

Vermont Electric Cooperative, Inc.

FINANCIAL STATEMENTS

December 31, 2010

Vermont Electric Cooperative, Inc.
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Kittell Branagan & Sargent

Certified Public Accountants

Vermont License # 167

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Vermont Electric Cooperative, Inc.
Johnson, Vermont

We have audited the accompanying statement of financial position of Vermont Electric Cooperative, Inc. (a nonprofit organization) as of December 31, 2010 and 2009, and the related statements of activities, and cash flows for the years then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Vermont Electric Cooperative, Inc. as of December 31, 2010 and 2009, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 9, 2011, on our consideration of Vermont Electric Cooperative, Inc.'s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements of Vermont Electric Cooperative, Inc. taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.



W. H. Hittell J. H. Hargrave & S. J. Sargent

St. Albans, Vermont
March 9, 2011

Vermont Electric Cooperative, Inc.
BALANCE SHEETS
December 31,

	<u>2010</u>	<u>2009</u>
<u>ASSETS</u>		
ELECTRIC PLANT, at cost	\$ 107,019,713	\$ 101,390,389
Less accumulated depreciation	<u>(28,066,001)</u>	<u>(26,135,936)</u>
Electric plant in service, net	78,953,712	75,254,453
Construction work in progress	<u>5,415,350</u>	<u>3,172,549</u>
TOTAL ELECTRIC PLANT, net	<u>84,369,062</u>	<u>78,427,002</u>
CURRENT ASSETS		
Cash	214,456	285,571
Notes receivable	308	1,915
Accounts receivable, net of allowance of \$220,527 and \$203,379 at December 31, 2010 and 2009, respectively	8,717,550	5,562,649
Unbilled revenue	4,576,172	4,357,090
Inventories	2,912,631	2,599,232
Prepaid expenses	<u>264,973</u>	<u>340,175</u>
TOTAL CURRENT ASSETS	<u>16,686,090</u>	<u>13,146,632</u>
OTHER ASSETS		
Nonutility property	65,697	65,697
Other investments	13,781,505	9,805,627
Deferred charges	<u>427,472</u>	<u>648,227</u>
TOTAL OTHER ASSETS	<u>14,274,674</u>	<u>10,519,551</u>
TOTAL ASSETS	<u>\$ 115,329,826</u>	<u>\$ 102,093,185</u>

LIABILITIES AND EQUITY

	<u>2010</u>	<u>2009</u>
EQUITIES		
Patronage capital assignable	\$ 24,360,442	\$ 20,325,111
Other equities	2,499,439	2,499,414
Contributions in aid of construction	<u>17,186,363</u>	<u>16,357,441</u>
 NET EQUITY	 <u>44,046,244</u>	 <u>39,181,966</u>
 LONG-TERM DEBT	 <u>55,820,961</u>	 <u>49,047,218</u>
 OBLIGATIONS UNDER CAPITAL LEASE	 <u>295,599</u>	 <u>308,693</u>
 CURRENT LIABILITIES		
Current portion of long-term debt	2,226,257	2,068,158
Current portion of capital lease obligations	13,094	15,443
Revolving debt	2,000,000	3,400,000
Accounts payable	7,293,288	5,506,673
Customer deposits	382,932	239,460
Deferred credits	246,896	319,810
Other accrued expenses	<u>3,004,555</u>	<u>2,005,764</u>
 TOTAL CURRENT LIABILITIES	 <u>15,167,022</u>	 <u>13,555,308</u>
 TOTAL LIABILITIES AND EQUITY	 <u>\$ 115,329,826</u>	 <u>\$ 102,093,185</u>

See Accompanying Notes to Financial Statements

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

	<u>2010</u>	<u>2009</u>
OPERATING REVENUE	<u>\$ 71,164,783</u>	<u>\$ 70,038,174</u>
OPERATING EXPENSES		
Purchased power	37,216,698	39,326,007
Transmission:		
Operations	6,687,143	7,091,847
Maintenance	654,520	549,126
Distribution:		
Operations, including vehicle depreciation expense of \$51,019 and \$44,193 in 2010 and 2009, respectively	4,447,565	4,359,764
Maintenance	6,037,901	3,936,756
Customer accounts	2,155,021	2,126,221
Administrative and general	3,393,343	2,804,775
General plant maintenance	165,041	131,922
Depreciation	3,417,325	3,122,694
Amortization	184,013	421,913
Taxes	690,623	666,857
Other deductions, net	541,651	25,331
TOTAL OPERATING EXPENSES	<u>65,590,844</u>	<u>64,563,213</u>
INCOME FROM OPERATIONS	<u>5,573,939</u>	<u>5,474,961</u>
OTHER INCOME (EXPENSES)		
Gain (loss) on sale of fixed assets	5,051	(91,519)
Other income (expenses)	14,559	(13,894)
Interest and dividend income	1,113,961	1,001,905
Other capital credits & dividends	400,191	268,786
TOTAL OTHER INCOME	<u>1,533,762</u>	<u>1,165,278</u>
NET INCOME BEFORE INTEREST CHARGES	<u>7,107,701</u>	<u>6,640,239</u>
INTEREST CHARGES		
Interest on long-term debt	2,908,213	2,792,052
Other interest	164,157	158,277
TOTAL INTEREST CHARGES	<u>3,072,370</u>	<u>2,950,329</u>
NET INCOME	<u>\$ 4,035,331</u>	<u>\$ 3,689,910</u>

