



Report of Independent Auditors
and Financial Statements for

Orcas Power & Light Cooperative

December 31, 2014 and 2013

MOSS-ADAMS_{LLP}

Certified Public Accountants | Business Consultants

CONTENTS

	PAGE
REPORT OF INDEPENDENT AUDITORS	1-2
FINANCIAL STATEMENTS	
Balance sheets	3-4
Statements of revenues and margins	5
Statements of changes in patronage capital and other equities	6
Statements of cash flows	7
Notes to financial statements	8-16
REPORT REQUIRED BY GOVERNMENT AUDITING STANDARDS	
Report of independent auditors on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with <i>Government Auditing Standards</i>	17-18

REPORT OF INDEPENDENT AUDITORS

To the Board of Directors
Orcas Power & Light Cooperative

Report on Financial Statements

We have audited the accompanying financial statements of Orcas Power & Light Cooperative (the Cooperative), which comprise the balance sheets as of December 31, 2014 and 2013, and the related statements of revenues and margins, changes in patronage capital and other equities, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 Cooperative'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 financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Orcas Power & Light Cooperative as of December 31, 2014 and 2013, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated April 14, 2015, on our consideration of the Cooperative'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 Orcas Power & Light Cooperative's internal control over financial reporting and compliance.

A handwritten signature in cursive script that reads "Mess Adams LLP".

Everett, Washington
April 14, 2015

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ORCAS POWER & LIGHT COOPERATIVE
BALANCE SHEETS

ASSETS

	December 31,	
	<u>2014</u>	<u>2013</u>
UTILITY PLANT, at cost		
Electric plant in service	\$ 91,153,197	\$ 86,319,228
Construction work in progress	<u>5,746,461</u>	<u>2,456,829</u>
	96,899,658	88,776,057
Less accumulated depreciation and amortization	<u>38,650,755</u>	<u>36,237,594</u>
Net utility plant	<u>58,248,903</u>	<u>52,538,463</u>
OTHER PROPERTY AND INVESTMENTS, at cost		
Nonutility property	175,658	499,096
Less accumulated depreciation	<u>100,767</u>	<u>72,823</u>
	74,891	426,273
Investments in associated organizations	<u>1,063,007</u>	<u>941,207</u>
Other property and investments	<u>1,137,898</u>	<u>1,367,480</u>
CURRENT ASSETS		
Cash and cash equivalents	2,254,476	797,873
Cash and cash equivalents - board-designated	1,279,617	2,006,349
Accounts receivable, less allowance for doubtful accounts of \$60,000 in 2014 and 2013	3,036,985	3,146,966
Interest receivable	6,330	7,394
Materials and supplies	2,720,342	2,141,563
Prepaid expenses	<u>586,081</u>	<u>122,451</u>
Total current assets	<u>9,883,831</u>	<u>8,222,596</u>
Total assets	<u>\$ 69,270,632</u>	<u>\$ 62,128,539</u>

ORCAS POWER & LIGHT COOPERATIVE
BALANCE SHEETS

EQUITIES, MARGINS, AND LIABILITIES

	December 31,	
	2014	2013
EQUITIES AND MARGINS		
Memberships	\$ 56,875	\$ 55,650
Patronage capital	36,127,936	37,250,121
Donated and other equities	4,477,381	4,024,445
Total equities and margins	40,662,192	41,330,216
LONG-TERM DEBT, less current maturities		
RUS mortgage notes	22,516,582	14,982,671
CFC mortgage notes	2,468,183	2,575,694
Total long-term debt	24,984,765	17,558,365
CURRENT LIABILITIES		
Accounts payable	1,931,398	1,732,736
Customer deposits	91,717	86,161
Accrued liabilities	751,048	696,742
Current maturities of long-term debt	666,387	555,792
Total current liabilities	3,440,550	3,071,431
DEFERRED CREDITS	183,125	168,527
Total equities, margins, and liabilities	\$ 69,270,632	\$ 62,128,539

