

**INSIDE PASSAGE  
ELECTRIC COOPERATIVE, INC.**

Financial Statements, Additional Information, and  
Supplementary RUS and Federal Single Audit Reports

Years Ended December 31, 2010 and 2009

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# INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.

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Independent Auditor's Report

Board of Directors  
Inside Passage Electric Cooperative, Inc.  
Auke Bay, Alaska

We have audited the accompanying balance sheets of Inside Passage Electric Cooperative, Inc. (the Cooperative), as of December 31, 2010 and 2009 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 audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 audits provide 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 Inside Passage Electric Cooperative, Inc. as of December 31, 2010 and 2009, 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.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 21, 2011, on our consideration of Inside Passage 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 the 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.

Board of Directors  
Inside Passage Electric Cooperative, Inc.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis and is not a required part of the basic financial statements. The Schedule of Expenditures of Federal Awards is required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. 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.

*Mikunda, Cottrell & Co.*

Anchorage, Alaska  
March 21, 2011

**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**

Balance Sheets

December 31, 2010 and 2009

<u>Assets</u>	<u>2010</u>	<u>2009</u>
Utility plant:		
Electric plant in service	\$ 19,611,280	19,492,500
Construction work in progress	21,649	33,125
Total utility plant	19,632,929	19,525,625
Less accumulated depreciation	(10,712,755)	(10,200,708)
Net utility plant	<u>8,920,174</u>	<u>9,324,917</u>
Other assets:		
Investments in associated organizations	875,767	837,884
Restricted cash:		
Consumer deposits	66,115	64,054
State of Alaska performance guarantee	8,600	8,600
Total other assets	<u>950,482</u>	<u>910,538</u>
Current assets:		
Cash	199,821	229,369
Accounts receivable, less provision for doubtful accounts of \$39,899 (\$36,467 in 2009)	582,238	358,273
Unbilled revenue	302,550	247,637
Materials and supplies inventory	385,565	391,153
Fuel inventory	350,085	351,526
Prepaid expenses	55,944	61,151
Other current and accrued assets	1,179	1,179
Total current assets	<u>1,877,382</u>	<u>1,640,288</u>
Deferred charges	<u>231,493</u>	<u>110,816</u>
Total assets	<u>\$ 11,979,531</u>	<u>11,986,559</u>

See accompanying notes to financial statements.

**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**

## Balance Sheets, continued

	<u>2010</u>	<u>2009</u>
<u>Equities and Liabilities</u>		
Equities:		
Patronage capital	\$ 1,649,666	1,351,229
Other equities	<u>3,886,177</u>	<u>3,886,177</u>
Total equities	<u>5,535,843</u>	<u>5,237,406</u>
Long-term debt:		
RUS mortgage notes	5,862,452	6,396,079
Less current maturities	<u>(543,760)</u>	<u>(533,579)</u>
Net long-term debt	<u>5,318,692</u>	<u>5,862,500</u>
Current liabilities:		
Current maturities of long-term debt	543,760	533,579
Accounts payable	243,942	168,620
Consumer deposits	66,851	65,329
Accrued payroll and related liabilities	<u>85,059</u>	<u>63,430</u>
Total current liabilities	<u>939,612</u>	<u>830,958</u>
Deferred credits	<u>185,384</u>	<u>55,695</u>
Total equities and liabilities	\$ <u>11,979,531</u>	<u>11,986,559</u>

See accompanying notes to financial statements.



**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**Statements of Operations  
Years Ended December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Operating revenues	\$ <u>5,242,015</u>	<u>4,674,195</u>
Operating expenses:		
Purchased power	176,094	170,242
Power production operations	2,746,004	2,538,372
Power production maintenance	181,937	181,568
Distribution operations	74,470	38,752
Distribution maintenance	42,840	39,203
Consumer accounts	187,320	173,561
Customer service and information	29,128	50,207
Administrative and general	850,524	786,208
Depreciation	478,141	478,256
Amortization	43,470	19,732
Taxes	<u>2,471</u>	<u>2,560</u>
Total operating expenses	<u>4,812,399</u>	<u>4,478,661</u>
Operating margins before other income (expenses)	429,616	195,534
Other income (expenses):		
Fixed charges - interest on long-term debt	(165,327)	(177,151)
Other income	<u>-</u>	<u>160,859</u>
Net other income (expenses)	<u>(165,327)</u>	<u>(16,292)</u>
Operating margins after other income (expenses)	264,289	179,242
Nonoperating margins (losses):		
Patronage capital (loss) from associated organizations	40,888	(48,060)
Interest income	3,366	14,595
Rental income, net of rental expenses	(11,742)	(11,742)
Other nonoperating revenues (expenses)	<u>1,636</u>	<u>(19,249)</u>
Net nonoperating margins (losses)	<u>34,148</u>	<u>(64,456)</u>
Net margins	\$ <u><u>298,437</u></u>	<u><u>114,786</u></u>

