



**Inside Passage Electric Cooperative,
Inc.**

Financial Statements, Supplementary
Information, and RUS and Single Audit
Reports
Years Ended December 31, 2013 and 2012

Inside Passage Electric Cooperative, Inc.

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

Years Ended December 31, 2013 and 2012

Inside Passage Electric Cooperative, Inc.

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Tel: 907-278-8878
Fax: 907-278-5779
www.bdo.com

3601 C Street, Suite 600
Anchorage, AK 99503

Independent Auditor's Report

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

Report on the Financial Statements

We have audited the accompanying financial statements of Inside Passage Electric Cooperative, Inc. (the Cooperative), which comprise the balance sheet as of December 31, 2013, and the related statements of revenues and patronage capital, and cash flows for the year 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 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 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.

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, 2013, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

2012 Financial Statements

The 2012 financial statements of Inside Passage Electric Cooperative, Inc. were audited by other auditors, whose report dated March 29, 2013 expressed an unmodified opinion on those statements.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of state financial assistance, as required by the *State of Alaska Audit Guide and Compliance Supplement for State Single Audits*, is presented for purposes of additional analysis and is not a required part of the financial statements. 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 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 financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated April 2, 2014, 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Inside Passage Electric Cooperative, Inc.'s internal control over financial reporting and compliance.

BDO USA, LLP

Anchorage, Alaska
April 2, 2014

Financial Statements

Inside Passage Electric Cooperative, Inc.

Balance Sheets

| <i>December 31,</i> | 2013 | 2012 |
|---|----------------------|----------------------|
| Assets | | |
| Utility plant: | | |
| Electric plant in service | \$ 19,101,622 | \$ 18,903,600 |
| Construction work in progress | 35,076 | - |
| Total utility plant | 19,136,698 | 18,903,600 |
| Less accumulated depreciation | (11,122,550) | (10,631,880) |
| Net utility plant | 8,014,148 | 8,271,720 |
| Other assets: | | |
| Investments in associated organizations | 1,197,778 | 1,151,357 |
| Restricted cash: | | |
| Consumer deposits | 84,781 | 59,242 |
| State of Alaska performance guarantees | 13,600 | 13,600 |
| Construction account | 101 | 101 |
| Total other assets | 1,296,260 | 1,224,300 |
| Current assets: | | |
| Cash | 443,688 | 82,491 |
| Accounts receivable, less provision for doubtful accounts of \$34,329 (\$34,118 in 2012) | 504,413 | 687,673 |
| Grants receivable | 46,892 | 44,759 |
| Unbilled revenue | 237,353 | 292,568 |
| Materials and supplies inventory | 286,567 | 287,446 |
| Fuel inventory | 494,800 | 558,400 |
| Prepaid expenses | 45,102 | 69,999 |
| Other current and accrued assets | 1,179 | 1,179 |
| Total current assets | 2,059,994 | 2,024,515 |
| Deferred charges | 18,368 | 17,422 |
| Total Assets | \$ 11,388,770 | \$ 11,537,957 |

See accompanying notes to financial statements.

Inside Passage Electric Cooperative, Inc.

Balance Sheets, continued

| <i>December 31,</i> | 2013 | 2012 |
|---|----------------------|----------------------|
| Equities and Liabilities | | |
| Equities: | | |
| Patronage capital | \$ 2,358,683 | \$ 2,057,580 |
| Other equities | 3,886,177 | 3,886,177 |
| Total equities | 6,244,860 | 5,943,757 |
| Long-term debt: | | |
| RUS mortgage notes | 4,454,475 | 4,870,347 |
| Less: | | |
| Current maturities | (304,777) | (413,573) |
| Advance payments on RUS notes | (100,000) | - |
| Net long-term debt | 4,049,698 | 4,456,774 |
| Current liabilities: | | |
| Current maturities of long-term debt | 304,777 | 413,573 |
| Accounts payable | 166,960 | 231,970 |
| Line of credit | - | 200,000 |
| Consumer deposits | 84,988 | 55,590 |
| Accrued payroll and related liabilities | 88,826 | 80,869 |
| Total current liabilities | 645,551 | 982,002 |
| Deferred credits | 448,661 | 155,424 |
| Total Equities and Liabilities | \$ 11,388,770 | \$ 11,537,957 |

See accompanying notes to financial statements.