ORCAS POWER & LIGHT COOPERATIVE
STATEMENTS OF REVENUES AND MARGINS

	Years Ended December 31,	
	<u>2014</u>	<u>2013</u>
OPERATING REVENUES	<u>\$ 22,029,026</u>	<u>\$ 21,431,277</u>
OPERATING EXPENSES		
Cost of power	8,037,428	7,514,128
Transmission	92,874	70,117
Distribution - operation	2,961,251	2,968,005
Distribution - maintenance	1,799,665	1,669,523
Consumer accounts	898,868	853,211
Administration and general	3,173,939	3,181,858
Depreciation and amortization	2,975,651	2,719,561
Taxes	<u>961,815</u>	<u>930,482</u>
Total operating expenses	<u>20,901,491</u>	<u>19,906,885</u>
Operating margins before fixed charges	1,127,535	1,524,392
FIXED CHARGES		
Interest on long-term debt	<u>908,934</u>	<u>786,193</u>
Operating margins after fixed charges	218,601	738,199
PATRONAGE CAPITAL CREDITS	<u>67,853</u>	<u>38,048</u>
Net operating margins	<u>286,454</u>	<u>776,247</u>
NONOPERATING MARGINS		
Interest income	32,130	33,261
Other income	23,457	46,901
Island Network division, net	<u>(220,088)</u>	<u>115,111</u>
	<u>(164,501)</u>	<u>195,273</u>
NET MARGINS	<u><u>\$ 121,953</u></u>	<u><u>\$ 971,520</u></u>

ORCAS POWER & LIGHT COOPERATIVE
STATEMENTS OF CHANGES IN PATRONAGE CAPITAL AND OTHER EQUITIES

	<u>Memberships</u>	<u>Patronage Capital</u>	<u>Donated and Other Equities</u>	<u>Total</u>
BALANCE, December 31, 2012	\$ 54,795	\$ 37,473,607	\$ 3,643,209	\$ 41,171,611
Increase in memberships, net	855	-	-	855
Net margins	-	971,520	-	971,520
Donated and returned capital	-	-	381,236	381,236
Retirement of capital credits, net	-	<u>(1,195,006)</u>	-	<u>(1,195,006)</u>
BALANCE, December 31, 2013	55,650	37,250,121	4,024,445	41,330,216
Increase in memberships, net	1,225	-	-	1,225
Net margins	-	121,953	-	121,953
Donated and returned capital	-	-	452,936	452,936
Retirement of capital credits, net	-	<u>(1,244,138)</u>	-	<u>(1,244,138)</u>
BALANCE, December 31, 2014	<u>\$ 56,875</u>	<u>\$ 36,127,936</u>	<u>\$ 4,477,381</u>	<u>\$ 40,662,192</u>

ORCAS POWER & LIGHT COOPERATIVE
STATEMENTS OF CASH FLOWS

	Years Ended December 31,	
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net margins	\$ 121,953	\$ 971,520
Adjustments to reconcile net margins to net cash from operating activities		
Depreciation and amortization	2,975,651	2,719,561
Changes in assets and liabilities		
Accounts receivable	109,981	(758,796)
Interest receivable	1,064	(546)
Prepaid expenses	(463,630)	(7,219)
Accounts payable	198,662	435,535
Customer deposits	5,556	9,160
Accrued liabilities	54,306	(157,453)
Deferred credits	14,598	11,414
Net cash from operating activities	<u>3,018,141</u>	<u>3,223,176</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to utility plant, net	(9,831,710)	(5,632,016)
Change in materials and supplies	(578,779)	(638,632)
Change in other property and investments, net	<u>229,582</u>	<u>(185,482)</u>
Net cash from investing activities	<u>(10,180,907)</u>	<u>(6,456,130)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments on long-term debt, net of cushion of credit adjustments	156,995	(1,027,495)
Proceeds from debt	7,380,000	3,200,000
Memberships, net	1,225	855
Retirements of patronage capital	(791,202)	(813,770)
Contributions in aid of construction	<u>1,145,619</u>	<u>583,883</u>
Net cash from financing activities	<u>7,892,637</u>	<u>1,943,473</u>
NET CHANGE IN CASH	729,871	(1,289,481)
CASH AND CASH EQUIVALENTS, beginning of year	<u>2,804,222</u>	<u>4,093,703</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 3,534,093</u>	<u>\$ 2,804,222</u>
SUPPLEMENTAL DISCLOSURES		
Cash paid for interest	<u>\$ 908,934</u>	<u>\$ 786,193</u>

