Report of Independent Auditors
and Consolidated Financial Statements for

Orcas Power & Light Cooperative and Subsidiary

December 31, 2015 and 2014

MOSS-ADAMS LLP

Certified Public Accountants | Business Consultants

CONTENTS

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REPORT OF INDEPENDENT AUDITORS

To the Board of Directors
Orcas Power & Light Cooperative and Subsidiary

Report on Financial Statements

We have audited the accompanying consolidated financial statements of Orcas Power & Light Cooperative and Subsidiary (collectively, the Cooperative), which comprise the consolidated balance sheets as of December 31, 2015 and 2014, and the related consolidated 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 consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Orcas Power & Light Cooperative as of December 31, 2015 and 2014, 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 Matters

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Cooperative's consolidated financial statements. The consolidating balance sheet and consolidating statement of revenues and margins (collectively, supplementary information) are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The supplementary information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain other procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated May 12, 2016, 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.

Moss Adams LLP

Everett, Washington
May 12, 2016

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ORCAS POWER & LIGHT COOPERATIVE
CONSOLIDATED BALANCE SHEETS

ASSETS

	December 31, 2015	December 31, 2014
UTILITY PLANT, at cost		
Electric plant in service	$ 100,576,686	$ 91,153,197
Fiber plant in service	3,564,230	74,891
Construction work in progress	5,070,552	5,746,461
	109,211,468	96,974,549
Less accumulated depreciation and amortization	42,423,228	38,650,755
Net utility plant	66,788,240	58,323,794
INVESTMENTS AND OTHER ASSETS		
Investments in associated organizations	1,093,967	1,063,007
Goodwill	282,257	-
Total investments and other assets	1,376,224	1,063,007
CURRENT ASSETS		
Cash and cash equivalents	1,923,361	2,254,476
Cash and cash equivalents - board-designated	-	1,279,617
Accounts receivable, less allowance for doubtful accounts of $60,000 in 2015 and 2014	3,648,088	3,036,985
Interest receivable	6,140	6,330
Materials and supplies	4,984,143	2,720,342
Prepaid expenses	324,983	586,081
Total current assets	10,886,715	9,883,831
Total assets	$ 79,051,179	$ 69,270,632

EQUITIES, MARGINS, AND LIABILITIES

	December 31, 2015	December 31, 2014
EQUITIES AND MARGINS		
Memberships	$ 56,395	$ 56,875
Patronage capital	37,130,221	36,127,936
Undistributed subsidiary losses	(1,780,113)	-
Donated and other equities	4,763,939	4,477,381
Total equities and margins	40,170,442	40,662,192
LONG-TERM DEBT, less current maturities		
RUS mortgage notes	24,815,541	22,516,582
CFC mortgage notes	9,130,734	2,468,183
Long-term lease liability	330,547	-
Total long-term debt	34,276,822	24,984,765
CURRENT LIABILITIES		
Accounts payable	2,052,735	1,931,398
Customer deposits	82,377	91,717
Accrued liabilities	829,503	751,048
Current maturities of long-term debt and leases	1,421,784	666,387
Total current liabilities	4,386,399	3,440,550
DEFERRED CREDITS	217,516	183,125
Total equities, margins, and liabilities	$ 79,051,179	$ 69,270,632

See accompanying notes.