See accompanying notes to financial statements.

**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**

## Statements of Equities

Years Ended December 31, 2010 and 2009

	<u>Other Equities</u>			
	<u>Retained</u> <u>Earnings</u>	<u>Donated</u> <u>Capital</u>	<u>Patronage</u> <u>Capital</u>	<u>Total</u>
Balances at January 1, 2009	\$ 3,881,841	4,336	1,236,443	5,122,620
Net margins	<u>-</u>	<u>-</u>	<u>114,786</u>	<u>114,786</u>
Balances at December 31, 2009	3,881,841	4,336	1,351,229	5,237,406
Net margins	<u>-</u>	<u>-</u>	<u>298,437</u>	<u>298,437</u>
Balances at December 31, 2010	\$ <u>3,881,841</u>	<u>4,336</u>	<u>1,649,666</u>	<u>5,535,843</u>

See accompanying notes to financial statements.

**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**

## Statements of Cash Flows

Years Ended December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Cash flows from operating activities:		
Cash received from customers	\$ 5,094,462	4,694,689
Cash paid to suppliers and employees	(4,275,133)	(3,982,839)
Interest received	3,366	14,595
Interest paid on long-term debt	<u>(165,327)</u>	<u>(177,151)</u>
Net cash provided by operating activities	<u>657,368</u>	<u>549,294</u>
Cash flows from investing activities:		
Additions to plant	(155,755)	(181,459)
Funds received from associated organizations	<u>3,005</u>	<u>-</u>
Net cash used by investing activities	<u>(152,750)</u>	<u>(181,459)</u>
Cash flows from financing activities:		
Principal payments on long-term debt	(533,627)	(521,803)
Increase (decrease) in consumer deposits	<u>1,522</u>	<u>(909)</u>
Net cash used by financing activities	<u>(532,105)</u>	<u>(522,712)</u>
Decrease in cash and cash equivalents	(27,487)	(154,877)
Cash and cash equivalents, beginning of year	<u>302,023</u>	<u>456,900</u>
Cash and cash equivalents, end of year	\$ <u>274,536</u>	<u>302,023</u>
Reconciliation of cash and cash equivalents to balance sheet:		
Cash and cash equivalents:		
Current assets	\$ 199,821	229,369
Restricted assets	<u>74,715</u>	<u>72,654</u>
	\$ <u>274,536</u>	<u>302,023</u>

See accompanying notes to financial statements.

**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**

Statements of Cash Flows, continued

	<u>2010</u>	<u>2009</u>
Reconciliation of net margins to net cash flows from operating activities:		
Net margins	\$ <u>298,437</u>	<u>114,786</u>
Adjustments to reconcile net margins to net cash provided (used) by operating activities:		
Depreciation	517,028	513,562
Amortization	43,470	19,732
(Income) loss allocation from investments in associated organizations	(40,888)	48,060
Gain on disposal of plant assets	-	(180,588)
(Increase) decrease in assets:		
Accounts receivable (net)	(223,965)	270,424
Unbilled revenue	(54,913)	6,115
Materials and supplies inventory	5,588	45,830
Fuel inventory	1,441	36,637
Prepaid expenses	5,207	(24,437)
Deferred charges	(120,677)	(94,506)
Other current and accrued assets	-	6
Increase (decrease) in liabilities:		
Accounts payable	75,322	36,472
Accrued payroll and related liabilities	21,629	(1,943)
Deferred credits	<u>129,689</u>	<u>(240,856)</u>
Total adjustments	<u>358,931</u>	<u>434,508</u>
Net cash provided by operating activities	\$ <u><u>657,368</u></u>	<u><u>549,294</u></u>

See accompanying notes to financial statements.

# INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.

Notes to Financial Statements

December 31, 2010 and 2009

(1) **Organization and Summary of Significant Accounting Policies**

On September 22, 2001 Tlingit-Haida Regional Electrical Authority's (THREA) Board of Directors agreed to reorganize THREA as a member-owned, non-profit electric cooperative and a separate non-subsidiary corporation, Inside Passage Electric Cooperative, Inc. (IPEC), was formed. On December 31, 2003, the Regulatory Commission of Alaska approved the application by THREA to transfer the Certificate of Public Convenience and Necessity to IPEC and effective January 1, 2004, operations were conducted in the name of IPEC.

Inside Passage Electric Cooperative, Inc. operates an electric utility from offices in Auke Bay, Alaska, which provides services to the southeast Alaska communities of Angoon, Hoonah, Kake, Klukwan, and Chilkat Valley. IPEC operates on a not-for-profit basis and, accordingly, seeks only to generate revenues sufficient to pay operating and maintenance costs, capital expenditures, depreciation, and interest on indebtedness and to provide for the establishment of reasonable margins and reserves.

The accounting records of IPEC conform to the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission as modified for electric borrowers of the Rural Utilities Service (RUS).

**Regulation**

Effective August 28, 1990, the Regulatory Commission of Alaska (RCA) granted THREA exemption from economic regulation by the Commission pursuant to AS 42.05711(b). With that exemption, THREA's rates were no longer subject to review and approval by the Commission except for power cost equalization (PCE) purposes, a State subsidy to rural Alaska electric consumers.

However, effective January 1, 2004 with the formation of IPEC, the Cooperative is again subject to economic regulation by the RCA.

**Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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.

**Cash Equivalents**

For purposes of the statements of cash flows, IPEC considers all cash on hand, cash in banks and highly liquid investments that are readily convertible to known amounts of cash and that present an insignificant risk of change in value due to changes in interest rates or other factors to be cash equivalents.

## INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.

Notes to Financial Statements, continued

### **Organization and Summary of Significant Accounting Policies, continued**

#### Restricted Cash

Restricted cash – State of Alaska performance guarantee consists of a certificate of deposit (in lieu of a bond) set aside for a right-of-way permit in the Chilkat Valley. The agreement requires the certificate to be continuously rolled over during the term of the agreement (55 years).

#### Fair Value Measurements

The Cooperative measures certain items at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, that is, other than in a forced liquidation or distress sale.

The Cooperative's financial assets and liabilities carried at fair value have been classified based on a hierarchy as defined in generally accepted accounting principles and are generally measured using the market approach or the income approach.

#### Investments

Investments in associated organizations are accounted for at cost and adjusted for the Cooperative's proportionate share of earnings, losses and distributions.

#### Inventory

Inventory of materials, supplies, and fuel are recorded at weighted average cost.

#### Plant Additions and Retirements

Additions and replacements to electric plant in service are at the original cost of contracted services, direct labor and materials, and indirect overhead charges. Except for certain specifically identifiable units of property, replacements and retirements of plant are charged to the accumulated provision for depreciation at the average unit cost of the property and unit removal costs less salvage. The cost of replacement is added to electric plant.

#### Contributions in Aid of Construction

Contributions in aid of construction are credited to the associated cost of construction of property units.

#### Depreciation

Depreciation rates have been applied on a straight-line basis using the following annual rates:

Production and distribution plant:	
Structures	2.0%
Other production plant	7.0%
Distribution plant	1.8 – 4.1%

## INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.

Notes to Financial Statements, continued

### Organization and Summary of Significant Accounting Policies, continued Depreciation, continued

#### General plant:

Structures	2.0%
Office furniture and equipment	7.0 – 20.0%
Transportation equipment	14.0%
Communication equipment	8.0%
Other general plant	5.0%

#### Capitalized Interest

Interest is capitalized to construction on major generation and distribution projects. No interest was capitalized in 2010 and 2009.

#### Unbilled Revenue

Unbilled revenues are based on estimated services provided from the last meter reading date in December to December 31.

#### Income Taxes

IPEC is exempt from federal and state income taxes on income by provision of section 501 (c) (12) of the Internal Revenue Code.