ORCAS POWER & LIGHT COOPERATIVE

NOTES TO FINANCIAL STATEMENTS

Note 1 - Organization and Summary of Significant Accounting Policies

Organization - Orcas Power & Light Cooperative (the Cooperative or OPALCO) is a power distribution and transmission cooperative organized in 1937 under the laws of the state of Washington for the purpose of supplying electric energy to its members. It serves 11,376 memberships, including 12,871 residential meters and 1,987 commercial and industrial meters distributing electricity to 20 islands in the San Juan archipelago.

The Cooperative's board of directors has the authority to set rates and charges for commodities and services furnished. Substantially all revenues are derived from the sale and distribution of electric power. During 2004, Island Network, a division of OPALCO, was created to market the Cooperative's fiber optic interests.

Basis of accounting and presentation - The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as applied to regulated enterprises, which conform to policies prescribed by the United States Department of Agriculture, Rural Utilities Service (RUS).

Utility plant - Plant in service is stated at original cost of construction or acquisition. Cost generally includes materials, labor, and overhead costs. The cost of additions, renewals, and improvements is capitalized. Repairs, maintenance, and minor replacements are charged to operating expense.

When property, which represents a retirement unit, is replaced or removed, the average cost of such property, together with removal cost, less salvage, is charged to accumulated depreciation. Management assesses impairment and the existence of asset retirement obligations annually, or as circumstances warrant. No impairment was recorded as of December 31, 2014 and 2013.

Depreciation rates have been applied on a straight-line basis. Transmission plant is depreciated using a composite rate of 2.75%, except for submarine cable, for which the rate is 2.86%. Distribution plant is depreciated using a composite rate of 3.17%.

General plant depreciation rates are as follows:

Structures and improvements	3.00%
Office furniture and equipment	5.19%
Transportation equipment	20.00%
Tools and equipment	15.00%
Power-operated equipment	30.00%
Communication equipment	10.00% - 20.00%
Other general plant	20.00%
Computer network	20.00% - 33.33%

Cash equivalents - The Cooperative considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. The board of directors of the Cooperative has designated certain amounts of cash and cash equivalents for future use at the board's discretion and approval.

ORCAS POWER & LIGHT COOPERATIVE

NOTES TO FINANCIAL STATEMENTS

Note 1 - Organization and Summary of Significant Accounting Policies (continued)

Accounts receivable - Accounts receivable are recorded when invoices are issued and are written off when they are determined to be uncollectible. Accounts receivable are reviewed for collectibility on a regular basis, and an allowance for doubtful accounts is estimated considering the Cooperative's historical losses and review of specific accounts.

Materials and supplies - The inventory of materials and supplies consists primarily of items for construction and maintenance of electric plant and is valued at average unit cost.

Investments in associated organizations - The Cooperative's investments in associated organizations (Note 3) are stated at cost, plus patronage capital credits issued, less distributions received, in accordance with RUS regulations.

Compensated absences - Employees accrue vacation ratably over the year based on tenure and are allowed to carry over to the following year up to one year of accumulated vacation, which is earned at a rate of 12 to 25 days per year. Employees are compensated for unused vacation pay upon separation from employment. Compensated absences in the amount of \$250,541 and \$218,415 are included in accrued liabilities as of December 31, 2014 and 2013, respectively.

