative. CCEC would further lease the gas rights and related easements, and the section of the landfill property on which the generation facility is located, from NEWSVT; and, (4) the Cooperative would purchase all the electrical output generated by CCEC (as well as any related renewable energy certificates (RECs), tax credits or other environmental attributes) on behalf of its patrons. These components are collectively referred to as the "Coventry Project".

In January 2005, the Cooperative and CCEC signed the following documents: (1) the Equipment and Facilities Lease whereby the Cooperative leases the generation and transmission interconnection to CCEC for a 33-year term with optional two-year term extensions; (2) the Electric Supply Agreement under which the Cooperative purchases all of the power and output generated by CCEC for a 33-year term with optional two-year term extensions. The Electric Supply Agreement was subsequently modified in January 2006 to eliminate the capacity charge; (3) the Promissory Note in the amount of \$286,675 from the Cooperative to CCEC, which was used by CCEC to purchase the gas collection from NEWSVT and Casella Waste Systems, Inc. under a Facility Acquisition Agreement entered into as of October 3, 2003. The note has an interest rate of 5% and is payable in 30 equal quarterly installments beginning with the first full calendar quarter following the date that CCEC first produces power, and is expected to be retired on schedule in 2013; and, (4) the Security Agreement that grants the Cooperative a security interest in all properties, assets and rights of CCEC.

A fourth engine was added to the initial three engines and went on line in January 2007 increasing the plant's gross rated output to 6.4 MW. The costs were funded by long-term borrowing from CFC, as described in Note 3, under CFC's implementation of the Clean Renewable Energy Bond (CREB) program created under the Energy Tax Incentives Act of 2005.

In June 2009, the Cooperative further increased the gross rated output from the Coventry Project to 8.0 MW by adding a fifth 1.6 MW engine to the facility. The cost of this expansion was approximately \$4.1 million, which also included an expansion of the building as well as improvements to the gas collection system. A portion of the financing, \$3.1 million was approved by the Rural Utilities Service under the terms and conditions of a guaranteed loan to the Cooperative from the Federal Financing Bank, as described in Note 3. The remaining \$1 million is financed from the Cooperative's 2008-2011 Construction Work Plan by reallocating funds previously earmarked for distribution projects to generation assets. The additional financing was necessary to support improvements to the gas collection system and building modifications in order to increase the production of methane at the plant.

WASHINGTON ELECTRIC COOPERATIVE, INC.
NOTES TO FINANCIAL STATEMENTS
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7. Commitments and contingencies - power supply (continued):

The summary of project costs and outstanding notes payable as of December 31, 2010 are:

	<u>Plant Cost</u>	<u>Note Balance</u>
Phase 1 - Initial Construction, Engines 1-3	\$ 8,502,732	\$ 6,487,610
Phase 2 - Engine 4	1,238,397	980,014
Phase 3 - Engine 5 plus building modifications	4,133,419	3,135,000
System Upgrades financed with general funds	<u>248,303</u>	<u>-</u>
	<u>\$ 14,122,851</u>	<u>\$ 10,602,624</u>

Of the \$14,122,851 plant cost, \$12,549,518 is capitalized to generation plant with the balance included in transmission plant.

In 2010 the Coventry Project provided approximately 62% of the Cooperative's total load requirements as measured by the 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 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 \$1,118,403 for 2010 and \$1,160,368 for 2009.

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 \$82,048 in 2010 and \$74,952 in 2009. Fixed costs were \$138,538 in 2010 and \$147,737 in 2009.

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, 2010, are as follows.

NYPA - The Cooperative receives power from the 912 MW 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.

WASHINGTON ELECTRIC COOPERATIVE, INC.
NOTES TO FINANCIAL STATEMENTS
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7. Commitments and contingencies - power supply (continued):

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' 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.

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 \$1,115,187 in 2010 and \$1,134,275 in 2009.

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 2011.

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. The Cooperative continues to pay for the operating and maintenance expenses of the Highgate converter. In 2010, there was a credit of \$21,783 and in 2009 there was a credit of \$28,716. These amounts are included in the total cost above for the Schedule B take or pay costs.

Small Power Producers - Vermont Public Service Board 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 \$566,868 in 2010 and \$552,540 in 2009. The Cooperative's costs are expected to increase moderately, before declining beginning in November 2012. The decline is due to the expiration of the Ryegate facility contract which ends in October 2012. The Rule 4.100 contracts 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.

WASHINGTON ELECTRIC COOPERATIVE, INC.
NOTES TO FINANCIAL STATEMENTS
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7. 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 \$672,660 and \$667,190 in Vermont Transco equity units in 2010, and 2009.

ISO-NE - The Cooperative, like all other utilities in New England, relies upon the Independent System Operator of New England (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 power supply resources are combined in the CDA with other VPPSA participants, and settled as a group by 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. However, the VPPSA CDA does not socialize the group settlement. Rather each utility participant is resettled by VPPSA and allocated costs and credits based on its own loads and resources. 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. The energy markets became locational in March 2003. Since then, generation in New England is paid and receives hourly locational marginal prices (LMPs) for energy production that is based on local supply and demand conditions. Load-serving entities (LSEs) are charged or pay hourly zonal average LMPs for energy and related ancillary products based on the supply and demand conditions within their zone. Since the Cooperative has both generation and load, it receives both credits and charges within the market system.

