

Vermont Electric Cooperative, Inc.

FINANCIAL STATEMENTS

December 31, 2007

Vermont Electric Cooperative, Inc.
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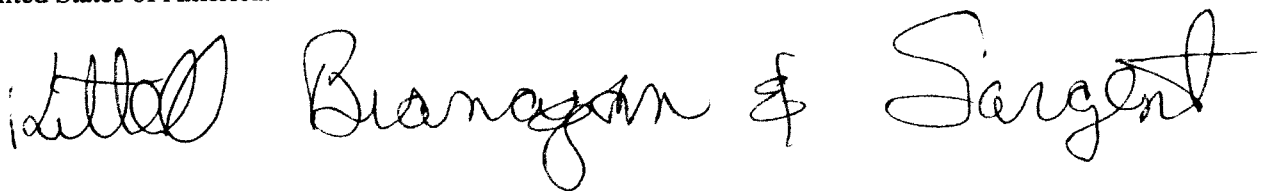
INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying financial statements of the Vermont Electric Cooperative, Inc. as of December 31, 2007 and 2006, and the related statements of operations, equities, and cash flows for the years then ended. These financial statements are the responsibility of the Cooperative's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 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 the Vermont Electric Cooperative, Inc. as of December 31, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

A large, stylized handwritten signature in black ink that reads "Kittell Branagan & Sargent". The signature is written in a cursive, flowing style.

St. Albans, Vermont
March 11, 2008

Vermont Electric Cooperative, Inc.

BALANCE SHEETS

December 31,

| | <u>ASSETS</u> | |
|---|----------------------|----------------------|
| | <u>2007</u> | <u>2006</u> |
| ELECTRIC PLANT, at cost | \$ 86,827,384 | \$ 79,630,408 |
| Less accumulated depreciation | <u>(24,848,638)</u> | <u>(22,914,529)</u> |
| Electric plant in service, net | 61,978,746 | 56,715,879 |
| Construction work in progress | <u>1,606,572</u> | <u>2,546,967</u> |
| TOTAL ELECTRIC PLANT, net | <u>63,585,318</u> | <u>59,262,846</u> |
| | | |
| CURRENT ASSETS | | |
| Cash | 1,867,135 | 4,014,603 |
| Notes receivable | 20,277 | 72,282 |
| Accounts receivable, net of allowance of \$151,856 and \$105,492 at December 31, 2007 and 2006, respectively | 6,091,477 | 5,211,306 |
| Unbilled revenue | 3,826,603 | 3,743,538 |
| Inventories | 1,702,290 | 1,749,446 |
| Prepaid expenses | <u>411,813</u> | <u>275,597</u> |
| TOTAL CURRENT ASSETS | <u>13,919,595</u> | <u>15,066,772</u> |
| | | |
| OTHER ASSETS | | |
| Nonutility property | 65,697 | 65,697 |
| Other investments | 9,379,950 | 8,722,987 |
| Deferred charges | <u>1,437,338</u> | <u>2,398,331</u> |
| TOTAL OTHER ASSETS | <u>10,882,985</u> | <u>11,187,015</u> |
| | | |
| TOTAL ASSETS | <u>\$ 88,387,898</u> | <u>\$ 85,516,633</u> |

LIABILITIES AND EQUITY

| | <u>2007</u> | <u>2006</u> |
|--|----------------------|----------------------|
| EQUITIES | | |
| Patronage capital assignable | \$ 15,223,435 | \$ 12,605,033 |
| Other equities | 2,499,377 | 2,499,350 |
| Contributions in aid of construction | <u>15,413,272</u> | <u>14,358,116</u> |
| | | |
| NET EQUITY | <u>33,136,084</u> | <u>29,462,499</u> |
| | | |
| LONG-TERM DEBT | <u>42,481,106</u> | <u>44,514,227</u> |
| | | |
| OBLIGATIONS UNDER CAPITAL LEASE | <u>353,716</u> | <u>381,510</u> |
| | | |
| CURRENT LIABILITIES | | |
| Current portion of long-term debt | 2,083,425 | 2,052,653 |
| Current portion of capital lease obligations | 27,795 | 26,116 |
| Revolving debt | 1,399,834 | - |
| Accounts payable | 5,006,404 | 4,941,560 |
| Customer deposits | 104,204 | 117,200 |
| Deferred credits | 1,301,246 | 1,617,208 |
| Other accrued expenses | <u>2,494,084</u> | <u>2,403,660</u> |
| | | |
| TOTAL CURRENT LIABILITIES | <u>12,416,992</u> | <u>11,158,397</u> |
| | | |
| TOTAL LIABILITIES AND EQUITY | <u>\$ 88,387,898</u> | <u>\$ 85,516,633</u> |