Patronage capital - Net margins are assigned to patrons upon closing of each calendar year. Capital credits of deceased patrons are redeemed on a less-than-full-value basis and paid to the estate of the patron upon approval by the board of directors. In addition, patrons may, at the discretion of the board of directors, receive a less-than-full-value cash settlement when they leave the system. Other capital distributions may be made at the discretion of the board of directors. Capital credits may be applied against delinquent accounts receivable balances upon approval by the board of directors. For the years ended December 31, 2014 and 2013, the board of directors approved a payout based on a 25-year first-in, first-out (FIFO) cycle.

Operating revenue recognition and unbilled revenue - The Cooperative records revenue billed to its members for electrical consumption on a monthly basis based upon monthly meter readings, assessment of base fees, and other monthly charges. The Cooperative estimates and records unbilled revenue from electric power delivered, but not yet billed, for services provided to the end of the year. At December 31, 2014 and 2013, unbilled revenue of \$952,754 and \$868,592, respectively, was included in the accounts receivable balance.

Income tax status - The Cooperative is exempt from income taxes under the provisions of Section 501(c)(12) of the Internal Revenue Code, except to the extent of unrelated business income, if any. The Cooperative follows Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 740-10, *Income Taxes*, which relates to accounting for uncertain tax positions. As of December 31, 2014 and 2013, the Cooperative does not have any uncertain tax positions. The Cooperative files an exempt organization tax return in the U.S. federal jurisdiction and is no longer subject to examination by taxing authorities for periods prior to 2011.

ORCAS POWER & LIGHT COOPERATIVE

NOTES TO FINANCIAL STATEMENTS

Note 1 - Organization and Summary of Significant Accounting Policies (continued)

Use of estimates - In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect certain reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses during the reporting period. These estimates include the allowance for doubtful accounts, unbilled revenue, and depreciation of electric plant. Actual results could differ from those estimates.

Concentration of credit risk - Financial instruments that potentially subject the Cooperative to concentrations of credit risk consist principally of cash and cash equivalents and trade accounts receivable. The Cooperative maintains its cash and cash equivalents in various financial institutions. At times, these balances exceed federally insured limits.

Credit is extended to customers generally without collateral requirements; however, the Cooperative requires deposits from some members upon connection, which is applied to unpaid bills in the event of default. Capital credits may be applied against delinquent accounts, upon approval by the board of directors.

Subsequent events - Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. The Cooperative recognizes in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheets, including the estimates inherent in the process of preparing the financial statements. The Cooperative's financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheets but arose after the balance sheet date and before the financial statements are available to be issued. The Cooperative has evaluated subsequent events through April 14, 2015, which is the date the financial statements are issued.

Note 2 - Electric Plant in Service

Electric plant in service consisted of the following major classes at December 31:

	<u>2014</u>	<u>2013</u>
Generation	\$ 33,163	\$ 47,059
Transmission	16,900,975	16,695,563
Distribution	60,188,087	57,525,668
General plant	12,491,411	11,058,485
Intangible plant	<u>1,539,561</u>	<u>992,453</u>
Total electric plant in service	<u>\$ 91,153,197</u>	<u>\$ 86,319,228</u>

ORCAS POWER & LIGHT COOPERATIVE

NOTES TO FINANCIAL STATEMENTS

Note 2 - Electric Plant in Service (continued)

The Cooperative assesses new members an amount equal to the estimated average cost of initial hookups. These contributions in aid of construction are credited to the appropriate work orders to offset the construction costs and are recorded as a reduction in gross plant in accordance with accounting requirements for RUS borrowers. Contributions in aid of construction in the amount of \$1,145,619 and \$583,883 were recorded during 2014 and 2013, respectively.