ORCAS POWER & LIGHT COOPERATIVE
CONSOLIDATED STATEMENTS OF REVENUES AND MARGINS

	Years Ended December 31,	
	2015	2014
OPERATING REVENUES		
Electricity sales	$ 24,571,028	$ 22,029,026
Fiber sales	1,829,439	-
Total operating revenues	26,400,467	22,029,026
OPERATING EXPENSES		
Cost of purchased power	7,787,142	8,037,428
Transmission	179,264	92,874
Distribution - operations	3,391,150	2,961,251
Distribution - maintenance	1,713,921	1,799,665
Consumer accounts	893,766	898,868
Fiber services	715,854	-
Administrative and general	6,184,087	3,173,939
Depreciation and amortization	3,434,683	2,975,651
Taxes	1,105,864	961,815
Total operating expenses	25,405,731	20,901,491
Operating margins before fixed charges	994,736	1,127,535
FIXED CHARGES		
Interest on long-term debt	1,047,248	908,934
Operating margins after fixed charges	(52,512)	218,601
PATRONAGE CAPITAL CREDITS	83,608	67,853
Net operating margins	31,096	286,454
NONOPERATING MARGINS		
Island Network division, net	-	(220,088)
Interest income	34,327	32,130
Other income	12,786	23,457
Total nonoperating margins	47,113	(164,501)
NET MARGINS	$ 78,209	$ 121,953

See accompanying notes.

CONSOLIDATED STATEMENTS OF CHANGES IN PATRONAGE CAPITAL AND OTHER EQUITIES

	Memberships	Patronage Capital	Donated and Other Equities	Undistributed Subsidiary Losses	Total
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	-	(1,244,138)	-	-	(1,244,138)
BALANCE, December 31, 2014	56,875	36,127,936	4,477,381	-	40,662,192
Increase in memberships, net	(480)	-	-	-	(480)
Net margins	-	1,858,322	-	(1,780,113)	78,209
Donated and returned capital	-	-	286,558	-	286,558
Retirement of capital credits, net	-	(856,037)	-	-	(856,037)
BALANCE, December 31, 2015	$ 56,395	$ 37,130,221	$ 4,763,939	$ (1,780,113)	$ 40,170,442

ORCAS POWER & LIGHT COOPERATIVE
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31, 2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES		
Net margins	$ 78,209	$ 121,953
Adjustments to reconcile net margins to net cash from operating activities		
Depreciation and amortization	3,434,683	2,975,651
Changes in assets and liabilities		
Accounts receivable	(611,103)	109,981
Interest receivable	190	1,064
Prepaid expenses	(21,159)	(463,630)
Accounts payable	121,337	198,662
Customer deposits	(9,340)	5,556
Accrued liabilities	78,455	54,306
Deferred credits	34,391	14,598
Net cash from operating activities	3,105,663	3,018,141
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to utility plant, net	(12,329,440)	(9,831,710)
Change in materials and supplies	(2,263,801)	(578,779)
Change in investments and other assets	(30,960)	229,582
Net cash from investing activities	(14,624,201)	(10,180,907)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments on long-term debt, net of cushion of credit adjustments	(4,433,884)	156,995
Proceeds from debt	14,481,338	7,380,000
Cash contributions in aid of construction	1,330,311	1,145,619
Memberships, net	(480)	1,225
Payments to acquire subsidiary	(900,000)	-
Retirements of patronage capital	(569,479)	(791,202)
Net cash from financing activities	9,907,806	7,892,637
NET CHANGE IN CASH	(1,610,732)	729,871
CASH AND CASH EQUIVALENTS, beginning of year	3,534,093	2,804,222
CASH AND CASH EQUIVALENTS, end of year	$ 1,923,361	$ 3,534,093
SUPPLEMENTAL DISCLOSURES		
Cash paid for interest	$ 1,047,248	$ 908,934
Assets acquired through capital lease	$ 622,349	$ -

See accompanying notes.

Note 1 - Organization and Summary of Significant Accounting Policies

Organization - Orcas Power & Light Cooperative and Subsidiary (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 11,137 memberships, including 12,963 residential meters and 2,039 commercial and industrial meters distributing electricity to 20 islands in the San Juan archipelago, in Washington State.

