

Vermont Electric Cooperative, Inc.

FINANCIAL STATEMENTS

December 31, 2016

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

Report on the Financial Statements

We have audited the accompanying financial statements of Vermont Electric Cooperative, Inc. (a nonprofit member owned cooperative), which comprise the statement of financial position as of December 31, 2016 and 2015, and the related statements of operations, equities and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

To the Board of Directors
Vermont Electric Cooperative, Inc.
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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, 2016 and 2015, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Kittell, Brangan + Sargent

St. Albans, Vermont
March 8, 2017

Vermont Electric Cooperative, Inc.

BALANCE SHEETS

December 31,

ASSETS

	<u>2016</u>	<u>2015</u>
ELECTRIC PLANT, at cost	\$ 162,899,424	\$ 152,503,341
Less accumulated depreciation	(44,587,708)	(40,898,484)
Electric plant in service, net	118,311,716	111,604,857
Construction work in progress	1,061,630	1,588,707
TOTAL ELECTRIC PLANT, net	<u>119,373,346</u>	<u>113,193,564</u>
CURRENT ASSETS		
Cash	2,308,647	1,145,572
Accounts receivable, net of allowance of \$527,451 and \$90,828 at December 31, 2016 and 2015, respectively	6,531,759	7,343,131
Unbilled revenue	5,359,809	5,053,856
Inventories	4,280,313	4,230,317
Prepaid expenses	451,964	470,451
TOTAL CURRENT ASSETS	<u>18,932,492</u>	<u>18,243,327</u>
OTHER ASSETS		
Nonutility property	65,697	65,697
Other investments	30,327,358	23,045,611
Deferred charges	-	684,313
TOTAL OTHER ASSETS	<u>30,393,055</u>	<u>23,795,621</u>
TOTAL ASSETS	<u>\$ 168,698,893</u>	<u>\$ 155,232,512</u>

LIABILITIES AND EQUITY

EQUITIES		
Patronage capital assignable	\$ 69,061,838	\$ 65,300,294
Other equities	648,122	561,974
NET EQUITY	<u>69,709,960</u>	<u>65,862,268</u>
LONG-TERM DEBT	<u>80,042,004</u>	<u>65,865,433</u>
OBLIGATIONS UNDER CAPITAL LEASE	<u>198,222</u>	<u>216,973</u>
DEFERRED COMPENSATION PLAN	<u>162,646</u>	<u>84,926</u>
CURRENT LIABILITIES		
Current portion of long-term debt	3,849,281	3,347,823
Current portion of capital lease obligations	18,751	17,661
Revolving debt	2,300,000	9,200,000
Accounts payable	6,192,121	7,017,313
Customer deposits	1,040,164	587,283
Deferred credits	396,391	183,099
Other accrued expenses	4,789,353	2,849,733
TOTAL CURRENT LIABILITIES	<u>18,586,061</u>	<u>23,202,912</u>
TOTAL LIABILITIES AND EQUITY	<u>\$ 168,698,893</u>	<u>\$ 155,232,512</u>

See Accompanying Notes to Financial Statements.

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

	<u>2016</u>	<u>2015</u>
OPERATING REVENUE	\$ 76,665,507	\$ 77,018,400
OPERATING EXPENSES		
Purchased power	37,858,159	39,712,543
Transmission:		
Operations	10,791,518	10,440,551
Maintenance	495,122	349,498
Distribution:		
Operations, including vehicle depreciation expense of \$140,522 and \$132,612 in 2016 and 2015, respectively	5,767,693	5,492,072
Maintenance	7,238,944	7,700,459
Customer accounts	2,899,620	2,517,345
Administrative and general	3,613,785	3,557,564
General plant maintenance	201,400	216,991
Depreciation	5,702,010	5,405,782
Taxes	756,846	761,615
Other deductions, net	22,124	8,340
TOTAL OPERATING EXPENSES	<u>75,347,221</u>	<u>76,162,760</u>
INCOME FROM OPERATIONS	<u>1,318,286</u>	<u>855,640</u>
OTHER INCOME		
Renewable energy credits	2,483,179	2,662,860
Loss on sale of fixed assets	(924)	(58,276)
Other income	25,531	10,192
Interest and dividend income	3,199,337	2,890,910
Other capital credits & dividends	580,728	562,895
TOTAL OTHER INCOME	<u>6,287,851</u>	<u>6,068,581</u>
NET INCOME BEFORE INTEREST CHARGES	<u>7,606,137</u>	<u>6,924,221</u>
INTEREST CHARGES		
Interest on long-term debt	3,153,000	3,140,597
Other interest	155,479	127,096
TOTAL INTEREST CHARGES	<u>3,308,479</u>	<u>3,267,693</u>
NET INCOME	<u>\$ 4,297,658</u>	<u>\$ 3,656,528</u>