Note 3 - Investments in Associated Organizations

Investments in associated organizations consisted of the following as of December 31:

	<u>2014</u>	<u>2013</u>
Capital term certificates of National Rural Utilities Cooperative Finance Corporation (CFC), interest from 3% to 5%, with maturities from 2020 through 2080	\$ 558,274	\$ 558,274
Patronage capital credits in CFC	227,265	220,572
Patronage capital credits in National Information Solutions Cooperative (NISC)	55,190	41,710
Patronage capital in Federated Rural Electric Insurance Exchange	131,945	113,651
Patronage capital - others	<u>90,333</u>	<u>7,000</u>
Total investments in associated organizations	<u>\$ 1,063,007</u>	<u>\$ 941,207</u>

CFC capital term certificates are purchased as a condition of the mortgage agreements with CFC. The certificates are nonmarketable and may not be redeemed prior to maturity.

Note 4 - Cash and Cash Equivalents

The Cooperative holds various cash accounts in the normal conduct of its business. As of December 31, 2014 and 2013, total cash and cash equivalents reported on the balance sheets were as follows:

	<u>2014</u>	<u>2013</u>
Petty cash funds	\$ 600	\$ 600
Cash in FDIC institutions	2,576,717	1,118,882
Cash in CFC commercial paper	805,126	1,533,112
Cash in CoBank	<u>151,650</u>	<u>151,628</u>
	<u>\$ 3,534,093</u>	<u>\$ 2,804,222</u>

ORCAS POWER & LIGHT COOPERATIVE
NOTES TO FINANCIAL STATEMENTS

Note 4 - Cash and Cash Equivalents (continued)

Investments in CFC commercial paper and CoBank are not federally insured; however, these funds are invested in accordance with the Cooperative's investment policy.

Note 5 - Long-Term Debt

The Cooperative has long-term debt due to RUS and CFC. Substantially all assets of the Cooperative are pledged as security for the long-term debt, and the notes are subject to certain covenants. Long-term debt consisted of the following at December 31:

	2014	2013
Mortgages payable to RUS, payable in quarterly installments of approximately \$363,000, including interest at rates ranging from 2.383% to 5.824%, maturing over various periods through January 2046.	\$ 23,237,924	\$ 16,483,340
Mortgages payable to CFC, payable in quarterly installments of approximately \$53,000, including interest at rates ranging from 5.6% to 5.85%, maturing over various periods through 2039.	2,576,009	2,693,387
RUS economic development loan, payable in monthly installments of \$667, bearing 0% interest, maturing in 2019.	72,663	-
RUS cushion of credit	(235,444)	(1,062,570)
	25,651,152	18,114,157
Less current maturities of long-term debt	666,387	555,792
	\$ 24,984,765	\$ 17,558,365

The aggregate long-term debt maturing over the next five years is as follows:

2015	\$ 666,387
2016	464,188
2017	551,246
2018	609,124
2019	589,743
Thereafter	22,770,464
	\$ 25,651,152

ORCAS POWER & LIGHT COOPERATIVE

NOTES TO FINANCIAL STATEMENTS

Note 5 - Long-Term Debt (continued)

Cushion of credit - RUS established a Cushion of Credit Payment Program, whereby borrowers may make advance payments on their RUS debt. These advance payments earn interest at the rate of 5% per annum. The advance payments, plus any accrued interest, can only be used for the payment of principal and interest on the debt. The Cooperative's participation in the Cushion of Credit Payment Program totaled \$235,444 and \$1,062,570 at December 31, 2014 and 2013, respectively, and is recorded as a reduction of RUS long-term debt on the balance sheets.

Economic development loan - In February 2014, the Cooperative was granted a long-term loan through the RUS Rural Electric Development Loan/Grant Program. The loan is in the amount of \$80,000 and bears interest at 0%.

New draws - In January 2014, the Cooperative made two long-term loan advance draws with the RUS in the amounts of \$878,000 and \$1,122,000 at an interest rate of 3.479% and 3.456%, respectively.

In September 2014, the Cooperative made a long-term loan advance draw with the RUS in the amount of \$2,000,000 at an interest rate of 3%.

In November 2014, the Cooperative made two long-term loan advance draws with the RUS in the amounts of \$500,000 and \$1,500,000 at an interest rate of 2.679% and 2.746%, respectively.

