

**INSIDE PASSAGE  
ELECTRIC COOPERATIVE, INC.**

Financial Statements, Supplementary Information,  
and RUS and State Single Audit Reports

Years Ended December 31, 2011 and 2010

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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, 2011 and 2010 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, 2011 and 2010, 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 26, 2012, 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 State Financial Assistance is presented for purposes of additional analysis and is not a required part of the basic financial statements. The Schedule of State Financial Assistance is required by the *State of Alaska Audit Guide and Compliance Supplement for State Single Audits*. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

*Mikunda, Cottrell & Co.*

Anchorage, Alaska  
March 26, 2012

**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**

## Balance Sheets

December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
<u>Assets</u>		
Utility plant:		
Electric plant in service	\$ 19,770,379	19,611,280
Construction work in progress	<u>60,504</u>	<u>21,649</u>
Total utility plant	19,830,883	19,632,929
Less accumulated depreciation	<u>(11,162,499)</u>	<u>(10,712,755)</u>
Net utility plant	<u>8,668,384</u>	<u>8,920,174</u>
Other assets:		
Investments in associated organizations	1,027,113	875,767
Restricted cash:		
Consumer deposits	163,274	66,115
State of Alaska performance guarantee	<u>8,600</u>	<u>8,600</u>
Total other assets	<u>1,198,987</u>	<u>950,482</u>
Current assets:		
Cash	50,318	199,821
Accounts receivable, less provision for doubtful accounts of \$33,979 (\$39,899 in 2010)	1,199,877	582,238
Unbilled revenue	277,088	302,550
Materials and supplies inventory	335,775	385,565
Fuel inventory	407,849	350,085
Prepaid expenses	85,580	55,944
Other current and accrued assets	<u>1,177</u>	<u>1,179</u>
Total current assets	<u>2,357,664</u>	<u>1,877,382</u>
Deferred charges	<u>49,882</u>	<u>231,493</u>
Total assets	<u>\$ 12,274,917</u>	<u>11,979,531</u>

See accompanying notes to financial statements.

**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**

## Balance Sheets, continued

	<u>2011</u>	<u>2010</u>
<u>Equities and Liabilities</u>		
Equities:		
Patronage capital	\$ 1,906,397	1,649,666
Other equities	<u>3,886,177</u>	<u>3,886,177</u>
Total equities	<u>5,792,574</u>	<u>5,535,843</u>
Long-term debt:		
RUS mortgage notes	5,318,661	5,862,452
Less current maturities	<u>(443,824)</u>	<u>(543,760)</u>
Net long-term debt	<u>4,874,837</u>	<u>5,318,692</u>
Current liabilities:		
Current maturities of long-term debt	443,824	543,760
Accounts payable	436,813	243,942
Line of credit	300,000	-
Accrued interest on line of credit	2,420	-
Consumer deposits	158,896	66,851
Accrued payroll and related liabilities	<u>83,099</u>	<u>85,059</u>
Total current liabilities	<u>1,425,052</u>	<u>939,612</u>
Deferred credits	<u>182,454</u>	<u>185,384</u>
Total equities and liabilities	\$ <u><u>12,274,917</u></u>	<u><u>11,979,531</u></u>

See accompanying notes to financial statements.



**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**Statements of Operations  
Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Operating revenues	\$ <u>5,926,124</u>	<u>5,242,015</u>
Operating expenses:		
Purchased power	156,958	176,094
Power production operations	3,338,500	2,746,004
Power production maintenance	230,417	181,937
Distribution operations	147,584	74,470
Distribution maintenance	59,784	42,840
Consumer accounts	239,796	187,320
Customer service and information	30,982	29,128
Administrative and general	841,842	850,524
Depreciation	505,067	478,141
Amortization	131,684	43,470
Taxes	<u>4,940</u>	<u>2,471</u>
Total operating expenses	<u>5,687,554</u>	<u>4,812,399</u>
Operating margins before fixed charges	238,570	429,616
Fixed charges:		
Interest on long-term debt	(153,201)	(165,327)
Other interest	<u>(11,174)</u>	<u>-</u>
Total fixed charges	<u>(164,375)</u>	<u>(165,327)</u>
Operating margins after fixed charges	74,195	264,289
Nonoperating margins (losses):		
Patronage capital from associated organizations	161,601	40,888
Interest income	3,247	3,366
Rental income (loss), net of rental expenses	9,382	(11,742)
Other nonoperating revenues	<u>8,306</u>	<u>1,636</u>
Net nonoperating margins (losses)	<u>182,536</u>	<u>34,148</u>
Net margins	\$ <u><u>256,731</u></u>	<u><u>298,437</u></u>

See accompanying notes to financial statements.