The Cooperative applies the provisions of Topic 740 of the FASB Accounting Standards Codification relating to accounting for uncertainty in income taxes. The Cooperative annually reviews its tax return and positions taken in accordance with the recognition standards. The Cooperative believes that it has no uncertain tax positions which would require disclosure or adjustment in these financial statements.

#### Concentration of Credit Risk

IPEC sells electricity and grants credit to consumers in several communities in southeast Alaska. Accordingly, the risk exists that the ability to collect amounts due from consumers could be affected by economic fluctuations in these areas. Historically, credit losses have not been significant.

IPEC's bank balances totaled \$405,092 and \$413,841 at December 31, 2010 and 2009, respectively. Of the totals, \$250,000 was insured by the Federal Deposit Insurance Corporation (FDIC) and the excess was collateralized with securities held by the pledging financial institution's trust department or agent in IPEC's name.

#### Reclassified Balances

Certain 2009 balances have been reclassified to conform with the current year presentation.

**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**

Notes to Financial Statements, continued

**Organization and Summary of Significant Accounting Policies, continued**

**Subsequent Events**

The Cooperative has evaluated subsequent events through March 21, 2011, the date on which the financial statements were issued.

(2) **Utility Plant and Depreciation Summary**

Major classes of the utility plant as of December 31, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Production plant	\$ 4,164,685	4,150,856
Distribution plant	13,085,807	13,014,641
General plant	2,333,841	2,327,003
Unclassified plant	<u>26,947</u>	<u>-</u>
Total electric plant in service	19,611,280	19,492,500
Construction work in progress	<u>21,649</u>	<u>33,125</u>
Total utility plant	<u>\$ 19,632,929</u>	<u>19,525,625</u>

Summary of depreciation provision:

	<u>2010</u>	<u>2009</u>
Depreciation expense	\$ 478,141	478,256
Depreciation to clearing account	27,145	23,565
Depreciation of rental	<u>11,742</u>	<u>11,741</u>
Total depreciation	<u>\$ 517,028</u>	<u>513,562</u>

(3) **Investments in Associated Organizations**

Investments in associated organizations consisted of the following at December 31, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Alaska Rural Electric Cooperative Association (ARECA) Insurance Exchange - Patronage capital credits	<u>\$ 765,369</u>	<u>727,486</u>
National Rural Utilities Cooperative Finance Corporation (NRUCFC):		
Capital term certificates	93,543	93,543
Patronage capital credits	15,855	15,855
Membership	<u>1,000</u>	<u>1,000</u>
Total NRUCFC	<u>110,398</u>	<u>110,398</u>
Total investments in associated organizations	<u>\$ 875,767</u>	<u>837,884</u>



**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**

Notes to Financial Statements, continued

(4) **Deferred Charges**

Deferred charges at December 31, 2010 and 2009 consisted of the following:

	<u>2010</u>	<u>2009</u>
Depreciation study	\$ 54,254	37,609
Software upgrade	97,852	-
Cost of power adjustment	23,114	69,157
Cost of service study	58,839	7,045
Other	<u>(2,566)</u>	<u>(2,995)</u>
Total deferred charges	<u>\$ 231,493</u>	<u>110,816</u>

These costs will either be amortized to expense or added to costs of construction depending on the determination of the charges' future economic benefit. Amortization to expense generally occurs over a period of one to five years. The cost of power adjustment is passed through to the consumers on the next tariff revision.

(5) **Other Equities**

Other equities consist of retained earnings and donated capital prior to the formation of the Cooperative on January 1, 2004. A summary of other equities at December 31, 2010 and 2009 follows:

	<u>2010</u>	<u>2009</u>
Retained earnings	\$ 3,881,841	3,881,841
Donated capital	<u>4,336</u>	<u>4,336</u>
Total other equities	<u>\$ 3,886,177</u>	<u>3,886,177</u>

(6) **Long-Term Debt**

**RUS Mortgage Notes**

The RUS long-term debt consists of two percent and five percent mortgage notes payable to the United States of America (RUS) as follows:

	<u>2010</u>	<u>2009</u>
Two percent mortgage notes	\$ 4,491,273	4,980,849
Five percent mortgage notes	<u>1,371,179</u>	<u>1,415,230</u>
Total RUS mortgage notes	5,862,452	6,396,079
Current maturities	<u>(543,760)</u>	<u>(533,579)</u>
Net long-term debt	<u>\$ 5,318,692</u>	<u>5,862,500</u>

## INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.

### Notes to Financial Statements, continued

#### Long-Term Debt, continued

The notes are for 35-year periods and are scheduled to be fully repaid at various dates from 2011 to 2033. The mortgage notes are subject to various covenants and requirements detailed in the loan documents.