Inside Passage Electric Cooperative, Inc.
Statements of Revenues and Patronage Capital

| <i>Years Ended December 31,</i> | 2013 | 2012 |
|---|--------------|--------------|
| Operating revenues | \$ 6,072,371 | \$ 6,083,590 |
| Operating expenses: | | |
| Purchased power | 89,052 | 93,185 |
| Power production operations | 3,464,889 | 3,574,037 |
| Power production maintenance | 252,264 | 260,807 |
| Distribution operations | 167,087 | 187,314 |
| Distribution maintenance | 40,372 | 64,686 |
| Consumer accounts | 191,131 | 161,589 |
| Customer service and information | 38,833 | 35,095 |
| Administrative and general | 1,019,053 | 1,021,285 |
| Depreciation | 503,384 | 510,310 |
| Amortization | - | 48,256 |
| Taxes | 5,093 | 5,125 |
| Total operating expenses | 5,771,158 | 5,961,689 |
| Operating margins before fixed charges | 301,213 | 121,901 |
| Fixed charges: | | |
| Interest on long-term debt | (131,135) | (141,630) |
| Other interest | (1,603) | (2,928) |
| Total fixed charges | (132,738) | (144,558) |
| Operating margins (losses) after fixed charges | 168,475 | (22,657) |
| Nonoperating margins: | | |
| Patronage capital from associated organizations | 101,046 | 149,338 |
| Interest income | 3,690 | 3,465 |
| Rental income, net of rental expenses | 28,053 | 21,472 |
| Other nonoperating revenues (expenses) | (161) | (435) |
| Net nonoperating margins | 132,628 | 173,840 |
| Net margins | 301,103 | 151,183 |
| Patronage Capital at beginning of year | 2,057,580 | 1,906,397 |
| Patronage Capital at end of year | \$ 2,358,683 | \$ 2,057,580 |

See accompanying notes to financial statements.

Inside Passage Electric Cooperative, Inc.

Statements of Cash Flows

| <i>Years Ended December 31,</i> | 2013 | 2012 |
|--|-------------------|-------------------|
| Cash Flows from Operating Activities | | |
| Cash received from customers | \$ 6,340,244 | \$ 6,202,006 |
| Cash paid to suppliers and employees | (5,022,364) | (5,708,160) |
| Other nonoperating income received | 31,582 | 24,502 |
| Interest paid on long-term debt and line of credit | (132,738) | (146,978) |
| Net cash provided by operating activities | 1,216,724 | 371,370 |
| Cash Flows from Investing Activities | | |
| Additions to plant | (899,950) | (599,140) |
| Grants received for construction | 620,500 | 684,232 |
| Advance contribution in aid from RUS | 110,709 | - |
| Funds received from associated organizations | 54,625 | 25,094 |
| Net cash provided (used) by investing activities | (114,116) | 110,186 |
| Cash Flows from Financing Activities | | |
| Principal payments on long-term debt | (515,872) | (448,314) |
| Draws (payments) on line of credit, net | (200,000) | (100,000) |
| Net cash used by financing activities | (715,872) | (548,314) |
| Increase (decrease) in cash and cash equivalents | 386,736 | (66,758) |
| Cash and Cash Equivalents, beginning of year | 155,434 | 222,192 |
| Cash and Cash Equivalents, end of year | \$ 542,170 | \$ 155,434 |
| Reconciliation of cash and cash equivalents to balance sheet: | | |
| Cash and cash equivalents: | | |
| Current assets | \$ 443,688 | \$ 82,491 |
| Restricted assets | 98,482 | 72,943 |
| | \$ 542,170 | \$ 155,434 |

See accompanying notes to financial statements.

Inside Passage Electric Cooperative, Inc.

Statements of Cash Flows, continued

| Years Ended December 31, | 2013 | 2012 |
|--|---------------------|-------------------|
| Reconciliation of net margins to net cash flows from operating activities: | | |
| Net margins | \$ 301,103 | \$ 151,183 |
| Adjustments to reconcile net margins to net cash provided by operating activities: | | |
| Depreciation | 534,889 | 541,815 |
| Income allocation from investments in associated organizations | (101,046) | (149,338) |
| (Increase) decrease in assets: | | |
| Accounts receivable, net | 183,260 | 237,202 |
| Unbilled revenue | 55,215 | (15,480) |
| Materials and supplies inventory | 879 | 48,329 |
| Fuel inventory | 63,600 | (150,551) |
| Prepaid expenses | 24,897 | 15,581 |
| Deferred charges | (946) | 32,460 |
| Other current and accrued assets | - | (2) |
| Increase (decrease) in liabilities: | | |
| Accounts payable | (65,010) | (204,843) |
| Accrued payroll and related liabilities | 7,957 | (2,230) |
| Accrued interest on line of credit | - | (2,420) |
| Consumer deposits | 29,398 | (103,306) |
| Deferred credits | 182,528 | (27,030) |
| Net Cash Provided by Operating Activities | \$ 1,216,724 | \$ 371,370 |

See accompanying notes to financial statements.