**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**Statements of Equities  
Years Ended December 31, 2011 and 2010

	<u>Other Equities</u>			
	<u>Retained Earnings</u>	<u>Donated Capital</u>	<u>Patronage Capital</u>	<u>Total</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	3,881,841	4,336	1,649,666	5,535,843
Net margins	<u>-</u>	<u>-</u>	<u>256,731</u>	<u>256,731</u>
Balances at December 31, 2011	\$ <u>3,881,841</u>	<u>4,336</u>	<u>1,906,397</u>	<u>5,792,574</u>

See accompanying notes to financial statements.

**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**

## Statements of Cash Flows

Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash flows from operating activities:		
Cash received from customers	\$ 5,336,877	5,094,462
Cash paid to suppliers and employees	(4,800,800)	(4,318,603)
Interest received	3,247	3,366
Interest paid on long-term debt and line of credit	<u>(161,955)</u>	<u>(165,327)</u>
Net cash provided by operating activities	<u>377,369</u>	<u>613,898</u>
Cash flows from investing activities:		
Additions to plant, net	(288,222)	(112,285)
Funds received from associated organizations	<u>10,255</u>	<u>3,005</u>
Net cash used by investing activities	<u>(277,967)</u>	<u>(109,280)</u>
Cash flows from financing activities:		
Principal payments on long-term debt	(543,791)	(533,627)
Draws on line of credit	300,000	-
Increase in consumer deposits	<u>92,045</u>	<u>1,522</u>
Net cash used by financing activities	<u>(151,746)</u>	<u>(532,105)</u>
Decrease in cash and cash equivalents	(52,344)	(27,487)
Cash and cash equivalents, beginning of year	<u>274,536</u>	<u>302,023</u>
Cash and cash equivalents, end of year	\$ <u><u>222,192</u></u>	<u><u>274,536</u></u>
Reconciliation of cash and cash equivalents to balance sheet:		
Cash and cash equivalents:		
Current assets	\$ 50,318	199,821
Restricted assets	<u>171,874</u>	<u>74,715</u>
	\$ <u><u>222,192</u></u>	<u><u>274,536</u></u>

See accompanying notes to financial statements.

**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**

## Statements of Cash Flows, continued

	<u>2011</u>	<u>2010</u>
Reconciliation of net margins to net cash flows from operating activities:		
Net margins	\$ <u>256,731</u>	<u>298,437</u>
Adjustments to reconcile net margins to net cash provided (used) by operating activities:		
Depreciation	536,572	517,028
Income allocation from investments in associated organizations	(161,601)	(40,888)
(Increase) decrease in assets:		
Accounts receivable (net)	(617,639)	(223,965)
Unbilled revenue	25,462	(54,913)
Materials and supplies inventory	49,790	5,588
Fuel inventory	(57,764)	1,441
Prepaid expenses	(29,636)	5,207
Deferred charges	181,611	(120,677)
Other current and accrued assets	2	-
Increase (decrease) in liabilities:		
Accounts payable	192,871	75,322
Accrued payroll and related liabilities	(1,960)	21,629
Deferred credits	<u>2,930</u>	<u>129,689</u>
Total adjustments	<u>120,638</u>	<u>315,461</u>
Net cash provided by operating activities	\$ <u><u>377,369</u></u>	<u><u>613,898</u></u>

See accompanying notes to financial statements.

## INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.

Notes to Financial Statements

December 31, 2011 and 2010

(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-subsiary 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**

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

The Cooperative completed a Depreciation Study in 2010 for filing with the RCA. The new depreciation rates were approved by the RCA with an effective date of January 1, 2011.

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

Production plant	0.12% – 6.49%
Distribution plant	1.52% – 10.27%
General plant	1.74% – 17.81%

Capitalized Interest

Interest is capitalized to construction on major generation and distribution projects. No interest was capitalized in 2011 and 2010.

## INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.

Notes to Financial Statements, continued

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

#### 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 \$353,842 and \$387,492 at December 31, 2011 and 2010, respectively. These balances were fully insured by the Federal Deposit Insurance Corporation (FDIC).

#### Reclassified Balances

Certain 2010 balances have been reclassified to conform with the current year presentation.

#### Subsequent Events

The Cooperative has evaluated subsequent events through March 26, 2012, the date on which the financial statements were issued.