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. During the October 2014 board meeting, the OPALCO management received board directive to provide internet, phone, and emergency communication services to its members. As a result, on January 9, 2015, OPALCO formed a separate business entity, Island Network, LLC. The entity is a wholly owned (100%) subsidiary of OPALCO and is considered a for-profit limited liability corporation (LLC). Island Network, LLC was established to market the activity related to providing internet and communications to the members. On February 6, 2015, Island Network acquired 100% of the outstanding stock of a nonrelated corporation, Rock Island, Inc. and began doing business as Rock Island Communications. The acquisition was funded through debt obtained by OPALCO from National Rural Utilities Cooperative Finance Corporation (CFC) and then subsequently loaned to Island Network, LLC for the purpose of the acquisition and start-up working capital. The acquisition of Rock Island, Inc. included an existing customer base, some back-office and customer-facing staff, and a retail store in Friday Harbor, Washington.

Principles of consolidation - The consolidated financial statements include the financial results of OPALCO and its wholly owned subsidiary, Island Network, LLC (the Cooperative). OPALCO has accounted for the investment using the equity method. All significant intercompany accounts and transactions have been eliminated in consolidation.

Basis of accounting and presentation - The consolidated 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, 2015 and 2014.

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

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 and fiber plant are 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%

Goodwill - Goodwill resulted from the acquisition of Rock Island, Inc. in February 2015. The acquisition was a 100% stock purchase of Rock Island, Inc. and included the customer base, employees, and retail store. Goodwill will be amortized over 10 years. Amortization of goodwill was $28,485 for the year ended December 31, 2015.

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 may designate certain amounts of cash and cash equivalents for future use at the board's discretion and approval.

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 fiber plant and is valued at average unit cost.

Investments in associated organizations - The Cooperative's investments in associated organizations (Note 4) are stated at cost, plus patronage capital credits issued, less distributions received, in accordance with RUS regulations.

Compensated absences - Employees of the Cooperative 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 $199,374 and $250,541 are included in accrued liabilities as of December 31, 2015 and 2014, respectively.

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

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, 2015 and 2014, the board of directors approved a 50% and 100% payout, respectively, 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, 2015 and 2014, unbilled revenue of $1,106,409 and $952,754, respectively, was included in the accounts receivable balance. Fiber revenues are billed to customers at the beginning of the month based on contractually agreed terms.

Income tax status - OPALCO 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.

Island Network, LLC is not exempt from federal income taxes. For Island Network, LLC, income taxes are provided for the tax effects of transactions reported in the consolidated financial statements, consisting of taxes currently due plus deferred taxes. Deferred taxes are recognized for differences between the basis of assets and liabilities for financial statement and income tax purposes. The differences relate to depreciable assets. The deferred tax liabilities represent the future tax return consequences of those differences, which will be taxable when the liabilities are settled.

Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for taxable temporary differences and deferred tax liabilities are recognized for deductible temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. Deferred tax assets relate primarily to net operating loss carryforwards, contributions in aid of construction, and accumulated amortization on the books. Deferred tax liabilities relate primarily to the use of accelerated depreciation for tax purposes. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

The Cooperative follows Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 740-10, *Income Taxes*, which relates to accounting for uncertain tax positions. The Cooperative records uncertain tax positions if the likelihood that the position will be sustained upon examination is less than 50%. As of December 31, 2015 and 2014, the Cooperative had no accrued amounts related to uncertain tax positions. Interest and penalties, if any, are recorded as interest expense and other expense, respectively.

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

Use of estimates - In preparing consolidated 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 consolidated balance sheet date but before the consolidated financial statements are issued. The Cooperative recognizes in the consolidated financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the consolidated balance sheets, including the estimates inherent in the process of preparing the consolidated financial statements. The Cooperative's consolidated financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the consolidated balance sheets but arose after the consolidated balance sheet date and before the consolidated financial statements are available to be issued. The Cooperative has evaluated subsequent events through May 12, 2016, which is the date the consolidated financial statements are issued.

Note 2 - Cash and Cash Equivalents

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

	2015	2014
Petty cash funds	$ 1,000	$ 600
Cash in FDIC institutions	1,770,697	2,576,717
Cash in CFC commercial paper	-	805,126
Cash in CoBank	151,664	151,650
	$ 1,923,361	$ 3,534,093

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 3 - Plant in Service

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

	2015	2014
Generation	$ 33,163	$ 33,163
Transmission	18,036,209	16,900,975
Distribution	65,484,096	60,188,087
General plant	15,483,657	12,491,411
Fiber plant	3,564,230	74,891
Intangible plant	1,539,561	1,539,561
Total plant in service	$ 104,140,916	$ 91,228,088

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 $1,330,311 and $1,145,619 were recorded during 2015 and 2014, respectively.