See Accompanying Notes to Financial Statements

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

	Other Equities (Deficits)					Total
	Capital Assignable	Retired Credits	Donated Capital	Postretirement Medical & Life Plan	Earnings (Losses)	
BALANCE, at December 31, 2014	\$ 62,174,495	\$ 197,848	\$ 214,584	\$ 73,949	\$ -	\$ 62,660,876
Donated capital	-	-	52	-	-	52
Net income for the year	-	-	-	-	3,656,528	3,656,528
Transfer to patronage capital assignable	3,656,528	-	-	-	(3,656,528)	-
Retirement of capital credits	<u>(530,729)</u>	<u>75,541</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(455,188)</u>
BALANCE, at December 31, 2015	65,300,294	273,389	214,636	73,949	-	65,862,268
Donated capital	-	-	9	-	-	9
Net income for the year	-	-	-	-	4,297,658	4,297,658
Transfer to patronage capital assignable	4,297,658	-	-	-	(4,297,658)	-
Retirement of capital credits	<u>(536,114)</u>	<u>86,139</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(449,975)</u>
BALANCE, at December 31, 2016	<u>\$ 69,061,838</u>	<u>\$ 359,528</u>	<u>\$ 214,645</u>	<u>\$ 73,949</u>	<u>\$ -</u>	<u>\$ 69,709,960</u>

See Accompanying Notes to Financial Statements

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

	<u>2016</u>	<u>2015</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 4,297,658	\$ 3,656,528
Noncash expenses (income) included in earnings:		
Depreciation	5,842,532	5,538,395
Amortization	34,308	34,308
(Gain)/Loss on sale of fixed assets	924	58,276
Hydro Quebec disallowance	(43,333)	(45,217)
Changes in assets and liabilities:		
Decrease in accounts receivable	505,419	2,603,680
Decrease (increase) in inventories	(49,996)	(364,989)
Decrease (increase) in prepaid expenses	18,487	93,164
Decrease (increase) in deferred charges	684,313	1,816,465
Decrease in accounts payable	(825,192)	(2,637,450)
Increase in customer deposits	452,881	7,192
Decrease in accrued expenses	1,939,620	(107,777)
Decrease in deferred credits	213,292	(32,471)
	<u>13,070,913</u>	<u>10,620,104</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES		
 CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to electric plant in service and construction work in progress	(11,986,265)	(12,603,094)
Proceeds from sale of electric plant in service	6,360	29,747
Return on capital investments	(166,451)	(168,510)
Purchase of investments	(7,037,576)	-
	<u>(19,183,932)</u>	<u>(12,741,857)</u>
NET CASH (USED) IN INVESTING ACTIVITIES		
 CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from long-term borrowings	18,000,000	-
Principal payments to creditors related to long-term borrowings	(3,356,279)	(3,337,550)
Net borrowing (payment) on line of credit	(6,900,000)	6,200,000
Additions to donated capital, net	9	52
Patronage capital retired, net	(449,975)	(455,188)
Principal payments under capital lease obligations	(17,661)	(16,636)
	<u>7,276,094</u>	<u>2,390,678</u>
NET CASH PROVIDED BY FINANCING ACTIVITIES		
 NET INCREASE IN CASH	 1,163,075	 268,925
 CASH - Beginning of Year	 <u>1,145,572</u>	 <u>876,647</u>
 CASH - End of Year	 <u>\$ 2,308,647</u>	 <u>\$ 1,145,572</u>

See Accompanying Notes to Financial Statements

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Vermont Electric Cooperative, Inc. (VEC or the Cooperative) is a rural electric cooperative utility established under the laws of the state of Vermont (VT). The Cooperative is subject to regulation by the Federal Energy Regulatory Commission (FERC) and its operations are under the jurisdiction of the Vermont Public Service Board (PSB). The PSB has the primary responsibility of regulating the Cooperative's rates. VEC is a distribution cooperative, providing residential and commercial electrical service to members in the State of Vermont.