See Accompanying Notes to Financial Statements

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

| | <u>2007</u> | <u>2006</u> |
|--|---------------------|---------------------|
| OPERATING REVENUE | \$ 66,838,234 | \$ 63,442,575 |
| OPERATING EXPENSES | | |
| Purchased power | 40,527,427 | 36,772,944 |
| Transmission: | | |
| Operations | 4,725,643 | 3,976,814 |
| Maintenance | 83,764 | 88,517 |
| Distribution: | | |
| Operations, including vehicle depreciation expense of \$59,621 and \$101,808 in 2007 and 2006, respectively | 3,846,203 | 3,161,919 |
| Maintenance | 3,383,415 | 2,909,508 |
| Customer accounts | 2,381,926 | 2,218,976 |
| Administrative and general | 3,005,686 | 2,682,013 |
| General plant maintenance | 129,531 | 130,052 |
| Depreciation | 2,736,274 | 2,665,991 |
| Amortization | 983,266 | 1,175,264 |
| Taxes | 636,687 | 594,844 |
| Other deductions, net | 43,205 | 265,695 |
| TOTAL OPERATING EXPENSES | <u>62,483,027</u> | <u>56,642,537</u> |
| INCOME FROM OPERATIONS | <u>4,355,207</u> | <u>6,800,038</u> |
| OTHER INCOME (EXPENSES) | | |
| Gain (loss) on sale of fixed assets | 28,039 | (37,343) |
| Other income (expenses) | (2,124) | 12,496 |
| Interest and dividend income | 923,214 | 631,567 |
| Other capital credits & dividends | 234,653 | 374,781 |
| TOTAL OTHER INCOME | <u>1,183,782</u> | <u>981,501</u> |
| NET INCOME BEFORE INTEREST CHARGES | <u>5,538,989</u> | <u>7,781,539</u> |
| INTEREST CHARGES | | |
| Interest on long-term debt | 2,960,260 | 3,079,530 |
| Other interest | 34,277 | 41,142 |
| TOTAL INTEREST CHARGES | <u>2,994,537</u> | <u>3,120,672</u> |
| INCOME FROM CONTINUING OPERATIONS | <u>2,544,452</u> | <u>4,660,867</u> |
| DISCONTINUED OPERATIONS | | |
| Income from operation of discontinued Southern Division | - | 423,918 |
| Loss on disposal of Southern Division | - | (1,185,829) |
| TOTAL INCOME (LOSS) FROM DISCONTINUED OPERATIONS | <u>-</u> | <u>(761,911)</u> |
| NET INCOME | <u>\$ 2,544,452</u> | <u>\$ 3,898,956</u> |

See Accompanying Notes to Financial Statements

Vermont Electric Cooperative, Inc.
STATEMENTS OF EQUITIES
For the Year 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, 2005 | \$ - | \$ 8,706,077 | \$ 12,212 | \$ 9,798 | \$ 214,251 | \$ 2,263,043 | \$ 12,855,009 | \$ 24,060,390 |
| Donated capital | - | - | - | - | 46 | - | - | 46 |
| Net income for the year | - | - | - | - | - | 3,898,956 | - | 3,898,956 |
| Transfer to patronage capital assignable | - | 3,898,956 | - | - | - | (3,898,956) | - | - |
| New contributions in aid of construction | - | - | - | - | - | - | 1,503,107 | 1,503,107 |
| BALANCE, at December 31, 2006 | - | 12,605,033 | 12,212 | 9,798 | 214,297 | 2,263,043 | 14,358,116 | 29,462,499 |
| Adjustment to adopt FASB 158 | - | 73,950 | - | - | - | - | - | 73,950 |
| Donated capital | - | - | - | - | 27 | - | - | 27 |
| Net income for the year | - | - | - | - | - | 2,544,452 | - | 2,544,452 |
| Transfer to patronage capital assignable | - | 2,544,452 | - | - | - | (2,544,452) | - | - |
| New contributions in aid of construction | - | - | - | - | - | - | 1,055,156 | 1,055,156 |
| BALANCE, at December 31, 2007 | \$ - | \$ 15,223,435 | \$ 12,212 | \$ 9,798 | \$ 214,324 | \$ 2,263,043 | \$ 15,413,272 | \$ 33,136,084 |