Vermont is one of multiple zones in the ISO-NE system. New ISO-NE markets and rules continue to develop and undergo implementation. The ISO-NE spot and longer-term markets augment the long-term power supply resources and agreements, and occasional shorter-term bilateral hedge contracts, that have been and are still used by the Cooperative to meet its power requirements. In particular, the Cooperative periodically hedges its market price exposure by contracting bilaterally for installed capacity and energy requirements, or entering into other financial hedges, while the balance of its needs are met with spot purchases and sales. This strategy limits, but does not entirely eliminate, the Cooperative's exposure to short-term market price and short-term and extraordinary fuel price variations. Furthermore, even bilateral or financial hedge contract prices can be subject to some volatility over the year, as they are driven by the

WASHINGTON ELECTRIC COOPERATIVE, INC.
NOTES TO FINANCIAL STATEMENTS
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7. Commitments and contingencies - power supply (continued):

volatile forward market price expectations for electricity and especially the underlying fuels used to generate electricity. However, consistent with its strategy to minimize exposure to volatility, the Cooperative's reliance on ISO-NE spot market purchases has been significantly reduced since the Coventry Landfill Gas Generation Project began operations in July 2005. In fact, since the Coventry Project's fourth engine has been in production, the Cooperative has had a surplus of energy relative to demand on an annual basis, selling back more energy to the spot market than it purchases on an hourly basis.

In 2010 the Cooperative's energy settlement load obligation with the ISO-NE was 77,693,187 kWh (this value represents WEC's retail sales, distribution and transmission losses, and uncollected accounts). To hedge its load obligation the Cooperative's power sources in 2010 totaled 82,329,570 kWh. The following table summarizes WEC's sources of power as follows:

	<u>2010</u>		<u>2009</u>	
	<u>KWH</u>	<u>Percentage</u>	<u>KWH</u>	<u>Percentage</u>
VDPS-NYPA	8,945,249	10.87%	10,866,964	12.58%
Hydro-Quebec	17,339,180	21.06%	16,734,090	19.37%
Small Power Producers	4,254,697	5.17%	4,164,396	4.82%
Wrightsville	2,726,144	3.31%	3,558,301	4.12%
GMP Rate W - Jones Brook	570,100	0.69%	581,400	0.67%
Coventry Clean Energy Corporation	<u>48,494,200</u>	<u>58.90%</u>	<u>50,505,760</u>	<u>58.45%</u>
	82,329,570	<u>100.00%</u>	86,410,911	<u>100.00%</u>
Load Obligation	<u>77,693,186</u>		<u>76,862,355</u>	
Excess Resources	<u>4,628,921</u>		<u>9,548,556</u>	

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.

In late 2004, the Cooperative reached an agreement with the Cape Light Compact of Massachusetts for sale of the RECs from the Coventry facility in 2005-2006, with an option for 2007 and beyond, which Cape Light Compact did exercise. In 2007, the Cooperative and Cape Light Compact entered into a new 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 time required by the NEPOOL Generation Information System (GIS) and RECs market administrator to accurately account for the RECs generated.

WASHINGTON ELECTRIC COOPERATIVE, INC.
NOTES TO FINANCIAL STATEMENTS
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8. Renewable Energy Certificates (continued):

The Cooperative sold \$1,304,017 in 2010 and \$2,600,920 in 2009 in RECs associated with the Coventry facility. There was \$641,068 and \$1,341,469 in REC receivables at December 31, 2010 and December 31, 2009 respectively.

In anticipation of additional generation and RECs resulting from the installation of the fifth engine, the Cooperative and Cape Light Compact reached an agreement in 2009 for sale of any additional RECs above 13,875 MWh per quarter at different terms than for the base output. No sales occurred during 2009 under the new provision. The contract also contains a provision that allows the contract price to be reset in 2010 and/or 2011 if market prices for RECs fall below a specified amount. In 2010, the contract price was reset due to a significant drop in REC market prices. The Cooperative expects the reset provision to be exercised again in 2011 and for there to be an additional decline in REC prices.

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 deferred \$200,000 of the revenue from the sale of REC's in 2009. The Cooperative used \$1,735,000 in previously deferred revenues in 2010 to cover lender requirements. At December 31, 2010 the balance in this restricted account was \$338,180.

9. Bank deposits in excess of insured limits:

At December 31, 2010, the Cooperative had an uninsured/uncollateralized exposure of approximately \$716,000 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, 2010 was approximately \$614,000.

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 match funds from its Construction Work Plan in a like amount over a period of three years. In January 2011 WEC was notified that up to an additional \$1,000,000 in ARRA grant funding would be made available to WEC to deploy its Automatic Meter Infrastructure (AMI) proposal. Pending WEC board approvals, the Cooperative intends to submit a Construction Work Plan to include its AMI proposal, and its associated RUS loan application, to the Vermont Public Service Board in early 2011, and to complete AMI deployment by the end of 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, 2010, and have issued our report thereon dated March 16, 2011. 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

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 16, 2011.

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 16, 2011

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