Regulatory Accounting

The Cooperative utilizes the Uniform System of Accounts established by the Rural Utilities Service (RUS), except where the PSB has prescribed other treatment. In accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 980, *Regulated Operations*, 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.

Cash and Cash Equivalents

The Cooperative considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. At December 31, 2016 the Cooperative had cash that was considered fully insured by the FDIC for amounts over \$250,000.

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, 2016

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 from 1973 through 2010, contributions in aid of construction were 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 2016 and 2015, the Cooperative received \$1,878,459 and \$2,719,214, respectively, in contributions in aid of construction.

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, 2013, 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 2016 and 2015, the Cooperative paid \$2,886,223 and \$2,845,958 for property taxes, \$391,655 and \$392,434 for gross revenue taxes and \$365,191 and \$369,182, 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.

Presentation

Certain amounts have been reclassified in the 2015 financial statements in order to conform with the 2016 presentation.

Vermont Electric Cooperative, Inc.
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2016

NOTE 2 ELECTRIC PLANT IN SERVICE

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

<u>December 31, 2016</u>	<u>Depreciable Life/Rate Per Year</u>	
Transmission Plant	2.75%	\$ 18,992,442
Distribution Plant	3.00%	128,666,573
Buildings and Structures	20-50	4,121,362
Transportation Equipment	5-10	1,140,056
General Plant	3-10	10,055,364
Hydro Quebec Disallowance	17	<u>(76,373)</u>
		<u>\$ 162,899,424</u>

<u>December 31, 2015</u>	<u>Depreciable Life/Rate Per Year</u>	
Transmission Plant	2.75%	\$ 16,259,114
Distribution Plant	3.00%	121,666,151
Buildings and Structures	20-50	4,106,237
Transportation Equipment	5-10	1,046,449
General Plant	3-10	9,545,096
Hydro Quebec Disallowance	17	<u>(119,706)</u>
		<u>\$ 152,503,341</u>

Depreciation of electric plant in service totaled \$5,842,532 and \$5,538,395 in 2016 and 2015, respectively.

- Reduction in power supply costs for 2016 and 2015 was \$43,333 and \$45,217, 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>2016</u>	<u>2015</u>
Investments in associated organizations		
National Rural Utilities Cooperative Finance Corporation (CFC) membership	\$ 2,917,875	\$ 2,873,816

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 3 OTHER INVESTMENTS (continued)

	<u>2016</u>	<u>2015</u>
Other investments		
Southeastern Data Cooperative capital credit	\$ 1,635	\$ 9,922
CoBank Capital Credit	858,981	745,457
NISC Capital Credit	161,601	145,343
Cooperative Response Center	14,296	13,401
Vermont Electric Power Company common stock	1,691,775	1,691,775
Vermont Transco, LLC Stock	24,370,075	17,332,498
New England Hydro-Transmission Corporation Common Stock	148,339	148,339
Other	162,781	85,060
	<u>27,409,483</u>	<u>20,171,795</u>
TOTAL OTHER INVESTMENTS	<u>\$ 30,327,358</u>	<u>\$ 23,045,611</u>

NOTE 4 DEFERRED CHARGES

Deferred charges at December 31, included:

	<u>2016</u>	<u>2015</u>
December 2013 Ice Storm	\$ -	\$ 290,332
December 2014 Winter Storm	-	393,976
Other deferred charges	-	5
	<u>\$ -</u>	<u>\$ 684,313</u>