Inside Passage Electric Cooperative, Inc.

Notes to Financial Statements

December 31, 2013 and 2012

1. Organization and Summary of Significant Accounting Policies

Inside Passage Electric Cooperative, Inc. (IPEC or the Cooperative) 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

IPEC is subject to economic regulation by the Regulatory Commission of Alaska (RCA). IPEC's rates are subject to review and approval by the Commission, including for power cost equalization (PCE) purposes, a State subsidy to rural Alaska electric consumers.

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.

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.

Inside Passage Electric Cooperative, Inc.

Notes to Financial Statements

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.

Other Equities

Other equities of \$3,886,177 consist of the equity balances transferred at the formation of IPEC and are recorded as donated capital.

Depreciation

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

| | |
|--------------------|-----------------|
| Production plant | 0.12% to 6.49% |
| Distribution plant | 1.52% to 10.27% |
| General plant | 1.74% to 17.81% |

Capitalized Interest

Interest is capitalized to construction on major generation and distribution projects. No interest was capitalized in 2013 and 2012.

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 Financial Accounting Standards Board (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.

Inside Passage Electric Cooperative, Inc.

Notes to 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 \$1,006,817 and \$435,755 at December 31, 2013 and 2012, respectively. The balances insured by the Federal Deposit Insurance Corporation (FDIC) at December 31, 2013 and 2012 are \$334,882 and \$435,755, respectively.

Reclassified Balances

Certain 2012 balances have been reclassified to conform with the current year presentation.

Subsequent Events

The Cooperative has evaluated subsequent events through April 2, 2014, 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, 2013 and 2012 are as follows:

| | 2013 | 2012 |
|---------------------------------|----------------------|----------------------|
| Production plant | \$ 3,384,206 | \$ 3,363,897 |
| Distribution plant | 13,432,868 | 13,271,848 |
| General plant | 2,284,548 | 2,267,855 |
| Total electric plant in service | 19,101,622 | 18,903,600 |
| Construction work in progress | 35,076 | - |
| Total Utility Plant | \$ 19,136,698 | \$ 18,903,600 |

Depreciation expense for the year ended December 31, 2013 and 2012 was as follows:

| | 2013 | 2012 |
|----------------------------------|-------------------|-------------------|
| Depreciation expense | \$ 503,384 | \$ 510,310 |
| Depreciation to clearing account | 18,610 | 18,610 |
| Depreciation of rental | 12,895 | 12,895 |
| Total Depreciation | \$ 534,889 | \$ 541,815 |

Inside Passage Electric Cooperative, Inc.

Notes to Financial Statements

3. Investments in Associated Organizations

Investments in associated organizations consisted of the following at December 31, 2013 and 2012:

| | 2013 | 2012 |
|---|---------------------|---------------------|
| Alaska Rural Electric Cooperative Association (ARECA) Insurance Exchange - patronage capital credits | \$ 1,079,891 | \$ 1,035,683 |
| National Rural Utilities Cooperative Finance Corporation (NRUCFC): | | |
| Capital term certificates | 93,543 | 93,543 |
| Patronage capital credits | 16,556 | 16,459 |
| Membership | 1,000 | 1,000 |
| Total NRUCFC | 111,099 | 111,002 |
| National Information Solutions Cooperative (NISC) patronage capital | 6,788 | 4,672 |
| Total Investments in Associated Organizations | \$ 1,197,778 | \$ 1,151,357 |

4. Accounts Receivable

Accounts receivable at December 31, 2013 and 2012 consisted of the following:

| | 2013 | 2012 |
|---------------------------------|-------------------|-------------------|
| Consumer accounts | \$ 352,702 | \$ 365,508 |
| Power cost equalization (PCE) | 163,625 | 333,659 |
| Contract services | 22,415 | 22,624 |
| Total accounts receivable | 538,742 | 721,791 |
| Allowance for doubtful accounts | (34,329) | (34,118) |
| Accounts Receivable, Net | \$ 504,413 | \$ 687,673 |

5. Deferred Charges

Deferred charges at December 31, 2013 and 2012 consisted of the following:

| | 2013 | 2012 |
|-------------------------------|------------------|------------------|
| Community based rates study | \$ 18,368 | \$ 17,422 |
| Total Deferred Charges | \$ 18,368 | \$ 17,422 |

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.