**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**

Notes to Financial Statements, continued

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

Major classes of the utility plant as of December 31, 2011 and 2010 are as follows:

	<u>2011</u>	<u>2010</u>
Production plant	\$ 4,185,876	4,164,685
Distribution plant	13,235,000	13,085,807
General plant	2,349,503	2,333,841
Unclassified plant	<u>-</u>	<u>26,947</u>
Total electric plant in service	19,770,379	19,611,280
Construction work in progress	<u>60,504</u>	<u>21,649</u>
 Total utility plant	 <u>\$ 19,830,883</u>	 <u>19,632,929</u>

Summary of depreciation provision:

	<u>2011</u>	<u>2010</u>
Depreciation expense	\$ 505,067	478,141
Depreciation to clearing account	18,610	27,145
Depreciation of rental	<u>12,895</u>	<u>11,742</u>
 Total depreciation	 <u>\$ 536,572</u>	 <u>517,028</u>

(3) **Investments in Associated Organizations**

Investments in associated organizations consisted of the following at December 31, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Alaska Rural Electric Cooperative Association (ARECA) Insurance Exchange - Patronage capital credits	 \$ <u>913,107</u>	 <u>765,369</u>
National Rural Utilities Cooperative Finance Corporation (NRUCFC):		
Capital term certificates	93,543	93,543
Patronage capital credits	16,077	15,855
Membership	<u>1,000</u>	<u>1,000</u>
Total NRUCFC	<u>110,620</u>	<u>110,398</u>
 Other – NISC patronage capital	 <u>3,386</u>	 <u>-</u>
 Total investments in associated organizations	 <u>\$ 1,027,113</u>	 <u>875,767</u>



**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**

Notes to Financial Statements, continued

(4) **Accounts Receivable**

Accounts receivable at December 31, 2011 and 2010 consisted of the following:

	<u>2011</u>	<u>2010</u>
Consumer accounts	\$ 413,439	338,557
Power cost equalization (PCE)	524,372	141,617
Contract services	21,043	27,111
Grants receivable	<u>275,002</u>	<u>114,852</u>
Total accounts receivable	1,233,856	622,137
Allowance for doubtful accounts	<u>(33,979)</u>	<u>(39,899)</u>
Accounts receivable, net	\$ <u>1,199,877</u>	<u>582,238</u>

(5) **Deferred Charges**

Deferred charges at December 31, 2011 and 2010 consisted of the following:

	<u>2011</u>	<u>2010</u>
Depreciation study	\$ 15,991	54,254
Software upgrade	-	97,852
Cost of power adjustment	-	23,114
Cost of service study	32,265	58,839
Other	<u>1,626</u>	<u>(2,566)</u>
Total deferred charges	\$ <u>49,882</u>	<u>231,493</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.

**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**

Notes to Financial Statements, continued

(6) **Other Equities**

Other equities consist of retained earnings and donated capital accumulated prior to the formation of the Cooperative on January 1, 2004. A summary of other equities at December 31, 2011 and 2010 follows:

	<u>2011</u>	<u>2010</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>

(7) **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>2011</u>	<u>2010</u>
Two percent mortgage notes	\$ 3,993,784	4,491,273
Five percent mortgage notes	<u>1,324,877</u>	<u>1,371,179</u>
Total RUS mortgage notes	5,318,661	5,862,452
Current maturities	<u>(443,824)</u>	<u>(543,760)</u>
Net long-term debt	\$ <u>4,874,837</u>	<u>5,318,692</u>

The notes are for 35-year periods and are scheduled to be fully repaid at various dates from 2012 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, 2011 follow:

Year Ending December 31:

2012	\$ 443,824
2013	413,573
2014	301,099
2015	308,694
2016	316,519
Thereafter	<u>3,534,952</u>
	\$ <u>5,318,661</u>

The above notes are secured by all assets of IPEC.

**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**

Notes to Financial Statements, continued

(8) **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, 2011 and 2010, \$300,000 and \$0 respectively, was due on the line of credit. The loan bears interest at a variable rate (3.20% at December 31, 2011).

(9) **Deferred Credits**

Deferred credits at December 31, 2011 and 2010 consisted of the following:

	<u>2011</u>	<u>2010</u>
Special equipment costs	\$ 55,200	57,200
Deferred customer credit	42,294	69,645
RUS grant advance	15,360	51,393
Deferred maintenance	1,995	1,995
Customer advances for construction	10,532	5,151
Prepaid rent deposit	3,420	-
Cost of power adjustment	<u>53,653</u>	<u>-</u>
Total deferred credits	\$ <u>182,454</u>	<u>185,384</u>

(10) **Lease**

On May 1, 2011, the Cooperative entered into an agreement to lease office space to Morris Engineering Group, LLC. The initial term of the lease covers a period of three years beginning May 1, 2011 and ending May 1, 2014. The schedule of future lease payments due to the Cooperative follows:

Year Ending December 31:

2012	\$ 49,672
2013	52,697
2014	<u>14,735</u>
Total	\$ <u>117,104</u>

## INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.

### Notes to Financial Statements, continued

(11) **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 2011 and 2010 were \$262,348 and \$250,497 respectively.