December 2013 Ice Storm Costs

Beginning on December 20, 2013 and continuing for several days an ice storm entered VEC's service territory causing widespread damages to the VEC system. The ice storm resulted in 2013 storm restoration costs impacting the income statement of \$6.1M. The storms impact on the state of Vermont was recognized by the Federal Emergency Management Agency (FEMA) as a national disaster and was declared for public assistance on January 29, 2014. On January 16, 2014 the Vermont Public Service Board issued an accounting order allowing for the deferral of the net ice storm income statement costs consisting of the \$6.1M from 2013 adjusted for FEMA estimated reimbursements of \$4.0M. In 2014, 2015 and 2016, utilizing operational savings, additional reimbursements and adjusting for major storm costs included in rates, VEC was able to write-off \$2.1M of the remaining deferred storm costs. There is no balance remaining in the accounting order and VEC will not need to seek future rate recovery for the storm damage.

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 4 DEFERRED CHARGES (continued)

December 2014 Winter Storm Costs

Beginning on December 9, 2014 and continuing for several days a winter storm entered VEC's service territory causing widespread damages to the VEC system. The winter storm resulted in 2014 storm restoration costs impacting the income statement of \$2.4M after adjusting for major storm costs included in current rates. The storms impact on the state of Vermont was recognized by the Federal Emergency Management Agency (FEMA) as a national disaster and was declared for public assistance on February 3, 2015. VEC estimated FEMA reimbursement for the storm damage of \$1.6M for the winter storm. On February 13, 2015 the Vermont Public Service Board issued an accounting order allowing for the deferral of the net ice storm income statement costs of \$800K. In 2015 & 2016 utilizing operation savings, additional reimbursements and adjusting for major storm costs included in rates, VEC was able to write-off \$800K of the remaining deferred storm costs. There is no balance remaining in the accounting order and VEC will not need to seek future rate recovery for the storm damage.

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.

NOTE 5 PATRONAGE CAPITAL & OTHER CAPITAL

Patronage capital at December 31, included:

	<u>2016</u>	<u>2015</u>
Assignable	\$ 4,297,658	\$ 3,656,528
Assigned to date	<u>67,225,886</u>	<u>63,569,358</u>
	71,523,544	67,225,886
Less: Retirements to date	<u>(2,461,706)</u>	<u>(1,925,592)</u>
	<u>\$ 69,061,838</u>	<u>\$ 65,300,294</u>

Other capital credits at December 31, included:

	<u>2016</u>	<u>2015</u>
Retired capital credits - gain	\$ 43,003	\$ 24,158
Retired capital credits - unlocated	289,023	228,629
Retired capital credits - no checks	<u>27,502</u>	<u>20,602</u>
	<u>\$ 359,528</u>	<u>\$ 273,389</u>

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 5 PATRONAGE CAPITAL & OTHER CAPITAL (continued)

The Cooperative is obligated to allocate credits to a capital account to each patron for all amounts in excess of annual operating costs and expenses. Capital credited to patrons' accounts can be retired in full or in part by determination of The Board of Directors. Determined retirement cannot exceed twenty-five percent (25%) of the capital allocation for the preceding year. After such retirement, the Cooperative will have total equity equal to at least forty percent (40%) of total assets of the Cooperative.