See Accompanying Notes to Financial Statements

Vermont Electric Cooperative, Inc.
STATEMENTS OF EQUITIES
For the Years Ended December 31,

	Issued and Subscribed	Capital Assignable	Other Equities (Deficits)				In Aid of Construction	Total
			Capital Credits	Gains and Losses	Donated Capital	Earnings (Losses)		
BALANCE, at December 31, 2008	\$ -	\$ 16,635,201	\$ 12,212	\$ 9,798	\$ 214,331	\$ 2,263,043	\$ 15,664,271	\$ 34,798,856
Donated capital	-	-	-	-	30	-	-	30
Net income for the year	-	-	-	-	-	3,689,910	-	3,689,910
Transfer to patronage capital assignable	-	3,689,910	-	-	-	(3,689,910)	-	-
New contributions in aid of construction	-	-	-	-	-	-	693,170	693,170
BALANCE, at December 31, 2009	-	20,325,111	12,212	9,798	214,361	2,263,043	16,357,441	39,181,966
Donated capital	-	-	-	-	25	-	-	25
Net income for the year	-	-	-	-	-	4,035,331	-	4,035,331
Transfer to patronage capital assignable	-	4,035,331	-	-	-	(4,035,331)	-	-
New contributions in aid of construction	-	-	-	-	-	-	828,922	828,922
BALANCE, at December 31, 2010	<u>\$ -</u>	<u>\$ 24,360,442</u>	<u>\$ 12,212</u>	<u>\$ 9,798</u>	<u>\$ 214,386</u>	<u>\$ 2,263,043</u>	<u>\$ 17,186,363</u>	<u>\$ 44,046,244</u>

See Accompanying Notes to Financial Statements

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

	<u>2010</u>	<u>2009</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 4,035,331	\$ 3,689,910
Noncash expenses (income) included in earnings:		
Depreciation	3,417,325	3,122,694
Amortization	184,013	421,913
(Gain) loss on sale of fixed assets	(5,051)	91,519
Hydro Quebec disallowance	(258,680)	(344,704)
Changes in assets and liabilities:		
Decrease in notes receivable	1,607	4,473
Increase in accounts receivable	(3,373,983)	(209,531)
Increase in inventories	(313,399)	(255,958)
Decrease (increase) in prepaid expenses	75,202	(136,463)
Increase in accounts payable	1,786,615	82,573
Increase in customer deposits	143,472	136,101
Increase (decrease) in accrued expenses	998,791	(332,151)
Decrease in deferred credits	<u>(72,914)</u>	<u>(221,232)</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>6,618,329</u>	<u>6,049,144</u>
 CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to electric plant in service and construction work in progress	(9,102,014)	(12,449,912)
Proceeds from sale of electric plant in service	6,360	38,076
Decrease in deferred charges	36,742	12,719
Return on capital investments	(227,234)	(198,932)
Proceeds (purchase) of investments	<u>(3,748,644)</u>	<u>33,118</u>
NET CASH USED IN INVESTING ACTIVITIES	<u>(13,034,790)</u>	<u>(12,564,931)</u>
 CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from long-term borrowings	9,000,000	6,000,000
Principal payments to creditors related to long-term borrowings	(2,068,158)	(1,902,573)
Net borrowing (payment) on line of credit	(1,400,000)	850,058
Increase in contributions in aid of construction	828,922	693,170
Additions to donated capital, net	25	30
Principal payments under capital lease obligations	<u>(15,443)</u>	<u>(29,580)</u>
NET CASH PROVIDED BY FINANCING ACTIVITIES	<u>6,345,346</u>	<u>5,611,105</u>
 NET DECREASE IN CASH	 (71,115)	 (904,682)
 CASH - Beginning of Year	 <u>285,571</u>	 <u>1,190,253</u>
 CASH - End of Year	 <u>\$ 214,456</u>	 <u>\$ 285,571</u>

See Accompanying Notes to Financial Statements

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2010

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Regulatory Jurisdictions

The Cooperative is a distribution cooperative, providing residential and commercial electrical service to members in the State of Vermont.

The operations of the Vermont Electric Cooperative, Inc. (the Cooperative) are under the jurisdiction of the Vermont Public Service Board (PSB). The PSB has the primary responsibility for regulating the Cooperative's rates. The Cooperative utilizes the Uniform System of Accounts established by the Rural Utilities Service (RUS), except where the PSB has prescribed other treatment. As described in Note 9, certain adjustments have been made to the accompanying financial statements for presentation under Generally Accepted Accounting Principles (GAAP). In accordance with Statement of Financial Accounting Standards No. 71, Accounting for the Effects of Certain Types of Regulation, the Cooperative records certain assets and liabilities in accordance with the economic effects of the rate making process.