In December 2014, the Cooperative made a long-term loan advance draw with the RUS in the amount of \$1,300,000 at an interest rate of 2.56%.

Swaptions - In 2011, the Cooperative entered into two interest rate swaption agreements to hedge the variability of a future interest rate increase greater than 5.5% that would be incurred at the time of future loan draws with RUS. The first swaption agreement had a notional value of \$3,000,000 and expired in March 2012 unexercised. The second swaption agreement had a notional value of \$2,882,000 and expired in March 2013, also unexercised.

Note 6 - Lines of Credit

The Cooperative has an unsecured perpetual line of credit for short-term financing with CFC in the amount of \$10,000,000. Interest on outstanding advances is based upon a variable rate. No amounts were outstanding at December 31, 2014 and 2013.

In January 2011, the Cooperative established a secured line of credit with CFC with an available balance of \$5,000,000 and a draw period end date prior to January 2016. Interest on outstanding advances is based upon a variable rate on the date of the draw. No amounts were outstanding on this line of credit at December 31, 2014 and 2013.

In January 2011, the Cooperative established a new unsecured perpetual line of credit with CoBank in the amount of \$5,000,000. No loan advances have been made on this account during 2014 or 2013.

ORCAS POWER & LIGHT COOPERATIVE

NOTES TO FINANCIAL STATEMENTS

Note 7 - Deferred Credits

As of December 31, 2014 and 2013, amounts carried on the Cooperative's balance sheets as deferred credits consisted primarily of Project PAL funds of \$42,170 and \$24,099, respectively, and the Member Owned Renewable Energy (MORE) Program funds of \$140,150 and \$143,623 for 2014 and 2013, respectively.

Project PAL was developed to help qualifying OPALCO members pay their winter heating bills. Project PAL is primarily funded by members voluntarily rounding up their monthly power bills to the next whole dollar. Requests for assistance are evaluated and grants are awarded by a separate council made up of volunteer OPALCO members. The council, by unanimous vote, reserves the right to allow or deny any grants due to extenuating circumstances. Policy and guidelines are reviewed by a volunteer council on a regular basis.

The MORE program was started in 2011. It is funded by voluntary contributions from Cooperative members for projects that promote sustainable, renewable energy. Once a year, Cooperative members who install renewable energy systems, such as solar photovoltaic or wind turbines, are offered an incentive based on the KWh production of their renewable energy system. Incentives are administered through an independent committee of Cooperative members. The member-owned generation facilities will allow the member generator to consume energy generated by their system, which will offset the amount of energy purchased by the Cooperative. All renewable energy systems are required to be pre-approved by the engineering department prior to construction.

Note 8 - Pension Benefits

In 1954, the Cooperative adopted a retirement program available for all employees meeting length of service requirements. The program is a multi-employer plan administered by the National Rural Electric Cooperative Association (NRECA) and includes a noncontributory defined benefit pension and a contributory defined contribution 401(k) plan. Approximately 1,000 rural electric systems participate in each of these plans.

Defined benefit plan - The NRECA Retirement Security Plan (RS Plan) is a defined benefit pension plan qualified under Section 401 and tax-exempt under Section 501(a) of the Internal Revenue Code. It is a multi-employer plan under the accounting standards. The plan sponsor's Employer Identification Number is 53-0116145 and the Plan Number is 48009.

A unique characteristic of a multi-employer plan compared with a single-employer plan is that all plan assets are available to pay benefits of 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.

Generally, all employees of the Cooperative are eligible to participate in the defined benefit plan after completing a year of eligible service. Employees are credited with meeting the year of eligible service after completing at least 1,000 hours of service in the first 12 consecutive months of employment or in the first calendar year in which 1,000 hours of service occur. There have been no significant changes that affect the comparability of 2014 and 2013 contributions.