See Accompanying Notes to Financial Statements

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

| | <u>2007</u> | <u>2006</u> |
|--|---------------------|---------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | \$ 2,544,452 | \$ 3,898,956 |
| Noncash expenses (income) included in earnings: | | |
| Depreciation and amortization | 2,736,274 | 2,665,991 |
| Amortization | 983,266 | 1,175,264 |
| (Gain) loss on sale of fixed assets | (28,039) | 37,343 |
| Hydro Quebec disallowance | (594,842) | (759,888) |
| Loss on abandonment of nonutility property | - | 53,514 |
| Loss on abandonment of equipment and workorders | 42,580 | 211,524 |
| Write-off of deferred charges | 16,587 | 72,170 |
| Loss on sale of southern division | - | 1,185,829 |
| Changes in assets and liabilities: | | |
| Decrease in notes receivable | 52,005 | 124,402 |
| Increase in accounts receivable | (963,236) | (178,379) |
| Increase in inventories | 47,156 | (257,448) |
| Increase in prepaid expenses | (136,216) | (12,389) |
| Decrease in accounts payable | 64,844 | 458,606 |
| Decrease in customer deposits | (12,996) | 1,453 |
| Decrease in accrued expenses | 90,424 | 82,624 |
| Decrease in deferred credits | (315,962) | (270,284) |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | <u>4,526,297</u> | <u>8,489,288</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Additions to electric plant in service and construction work in progress | (6,517,149) | (6,545,819) |
| Proceeds from sale of electric plant in service | 38,703 | 4,156,532 |
| (Increase) decrease in deferred charges | (38,860) | 47,964 |
| Purchase of investments | (695,404) | (4,752,714) |
| Proceeds from return of capital | 38,441 | 46,223 |
| Adjustment to adopt FAS 158 | 73,951 | - |
| NET CASH USED IN INVESTING ACTIVITIES | <u>(7,100,318)</u> | <u>(7,047,814)</u> |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Proceeds from long-term borrowings | - | 250,000 |
| Principal payments to creditors related to long-term borrowings | (2,002,349) | (1,967,025) |
| Net borrowing (payment) on line of credit | 1,399,834 | - |
| Increase in contributions in aid of construction | 1,055,156 | 1,503,107 |
| Additions to donated capital, net | 27 | 46 |
| Principal payments under capital lease obligation | (26,115) | (48,934) |
| NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES | <u>426,553</u> | <u>(262,806)</u> |
| NET INCREASE (DECREASE) IN CASH | (2,147,468) | 1,178,668 |
| CASH - Beginning of Year | <u>4,014,603</u> | <u>2,835,935</u> |
| CASH - End of Year | <u>\$ 1,867,135</u> | <u>\$ 4,014,603</u> |

See Accompanying Notes to Financial Statements

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2007

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.

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.

Vermont Electric Cooperative, Inc.
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2007

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 2007 and 2006, the Cooperative received \$1,055,156 and \$1,503,107, respectively, in contributions in aid of construction.

Corporate Structure and Income Taxes

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

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 2007 and 2006, the Cooperative paid \$1,678,222 and \$1,605,525 for property taxes, \$320,869 and \$313,360 for gross revenue taxes and \$315,818 and \$308,183, 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.