Revenue Recognition

The Cooperative recognizes revenue for electric service in the month that service is rendered. This method of recognizing operating revenue is consistent with industry practice.

Unbilled Revenue

The Cooperative records unbilled revenue for the amount of electricity consumed from the last meter reading date to the last day of the year.

Electric Plant

Electric plant is stated at cost. The Cooperative employs the straight-line and straight-line composite methods for determining the annual charge for depreciation. Under RUS accounting, a portion of depreciation expense on transportation equipment is allocated to transmission and distribution expense.

Maintenance and repairs are charged to expense as incurred. When assets are retired or otherwise disposed of, the costs are removed from plant, and such costs, plus removal costs, less salvage, are charged to accumulated depreciation.

Investments

Investments in stock of associated companies and other investments are stated at cost. Because these investments are not publicly traded, market values are not readily determinable.

Inventories

Inventories are stated at the lower of cost or market, cost is determined on a rolling average basis.

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2010

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Amortization

The Cooperative follows the policy of charging to operating expenses annual amounts of amortization which allocate the cost of various deferred charges over periods established by management for rate-making purposes. The Cooperative employs the straight-line method for determining the annual charge for amortization.

Contributions in Aid of Construction

As explained in note 1 above, the Cooperative follows RUS accounting guidelines, except as otherwise prescribed or allowed by its state regulator, the PSB. In accordance with state regulatory requirements, contributions in aid of construction are accounted for as a component of members' equity rather than as a reduction of electric plant in service. All contributions in aid of construction come from members of the Cooperative. During 2010 and 2009, the Cooperative received \$828,922 and \$693,170, respectively, in contributions in aid of construction. Subsequent to year end the PSB issued Docket No. 7554 recommending the Cooperative allocate contributions in aid of construction in a manner consistent with GAAP along the same manner used to allocate energy patronage capital.

Corporate Structure and Income Taxes

The Cooperative is a nonprofit and non-stock membership corporation organized under provisions of the Electric Cooperative Act of Vermont. The Cooperative is an organization described in Section 501(c)(12) of the Internal Revenue Code, and has been recognized by the Internal Revenue Service as an organization exempt from taxes on related income under Section 501(a).

Consideration has been given to uncertain tax positions. The federal income tax returns for the years ended after December 31, 2007, remain open for potential examination by major tax jurisdictions, generally for three years after they were filed.

Taxes

The Cooperative pays property, gross revenue and gross receipts taxes on a yearly basis. Gross revenue taxes are paid to the State of Vermont annually. During 2010 and 2009, the Cooperative paid \$2,078,802 and \$2,091,346 for property taxes, \$350,264 and \$336,334 for gross revenue taxes and \$340,359 and \$330,523 respectively, for gross receipt taxes. In accordance with RUS accounting guidelines, the property tax payments are allocated to various other accounts. Gross receipts taxes are paid to the State of Vermont on a quarterly basis as a percentage of sales.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2010

NOTE 2 ELECTRIC PLANT IN SERVICE

An analysis of electric plant in service at is as follows:

<u>December 31, 2010</u>	<u>Depreciable Life/Rate Per Year</u>	
Transmission Plant	2.75%	\$ 7,403,929
Distribution Plant	3.00%	93,078,120
Buildings and Structures	20-50	1,917,384
Transportation Equipment	5-10	780,558
General Plant	3-10	4,580,890
Hydro Quebec Disallowance	17	<u>(741,168)</u>
		<u>\$ 107,019,713</u>

<u>December 31, 2009</u>	<u>Depreciable Life/Rate Per Year</u>	
Production Plant	5.00%	\$ 591,129
Transmission Plant	2.75%	7,304,170
Distribution Plant	3.00%	88,268,303
Buildings and Structures	20-50	1,816,843
Transportation Equipment	5-10	686,288
General Plant	3-10	3,723,504
Hydro Quebec Disallowance	17	<u>(999,848)</u>
		<u>\$ 101,390,389</u>

Depreciation of electric plant in service totaled \$3,417,325 and \$3,122,694 in 2010 and 2009, respectively.

- Reduction in power supply costs for 2010 and 2009 was \$258,680 and \$344,704, respectively. The remaining disallowance will be amortized over the remaining life of the Hydro-Quebec Participation Agreement.