Note 4 - Investments in Associated Organizations

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

	2015	2014
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	235,291	227,265
Patronage capital credits in National Information Solutions Cooperative (NISC)	77,828	55,190
Patronage capital in Federated Rural Electric Insurance Exchange	152,241	131,945
Patronage capital - others	70,333	90,333
Total investments in associated organizations	$ 1,093,967	$ 1,063,007

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 5 - Related Party Transactions

In January 2015, OPALCO funded Island Network, LLC in the amount of $1,000,000 to purchase Rock Island, Inc. In February 2015, OPALCO funded the start-up costs and working capital for Island Network, LLC (DBA Rock Island Communications (RIC)) in the form of a loan. Included in this loan were advances to fund operations in 2015 in the amount of $4,917,164. OPALCO also transferred infrastructure and inventory from the old Island Network Department to Rock Island in the amount of $1,112,828 that is also held as a loan.

During 2015, OPALCO incurred $99,822 in interest income associated with advances taken by Rock Island Communications. This income has been eliminated upon consolidation.

During 2015, OPALCO incurred $29,100 in costs associated with customer fees for internet services provided by Rock Island Communications, OPALCO also billed the subsidiary for use of electricity in the amount of $10,889, and $58,294 for the use of OPALCO's communications infrastructure. These intercompany balances have been eliminated upon consolidation.

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, 2015 and 2014.

In January 2010, the Cooperative established a new unsecured perpetual line of credit with CFC in the amount of $5,000,000. Advances outstanding as of December 31, 2015 and 2014, were $2,468,531. The maturity date of this line of credit is November 2040.

In January 2011, the Cooperative established an unsecured perpetual line of credit with CoBank in the amount of $5,000,000. No loan advances have been made on this account in 2015 or 2014.

In February 2015, the Cooperative established a new unsecured perpetual line of credit with CFC in the amount of $5,000,000. Loan advances of $3,705,520 have been made on this account during 2015. The maturity date of this line of credit is January 2051.

In December 2015, the Cooperative established a new unsecured perpetual line of credit with CFC in the amount of $3,400,000. Loan advances of $3,358,989 have been made on this account during 2015. The maturity date of this line of credit is November 2039.

Note 7 - Long-Term Debt and Capital Lease Obligations

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:

	2015	2014
Mortgages payable to RUS, payable in quarterly installments of approximately $150,000, including interest at rates ranging from 2.38% to 5.83%, maturing over various periods through December 2046.	$ 25,691,555	$ 23,237,924
Mortgages payable to CFC, payable in quarterly installments of approximately $170,000, including interest at rates ranging from 2.65% to 5.70%, maturing over various periods through 2039.	9,533,040	2,576,009
RUS economic development loan, payable in monthly installments of $667, bearing 0% interest, maturing in 2019.	64,659	72,663
RUS cushion of credit	(126,903)	(235,444)
Long-term debt	35,162,351	25,651,152
Capital lease obligations, stated at present value of future minimum lease payments	536,255	-
	35,698,606	25,651,152
Less current maturities of long-term debt	1,421,784	666,387
	$ 34,276,822	$ 24,984,765

The aggregate long-term debt and capital lease obligations maturing over the next five years are as follows:

2016	$ 1,421,784
2017	1,561,928
2018	1,621,974
2019	1,456,168
2020	1,506,078
Thereafter	28,257,577
	$ 35,825,509

Note 7 - Long-Term Debt (continued)

Capital lease obligations - During 2015, Island Network, LLC acquired computer equipment under two capital lease obligation agreements in the amounts of $580,617 and $41,731, with the imputed interest rate of 0%, respectively. Each lease has a three-year term, with maturity dates of August 2018 and November 2018, respectively. Leases are collateralized by the related equipment.