NOTE 2 ELECTRIC PLANT IN SERVICE

An analysis of electric plant in service at December 31, 2007 is as follows:

| | Depreciable life/rate per <u>Year</u> | |
|-------------------------------------|---|----------------------|
| Production Plant | 5.00% | \$ 591,129 |
| Transmission plant | 2.75% | 5,115,525 |
| Distribution plant | 3.00% | 74,863,275 |
| Completed construction unclassified | 3.00% | 1,120,109 |
| Buildings and structures | 15-50 | 2,001,459 |
| Transportation equipment | 4-22 | 651,611 |
| General plant | 3-10 | 4,280,628 |
| Hydro Quebec Disallowance * | | <u>(1,796,352)</u> |
| | | <u>\$ 86,827,384</u> |

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2007

NOTE 2 ELECTRIC PLANT IN SERVICE (continued)

An analysis of electric plant in service at December 31, 2006 is as follows:

| | Depreciable life/rate per Year | | |
|-----------------------------|--------------------------------------|-----------|-------------------|
| Transmission plant | 2.75% | \$ | 4,842,081 |
| Distribution plant | 3.00% | | 70,065,714 |
| Buildings and structures | 15-50 | | 2,001,459 |
| Transportation equipment | 4-22 | | 854,998 |
| General plant | 3-10 | | 4,257,300 |
| Hydro Quebec Disallowance * | | | (2,391,144) |
| | | <u>\$</u> | <u>79,630,408</u> |

Depreciation of electric plant in service totaled \$2,736,274 and \$2,863,885 in 2007 and 2006, respectively. Depreciation expense from continuing operations totaled \$2,665,991 for 2006, while depreciation expense for discontinued operations totaled \$197,894.

* Reduction in power supply costs for 2007 and 2006 was \$(594,792) and \$(759,888), respectively. The remaining disallowance will be amortized over the remaining life of the Hydro-Quebec Participation Agreement.

NOTE 3 OTHER INVESTMENTS

Other investments include the following cost balances at December 31,:

| | <u>2007</u> | <u>2006</u> |
|---|---------------------|---------------------|
| Investments in associated organizations | | |
| National Rural Utilities Cooperative Finance Corporation (CFC) membership | <u>\$ 1,902,851</u> | <u>\$ 1,991,311</u> |
| Other investments | | |
| Southeastern Data Cooperative capital credit | 29,449 | 30,050 |
| CoBank capital credit | 186,097 | 158,951 |
| Vermont Electric Power Company common stock | 1,691,776 | 1,691,775 |
| Vermont Transco, LLC Stock | 5,128,750 | 4,378,750 |
| New England Hydro-Transmission Corporation Common Stock | 410,585 | 448,424 |
| Other | <u>30,442</u> | <u>23,726</u> |
| | <u>7,477,099</u> | <u>6,731,676</u> |
| TOTAL OTHER INVESTMENTS | <u>\$ 9,379,950</u> | <u>\$ 8,722,987</u> |

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2007

NOTE 4 DEFERRED CHARGES

Deferred charges at December 31, include:

| | <u>2007</u> | <u>2006</u> |
|-------------------------------|---------------------|---------------------|
| Debt issuance costs | \$ 455,204 | \$ 501,857 |
| NRECA liability | 30,253 | 40,337 |
| Acquisition of Citizens (VED) | 951,599 | 1,888,212 |
| Automated Meter Info System | (25,640) | (48,665) |
| Other deferred charges | <u>25,922</u> | <u>16,590</u> |
| | <u>\$ 1,437,338</u> | <u>\$ 2,398,331</u> |

Debt Issuance Costs

Debt issuance costs were incurred to issue a series of first mortgage bonds in 1997 and are recoverable in rates through May 1, 2017. Amortization was \$46,653 for the years ended December 31, 2007 and 2006.

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 \$10,084 for the years ended December 31, 2007 and 2006.

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 \$936,613 and \$1,095,837 for the years ended December 31, 2007 and 2006, respectively.

Automated Meter Information System

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

Other

These charges represent the costs of surveys conducted and plans developed that are recoverable through rates over a three-year period. Amortization charged to purchased power was \$-0- and \$2,500 for the years ended December 31, 2007 and 2006, respectively.