NOTE 3 OTHER INVESTMENTS

Other investments for which there is no active market and stated at cost are as follows December 31,:

	<u>2010</u>	<u>2009</u>
Investments in associated organizations		
National Rural Utilities Cooperative Finance Corporation (CFC) membership	<u>\$ 2,448,421</u>	<u>\$ 2,303,694</u>

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2010

NOTE 3 OTHER INVESTMENTS (continued)

	<u>2010</u>	<u>2009</u>
Other investments		
Southeastern Data Cooperative capital credit	\$ 28,860	\$ 28,860
CoBank capital credit	321,532	246,278
Cooperative Response Center	10,000	10,000
Vermont Electric Power Company common stock	1,691,775	1,691,775
Vermont Transco, LLC Stock	8,928,750	5,128,750
New England Hydro-Transmission Corporation Common Stock	298,515	349,871
Other	53,652	46,399
	<u>11,333,084</u>	<u>7,501,933</u>
TOTAL OTHER INVESTMENTS	<u>\$ 13,781,505</u>	<u>\$ 9,805,627</u>

NOTE 4 DEFERRED CHARGES

Deferred charges at December 31, included:

	<u>2010</u>	<u>2009</u>
NRECA liability	\$ -	\$ 10,084
2008 Series A Debt Issuance Costs	428,848	463,156
Automated Meter Info System	-	(3,495)
Business Process Review Audit	-	135,084
Other deferred charges	(1,376)	43,398
	<u>\$ 427,472</u>	<u>\$ 648,227</u>

NRECA Liability

This liability was incurred as a result of retirement service cost in 1990 and is recoverable through rates through December 31, 2010. Amortization charged to pension expense was \$10,085 for the years ended December 31, 2010 and 2009.

2008 Series A Debt Issuance Costs

Debt issuance costs were incurred to issue a series of first mortgage bonds in 2008 and are recoverable in rates through June 30, 2023. Amortization was \$34,308 and \$34,308 for the years ended December 31, 2010 and 2009.

Vermont Electric Cooperative, Inc.
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2010

NOTE 4 DEFERRED CHARGES (continued)

Acquisition of Citizens Communication Corporation (Vermont Electric Division)

The Cooperative purchased the assets of Citizens Communication Corporation (Vermont Electric Division) on April 1, 2005. Costs incurred in the acquisition of the assets and regulatory costs assumed in the purchase are included in this amount. These amounts will be recoverable in rates over a period of 40 to 60 months. Amortization was \$0 and \$237,899 for the years ended December 31, 2010 and 2009, respectively.

Automated Meter Information System (AMI)

These charges represent the deferred labor component of meter installs yet to be performed, and offset the capitalized component. The charge is reduced as labor is incurred on the install.

Business Process Review

The Cooperative incurred costs related to the implementations of a Business Process Review Audit. A system assessment was completed during 2008 highlighting areas of attention for VEC to address as part of the Cooperative's long term capital plan. VEC received regulatory approval to defer the costs associated with the implementation and to recover the costs over a twenty-four month period beginning January, 2009.

Other

These charges represent the costs of preliminary construction surveys that will be expensed or capitalized upon completion of studies. Also included are costs of plans developed that are recoverable through rates. Amortization charged to purchased power was \$2,500 and \$2,500 for the years ended December 31, 2010 and 2009.

NOTE 5 LONG-TERM DEBT

Long-term debt consists of the following at December 31,

	<u>2010</u>	<u>2009</u>
2001 Series A bonds, 6.35%, due through 2011	\$ 284,283	\$ 639,507
2002 Series A bonds, 5.70%, due through 2027	1,498,827	1,556,174
2003 Series A bonds, 6.64%, due through 2028	1,282,033	1,330,473
2003 Series B bonds, 6.60%, due through 2023	362,538	383,936
2004 Series A bonds, as elected, due through 2034	19,320,403	19,671,115
2005 Series A bonds, as elected, due through 2034	3,235,068	3,387,668
2006 Series A bonds, 6.85%, due through 2035	3,990,742	4,052,299
2008 Series A bonds, as elected, due through 2023	8,465,625	9,142,875

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2010

NOTE 5 LONG-TERM DEBT (continued)

	<u>2010</u>	<u>2009</u>
2008 Series B bonds, 5.94%, due through 2038	4,197,479	4,348,739
2009 Series A bonds, 4.17%, due through 2039	5,897,163	6,000,000
2010 Series A bonds, as elected, due through 2040	9,000,000	-
Prior Service Cost, NRECA Retirement Loan, 6.45%, due through 2015	<u>513,057</u>	<u>602,590</u>
	58,047,218	51,115,376
Less: Current installments of long-term debt	<u>(2,226,257)</u>	<u>(2,068,158)</u>
 TOTAL LONG-TERM DEBT	 <u>\$ 55,820,961</u>	 <u>\$ 49,047,218</u>

2001 Bonds

On April 1, 2001, the Cooperative issued \$2,750,000 of First Mortgage Bonds, the proceeds of which were used to fund capital expenditures and for general operating purposes. The bonds have a term of 10 years and interest at 6.35%, with interest and principal payable quarterly.

2002 Bonds

On October 1, 2002, the Cooperative issued \$1,900,000 of First Mortgage Bonds, the proceeds of which were used to fund capital expenditures. The bonds have a term of 25 years and bear interest at 5.70%, with varying quarterly interest and principal payments.

2003 Bonds, Series A

On May 1, 2003, the Cooperative issued \$1,600,000 of First Mortgage Bonds, the proceeds of which were used to fund capital expenditures. The bonds have a term of 25 years and bear interest at 6.64% at December 31, 2010, with interest and principal payable quarterly.

