REPORT OF INDEPENDENT AUDITORS
AND CONSOLIDATED FINANCIAL STATEMENTS

ORCAS POWER & LIGHT COOPERATIVE AND SUBSIDIARY

December 31, 2017 and 2016

MOSSADAMS

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Report of Independent Auditors

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

Report on the 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, 2017 and 2016, 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.

Auditor's 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 and Subsidiary as of December 31, 2017 and 2016, 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 sheets as of December 31, 2017 and 2016, and consolidating statements of revenues and margins for the years then ended (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 4, 2018, 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 4, 2018

Orcas Power & Light Cooperative
Consolidated Balance Sheets

ASSETS

	December 31, 2017	December 31, 2016
UTILITY PLANT, at cost		
Electric plant in service	$ 124,265,509	$ 105,702,896
Broadband plant in service	11,342,799	8,511,937
Construction work in progress	11,411,969	13,039,047
	147,020,277	127,253,880
Less accumulated depreciation and amortization	47,115,324	46,438,573
Net utility plant	99,904,953	80,815,307
INVESTMENTS AND OTHER ASSETS		
Investments in associated organizations	2,654,603	1,125,332
Goodwill	220,108	251,183
Total investments and other assets	2,874,711	1,376,515
CURRENT ASSETS		
Cash and cash equivalents	2,302,774	4,001,268
Cash and cash equivalents - board designated	750,000	-
Accounts receivable, less allowance for doubtful accounts of $65,600 and $60,000 in 2017 and 2016	3,199,200	3,820,840
Interest receivable	13,218	9,386
Materials and supplies	5,277,557	5,162,378
Prepaid expenses	461,688	471,655
Total current assets	12,004,437	13,465,527
Total assets	$ 114,784,101	$ 95,657,349

EQUITIES, MARGINS, AND LIABILITIES

	December 31, 2017	December 31, 2016
EQUITIES AND MARGINS		
Memberships	$ 55,960	$ 56,905
Patronage capital	40,181,088	38,334,632
Undistributed subsidiary losses	(7,069,952)	(4,517,947)
Donated and other equities	5,984,621	5,403,526
Total equities and margins	39,151,717	39,277,116
LONG-TERM DEBT, less current maturities		
RUS mortgage notes	41,812,701	31,418,746
CFC mortgage notes	8,561,284	8,812,642
Note payable	13,500,000	8,740,000
Long-term lease liability	735,005	177,989
Total long-term debt	64,608,990	49,149,377
CURRENT LIABILITIES		
Accounts payable	3,559,396	2,077,036
Customer deposits	87,218	89,928
Accrued liabilities	2,466,212	1,453,577
Line of credit	2,400,000	2,000,000
Current maturities of long-term debt and leases	2,234,566	1,328,376
Total current liabilities	10,747,392	6,948,917
DEFERRED CREDITS	276,002	281,939
Total equities, margins, and liabilities	$ 114,784,101	$ 95,657,349

See accompanying notes.

Orcas Power & Light Cooperative
Consolidated Statements of Revenues and Margins

	Years Ended December 31, 2017	2016
OPERATING REVENUES		
Electricity sales	$ 27,921,348	$ 25,217,207
Broadband sales	3,575,147	2,286,266
Total operating revenues	31,496,495	27,503,473
OPERATING EXPENSES		
Cost of purchased power	8,916,059	7,942,885
Transmission	210,740	108,288
Distribution - operations	3,617,096	3,202,068
Distribution - maintenance	1,767,342	1,692,344
Consumer accounts	982,216	947,326
Broadband services	708,340	727,794
Administrative and general	6,920,827	6,140,268
Depreciation and amortization	4,785,697	4,131,537
Taxes	1,410,079	1,237,914
Total operating expenses	29,318,396	26,130,424
Operating margins before fixed charges	2,178,099	1,373,049
FIXED CHARGES		
Interest on long-term debt	1,493,364	1,196,591
Operating margins after fixed charges	684,735	176,458
PATRONAGE CAPITAL CREDITS	77,586	81,361
Net operating margins	762,321	257,819
NONOPERATING MARGINS		
Interest income	144,408	36,286
Other income (loss)	(59,445)	30,318
Total nonoperating margins	84,963	66,604
NET MARGINS	$ 847,284	$ 324,423

See accompanying notes.