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 $126,903 and $235,444 at December 31, 2015 and 2014, respectively, and is recorded as a reduction of RUS long-term debt on the consolidated balance sheets.

New draws - In June 2015, the Cooperative made a long-term loan advance draw with the RUS in the amount of $2,500,000 at an interest rate of 2.767%.

In August 2015, the Cooperative made a long-term loan advance draw with the RUS in the amount of $2,000,000 at an interest rate of 2.649%.

In October 2015, the Cooperative made a long-term loan advance draw with the RUS in the amount of $2,000,000 at an interest rate of 2.53%.

In December 2015, the Cooperative refinanced RUS long-term loans with the total principal balance of $3,358,989 at an interest rate of 5% with a new CFC loan at the interest rate of 4.21%.

Note 8 - Operating Lease Commitments

Operating leases - Island Network, LLC leases equipment under a five-year noncancelable operating lease expiring in May 2020.

Future minimum lease payments under noncancelable operating lease are as follows:

2016	$ 86,975
2017	86,975
2018	86,975
2019	87,975
2020	28,991
	$ 377,891

Rent expense under the operating lease for the years ended December 31, 2015 and 2014, was $57,983 and $0, respectively.

Note 9 - Income Taxes

The components of the provision for income tax benefit (expense) are as follows as of December 31:

	2015	2014
Deferred income tax benefit		
Federal	$ 604,597	$ -
Change in valuation allowance	(604,597)	-
Total income tax benefit	$ -	$ -

The provision for income taxes differs from the amount computed by applying the current statutory federal income tax rate to earnings before taxes due to the effects of nondeductible items, the change in the valuation allowance, and prior-year over or under accruals.

The components of the net deferred tax asset (liability) recorded in the accompanying consolidated balance sheets at December 31 are as follows:

	2015	2014
Deferred tax assets		
Book amortization greater than tax	$ 9,685	$ -
Net operating loss carryforward	816,636	-
	826,321	-
Less valuation allowance	(604,597)	-
Total deferred tax assets	221,724	-
Deferred tax liabilities		
Tax depreciation greater than book	(221,724)	-
Total deferred tax liabilities	(221,724)	-
Net deferred income tax asset (liability)	$ -	$ -

The Cooperative has federal net operating loss carryforwards of approximately $2,400,000, which expire in 2035. The deferred tax asset related to these carryforwards was fully offset by a valuation allowance.

Note 10 - Deferred Credits

As of December 31, 2015 and 2014, amounts carried on the Cooperative's consolidated balance sheets as deferred credits consisted primarily of Project PAL funds of $51,653 and $42,170, respectively, and the Member Owned Renewable Energy (MORE) Program funds of $165,059 and $140,150 for 2015 and 2014, 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 a solar photovoltaic system 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 preapproved by the engineering department prior to construction.

Note 11 - 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 RS 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.

Note 11 - Pension Benefits (continued)

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 2015 and 2014 contributions.

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 105.52% and 115.92% funded as of January 1, 2015 and 2014, 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, 2015, was 3.44%. The defined benefit plan used an assumed 6.16% 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 2015 and in 2014 represented less than 5% of the total contributions made to the plan by all participating employers. The Cooperative makes monthly contributions to the RS Plan at the required contribution rate. Contributions made by the Cooperative were $1,036,873 and $1,182,977 for the years ended December 31, 2015 and 2014, respectively. Withdrawal from the RS Plan may result in the Cooperative having an obligation to the plan. The Cooperative does not currently intend to withdraw from the RS Plan, and, accordingly, no provision has been included in the accompanying consolidated 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 $151,948 and $155,195 for the years ended December 31, 2015 and 2014, 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 12 - 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, 2015, the Cooperative employed approximately 73% of its workforce under the collective bargaining agreement.

Note 12 - Commitments and Contingencies (continued)

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.