NOTE 6 LONG-TERM DEBT

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

	<u>2016</u>	<u>2015</u>
2002 Series A bonds, 5.70%, due through 2027	\$ 1,110,955	\$ 1,167,715
2003 Series A bonds, 6.64%, due through 2028	960,018	1,006,589
2003 Series B bonds, 6.60%, due through 2023	221,508	241,784
2004 Series A bonds, as elected, due through 2034	16,629,136	17,169,192
2005 Series A bonds, as elected, due through 2034	2,295,108	2,455,054
2006 Series A bonds, as elected, due through 2035	3,504,819	3,604,887
2008 Series A bonds, as elected, due through 2023	4,402,125	5,079,375
2008 Series B bonds, as elected, due through 2038	3,289,916	3,441,176
2009 Series A bonds, as elected, due through 2039	5,181,929	5,313,830
2010 Series A bonds, as elected, due through 2035	6,798,734	7,227,610
2012 Series A bonds, as elected, due through 2032	4,150,869	4,350,932
2012 Series B bonds, as elected, due through 2027	2,960,114	3,180,419
2013 Series A bonds, as elected, due through 2033	5,832,517	6,063,810
2014 Series A bonds, as elected, due through 2034	8,827,113	9,168,191
2016 Series A bonds, as elected, due through 2046	9,449,424	-
2016 Series B bonds, 4.45%, due through 2046	<u>8,500,000</u>	<u>-</u>
Total long-term debt before unamortized debt issuance costs	84,114,285	69,470,564
Unamortized debt issuance cost	<u>(223,000)</u>	<u>(257,308)</u>
Total long-term debt	83,891,285	69,213,256
Less: Current installments of long-term debt	<u>(3,849,281)</u>	<u>(3,347,823)</u>
TOTAL LONG-TERM DEBT	<u>\$ 80,042,004</u>	<u>\$ 65,865,433</u>

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 6 LONG-TERM DEBT (continued)

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% at December 31, 2016, with interest and principal payable quarterly.

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, 2016, 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 interest at 6.60% at December 31, 2016, 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 2004 Bonds, Series A into seven separate agreements with various variable and fixed rate options. The 2004 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>2016</u>	<u>2015</u>
VT0079024008 - 6.70% Fixed 27 Years	\$ 1,758,613	\$ 1,811,290
VT0079024002 - 4.41% Fixed 15 Years	3,290,332	3,407,988
VT0079024003 - 4.25% Fixed 19 Years	1,623,255	1,685,846
VT0079024004 - 5.65% Fixed 14 Years	3,289,637	3,396,788
VT0079024005 - 6.40% Fixed 25 Years	1,686,840	1,737,636
VT0079024006 - 6.45% Fixed 30 Years	3,379,098	3,480,316
VT0079024007 - 6.45% Fixed 25 Years	<u>1,601,361</u>	<u>1,649,328</u>
	<u>\$ 16,629,136</u>	<u>\$ 17,169,192</u>

2005 Bonds Series A

On January 5, 2005, the Cooperative issued \$4,100,000 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 3.00% to 6.90% at December 31, 2016.

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.

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 6 LONG-TERM DEBT (continued)

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 4.85% 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 3.52%, 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 3.12%, 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 2.66%, with interest and principal payments payable quarterly.

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 a fixed rate of 4.58% and a variable rate of which was 1.72% for December 2016, with interest and principal payments payable semi-annually.

2012 Series A Bonds

On May 1, 2012, the Cooperative issued \$5,000,000 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 20 year terms and bear interest at a fixed rate of 3.41% with interest and principal payments payable quarterly.

2012 Series B Bonds

On December 26, 2012 the Cooperative issued \$3,800,000 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 year terms and bear interest at a fixed rate of 3.26% with interest and principal payments payable quarterly.

2013 Series A Bonds

On December 16, 2013 the Cooperative issued \$6,500,000 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 20 year terms and bear interest at a fixed rate of 4.1% with interest and principal payments payable quarterly.

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 6 LONG-TERM DEBT (continued)

2014 Series A Bonds

On June 27, 2014, the Cooperative issued \$9,650,000 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 20 year terms and bear interest at a fixed rate of 3.95% with interest and principal payments payable quarterly.

2016 Series A Bonds

On June 13, 2016 the Cooperative issued \$9,500,000 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 a fixed rate of 2.81% with interest and principal payments payable quarterly.

2016 Series B Bonds

On December 28, 2016 the Cooperative issued \$8,500,000 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 a fixed rate of 4.45% with interest and principal payments payable quarterly.

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.

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

Year Ending December,	
2017	\$ 3,849,281
2018	3,920,307
2019	4,047,227
2020	4,177,976
2021	4,321,344
Thereafter	63,798,150
	\$ 84,114,285

The Cooperative's short term credit facility consists of a revolving line of credit agreement and security agreement 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 twenty million in aggregate. The short term credit facility is available from two Cooperative lenders. The Cooperative had drawn short term loans of \$2,300,000 and \$9,200,000, as of December 31, 2016 and 2015, respectively. Advances under this line of credit bear a variable rate of interest, which was 2.87% at December 31, 2016. The credit facilities have maturity dates of December 18, 2018 and February 21, 2018.