	Memberships	Patronage Capital	Donated and Other Equities	Undistributed Subsidiary Equities	Total
BALANCE, December 31, 2015	$ 56,395	$ 37,130,221	$ 4,763,939	$ (1,780,113)	$ 40,170,442
Increase in memberships, net	510	-	-	-	510
Net margins (losses)	-	3,062,257	-	(2,737,834)	324,423
Donated and returned capital	-	-	639,587	-	639,587
Retirement of capital credits, net	-	(1,857,846)	-	-	(1,857,846)
BALANCE, December 31, 2016	56,905	38,334,632	5,403,526	(4,517,947)	39,277,116
Decrease in memberships, net	(945)	-	-	-	(945)
Net margins (losses)	-	3,399,289	-	(2,552,005)	847,284
Donated and returned capital	-	-	581,095	-	581,095
Retirement of capital credits, net	-	(1,552,833)	-	-	(1,552,833)
BALANCE, December 31, 2017	$ 55,960	$ 40,181,088	$ 5,984,621	$ (7,069,952)	$ 39,151,717

Orcas Power & Light Cooperative
Consolidated Statements of Cash Flows

	Years Ended December 31,	
	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Net margins	$ 847,284	$ 324,423
Adjustments to reconcile net margins to net cash from operating activities		
Depreciation and amortization	4,785,697	4,131,537
Changes in assets and liabilities		
Accounts receivable	621,640	(172,752)
Interest receivable	(3,832)	(3,246)
Prepaid expenses	41,042	(115,598)
Accounts payable	1,482,360	24,301
Customer deposits	(2,710)	7,551
Accrued liabilities	1,012,635	624,074
Deferred credits	(5,937)	64,423
Net cash from operating activities	8,778,179	4,884,713
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to utility plant, net	(25,524,882)	(19,816,558)
Change in materials and supplies	(115,179)	(178,235)
Change in investments and other assets	(1,529,271)	(31,365)
Net cash used for investing activities	(27,169,332)	(20,026,158)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments on long-term debt, net of cushion of credit adjustments	(444,197)	(2,702,853)
Proceeds from debt	16,810,000	17,482,000
Proceeds from line of credit	400,000	2,000,000
Cash contributions in aid of construction	1,649,539	1,657,954
Memberships, net	(945)	510
Retirements of patronage capital	(971,738)	(1,218,259)
Net cash from financing activities	17,442,659	17,219,352
NET CHANGE IN CASH	(948,494)	2,077,907
CASH AND CASH EQUIVALENTS, beginning of year	4,001,268	1,923,361
CASH AND CASH EQUIVALENTS, end of year	$ 3,052,774	$ 4,001,268
SUPPLEMENTAL DISCLOSURES		
Cash paid for interest	$ 2,056,382	$ 1,193,345
Assets acquired through capital lease	$ 1,277,106	$ 87,995

See accompanying notes.

Note 1 – Organization and Summary of Significant Accounting Policies

Organization – Orcas Power & Light Cooperative (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 11,393 memberships, including 13,136 residential meters and 1,872 commercial and industrial meters distributing electricity to 20 islands in the San Juan archipelago, in Washington State. Substantially all revenues are derived from the sale and distribution of electric power. The Cooperative's board of directors has the authority to set rates and charges for commodities and services furnished.

During the October 2014 board meeting, the OPALCO management received a 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.

The Cooperative's board of directors has the authority to set rates and charges for commodities and services furnished.

Principles of consolidation – The consolidated financial statements include the financial results of OPALCO and its wholly owned subsidiary, Island Network, LLC (collectively, 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, 2017 and 2016.

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 broadband 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 is being amortized over 10 years. Amortization of goodwill was $31,074 for the years ended December 31, 2017 and 2016.

Cash equivalents – The Cooperative considers all highly liquid investments with a 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. In 2017 the board designated $750,000 to be restricted for unforeseen circumstances.

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 broadband 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 $239,889 and $218,142 are included in accrued liabilities as of December 31, 2017 and 2016, 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, 2017 and 2016, the board of directors approved a 145% and 150% payout, respectively, based on a 25-year first-in, first-out (FIFO) cycle.