Inside Passage Electric Cooperative, Inc.

Notes to Financial Statements

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:

| | 2013 | 2012 |
|---|---------------------|---------------------|
| Two percent mortgage notes | \$ 3,229,426 | \$ 3,594,137 |
| Five percent mortgage notes | 1,225,049 | 1,276,210 |
| Total RUS mortgage notes | 4,454,475 | 4,870,347 |
| Less current maturities | (304,777) | (413,573) |
| Less advance payments on RUS mortgage notes | (100,000) | - |
| Net Long-Term Debt | \$ 4,049,698 | \$ 4,456,774 |

The notes are for 35-year periods and are scheduled to be fully repaid at various dates from 2014 to 2033. The mortgage notes are subject to various covenants and requirements detailed in the loan documents. The above notes are secured by all assets of IPEC.

Annual Requirements for Long-Term Debt

The estimated annual requirements for principal reduction of the RUS long-term debt outstanding as of December 31, 2013 follow:

Year Ending December 31:

| | |
|------------|---------------------|
| 2014 | \$ 304,777 |
| 2015 | 312,593 |
| 2016 | 320,653 |
| 2017 | 314,969 |
| 2018 | 309,958 |
| Thereafter | 2,891,525 |
| | \$ 4,454,475 |

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, 2013 and 2012, \$0 and \$200,000 respectively, was due on the line of credit.

Inside Passage Electric Cooperative, Inc.

Notes to Financial Statements

8. Deferred Credits

Deferred credits at December 31, 2013 and 2012 consisted of the following:

| | 2013 | 2012 |
|------------------------------------|-------------------|-------------------|
| Special equipment costs | \$ 94,500 | \$ 53,550 |
| Deferred customer credit | 20,777 | 27,167 |
| RUS grant advance | 110,709 | - |
| Deferred maintenance | 1,342 | 1,995 |
| Customer advances for construction | 69,648 | 17,054 |
| Prepaid rent deposit | 3,420 | 3,420 |
| Cost of power adjustment | 148,265 | 52,238 |
| Total Deferred Credits | \$ 448,661 | \$ 155,424 |

9. 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 Cooperative is scheduled to receive payments of \$14,735 during the year ending December 31, 2014.

10. Employee Benefit Plan

Defined Benefit Pension Plan

Pension benefits for substantially all employees are provided through participation in the National Rural Electric Cooperative Association (NRECA) pension program. The plan is a master multi-employer defined benefit plan qualified under Section 401 and tax exempt under Section 501(a) of the Internal Revenue Code.

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

NRECA Retirement Security Plan

The NRECA Retirement Security Plan (RS Plan) sponsor's Employer Identification Number is 53-0116145 and the Plan Number is 333. The Cooperative's contributions to the RS Plan in 2013 and in 2012 represented less than 5% of the total contributions made to the Plan by all participating employers. The Cooperative made contributions to the Plan of \$283,607 in 2013 and \$236,320 in 2012. There have been no significant changes that affect the comparability of 2013 and 2012 contributions.

Inside Passage Electric Cooperative, Inc.

Notes to Financial Statements

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 percent funded on January 1, 2013 and between 65 percent and 80 percent funded on January 1, 2012 based on the PPA funding target and PPA actuarial value of assets on those dates.

Because the 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.

NRECA 401(K) Plan

The Cooperative also participates in a 401(K) 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 2013 and 2012 were \$28,250 and \$27,073, respectively.

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 material effect to its financial position.

Supplementary Information

Inside Passage Electric Cooperative, Inc.

Schedule of State Financial Assistance

Year Ended December 31, 2013

| State Grant Title | Grant Number | Grant Award | State Share of Expenditures |
|---|--------------|--------------|-----------------------------|
| Alaska Energy Authority | | | |
| *Gartina Falls Hydroelectric Project | 7060922 | \$ 6,694,000 | \$ 189,291 |
| *Hoonah-IPEC Hydro Project | 7030019 | 850,000 | 372,182 |
| *Tenakee Inlet Geothermal Resources | 7040073 | 568,730 | 61,160 |
| Total State Financial Assistance | | | \$ 622,633 |

*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 Single Audit Reports



Tel: 907-278-8878
Fax: 907-278-5779
www.bdo.com

3601 C Street, Suite 600
Anchorage, AK 99503

Independent Auditor's Report on Compliance With Aspects of Contractual Agreements and Regulatory Requirements for Electric Borrowers

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

We have audited, 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, the financial statements of Inside Passage Electric Cooperative, Inc. (the Cooperative), which comprise the consolidated balance sheet as of December 31, 2013, and the related statements of revenues and patronage capital, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated April 2, 2014. In accordance with *Government Auditing Standards*, we have also issued our report dated April 2, 2014, on our consideration of the Cooperative's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. In accordance with the *State of Alaska Audit Guide and Compliance Supplement for State Single Audits*, we have also issued our report, dated April 2, 2014, on compliance for each major state program and on internal control over compliance. No reports other than the reports referred to above and our schedule of findings and recommendations related to our audit have been furnished to management.