#### Annual Requirements for Long-Term Debt

The estimated annual requirements for principal reduction of the RUS long-term debt outstanding as of December 31, 2010 follow:

#### Year Ending December 31:

2011	\$ 543,760
2012	448,270
2013	415,883
2014	304,770
2015	312,586
Thereafter	<u>3,837,183</u>
	<u>\$ 5,862,452</u>

The above notes are secured by all assets of IPEC.

#### (7) Line of Credit

IPEC has a \$3,000,000 perpetual line of credit with NRUCFC. Provisions on the line of credit require repayment in full within 360 days of the advance. Interest is accrued and payable quarterly. At December 31, 2010 and 2009, nothing was due on the line of credit.

#### (8) Deferred Credits

Deferred credits at December 31, 2010 and 2009 consisted of the following:

	<u>2010</u>	<u>2009</u>
Special equipment costs	\$ 57,200	53,700
Deferred customer credit	69,645	-
RUS construction in aid grants	51,393	-
Deferred maintenance	1,995	1,995
Customer advances for construction	<u>5,151</u>	<u>-</u>
Total deferred credits	<u>\$ 185,384</u>	<u>55,695</u>

## INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.

### Notes to Financial Statements, continued

(9) **Pension Plan and 401K Plan**

Pension benefits are provided for substantially all employees through participation in the National Rural Electric Cooperative Association (NRECA) Retirement and Security program, a defined benefit pension plan qualified under Section 401 and tax exempt pursuant to Section 501(a) of the Internal Revenue Code. The Plan is a multi-employer plan in which the accumulated benefits and plan assets are not determined or allocated by individual employer. IPEC funds pension costs at rates determined by NRECA. Contributions made during 2010 and 2009 were \$250,497 and \$165,720 respectively.

The Cooperative also participates in a 401K plan that is available to all permanent full-time eligible employees. Employees may contribute to the plan on a payroll deduction basis but the Cooperative does not provide any employer match.

(10) **Kwaan Electric Transmission Intertie Cooperative, Inc.**

In 2004, IPEC, along with Alaska Electric Light and Power Company, formed a new cooperative named Kwaan Electric Transmission Intertie Cooperative, Inc. (Kwaan). Kwaan was organized for the purpose of extending the availability of low cost electricity in Southeast Alaska through the acquisition and construction of electric transmission interties.

(11) **Contingencies and Commitments**

IPEC is party to various claims, for and against its interest, which are either covered by insurance or management believes will not have a detrimental effect to its financial position.

**ADDITIONAL INFORMATION**

**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**

Schedule of Expenditures of Federal Awards

Year Ended December 31, 2010

<u>Federal Grant Title</u>	<u>Grant Number</u>	<u>Catalog of Federal Domestic Assistance Number</u>	<u>Total Grant Award</u>	<u>Federal Share of Expenditures</u>
<b>Department of Agriculture -</b>				
<b>Rural Utilities Service -</b>				
High Energy Cost Grant - Diesel Generator	N/A	10.859	\$ 735,000	695,166
High Energy Cost Grant - SCADA	N/A	10.859	178,190	<u>119,259</u>
Total Department of Agriculture			\$	<u>814,425</u>

Note 1: Basis of Presentation

The schedule of expenditures of federal awards includes the federal grant activity of Inside Passage Electric Cooperative, Inc. and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*.

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**SUPPLEMENTARY RUS AND FEDERAL SINGLE AUDIT REPORTS**

Independent Auditor's Management Letter Report for RUS

Board of Directors  
Inside Passage Electric Cooperative, Inc.  
Auke Bay, Alaska

We have audited the financial statements of Inside Passage Electric Cooperative, Inc. (the Cooperative) as of and for the years ended December 31, 2010 and 2009, and have issued our report thereon dated March 21, 2011. We conducted our audits 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 7 CFR Part 1773, Policy on Audits of Rural Utilities Service (RUS) Borrowers. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit, we considered the Cooperative'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 the Cooperative's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Cooperative'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 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.