Operating revenue recognition and unbilled revenue – OPALCO 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. OPALCO 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, 2017 and 2016, unbilled revenue of $1,143,180 and $1,144,526, respectively, was included in the accounts receivable balance. Broadband 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 has elected to be taxed as a C-corporation and is taxable for federal income tax purposes. 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 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, capitalized organization cots 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, 2017 and 2016, 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 4, 2018, 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:

	2017	2016
Petty cash funds	$ 841	$ 992
Cash in FDIC institutions	2,898,824	2,748,871
Cash in CFC commercial paper	-	1,099,464
Cash in CoBank	153,109	151,941
	$ 3,052,774	$ 4,001,268

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:

	2017	2016
Generation	$ 33,163	$ 33,163
Transmission	31,028,699	18,098,624
Distribution	70,637,753	67,708,316
General plant	21,026,332	18,323,231
Broadband plant	11,342,799	8,511,937
Intangible plant	1,539,562	1,539,562
Total plant in service	$ 135,608,308	$ 114,214,833

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 $1,649,539 and $1,657,954 were recorded during 2017 and 2016, respectively.

Note 4 – Investments in Associated Organizations

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

	2017	2016
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
Capital term certificate from Pacific Northwest Generating Cooperative, interest at 0% maturing in September 2028	502,560	-
Select Note Investments in CFC bearing interest at 1.5% with maturities in the second quarter of 2018	1,000,000	-
Patronage capital credits in CFC	267,040	249,780
Patronage capital credits in National Information Solutions Cooperative (NISC)	97,446	88,602
Patronage capital in Federated Rural Electric Insurance Exchange	193,399	177,191
Patronage capital - others	35,884	51,485
Total investments in associated organizations	$ 2,654,603	$ 1,125,332

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

There is an intercompany loan between Island Network LLC and OPALCO for acquisition funding and transferred infrastructure and inventory from the Island Network Department to Island Network, LLC. At December 31, 2017, OPALCO's investment in subsidiary of ($4,944,797) represents the intercompany loan of $2,125,155 less undistributed subsidiary equities of ($7,069,952). The liability and associated investment are eliminated upon consolidation.

During 2017 and 2016, OPALCO incurred $79,288 and $181,471, respectively, in interest income associated with advances taken by Rock Island Communications. This income has been eliminated upon consolidation.

During 2017 and 2016, OPALCO incurred $69,840 and $34,921, respectively, in costs associated with customer fees for internet services provided by Rock Island Communications. OPALCO also billed the subsidiary for the use of electricity in the amount of $63,837 and $31,822, respectively, and $86,285 and $87,873, respectively, 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, 2017 and 2016.

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 2017 or 2016.

In November 2017, Island Network, LLC executed an amendment to its existing revolving credit promissory note increasing the total aggregate principal commitment from $2,000,000 to $2,500,000. Draws on the revolving credit promissory note are at variable interest rates measured at the time of advance. The loan term expires in November 2018 and is renewed each year at the discretion of the Lender. The note is guaranteed by OPALCO. Advances outstanding on the revolving credit promissory note were $2,400,000 with interest rate of 3.67% as of December 31, 2017.

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:

	2017	2016
Mortgages payable to RUS, payable in quarterly installments of approximately $310,000, including interest at rates ranging from 2.38% to 5.82%, maturing over various periods through December 2046.	$ 45,580,690	$ 33,913,325
Mortgages payable to CFC, payable in quarterly installments of approximately $63,000, including interest at rates ranging from 3.0% to 4.7%, maturing over various periods through 2039.	8,812,641	9,055,103
RUS economic development loan, payable in monthly installments of $667, bearing 0% interest, maturing in 2019.	23,333	56,655
CoBank loan, payable in monthly interest only installments of approximately $30,000. Interest rates ranging from 2.71% to 3.32%. Maturing over various periods through 2046.	13,500,000	8,740,000
RUS cushion of credit	(2,308,639)	(1,701,107)
Long-term debt	65,608,025	50,063,976
Capital lease obligations, stated at present value of future minimum lease payments	1,235,531	413,777
	66,843,556	50,477,753
Less current maturities of long-term debt and capital lease obligations	2,234,566	1,328,376
	$ 64,608,990	$ 49,149,377

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 $2,308,639 and $1,701,107 at December 31, 2017 and 2016, respectively, and is recorded as a reduction of RUS long-term debt on the consolidated balance sheets.