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2007

NOTE 5 LONG-TERM DEBT

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

| | <u>2007</u> | <u>2006</u> |
|---|--------------------------|--------------------------|
| 1997 Series A bonds, 8.05%, due through 2017 | \$ 10,750,000 | \$ 11,825,000 |
| 2001 Series A bonds, 6.35%, due through 2011 | 1,348,514 | 1,627,526 |
| 2002 Series A bonds, 5.70%, due through 2027 | 1,675,721 | 1,724,910 |
| 2003 Series A bonds, 6.64%, due through 2028 | 1,432,258 | 1,474,480 |
| 2003 Series B bonds, 6.60%, due through 2023 | 429,080 | 447,882 |
| 2004 Series A bonds, as elected, due through 2034 | 20,309,783 | 20,586,882 |
| 2005 Series A bonds, as elected, due through 2034 | 3,689,999 | 3,826,666 |
| 2006 Series A bonds, 6.85%, due through 2035 | 2,205,739 | 2,231,673 |
| 2006 Series A bonds, 6.50%, due through 2035 | 1,958,088 | 1,982,617 |
| Prior Service Cost, NRECA Retirement Loan, 6.45%, due through 2015 | <u>765,349</u> | <u>839,244</u> |
| | 44,564,531 | 46,566,880 |
| Less: Current installments of long-term debt | <u>(2,083,425)</u> | <u>(2,052,653)</u> |
| TOTAL LONG-TERM DEBT | <u>\$ 42,481,106</u> | <u>\$ 44,514,227</u> |

1997 Bonds

On September 4, 1997, the Cooperative issued \$21,500,000 of First Mortgage Bonds, the proceeds of which were used to pay certain creditors and reorganization costs, including the retirement of all outstanding long-term debt. The bonds have a term of 20 years and bear interest at 8.05%, with interest payable semiannually and annual principal payments of \$1,075,000. The bonds were sold at full face value in a private placement.

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, 2007, with interest and principal payable quarterly.

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2007

NOTE 5 LONG-TERM DEBT (continued)

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, 2007, 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,:

| | <u>2007</u> | <u>2006</u> |
|-------------------------------------|----------------------|----------------------|
| VT0079024008 – 6.70% Fixed 23 Years | \$ 2,127,432 | \$ 2,156,400 |
| VT0079024002 – 6.30% Fixed 26 Years | 4,024,908 | 4,067,314 |
| VT0079024003 – 5.50% Fixed 11 Years | 2,028,028 | 2,060,408 |
| VT0079024004 – 5.65% Fixed 14 Years | 4,061,341 | 4,124,593 |
| VT0079024005 – 6.40% Fixed 25 Years | 2,043,103 | 2,071,159 |
| VT0079024006 – 6.45% Fixed 30 Years | 4,087,770 | 4,143,429 |
| VT0079024007 – 6.45% Fixed 25 Years | <u>1,937,201</u> | <u>1,963,579</u> |
| | <u>\$ 20,309,783</u> | <u>\$ 20,586,882</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 7.30% at December 31, 2007.

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.

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2007

NOTE 5 LONG-TERM DEBT (continued)

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:

| <u>Year Ending December 31.:</u> | |
|--------------------------------------|----------------------|
| 2008 | \$ 2,083,425 |
| 2009 | 2,141,658 |
| 2010 | 2,203,879 |
| 2011 | 2,270,357 |
| 2012 | 1,936,848 |
| Thereafter | <u>33,928,364</u> |
| | <u>\$ 44,564,531</u> |

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 ten million in short term loans or issuance of letters of credit on VEC's behalf as long as the total outstanding principal does not exceed ten million in aggregate. The Cooperative had drawn short term loans of \$1,399,834 and \$-0-, as of December 31, 2007 and 2006, respectively. Advances under this line of credit bear a variable rate of interest, which was 6.40% at December 31, 2007.