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 7 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>2016</u>	<u>2015</u>
General Plant	\$ 363,597	\$ 363,597
Less: Accumulated Amortization	<u>199,978</u>	<u>181,798</u>
	<u>\$ 163,619</u>	<u>\$ 181,799</u>

Future minimum lease payments under the capital lease, together with present value of the net minimum lease payments, as of December 31, 2016 are as follows:

<u>Year Ending December 31,:</u>	
2017	\$ 31,259
2018	31,259
2019	31,259
2020	31,259
2021	31,259
Thereafter	<u>125,036</u>
Total minimum lease payments	281,331
Less amount representing interest	<u>(64,358)</u>
Present value of the minimum lease payments	216,973
Less current installments	<u>(18,751)</u>
Capital lease obligations, excluding current installments	<u>\$ 198,222</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>	
2017	\$ 389,533
2018	343,598
2019	299,100
2020	235,618
2021	<u>105,708</u>
	<u>\$ 1,373,557</u>

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 7 LEASES (continued)

Total operating lease expense for 2016 and 2015 was \$438,405 and \$494,693, respectively.

NOTE 8 PENSION PLAN

Multiemployer Retirement Security Plan

All eligible employees of the Cooperative participate in the 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 multi-employer 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 plan sponsor's Employer Identification Number is 03-0164375 and the Plan Number is 01-46007-001.

A unique characteristic of multiemployer plans compared to a single employer plan is that all plan assets are available to pay benefits to 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.

The Cooperatives contributions to the RS Plan in 2016 and 2015 represent less than 5 percent of the total contributions made to the plan by all participating employers. At December 31, 2016 and 2015 The Cooperative made contributions to the plan of \$944,878 and \$969,219, respectively. There have been no significant changes that affect the comparability of 2016 and 2015 contributions. Pension expense for the prior service costs for December 31, 2016 and 2015 was \$26,839 and \$26,528, respectively.

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 over 80% funded on January 1, 2016 and over 80% funded on January 1, 2015, based on the PPA funding target and the actuarial value of assets at those dates.

Because of provisions of the PPA do not apply to the RS Plan, funding improvement plans and surcharges are not applicable. Future contribution requirements are determined each year as part of the actuarial valuation of the plan and may change as a result of plan experience.

Section 457(b) Deferred Compensation Plan

The Cooperative has an executive retirement plan that is designed in accordance with Section 457(b) of the Internal Revenue Code. The plan became effective on June 1, 2014 and is administered by NRECA. The plan is available to highly compensated employees who are not a current participant in the RS plan. The Cooperative has the option to make elective annual contributions to the plan on behalf of each participant. No such contributions were made in 2016 and 2015 by the Cooperative. The Board of Directors is responsible for determining the investment fund or funds into which the participants account is invested. The funds remain assets of the Cooperative until such time as the participant, or the participant's beneficiary, withdrawals the funds in accordance with plan provisions. Assets held for this plan and reported in investments for December 31, 2016 and 2015 was \$162,646 and \$84,926, respectively.

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 9 COMMITMENTS AND CONTINGENCIES

Power Contracts

In 2016 and 2015, the Cooperative has entered into contracts with Exelon and NextEra to replace expiring contracts covering from one year to twenty 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 project was placed into service in 2011. 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 purchase power agreement 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 project was placed into service in 2012.

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 were approved by the Vermont Public Service Board. The new contract began in 2012.

In 2011, VEC participated in a joint utility negotiation with NextEra Energy Resources for a unit contingent contract for output from the Seabrook nuclear plant for a term of twenty years. The contract is for 10 MW including capacity and energy beginning in 2015 at a fixed price with a known fixed escalating adjustment each year. The contract was approved by the Vermont Public Service Board and the utilities membership in 2012.