The Cooperative also participates in a 401K plan that is available to all employees. Employees may contribute to the plan on a payroll deduction basis. Beginning in 2011, the Cooperative will match 100% of the first 3% of employee contributions and up to an additional 50% of the next 2% of employee contributions. Contributions made during 2011 were \$17,043.

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

In 2004, IPEC, along with Alaska Electric Light and Power Company, formed a 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.

(13) **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.

**SUPPLEMENTARY INFORMATION**

**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**

Schedule of State Financial Assistance

Year Ended December 31, 2011

<u>State Grant Title</u>	<u>Grant Number</u>	<u>Grant Award</u>	<u>State Share of Expenditures</u>
<b>Department of Commerce, Community, and Economic Development</b>			
*Southern Energy, Inc. Hydroelectric Project Purchase	12-DC-525	\$ 1,265,000	<u>1,237,509</u>
<b>Alaska Energy Authority</b>			
*Reconnaissance Study of Tenakee Inlet Geothermal Resourc	7040073	599,200	311,348
*Hoonah-IPEC Hydro Project	7030019	850,000	<u>104,852</u>
Total Alaska Energy Authority			<u>416,200</u>
Total State Financial Assistance			\$ <u>1,653,709</u>

\*Major program

Note 1: Basis of Presentation

The schedule of state financial assistance includes the state 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 the *State of Alaska Audit Guide and Compliance Supplement for State Single Audits*.

**RUS AND STATE 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, 2011 and 2010, and have issued our report thereon dated March 26, 2012. 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.

Management of Inside Passage Electric Cooperative, Inc. is responsible for establishing and maintaining effective 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.



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 26, 2012 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.

Board of Directors  
Inside Passage Electric Cooperative, Inc.

## **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, 2011:
  - 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, 2011, 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, 2011 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	\$ 15,991
Cost of service study	32,265
Other	<u>1,626</u>
Total deferred charges	<u>\$ 49,882</u>

Board of Directors  
Inside Passage Electric Cooperative, Inc.

**COMMENTS ON OTHER ADDITIONAL MATTERS, continued**

Deferred credits:	
Special equipment costs	\$ 55,200
Deferred customer credit	42,294
RUS grant advance	15,360
Deferred maintenance	1,995
Customer advances for construction	10,532
Prepaid rent deposit	3,420
Cost of power adjustment	<u>53,653</u>
Total deferred credits	\$ <u>182,454</u>

There were no investments at December 31, 2011.

\* \* \* \* \*

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 26, 2012

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, 2011 and 2010, and have issued our report thereon dated March 26, 2012. 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

Management of Inside Passage Electric Cooperative, Inc. is responsible for establishing and maintaining effective 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 26, 2012

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 the State of Alaska Audit Guide and Compliance Supplement for State Single Audits

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

Compliance

We have audited the compliance of Inside Passage Electric Cooperative, Inc. with the types of compliance requirements described in *the State of Alaska Audit Guide and Compliance Supplement for State Single Audits* that could have a direct and material effect on each of its major state programs for the year ended December 31, 2011. The Cooperative's major state programs are identified in the accompanying Schedule of State Financial Assistance. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major state programs 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 the *State of Alaska Audit Guide and Compliance Supplement for State Single Audits*. Those standards and the *State of Alaska Audit Guide and Compliance Supplement for State Single Audits* 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 state 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, the Cooperative complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major state programs for the year ended December 31, 2011.

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 state 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 state 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 the *State of Alaska Audit Guide and Compliance Supplement for State Single Audits* 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 state 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 state 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, and the State of Alaska, and is not intended to be and should not be used by anyone other than these specified parties.

*Mikunda, Cottrell & Co.*

Anchorage, Alaska  
March 26, 2012



**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**

Schedule of Findings and Questioned Costs

Year Ended December 31, 2011

**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 | <u>  X  </u> | no            |
| • Significant deficiency(ies) identified?               | _____ | yes | <u>  X  </u> | none reported |
| • Noncompliance material to financial statements noted? | _____ | yes | <u>  X  </u> | no            |

**State Awards**

Internal control over major programs:

- |   |       |     |              |               |
|---|-------|-----|--------------|---------------|
| • Material weakness(es) identified?       | _____ | yes | <u>  X  </u> | no            |
| • Significant deficiency(ies) identified? | _____ | yes | <u>  X  </u> | none reported |

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

Unqualified

Dollar threshold used to distinguish a state major program

\$75,000

**II. Financial Statement Findings**

None noted.

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

None noted.

**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**

Summary Schedule of Prior Audit Findings

Year Ended December 31, 2011

**Federal and State**

There were no prior year audit findings.

**INSIDE PASSAGE ELECTRIC COOPERATIVE, INC.**

Corrective Action Plan

Year Ended December 31, 2011

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