Note 7 – Long-Term Debt and Capital Lease Obligations (continued)

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

2018	$ 2,234,566
2019	1,830,919
2020	1,633,768
2021	1,835,087
2022	2,322,567
Thereafter	56,986,649
	$ 66,843,556

Capital lease obligations – During 2016, OPALCO acquired computer equipment under a capital lease agreement in the amount of $87,995, with an imputed interest rate of 0%. The lease has a three-year term with a maturity date of October 2019.

During 2017, Island Network, LLC acquired computer equipment under a capital lease agreement in the amount of $271,847, with an imputed interest rate of 0%. The lease has a three-year term with a maturity date of April 2020. Lease is collateralized by the related equipment.

During 2017, Island Network, LLC acquired computer equipment under a capital lease agreement in the amount of $468,340, with an imputed interest rate of 0%. The lease has a three-year term with a maturity date of February 2020. Lease is collateralized by the related equipment.

During 2017, Island Network, LLC acquired computer equipment under a capital lease agreement in the amount of $133,281, with an interest rate of 5.2%. The lease has a three-year term with a maturity date of July 2020. Lease is collateralized by the related equipment.

During 2017, Island Network, LLC acquired construction equipment under a capital lease agreement in the amount of $368,914, with an interest rate of 4.3%. The lease has an eight-year term with a maturity date of December 2025. Lease is collateralized by the related equipment.

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 leases, are as follows:

2018	$ 113,400
2019	113,400
2020	113,400
2021	109,950
	$ 450,150

Rent expense under the operating lease for the years ended December 31, 2017 and 2016, was $113,400 and $86,975, respectively.

Note 9 – Income Taxes

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

	2017	2016
Deferred income tax benefit (expense)		
Federal	$ 1,079,837	$ 906,994
Change in federal rate	(990,840)	-
Change in valuation allowance	(88,997)	(906,994)
Total income tax expense	$ -	$ -

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 “Tax Reform Act” was enacted December 22, 2017. The law includes significant changes to the U.S. corporate system, including a Federal corporate rate reduction from 34% to 21%. As a result of when the Act was signed into law, the Company's deferred tax assets and liabilities were required to be remeasured using the lower 21% federal rate as of December 31, 2017.

Note 9 – Income Taxes (continued)

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

	2017	2016
Deferred tax assets		
Net operating loss carryforward	$ 2,538,382	$ 2,634,339
Allowance for bad debts	1,175	3,140
Deferred revenue	-	363
Capitalized organizational costs	8,960	14,507
Contribution timing differences	4,160	686
	2,552,677	2,653,035
Less valuation allowance	(1,600,588)	(1,511,591)
Total deferred tax assets	952,089	1,141,444
Deferred tax liabilities		
Tax depreciation greater than book	(936,403)	(1,117,013)
Tax amortization greater than book	(1,742)	(1,854)
Change in prepaid insurance	(13,944)	(22,577)
Total deferred tax liabilities	(952,089)	(1,141,444)
Net deferred income tax asset (liability)	$ -	$ -

Island Network, LLC has federal net operating loss carryforwards of $12,087,500, which begin to expire in 2035.

Note 10 – Deferred Credits

As of December 31, 2017 and 2016, amounts carried on the Cooperative’s consolidated balance sheets as deferred credits consisted primarily of Project PAL funds of $33,859 and $55,305, respectively; the Member Owned Renewable Energy (MORE) Program funds of $149,600 and $158,361, respectively; and the Energy Assist Program for $92,543 and $67,468 for 2017 and 2016, 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.

Note 10 – Deferred Credits (continued)

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.

OPALCO's Energy Assist Program was started in 2016 to assist low income households with their OPALCO electric bills on a year-round basis. This is an OPALCO administered program that is meant to ease the affordability gap in San Juan County and support the community. The program is funded through rates as a separate line item on each co-op member's monthly bill. Members must be on the standard Residential rate and verify their qualification through another endorsed low income assistance program to qualify for the Energy Assist Credit.