2003 Bonds, Series B

On November 1, 2003, the Cooperative issued \$500,000 of First Mortgage Bonds, the proceeds of which were used to fund a warehouse addition. The bonds have a term of 20 years and bear a variable rate of interest, which was 6.60% at December 31, 2010, with interest and principal payable quarterly.

2004 Bonds, Series A

On April 1, 2004 the Cooperative issued \$21,337,226 of First Mortgage Bonds, the proceeds were used to purchase the Vermont assets of Citizens Communication Corporation (Vermont Electric Division). The bonds were advanced in various denominations, management has elected to group the 2005 Bonds, Series A into six separate agreements with various variable and fixed rate options. The 2005 Bonds, Series A have a term of 30 years. The interest rates, fixed rate terms and debt consist of the following at December 31,:

Vermont Electric Cooperative, Inc.
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2010

NOTE 5 LONG-TERM DEBT (continued)

	<u>2010</u>	<u>2009</u>
VT0079024008 - 6.70% Fixed 23 Years	\$ 2,028,032	\$ 2,063,389
VT0079024002 - 6.30% Fixed 27 Years	3,835,201	3,902,395
VT0079024003 - 5.50% Fixed 11 Years	1,919,020	1,957,449
VT0079024004 - 5.65% Fixed 14 Years	3,847,760	3,923,162
VT0079024005 - 6.40% Fixed 25 Years	1,946,926	1,981,121
VT0079024006 - 6.45% Fixed 30 Years	3,896,775	3,964,714
VT0079024007 - 6.45% Fixed 25 Years	<u>1,846,689</u>	<u>1,878,885</u>
	<u>\$ 19,320,403</u>	<u>\$ 19,671,115</u>

2005 Bonds Series A

On January 5, 2005, the Cooperative issued \$4,237,752 of First Mortgage Bonds, the proceeds of which were used to refinance the line of credit. The bonds have a term of 30 years at various fixed rate options, paying from 5.75% to 6.90% at December 31, 2010.

The loan agreements allow management the ability to set the terms of the fixed rate bonds (Conversion Request). At the end of each fixed rate period management needs to convert to a new term and reprice the fixed rate or the bond will revert to the Variable Rate Option. The interest rate will be paid in accordance with the interest rate options for Fixed and Variable Rates as outlined in the loan agreements.

2006 Series A Bonds

On January 1, 2006, the Cooperative issued \$4,250,000 of First Mortgage Bonds, the proceeds of which were to refinance the line of credit and fund the Cooperative's plant additions. The bonds have 30 year terms and bear interest at 6.50% and 6.85%, with interest and principal payments payable quarterly.

2008 Series A Bonds

On June 30, 2008, the Cooperative issued \$10,158,750 of First Mortgage Bonds, the proceeds of which were to refinance the 1997 First Mortgage Bonds. The bonds have 15 year terms and bear interest at 5.69% and 4.45%, with interest and principal payments payable quarterly.

2008 Series B Bonds

On December 1, 2008, the Cooperative issued \$4,500,000 of First Mortgage Bonds, the proceeds of which were to refinance the line of credit and fund the Cooperative's plant additions. The bonds have 30 year terms and bear interest at 5.94%, with interest and principal payments payable quarterly.

2009 Series A Bonds

On October 1, 2009, the Cooperative issued \$6,000,000 of First Mortgage Bonds, the proceeds of which were to refinance the line of credit and fund the Cooperative's plant additions. The bonds have 30 year terms and bear interest at 4.17%, with interest and principal payments payable quarterly.

Vermont Electric Cooperative, Inc.
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2010

NOTE 5 LONG-TERM DEBT (continued)

2010 Series A Bonds

On November 1, 2010, the Cooperative issued \$9,000,000 of First Mortgage Bonds, the proceeds of which were to refinance the line of credit and fund the Cooperative's plant additions. The bonds have 15 and 25 year terms and bear interest at 4.58% and a variable rate of which was 1.36% for December 2010, with interest and principal payments payable semi-annually.

Security for First Mortgage Bonds

As security for the mortgage bonds, the Cooperative has pledged substantially all net electric plant assets. In addition, the Mortgage Indentures obligate the Cooperative to meet certain rate and financial covenants. Additionally, the Cooperative must achieve and sustain various equity levels per loan agreement.

NRECA Loans

NRECA Retirement & Security program loan represents amounts due for employee benefit prior service costs. The loans have a term of 10 years and bear interest at 6.45% with quarterly installments paid in March, June, September and December of each year.

The maturities of long-term debt for the next five years and thereafter are as follows:

Year Ending December,	
2011	\$ 2,226,257
2012	2,182,278
2013	2,243,629
2014	2,308,467
2015	2,345,439
Thereafter	46,741,148
	\$ 58,047,218

The Cooperative's short term credit facility consists of a revolving line of credit agreement and security agreement provide for a short term credit facility that can provide for up to twenty million in short term loans or issuance of letters of credit on VEC's behalf as long as the total outstanding principal short term loan does not exceed ten million in aggregate. The Cooperative had drawn short term loans of \$2,000,000 and \$3,400,000, as of December 31, 2010 and 2009, respectively. Advances under this line of credit bear a variable rate of interest, which was 3.42% at December 31, 2010. The revolving line of credit matures July 1, 2011, and the letters of credit are set to expire March 31, 2011.