The Cooperative entered into a purchase power agreement with BDE Grand Isle Solar, LLC in 2015 for 5 MW of nameplate capacity for a solar farm to be located in Grand Isle, Vermont. The agreement covers a period of twenty-five years. The project is planned to be in service in 2017.

The Cooperative entered into a purchase power agreement with SoCore Vt Alburgh, LLC in 2016 for 1 MW of nameplate capacity for a solar farm to be located in Alburgh, Vermont. The agreement covers a period of twenty-five years. The project was placed into service in December, 2016.

The Cooperative entered into a purchase power agreement with SoCore Vt Magee Hill, LLC in 2016 for 1.26MW of nameplate capacity for a solar farm to be located in Hinesburg, Vermont. The agreement covers a period of twenty-five years. The project is planned to be in service in 2017.

The Cooperative has entered into agreements to sell the environmental attributes, renewable energy credits (REC's), from the two wind farms in Sheffield and Lowell and other smaller renewable generation projects and purchase environmental attributes when needed. Agreements to sell and purchase the REC's have been executed with EDF Trading, BNC, Great Eastern Energy, Direct Energy, Vitol, GDF and Aspre Energy. The contracts are for REC's generated from 2015 through 2019.

Vermont Electric Cooperative, Inc.
 NOTES TO FINANCIAL STATEMENTS
 December 31, 2016

NOTE 9 COMMITMENTS AND CONTINGENCIES (continued)

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

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 and CoBank, ACB 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 \$1,500,000 and \$1,500,000 of the total letter of credit at December 31, 2016 and 2015, respectively.

NOTE 10 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, 2016:

Change in benefit obligation:	
Benefit obligation at beginning of year	\$ 285,435
Interest Cost	5,476
Benefits paid	(18,283)
Actuarial loss	<u>(48,709)</u>
Benefit obligation at end of year	<u>\$ 223,919</u>
Change in plan assets:	
Employer contribution	\$ 18,283
Benefits paid	<u>(18,283)</u>
Fair value of plan assets at end of year	<u><u>\$ -</u></u>

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 10 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:

2017	\$	19,255
2018		17,953
2019		18,457
2020		15,968
2021		16,198
2022-2026		77,030

Assumptions

Weighted average assumptions used to determine the benefit obligation as of December 31, 2016 and the periodic benefit cost for the fiscal year then ended are as follows:

Discount rate – beginning of year	2.50%
Discount rate – end of year	2.00%
Rate of compensation increase	N/A

NOTE 11 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 \$57,176 and \$63,536, as of December 31, 2016 and 2015, respectively.

NOTE 12 SUPPLEMENTAL CASH FLOW INFORMATION

	<u>2016</u>	<u>2015</u>
Cash paid during the year for interest	\$ <u>3,386,623</u>	\$ <u>3,246,175</u>

NOTE 13 CHANGE IN ACCOUNTING PRINCIPAL - RETROSPECTIVE APPLICATION

On January 1, 2016, the Cooperative changed its method of accounting for debt issue costs to conform with ASU 2015-03, effective for fiscal years beginning after December 15, 2015. The change was adopted retroactively. Under the new accounting method, the Cooperative must now report their debt costs net of debt issue costs, increasing the effective interest rate. As a result, the cumulative effect of applying the new method, the following amounts increased (decreased):

Vermont Electric Cooperative, Inc.
NOTES TO FINANCIAL STATEMENTS
December 31, 2016

NOTE 13 CHANGE IN ACCOUNTING PRINCIPAL - RETROSPECTIVE APPLICATION (continued)

	<u>2016</u>	<u>2015</u>
Deferred Charges	<u>\$ (223,000)</u>	<u>\$ (257,308)</u>
Long-Term Debt	<u>\$ (223,000)</u>	<u>\$ (257,308)</u>

The adoption had no effect on the Cooperative's equity, statement of operations or statement of cash flows for the years ended December 31, 2016 and 2015.

NOTE 14 SUBSEQUENT EVENTS

In accordance with professional accounting standards, the Cooperative has evaluated subsequent events through March 8, 2017, the date which the financial statements were available to be issued. All subsequent events requiring recognition as of December 31, 2016 have been incorporated into these financial statements herein.