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.

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 2017 and 2016 contributions.

Note 11 – 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 94.17% and 95.55% funded as of January 1, 2017 and 2016, 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, 2017, was 3.03%. The defined benefit plan used an assumed 9.95% 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 2017 and in 2016 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 $1,293,548 and $1,177,615 for the years ended December 31, 2017 and 2016, 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 $18,000. 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 $162,616 and $148,816 for the years ended December 31, 2017 and 2016, 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 – In October 2017, OPALCO entered into power sales contract with Pacific Northwest Generating Cooperative (PNGC) to provide the power supply through September 30, 2028. This contract supersedes the previous power sales contract with Bonneville Power Administration (BPA).

Union contract – The current collective bargaining agreement is effective for the period January 1, 2014, through December 31, 2018. As of December 31, 2017, the Cooperative employed approximately 73% of its workforce under the 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.

Note 12 – Commitments and Contingencies (continued)

Submarine cable replacement – The final installation phase of the Lopez to San Juan submarine cable replacement project was completed during the fourth quarter of 2017. At year end, OPALCO is in the process of closing out final negotiations with the primary contractor.

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 nonmonetary agreement has an initial term of 10 years with extension options and includes the joint lease of FCC spectrum, transfer of infrastructure and equipment, and ongoing services. As the fair value of the assets agreement is not determinable within reasonable limits the agreement, per GAAP, it has not been quantified within the financial statements. The investment was made 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 2018, Island Network, LLC executed a multiple advance term promissory note with CoBank in the amount of $5,500,000. Draws on the multiple advance term commitment are at variable interest rates measured at the time of advance. The loan term expires in December 2022 and the note matures in December 2037. The loan is guaranteed by OPALCO.

Supplementary Information

Orcas Power & Light Cooperative
Consolidating Balance Sheet
December 31, 2017

	OPALCO	Island Network, LLC	Eliminating Entries	Consolidated Total
ASSETS				
Electric plant in service	$ 124,265,509	$ -	$ -	$ 124,265,509
Broadband plant in service	-	11,342,799	-	11,342,799
Construction work in progress	10,630,331	781,638	-	11,411,969
	134,895,840	12,124,437	-	147,020,277
Less accumulated depreciation and amortization	45,632,268	1,483,056	-	47,115,324
Net utility plant	89,263,572	10,641,381	-	99,904,953
INVESTMENTS AND OTHER ASSETS				
Investments in associated organizations	2,654,603	-	-	2,654,603
Investment in subsidiary (Note 5)	(4,944,797)	-	4,944,797	-
Goodwill	-	220,108	-	220,108
Total investments and other assets	(2,290,194)	220,108	4,944,797	2,874,711
CURRENT ASSETS				
Cash and cash equivalents	2,269,223	33,551	-	2,302,774
Cash and cash equivalents - board designated	750,000	-	-	750,000
Accounts receivable, less allowance for doubtful accounts of $65,600 and $60,000 in 2017 and 2016	3,136,480	421,998	(359,278)	3,199,200
Interest receivable	13,218	-	-	13,218
Materials and supplies	3,221,936	2,055,621	-	5,277,557
Prepaid expenses	343,441	118,247	-	461,688
Total current assets	9,734,298	2,629,417	(359,278)	12,004,437
TOTAL ASSETS	$ 96,707,676	$ 13,490,906	$ 4,585,519	$ 114,784,101
EQUITIES AND MARGINS				
Memberships	$ 55,960	$ -	$ -	$ 55,960
Patronage capital	40,181,088	-	-	40,181,088
Undistributed subsidiary losses	(7,069,952)	(7,069,952)	7,069,952	(7,069,952)
Donated and other equities	5,984,621	-	-	5,984,621
Total equity and margins	39,151,717	(7,069,952)	7,069,952	39,151,717
LONG-TERM DEBT, less current maturities				
RUS mortgage notes	41,812,701	-	-	41,812,701
CFC mortgage notes	8,561,284	-	-	8,561,284
Note payable	-	13,500,000	-	13,500,000
Payable to OPALCO (Note 5)	-	2,125,155	(2,125,155)	-
Long-term lease liability	24,443	710,562	-	735,005
Total long-term debt	50,398,428	16,335,717	(2,125,155)	64,608,990
CURRENT LIABILITIES				
Accounts payable	2,997,993	920,681	(359,278)	3,559,396
Customer deposits	87,218	-	-	87,218
Accrued liabilities	2,032,945	433,267	-	2,466,212
Line of credit - CoBank	-	2,400,000	-	2,400,000
Current maturities of long-term debt	1,763,373	471,193	-	2,234,566
Total current liabilities	6,881,529	4,225,141	(359,278)	10,747,392
DEFERRED CREDITS	276,002	-	-	276,002
EQUITIES, MARGINS, AND LIABILITIES	$ 96,707,676	$ 13,490,906	$ 4,585,519	$ 114,784,101