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2010

NOTE 6 LEASES

Capital Leases

Leases that meet the criteria of capital leases have been capitalized and the related assets are included in electric plant in service as follows:

	<u>2010</u>	<u>2009</u>
General Plant	\$ 363,597	\$ 635,893
Less: Accumulated Amortization	<u>90,899</u>	<u>339,618</u>
	<u>\$ 272,698</u>	<u>\$ 296,275</u>

Future minimum lease payments under the capital lease, together with present value of the net minimum lease payments, as of December 31, 2010 are as follows:

<u>Year Ending December 31,:</u>	
2011	\$ 31,259
2012	31,259
2013	31,259
2014	31,259
2015	31,259
Thereafter	<u>312,590</u>
Total minimum lease payments	468,885
Less amount representing interest	<u>(160,192)</u>
Present value of the minimum lease payments	308,693
Less current installments	<u>(13,094)</u>
Capital lease obligations, excluding current installments	<u>\$ 295,599</u>

Operating Leases

The Cooperative has several non-cancelable operating leases for vehicles and equipment. The future minimum lease payments under these non-cancelable operating leases as of December 31, are as follows:

<u>Year Ending December 31,</u>	
2011	\$ 943,745
2012	797,248
2013	491,898
2014	334,635
2015	186,557
Thereafter	<u>52,698</u>
	<u>\$ 2,806,781</u>

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2010

NOTE 6 LEASES (continued)

Total operating lease expense for 2010 and 2009 was \$945,797 and \$870,757, respectively.

NOTE 7 PENSION PLAN

All employees of the Cooperative participate in the National Rural Electric Cooperative Association (NRECA) Retirement and Security Program, a defined benefit pension plan qualified under Section 401 and tax-exempt under Section 501(a) of the Internal Revenue Code. In this multiemployer plan, which is available to all member cooperatives of NRECA, the accumulated benefits and plan assets are not determined or allocated separately by individual employer. The Cooperative makes annual contributions to the plan equal to the amounts accrued for pension expense. Contributions to this plan totaled \$1,166,791 and \$887,289 for 2010 and 2009, respectively.

NOTE 8 COMMITMENTS AND CONTINGENCIES

Power Contracts

In 2010 and 2009, the Cooperative has entered into contracts with Morgan Stanley, NextEra Energy and Merrill Lynch to replace expiring contracts covering from one year to three years based on forecasted power usage.

The Cooperative entered into a contract in the first quarter of 2009 with First Wind Energy for 20 MW of nameplate capacity for a wind farm to be located in Sheffield, Vermont. The contract covers a period of twenty years and includes a portion of the MW at a predetermined fixed price and a portion at a variable market rate.

The Cooperative entered into a letter of intent to purchase from Green Mountain Power Corporation for 8 MW of nameplate capacity for a wind farm located in Lowell, Vermont. The agreement covers a period of twenty-five years at a price shared between the two utilities.

The Cooperative entered into a contract for a peaking generating unit with Vermont Public Power Supply Authority (VPPSA) in the second quarter of 2009 to provide for some peaking energy, capacity and ancillary services over the life of the facility estimated to be twenty years. The project was placed into service in 2010.

As a result of the acquisition of Citizens Vermont Electric Division, power supply contracts serving the Citizens customers were assigned to Vermont Electric Cooperative, Inc. These contracts included a long term power supply agreement with Hydro Quebec. In 2010, VEC participated in a joint utility negotiation to extend the Hydro Quebec contract on terms and prices that are currently being reviewed by the Vermont Public Service Board.

All power contracts serve the entire load of the Cooperative, net of required purchases from independent power producers and the State of Vermont.

Power purchased in excess of usage is resold on the spot market and power purchased through the contracts that is less than usage requires the Cooperative to purchase the difference on the spot market.

Vermont Electric Cooperative, Inc.
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2010

NOTE 8 COMMITMENTS AND CONTINGENCIES (continued)

Other Legal and Regulatory Matters

In 1987, the Village of Derby filed a petition with the PSB to create its own municipal utility and acquire the assets of the Cooperative in the village, under PSB Docket No. 5213 and No. 5246. During 1999, the Cooperative's board of trustees and the Trustees of the Village agreed to the following: (a) a single \$75,000 cash payment by the Cooperative to the Village; and (b) provision by the Cooperative of credit on the Village's municipal electric account in the amount equal to the electric usage charges billed for the Village's own municipal account for a period of ten (10) years. As of December 31, 2010, the credits are being recovered from the Cooperative's other rate payers.

The Cooperative is exposed to various risks of loss related to torts; theft of, damage to an destruction of assets; errors and omissions; injuries to employees; stray voltage and natural disasters. The Cooperative manages these risks through commercial insurance packages purchased in the name of the Cooperative. The Cooperative has transferred the risk of loss to the commercial insurance carrier. Insurance settlements have not exceeded insurance coverage for any of the past five fiscal years.