Submarine cable replacement - The first phase of the three-year submarine cable replacement project was completed during the fourth quarter of 2015 on Lopez and San Juan Islands with the boring and environmental permitting processes. A contract with Sumitomo Electric USA was entered into for the manufacture and installation of the submarine cable. The cable manufacture will span over 2016 and 2017, with the final installation of the cable in 2017. The $15,000,000 project will be funded by an RUS approved transmission loan in the amount of $17,100,000.

T-Mobile agreement - During 2015, Island Network, LLC established a long-term agreement with T-Mobile US to deploy LTE wireless capability throughout San Juan County. The agreement was a noncash investment with the intention to assist Island Network, LLC in bringing a profitable product faster to market and serve a higher number of subscribers.

Note 13 - Subsequent Events

In January 2016, OPALCO made a long-term loan advance draw with RUS in the amount of $800,000, at an interest rate of 2.510%. The new loan matures in December 2046.

In March 2016, OPALCO made a long-term loan advance draw with RUS in the amount of $1,500,000, at an interest rate of 2.391%. The new loan matures in December 2046.

In April 2016, OPALCO made a long-term loan advance draw with RUS in the amount of $942,000, at an interest rate of 2.327%. The new loan matures in December 2046.

In the first quarter of 2016, OPALCO repriced eligible CFC loans, in the total amount of $1,366,385, from an interest rate of 5.6% to a long-term fixed rate of 4.15%.

In the first quarter of 2016, OPALCO extended with CFC the $1 million of available balance on the secure line of credit for an additional five years.

In May 2016, Island Network, LLC executed a long-term credit agreement with CoBank in the amount of $10,000,000. Draws on the credit line are at variable interest rates measured at the time of advance. The new loan matures in April 2021 and is guaranteed by OPALCO. In May 2016, Island Network, LLC made an advance draw in the amount of $7,500,000 at an interest rate of 3.32% for the purpose of funding operations and repayment of the initial start-up loan from OPALCO.

In May 2016, Island Network, LLC executed a long-term credit agreement with CoBank in the amount of $2,000,000. Draws on the credit line are at variable interest rates measured at the time of advance. The new loan matures in April 2017 and is guaranteed by OPALCO.

ORCAS POWER & LIGHT COOPERATIVE
CONSOLIDATING BALANCE SHEET
DECEMBER 31, 2015

	OPALCO	Island Network, LLC	Eliminating Entries	Consolidated Total
ASSETS				
Electric plant in service	$ 100,576,686	$ -	$ -	$ 100,576,686
Fiber plant in service	-	3,564,230	-	3,564,230
Construction work in progress	3,434,810	1,635,742	-	5,070,552
	104,011,496	5,199,972	-	109,211,468
Less accumulated depreciation and amortization	41,160,577	1,262,651	-	42,423,228
Net plant	62,850,919	3,937,321	-	66,788,240
INVESTMENTS AND OTHER ASSETS				
Investments in associated organizations	1,093,967	-	-	1,093,967
Investment in subsidiary	5,249,879	-	(5,249,879)	-
Goodwill	-	282,257	-	282,257
Total investments and other assets	6,343,846	282,257	(5,249,879)	1,376,224
CURRENT ASSETS				
Cash and cash equivalents	1,697,385	225,976	-	1,923,361
Accounts receivable, less allowance for doubtful accounts of $60,000 in 2015 and 2014	3,558,212	89,876	-	3,648,088
Interest receivable	6,140	-	-	6,140
Materials and supplies	3,341,939	1,642,204	-	4,984,143
Prepayments and other current assets	311,801	13,182	-	324,983
Total current assets	8,915,477	1,971,238	-	10,886,715
TOTAL ASSETS	$ 78,110,242	$ 6,190,816	$ (5,249,879)	$ 79,051,179
EQUITIES AND MARGINS				
Memberships	$ 56,395	$ -	$ -	$ 56,395
Patronage capital	37,130,221	-	-	37,130,221
Undistributed subsidiary losses	(1,780,113)	(1,780,113)	1,780,113	(1,780,113)
Donated and other equities	4,763,939	-	-	4,763,939
Total equity and margins	40,170,442	(1,780,113)	1,780,113	40,170,442
LONG-TERM DEBT, less current maturities				
RUS mortgage notes	24,815,541	-	-	24,815,541
CFC mortgage notes	9,130,734	-	-	9,130,734
Long-term lease liability	-	330,547	-	330,547
Total long-term debt	33,946,275	330,547	-	34,276,822
CURRENT LIABILITIES				
Accounts payable	1,765,437	287,298	-	2,052,735
Customer deposits	82,377	-	-	82,377
Accrued liabilities	712,119	117,384	-	829,503
Payable to OPALCO	-	7,029,992	(7,029,992)	-
Current maturities of long-term debt	1,216,076	205,708	-	1,421,784
Total current liabilities	3,776,009	7,640,382	(7,029,992)	4,386,399
DEFERRED CREDITS	217,516	-	-	217,516
EQUITIES, MARGINS, AND LIABILITIES	$ 78,110,242	$ 6,190,816	$ (5,249,879)	$ 79,051,179