Board of Directors  
Inside Passage Electric Cooperative, Inc.

Section 1773.33 requires comments on specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and other additional matters. We have grouped our comments accordingly. In addition to obtaining reasonable assurance about whether the financial statements are free from material misstatements, at your request, we performed tests of specific aspects of the internal control over financial reporting, of compliance with specific RUS loan and security instrument provisions, and of additional matters. The specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and additional matters tested include, among other things, the accounting procedures and records, materials control, compliance with specific RUS loan and security instrument provisions set forth in 7 CFR 1773.33(e)(1), related party transactions, depreciation rates, a schedule of deferred debits and credits, and a schedule of investments, upon which we express an opinion. In addition, our audit of the financial statements also included the procedures specified in 7 CFR 1773.38 - .45. Our objective was not to provide an opinion on these specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, or additional matters, and accordingly, we express no opinion thereon.

No reports other than our independent auditor's report on the financial statements, our independent auditor's report on compliance and on internal control over financial reporting, and our independent auditor's report on compliance with requirements that could have a direct and material effect on each major program and on internal control over compliance, all dated March 21, 2011 or summary of recommendations related to our audit have been furnished to management.

Our comments on specific aspects of internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and other additional matters as required by 7 CFR 1773.33 are presented below.

#### **COMMENTS ON CERTAIN SPECIFIC ASPECTS OF THE INTERNAL CONTROL OVER FINANCIAL REPORTING**

We noted no matters regarding the Cooperative's internal control over financial reporting and its operation that we consider to be a material weakness as previously defined with respect to:

- The accounting procedures and records;
- The process for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts; and,
- The materials control.

## **COMMENTS ON COMPLIANCE WITH SPECIFIC RUS LOAN AND SECURITY INSTRUMENT PROVISIONS**

At your request, we have performed the procedures enumerated below with respect to compliance with certain provisions of laws, regulations, contracts, and grants. The procedures we performed are summarized as follows:

- Procedures performed with respect to the requirement for a borrower to obtain written approval of the mortgagee to enter into any contract for the management, operation or maintenance of property, or for the use of mortgaged property by others for the year ended December 31, 2010:
  - Obtained and read a borrower-prepared schedule of new written contracts entered into during the year for the operation or maintenance of its property, or for the use of its property by others.
  - Reviewed Board of Director's minutes to ascertain whether board-approved written contracts are included in the borrower-prepared schedule.
- Procedure performed with respect to the requirement to submit RUS Form 7 to the RUS:
  - Agreed amounts reported in Form 7 to the Cooperative's records.

The results of our tests indicate that, with respect to the items tested, the Cooperative complied, in all material respects, with the specific RUS loan and security instrument provisions referred to below. The specific provisions tested include the requirements that:

- The borrower has obtained written approval of the RUS to enter into any contract for the management, operation or maintenance of property, or for the use of mortgaged property by others as defined in 7 CFR 1773.33(e)(1)(i); and
- The borrower has submitted its Form 7 to the RUS and the Form 7, Financial and Statistical Report, as of December 31, 2010, represented by the borrower as having been submitted to RUS is in agreement with the Cooperative's audited records in all material respects.

## **COMMENTS ON OTHER ADDITIONAL MATTERS**

In connection with our audit of the financial statements of the Cooperative, nothing came to our attention that caused us to believe that the Cooperative failed to comply with respect to:

- The reconciliation of continuing property records to the controlling general ledger plant accounts addressed at 7 CFR 1773.33(c)(1);

**COMMENTS ON OTHER ADDITIONAL MATTERS, continued**

- The clearing of construction accounts and the accrual of depreciation on completed construction addressed at 7 CFR 1773.33(c)(2);
- The retirement of plant addressed at 7 CFR 1773.33(c)(3) and (4);
- Approval of the sale, lease or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap addressed at 7 CFR 1773.33 (c)(5);
- The disclosure of material related party transactions, in accordance with Statement of Financial Accounting Standards No. 57, Related Party Transactions, for the year ended December 31, 2010 in the financial statements referenced in the first paragraph of this report addressed at 7 CFR 1773.33(f);
- Depreciation rates addressed at 7 CFR 1773.33(g);
- The detailed schedule of deferred debits and deferred credits; and
- The detailed schedule of investments.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The detailed schedule of deferred debits and deferred credits required by 7 CFR 1773.33(h), and the detailed schedule of investments required by 7 CFR 1773.33(i), provided below, are presented for purposes of additional analysis and are not a required part of the basic financial statements. This information has been subjected to the auditing procedures applied in our 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.