Orcas Power & Light Cooperative
Consolidating Balance Sheet
December 31, 2016

	OPALCO	Island Network, LLC	Eliminating Entries	Consolidated Total
ASSETS				
Electric plant in service	$ 105,702,896	$ -	$ -	$ 105,702,896
Broadband plant in service	-	8,511,937	-	8,511,937
Construction work in progress	12,489,462	549,585	-	13,039,047
	118,192,358	9,061,522	-	127,253,880
Less accumulated depreciation and amortization	44,622,436	1,816,137	-	46,438,573
Net utility plant	73,569,922	7,245,385	-	80,815,307
INVESTMENTS AND OTHER ASSETS				
Investments in associated organizations	1,125,332	-	-	1,125,332
Investment in subsidiary (Note 5)	(2,389,472)	-	2,389,472	-
Goodwill	-	251,183	-	251,183
Total investments and other assets	(1,264,140)	251,183	2,389,472	1,376,515
CURRENT ASSETS				
Cash and cash equivalents	3,906,844	94,424	-	4,001,268
Accounts receivable, less allowance for doubtful accounts of $60,000 in 2016 and 2015	3,610,821	210,019	-	3,820,840
Interest receivable	9,386	-	-	9,386
Materials and supplies	3,711,223	1,451,155	-	5,162,378
Prepaid expenses	349,741	121,914	-	471,655
Total current assets	11,588,015	1,877,512	-	13,465,527
TOTAL ASSETS	$ 83,893,797	$ 9,374,080	$ 2,389,472	$ 95,657,349
EQUITIES AND MARGINS				
Memberships	$ 56,905	$ -	$ -	$ 56,905
Patronage capital	38,334,632	-	-	38,334,632
Undistributed subsidiary losses	(4,517,947)	(4,517,947)	4,517,947	(4,517,947)
Donated and other equities	5,403,526	-	-	5,403,526
Total equity and margins	39,277,116	(4,517,947)	4,517,947	39,277,116
LONG-TERM DEBT, less current maturities				
RUS mortgage notes	31,418,746	-	-	31,418,746
CFC mortgage notes	8,812,642	-	-	8,812,642
Note payable	-	8,740,000	-	8,740,000
Payable to OPALCO (Note 5)	-	2,128,475	(2,128,475)	-
Long-term lease liability	53,775	124,214	-	177,989
Total long-term debt	40,285,163	10,992,689	(2,128,475)	49,149,377
CURRENT LIABILITIES				
Accounts payable	1,692,979	384,057	-	2,077,036
Customer deposits	89,928	-	-	89,928
Accrued liabilities	1,144,752	308,825	-	1,453,577
Line of credit - CoBank	-	2,000,000	-	2,000,000
Current maturities of long-term debt	1,121,920	206,456	-	1,328,376
Total current liabilities	4,049,579	2,899,338	-	6,948,917
DEFERRED CREDITS	281,939	-	-	281,939
EQUITIES, MARGINS, AND LIABILITIES	$ 83,893,797	$ 9,374,080	$ 2,389,472	$ 95,657,349

Orcas Power & Light Cooperative
Consolidating Statement of Revenues and Margins
Year Ended December 31, 2017