Letter of Credit

The Cooperative can issue letters of credit through National Rural Utilities Cooperative Finance Corporation using the short term credit facility. The purpose of letters of credit is to allow the availability of credit for power suppliers and other vendors. The Cooperative had used \$2,000,000 and \$1,250,000 of the total letter of credit at December 31, 2010 and 2009, respectively.

NOTE 9 POSTRETIREMENT MEDICAL AND LIFE PLAN

The plan was acquired on April 1, 2004 as part of the acquisition of Citizens Communication Corporation (Vermont Electric Division).

The table below presents in accordance with professional accounting standards and details about the Cooperatives Plan, including its funded status, components of net periodic benefit cost, and certain assumptions used in determining the funded status and cost at December 31, 2010:

Change in benefit obligation:	
Benefit obligation at beginning of year	\$ 145,415
Interest cost	18,693
Benefits paid	(48,935)
Actuarial (gain) loss	<u>263,338</u>
Benefit obligation at end of year	<u>\$ 378,511</u>
Change in plan assets:	
Employer contribution	\$ 48,935
Benefits paid	<u>(48,935)</u>
Fair value of plan assets at end of year	<u>\$ -</u>

Vermont Electric Cooperative, Inc.
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2010

NOTE 9 POSTRETIREMENT MEDICAL AND LIFE PLAN (continued)

Expected future benefit payments for each of the next five fiscal years and in the aggregate for the following five years are as follows:

2011	\$ 48,935
2012	48,935
2013	48,935
2014	48,935
2015	41,423
2016-2020	193,594

Assumptions

Weighted average assumptions used to determine the benefit obligation as of December 31, 2010 and the periodic benefit cost for the fiscal year then ended are as follows:

Discount rate – beginning of year	5.75%
Discount rate – end of year	3.50%
Rate of compensation increase	N/A

NOTE 10 SALE-LEASE BACK AGREEMENT

On December 28, 2005, the Cooperative entered into a sale-leaseback agreement for a portion of a property sale of land and buildings. Under the agreement the Cooperative has conveyed title to the land and buildings, however, will leaseback a warehouse and the portion of land where the warehouse is located under a capital lease transaction.

The Cooperative will lease the warehouse facility for \$45,000 per year for a period of 20 years, which consists of an initial 5 year term and three subsequent 5 year renewal periods. The Cooperatives obligations are disclosed as part of the Note 6 – Leases.

The portion of the gain on sale of assets for the warehouse was deferred and is being amortized over the term of the lease agreement. The Cooperative had a deferred gain of \$95,336 and \$101,696, as of December 31, 2010 and 2009, respectively.

NOTE 11 ACQUISITION OF ASSETS OF VERMONT ELECTRIC DIVISION OF CITIZENS COMMUNICATIONS CORPORATION

On April 1, 2004, the Cooperative purchased the Vermont assets of Citizens Communication Corporation, (Vermont Electric Division). The assets purchased consisted of VED’s distribution assets, a portion of VED’s transmission assets, regulatory assets, VELCO stock and other investments and receivables.

As a condition of the sale the Cooperative entered into a Memorandum of Understanding (MOU) with the PSB. The MOU places restrictions on rates and potential financial penalties to certain individuals within the organization if various conditions are not met.

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2010

NOTE 11 ACQUISITION OF ASSETS OF VERMONT ELECTRIC DIVISION OF CITIZENS
COMMUNICATIONS CORPORATION (continued)

At closing, Citizens provided a credit to the Cooperative in the amount of \$2,900,000 to reduce the amount of cash payable by the Cooperative, but not as a reduction of the purchase price or the amount financed by the Cooperative. The \$2,900,000 is to be used as follows: a) The Cooperative established a reserve of \$1,200,000 to be used exclusively for vegetation management, b) The Cooperative established a reserve in the amount of \$1,200,000 to be used exclusively for purchase power costs and, c) The Cooperative established a reserve in the amount of \$500,000 to mitigate costs to maintain certain debt covenants during the five-year period that rates are to remain constant.

During 2005, the Cooperative consumed the entire \$1,200,000 reserve established for Purchase Power Costs. During 2009, the Cooperative consumed \$300,000 to offset tree trimming costs. As of December 31, 2010, the Cooperative had exhausted the reserve.

NOTE 12 SUPPLEMENTAL CASH FLOW INFORMATION

	<u>2010</u>	<u>2009</u>
Cash paid during the year for interest	\$ 3,055,696	\$ 2,920,903

NOTE 13 SUBSEQUENT EVENT

In accordance with professional accounting standards, the Cooperative has evaluated subsequent events through March 9, 2011, the date which the financial statements were available to be issued. All subsequent events requiring recognition as of December 31, 2010 have been incorporated into these financial statements herein.

Vermont Electric Cooperative, Inc.