Deferred charges:

Depreciation study	\$ 54,254
Software upgrade	97,852
Cost of power adjustment	23,114
Cost of service study	58,839
Other	<u>(2,566)</u>
Total deferred charges	\$ <u>231,493</u>

Board of Directors  
Inside Passage Electric Cooperative, Inc.

**COMMENTS ON OTHER ADDITIONAL MATTERS, continued**

Deferred credits:	
Special equipment costs	\$ 57,200
Deferred customer credit	69,645
RUS construction in aid grants	51,393
Deferred maintenance	1,995
Customer advances for construction	<u>5,151</u>
Total deferred credits	<u>\$ 185,384</u>

There were no investments at December 31, 2010.

\* \* \* \* \*

This report is intended solely for the information and use of the Board of Directors, management, the Rural Utilities Service, and other federal agencies and is not intended to be and should not be used by anyone other than these specified parties.

*Mikunda, Cottrell & Co.*

Anchorage, Alaska  
March 21, 2011

Independent Auditor's 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

Board of Directors  
Inside Passage Electric Cooperative, Inc.  
Auke Bay, Alaska

We have audited the financial statements of Inside Passage Electric Cooperative, Inc. (the Cooperative), as of and for the years ended December 31, 2010 and 2009, and have issued our report thereon dated March 21, 2011. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Cooperative'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 the Cooperative's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Cooperative'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 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.

Board of Directors  
Inside Passage Electric Cooperative, Inc.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Cooperative'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*.

This report is intended solely for the information and use of the Board of Directors, management, others within the entity, the Rural Utilities Service, and other federal agencies and is not intended to be and should not be used by anyone other than these specified parties.

*Mikunda, Cottrell & Co.*

Anchorage, Alaska  
March 21, 2011

Independent Auditor's Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133

Board of Directors  
Inside Passage Electric Cooperative, Inc.  
Auke Bay, Alaska

Compliance

We have audited the compliance of Inside Passage Electric Cooperative, Inc. (the Cooperative) with the types of compliance requirements described in the OMB *Circular A-133 Compliance Supplement* that could have a direct and material effect on its major federal program for the year ended December 31, 2010. The Cooperative's major federal program is 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 its major federal program is the responsibility of the Cooperative's management. Our responsibility is to express an opinion on the Cooperative's 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 the Cooperative's 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 the Cooperative's compliance with those requirements.

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

Board of Directors  
Inside Passage Electric Cooperative, Inc.

### Internal Control Over Compliance

The management of the Cooperative 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 the Cooperative's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our 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 the Cooperative's 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.

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

*Mikunda, Cottrell & Co.*

Anchorage, Alaska  
March 21, 2011



**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**

Schedule of Findings and Questioned Costs

Year Ended December 31, 2010

**I. Summary of Auditor's Results**

**Financial Statements**

Type of auditor's report issued

Unqualified

Internal control over financial reporting:

- Material weakness(es) identified?  yes  no
- Significant deficiency(ies) identified that are not considered to be material weakness(es)?  yes  none reported
- Noncompliance material to financial statements noted?  yes  no

**Federal Awards**

Internal control over major programs:

- Material weakness(es) identified?  yes  no
- Significant deficiency(ies) identified that are not considered to be material weakness(es)?  yes  none reported

Type of auditor's report issued on compliance for major programs

Unqualified

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133?

yes  no

Identification of major programs:

<u>Agency</u>	<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
Department of Agriculture	10.859	Assistance to High Energy Cost Rural Communities

Dollar threshold used to distinguish between Type A and Type B programs:

\$300,000

Auditee qualified as low-risk auditee?

yes  no

**II. Financial Statement Findings**

None noted.

**III. Federal Award Findings and Questioned Costs**

None noted.

**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**

Summary Schedule of Prior Audit Findings

Year Ended December 31, 2010

**Federal**

There were no prior year audit findings.

**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**

Corrective Action Plan

Year Ended December 31, 2010

There are no current year findings; therefore no corrective action plan is required.