	OPALCO	Island Network, LLC	Eliminating Entries	Consolidated Total
OPERATING REVENUES				
Electricity sales	$ 27,985,185	$ -	$ (63,837)	$ 27,921,348
Broadband sales	-	3,644,987	(69,840)	3,575,147
Total operating revenues	27,985,185	3,644,987	(133,677)	31,496,495
OPERATING EXPENSES				
Cost of purchased power	8,916,059	-	-	8,916,059
Transmission	210,740	-	-	210,740
Distribution - operations	3,617,096	-	-	3,617,096
Distribution - maintenance	1,767,342	-	-	1,767,342
Consumer accounts	982,216	-	-	982,216
Broadband services	-	858,462	(150,122)	708,340
Administrative and general	3,394,059	3,596,608	(69,840)	6,920,827
Depreciation and amortization	3,699,958	1,085,739	-	4,785,697
Taxes	1,261,409	148,670	-	1,410,079
Total operating expenses	23,848,879	5,689,479	(219,962)	29,318,396
Operating margins before fixed charges	4,136,306	(2,044,492)	86,285	2,178,099
FIXED CHARGES				
Interest on long-term debt	1,061,579	511,073	(79,288)	1,493,364
Operating margins after fixed charges	3,074,727	(2,555,565)	(165,573)	684,735
PATRONAGE CAPITAL CREDITS	77,586	-	-	77,586
Net operating margins	3,152,313	(2,555,565)	(165,573)	762,321
NONOPERATING MARGINS				
Interest income	223,696	-	(79,288)	144,408
Other income	23,280	3,560	(86,285)	(59,445)
Total nonoperating margins	246,976	3,560	(165,573)	84,963
Net operating and nonoperating margins	3,399,289	(2,552,005)	(331,146)	847,284
LOSS FROM SUBSIDIARY	(2,552,005)	-	2,552,005	-
NET MARGINS	$ 847,284	$ (2,552,005)	$ 2,552,005	$ 847,284

Orcas Power & Light Cooperative
Consolidating Statement of Revenues and Margins
Year Ended December 31, 2016

	OPALCO	Island Network, LLC	Eliminating Entries	Consolidated Total
OPERATING REVENUES				
Electricity sales	$ 25,249,029	$ -	$ (31,822)	$ 25,217,207
Broadband sales	-	2,286,266	-	2,286,266
Total operating revenues	25,249,029	2,286,266	(31,822)	27,503,473
OPERATING EXPENSES				
Cost of purchased power	7,942,885	-	-	7,942,885
Transmission	108,288	-	-	108,288
Distribution - operations	3,202,068	-	-	3,202,068
Distribution - maintenance	1,692,344	-	-	1,692,344
Consumer accounts	947,326	-	-	947,326
Broadband services	-	759,616	(31,822)	727,794
Administrative and general	2,926,586	3,248,603	(34,921)	6,140,268
Depreciation and amortization	3,546,977	584,560	-	4,131,537
Taxes	1,137,058	100,856	-	1,237,914
Total operating expenses	21,503,532	4,693,635	(66,743)	26,130,424
Operating margins before fixed charges	3,745,497	(2,407,369)	34,921	1,373,049
FIXED CHARGES				
Interest on long-term debt	1,095,316	282,746	(181,471)	1,196,591
Operating margins after fixed charges	2,650,181	(2,690,115)	(216,392)	176,458
PATRONAGE CAPITAL CREDITS	81,361	-	-	81,361
Net operating margins	2,731,542	(2,690,115)	(216,392)	257,819
NONOPERATING MARGINS				
Rental expense	-	(52,952)	52,952	-
Interest income	217,757	-	(181,471)	36,286
Other income	112,958	5,233	(87,873)	30,318
Total nonoperating margins	330,715	(47,719)	(216,392)	66,604
Net operating and nonoperating margins	3,062,257	(2,737,834)	(432,784)	324,423
LOSS FROM SUBSIDIARY	(2,737,834)	-	2,737,834	-
NET MARGINS	$ 324,423	$ (2,737,834)	$ 2,737,834	$ 324,423

Report Required by *Government Auditing Standards*

MOSSADAMS

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, 2017, 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 4, 2018.

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 4, 2018