ORCAS POWER & LIGHT COOPERATIVE

NOTES TO FINANCIAL STATEMENTS

Note 8 - Pension Benefits (continued)

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 115.92% and 104.72% funded as of January 1, 2014 and 2013, respectively, based on the PPA funding target and PPA actuarial value of assets on those dates. The average increase in rates of compensation for the defined benefit plan as a whole for the year ended January 1, 2014, was 2.88%. The defined benefit plan used an assumed 19.40% return on plan assets in the most recent system-wide annual actuarial valuation. The defined benefit plan invests in equity and debt securities and cash equivalents.

The Cooperative’s contributions to the RS Plan in 2014 and in 2013 represented less than 5% of the total contributions made to the plan by all participating employers. The Cooperative makes monthly contributions to the plan at the required contribution rate. Contributions made by the Cooperative were \$1,182,977 and \$1,167,729 for the years ended December 31, 2014 and 2013, respectively. Withdrawal from the plan may result in the Cooperative having an obligation to the plan. The Cooperative does not currently intend to withdraw from the plan, and, accordingly, no provision has been included in the accompanying financial statements.

Defined contribution plan - Upon completion of 30 days of eligibility service, all eligible employees of the Cooperative may participate in the defined contribution plan and may elect to make pre-tax employee elective contributions up to 100% of the participant’s salary to a maximum of \$17,500. Upon completion of a year of eligible service, the Cooperative will match employee contributions equal to 100% of employee elective contributions, not to exceed 4% of an employee’s annual compensation. The Cooperative employer portion of the 401(k) plan contributions totaled \$155,195 and \$153,656 for the years ended December 31, 2014 and 2013, respectively.

Postemployment benefits - The Cooperative allows employees to remain in its medical plan after retirement, but the employee is required to pay the full group medical rate. Although a group rate includes a deemed subsidy for retirees, management has determined that the impact on financial position and results of operations is not material and has not recognized a liability for such benefit.

Note 9 - Commitments and Contingencies

Power supply contracts - The Cooperative has a power sales contract with the Bonneville Power Administration (BPA) to provide the Cooperative’s power supply through September 30, 2028.

Union contract - The current collective bargaining agreement is effective for the period January 1, 2014, through December 31, 2018. As of December 31, 2014, the Cooperative employed approximately 65% of its workforce under the new collective bargaining agreement.

Legal - In the normal course of business, the Cooperative is party to claims and matters of litigation. The ultimate outcome of these matters cannot presently be determined; however, in the opinion of management of the Cooperative, the resolution of these matters will not have a material adverse effect on the Cooperative’s financial position, results of operations, or liquidity.

ORCAS POWER & LIGHT COOPERATIVE
NOTES TO FINANCIAL STATEMENTS

Note 10 - Subsequent Events

Subsequent to year-end, effective January 9, 2015, OPALCO created the separate business entity Island Network LLC (IN LLC), a limited liability corporation. This for-profit LLC was formed to take on the activity related to and surrounding all fiber and internet business.

In February 2015, the Cooperative made a long-term loan advance draw with CFC in the amount of \$3,000,000 at an interest rate of 4.05%; the loan matures in December 2021.

Effective February 6, 2015, 100% of the stock of Rock Island Inc. was purchased by IN LLC, a wholly owned, for-profit subsidiary of OPALCO. The acquisition was funded through debt obtained by OPALCO from CFC and then subsequently loaned to IN LLC for the purpose of this acquisition.

REPORT REQUIRED BY GOVERNMENT AUDITING STANDARDS

REPORT OF INDEPENDENT AUDITORS 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*

To the Board of Directors
Orcas Power & Light Cooperative

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 financial statements of Orcas Power & Light Cooperative (the Cooperative) as of and for the year ended December 31, 2014, and the related notes to the financial statements, which collectively comprise the Cooperative's basic financial statements, and have issued our report thereon dated April 14, 2015.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Cooperative'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 financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Cooperative's internal control. Accordingly, we do not express an opinion on the effectiveness of the Cooperative'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 the Cooperative's 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.

A handwritten signature in cursive script that reads "Mess Adams LLP".

Everett, Washington

April 14, 2015