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>2007</u> | <u>2006</u> |
|--------------------------------|-------------------|-------------------|
| General Plant | \$ 624,056 | \$ 624,056 |
| Less: Accumulated Amortization | <u>260,980</u> | <u>209,329</u> |
| | <u>\$ 363,076</u> | <u>\$ 414,727</u> |

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2007

NOTE 6 LEASES (continued)

Future minimum lease payments under the capital lease, together with present value of the net minimum lease payments, as of December 31, 2007 are as follows:

| | |
|--|-------------------|
| Year Ending <u>December 31.:</u> | |
| 2008 | \$ 50,052 |
| 2009 | 50,052 |
| 2010 | 34,392 |
| 2011 | 31,260 |
| 2013 | 31,260 |
| Thereafter | <u>406,368</u> |
| Total minimum lease payments | 603,384 |
| Less amount representing interest | <u>(221,873)</u> |
| Present value of the minimum lease payments | 381,511 |
| Less current installments | <u>(27,795)</u> |
| Capital lease obligations, excluding current installments | <u>\$ 353,716</u> |

Operating Leases

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

| | |
|-------------------------------------|---------------------|
| Year Ending <u>December 31.:</u> | |
| 2008 | \$ 770,767 |
| 2009 | 691,098 |
| 2010 | 676,495 |
| 2011 | 641,490 |
| 2012 | 495,869 |
| Thereafter | <u>317,436</u> |
| | <u>\$ 3,593,155</u> |

Total operating lease expense for 2007 and 2006 was \$758,403 and \$620,313, respectively.

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2007

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 \$724,718 and \$711,600 for 2007 and 2006, respectively.

NOTE 8 COMMITMENTS AND CONTINGENCIES

Power Contracts

In 2007, the Cooperative has entered into contracts with Constellation, J. Aron and Integrys (formerly WPS) to replace expiring contracts covering from one year to four years based on forecasted power usage.

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.

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.

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, 2007, 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.

Vermont Electric Cooperative, Inc.
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2007

NOTE 8 COMMITMENTS AND CONTINGENCIES (continued)

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 \$1,250,000 and \$3,500,000 of the total letter of credit at December 31, 2007 and 2006, 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 Cooperative has adopted Financial Accounting Standards Board (FASB) Statement No. 158 – *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* as of December 31, 2007. The impact of this adoption on the financial statements resulted in recording an adjustment to adopt FASB Statement No. 158 of \$73,950 which has been reflected in the statement of equities as a change in unrestricted net assets.

The table below presents 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, 2007:

| | |
|--|-------------------|
| Change in benefit obligation: | |
| Benefit obligation at beginning of year | \$ 360,869 |
| Interest cost | 19,775 |
| Plan Amendments | (169,184) |
| Actuarial (gain) loss | 8,761 |
| Benefits paid | <u>(44,957)</u> |
| | |
| Benefit obligation at end of year | <u>\$ 175,264</u> |
| | |
| Change in plan assets: | |
| Employer contribution | \$ 44,957 |
| Benefits paid | <u>(44,957)</u> |
| | |
| Fair value of plan assets at end of year | <u>\$ -</u> |

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

| | |
|-----------|-----------|
| 2008 | \$ 13,820 |
| 2009 | 14,238 |
| 2010 | 13,819 |
| 2011 | 13,460 |
| 2012 | 13,816 |
| 2013-2017 | 70,793 |

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2007

NOTE 9 POSTRETIREMENT MEDICAL AND LIFE PLAN (continued)

Assumptions

Weighted average assumptions used to determine the benefit obligation as of December 31, 2007 and the periodic benefit cost for the fiscal year then ended are as follows:

| | |
|--|-------|
| Discount rate | 5.75% |
| Expected long-term return on plan assets | N/A |
| 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 \$114,416 and \$120,776, as of December 31, 2007 and 2006, 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.

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.

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2007

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

During 2005, the Cooperative consumed the entire \$1,200,000 reserve established for Purchase Power Costs. During 2007, the Cooperative consumed \$300,000 to offset tree trimming costs. As of December 31, 2007, the Cooperative had a remaining reserve of \$1,100,000.

NOTE 12 DISCONTINUED OPERATIONS

During 2006, the Cooperative committed to and executed the sale of its Southern division. The sale was completed December 2006. In accordance with FAS 144, the Cooperative has reported results of operations as discontinued operations the all periods presented. Results of operations for the Southern division resulted in income of \$432,918 during 2006. In addition, the sale resulted in loss on disposal of \$1,185,829.

NOTE 13 SUPPLEMENTAL CASH FLOW INFORMATION

| | <u>2007</u> | <u>2006</u> |
|--|---------------------|---------------------|
| Cash paid during the year for interest | \$ <u>2,899,584</u> | \$ <u>3,026,946</u> |