ORCAS POWER & LIGHT COOPERATIVE
CONSOLIDATING STATEMENT OF REVENUES AND MARGINS
YEAR ENDED DECEMBER 31, 2015

	OPALCO	Island Network, LLC	Eliminating Entries	Consolidated Total
OPERATING REVENUES				
Electricity sales	$ 24,581,917	$ -	$ (10,889)	$ 24,571,028
Fiber sales	-	1,829,439	-	1,829,439
Total operating revenues	24,581,917	1,829,439	(10,889)	26,400,467
OPERATING EXPENSES				
Cost of purchased power	7,787,142	-	-	7,787,142
Transmission	179,264	-	-	179,264
Distribution - operations	3,391,150	-	-	3,391,150
Distribution - maintenance	1,713,921	-	-	1,713,921
Consumer accounts	893,766	-	-	893,766
Fiber services	-	726,743	(10,889)	715,854
Administrative and general	3,638,817	2,632,664	(87,394)	6,184,087
Depreciation and amortization	3,308,154	126,529	-	3,434,683
Taxes	1,046,626	59,238	-	1,105,864
Total operating expenses	21,958,840	3,545,174	(98,283)	25,405,731
Operating margins before fixed charges	2,623,077	(1,715,735)	87,394	994,736
FIXED CHARGES				
Interest on long-term debt	1,047,248	99,822	(99,822)	1,047,248
Operating margins after fixed charges	1,575,829	(1,815,557)	(187,216)	(52,512)
PATRONAGE CAPITAL CREDITS	83,608	-	-	83,608
Net operating margins	1,659,437	(1,815,557)	(187,216)	31,096
NONOPERATING MARGINS				
Rental income	-	29,100	(29,100)	-
Interest income	127,805	6,344	(99,822)	34,327
Other income	71,080	-	(58,294)	12,786
Total nonoperating margins	198,885	35,444	(187,216)	47,113
Net operating and nonoperating margins	1,858,322	(1,780,113)	(374,432)	78,209
LOSS FROM SUBSIDIARY	(1,780,113)	-	1,780,113	-
NET MARGINS	$ 78,209	$ (1,780,113)	$ 1,780,113	$ 78,209

REPORT REQUIRED BY *GOVERNMENT AUDITING STANDARDS*

MOSS-ADAMS LLP
Certified Public Accountants | Business Consultants

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 and Subsidiary

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Orcas Power & Light Cooperative and Subsidiary (collectively, the Cooperative) as of and for the year ended December 31, 2015, and the related notes to the consolidated financial statements, which collectively comprise the Cooperative's consolidated financial statements, and have issued our report thereon dated May 12, 2016.

Internal Control Over Financial Reporting

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

Purpose of This Report

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

Moss Adams LLP

Everett, Washington
May 12, 2016