**ADDITIONAL REPORTS REQUIRED BY
THE SINGLE AUDIT ACT**

December 31, 2010

Vermont Electric Cooperative, Inc.
 SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
 For the Year Ended December 31, 2010

Federal Grantor/ Pass-through Grantor/ Program Title	Grantor Pass-through Number	Federal CFDA Number	Expended
US DEPARTMENT OF ENERGY,			
Passed through Vermont Transco, LLC:			
Electricity Delivery and Energy Reliability, Research, Development and Analysis (ARRA)	DE-OE0000315	81.122	\$ 1,547,307
US DEPARTMENT OF COMMERCE			
Direct Assistance:			
Economic Development Administration Grant		11.307	1,030,869
US DEPARTMENT OF HOMELAND SECURITY			
Direct Assistance:			
FEMA - Hazard Mitigation Grant		97.039	<u>1,184,442</u>
TOTAL			<u>\$ 3,762,618</u>

The Schedule of Expenditures of Federal Awards was prepared using the significant accounting policies outlined in Note 1 to the basic financial statements.



Kittell Branagan & Sargent

Certified Public Accountants

Vermont License # 167

REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE
AND OTHER MATTERS BASED ON AN
AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS

To the Board of Trustees of
Vermont Electric Cooperative, Inc.

We have audited the financial statements of December 31, 2010 (a nonprofit organization) as of and for the year ended December 31, 2010, and have issued our report thereon dated March 9, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered Vermont Electric Cooperative, Inc.'s internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Vermont Electric Cooperative, Inc.'s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Vermont Electric Cooperative, Inc.'s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

To the Board of Trustees of
Vermont Electric Cooperative, Inc.
Report 2, continued

We noted certain matters that we reported to management of Vermont Electric Cooperative, Inc. in a separate letter dated March 9, 2011.

This report is intended solely for the information and use of management, others within the entity, the Board of Trustees, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Handwritten signature in cursive script that reads "William Branson & Sargent".

St. Albans, Vermont
March 9, 2011



Kittell Branagan & Sargent

Certified Public Accountants

Vermont License # 167

INDEPENDENT AUDITOR'S REPORT
ON COMPLIANCE WITH REQUIREMENTS
THAT COULD HAVE A DIRECT MATERIAL
EFFECT ON EACH MAJOR PROGRAM AND ON
INTERNAL CONTROL OVER COMPLIANCE IN
ACCORDANCE WITH OMB CIRCULAR A-133

To the Board of Trustees of
Vermont Electric Cooperative, Inc.

Compliance

We have audited Vermont Electric Cooperative, Inc. compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Vermont Electric Cooperative, Inc.'s major federal programs for the year ended December 31, 2010. Vermont Electric Cooperative, Inc. major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Vermont Electric Cooperative, Inc. management. Our responsibility is to express an opinion on Vermont Electric Cooperative, Inc. compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Vermont Electric Cooperative, Inc. compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Vermont Electric Cooperative, Inc. compliance with those requirements.

In our opinion, Vermont Electric Cooperative, Inc. complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2010.

Internal Control Over Compliance

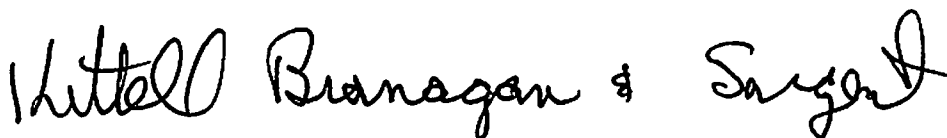
Management of Vermont Electric Cooperative, Inc. is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Vermont Electric Cooperative, Inc. internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Vermont Electric Cooperative, Inc. internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

Vermont Electric Cooperative, Inc. responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit Vermont Electric Cooperative, Inc. responses and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of management, others within the entity, the Board of Trustees, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Handwritten signature in cursive script that reads "William Branagan & Sargent".

Vermont Electric Cooperative, Inc.
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
December 31, 2010

A. SUMMARY OF AUDIT RESULTS

1. The auditor's report expresses an unqualified opinion on the financial statements of Vermont Electric Cooperative, Inc..
2. There were no significant deficiencies disclosed during the audit of the financial statements.
3. No instances of noncompliance material to the financial statements of Vermont Electric Cooperative, Inc. were disclosed during the audit.
4. There were no significant deficiencies disclosed during the audit of the major federal award programs.
5. The auditor's report on compliance for the major federal award programs for Vermont Electric Cooperative, Inc. expresses an unqualified opinion.
6. There were no audit findings relative to the major federal award programs for Vermont Electric Cooperative, Inc..
7. The programs tested as a major programs were CFDA #81.122 Electricity Deliver and Energy Reliability, Research, Development and Analysis, CFDA #11.307 Economic Development Administration Grant, CFDA #97.039 FEMA – Hazard Mitigation Grant.
8. The threshold for distinguishing Types A and B programs was \$300,000.
9. Vermont Electric Cooperative, Inc. was not determined to be a low-risk auditee.

B. FINDINGS – FINANCIAL STATEMENTS AUDIT

- There were no findings related to the financial statements audit.

C. FINDINGS AND QUESTIONED COSTS – MAJOR FEDERAL AWARD PROGRAMS AUDIT

- There were no findings or questioned costs related to the major federal award programs.