In connection with our audit, nothing came to our attention that caused us to believe that the Cooperative failed to comply with the terms, covenants, provisions, or conditions of their loan, grant, and security instruments as set forth in 7 CFR Part 1773, Policy on Audits of Rural Utilities Service Borrowers, §1773.33 and clarified in the RUS policy memorandum dated February 7, 2014, insofar as they relate to accounting matters as enumerated below. However, our audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding the Cooperative's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters. In connection with our audit, we noted no matters regarding the Cooperative's accounting and records to indicate that the Cooperative did not:

- Maintain adequate and effective accounting procedures;
- Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts;
- Reconcile continuing property records to the controlling general ledger plant accounts;
- Clear construction accounts and accrue depreciation on completed construction;
- Record and properly price the retirement of plant;

- Seek approval of the sale, lease or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap;
- Maintain adequate control over materials and supplies;
- Prepare accurate and timely Financial and Operating Reports;
- Obtain written RUS approval to enter into any contract for the management, operation, or maintenance of the borrower's system if the contract covers all or substantially all of the electric system;
- Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles;
- Record depreciation in accordance with RUS requirements (See RUS Bulletin 183-1, Depreciation Rates and Procedures);
- Comply with the requirements for the detailed schedule of deferred debits and deferred credits; and
- Comply with the requirements for the detailed schedule of investments.

This report is intended solely for the information and use of the Board of Directors, management, and the RUS and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

BDO USA, LLP

Anchorage, Alaska
April 2, 2014



Tel: 907-278-8878
Fax: 907-278-5779
www.bdo.com

3601 C Street, Suite 600
Anchorage, AK 99503

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, in accordance with the 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, the financial statements of Inside Passage Electric Cooperative, Inc., (the Cooperative) which comprise the balance sheet as of December 31, 2013, and the related statements of revenues and patronage capital, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated April 2, 2014.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered Inside Passage Electric Cooperative, Inc.'s internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the Cooperative's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Inside Passage Electric Cooperative, Inc.'s financial statements are free from 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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

BDO USA, LLP

Anchorage, Alaska
April 2, 2014



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Independent Auditor's Report on Compliance for Each Major State Program and Report on Internal Control Over Compliance Required by the *State of Alaska Audit Guide and Compliance Supplement for State Single Audits*

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

Report on Compliance for Each Major State Program

We have audited Inside Passage Electric Cooperative, Inc.'s (the Cooperative's), compliance 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 Inside Passage Electric Cooperative, Inc.'s major state programs for the year ended December 31, 2013. The Cooperative's major state programs are identified in the accompanying schedule of state financial assistance.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its state programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Inside Passage Electric Cooperative, Inc.'s major state programs based on our audit of the types of compliance requirements referred to above. 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 on compliance for each major state program. However, our audit does not provide a legal determination of the Cooperative's compliance.

Opinion on Each Major State Program

In our opinion, Inside Passage Electric Cooperative, Inc. complied, in all material respects, with the types of 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, 2013.

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Report on Internal Control Over Compliance

Management of Inside Passage Electric Cooperative, Inc. is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Cooperative's internal control over compliance with the types of requirements that could have a direct and material effect on a major state program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major state program 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. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a state program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

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 material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the *State of Alaska Audit Guide and Compliance Supplement for State Single Audits*. Accordingly, this report is not suitable for any other purpose.

BDO USA, LLP

Anchorage, Alaska
April 2, 2014

Inside Passage Electric Cooperative, Inc.

Schedule of Findings and Questioned Costs Year Ended December 31, 2013

Section I - Summary of Auditors' Results

Financial Statements

| | | |
|---|---------------|--------------------------|
| Type of auditor's report issued: | Unmodified | |
| Internal control over financial reporting: | | |
| Material weakness(es) identified? | <u> </u> yes | <u> X</u> no |
| Significant deficiency(ies) identified? | <u> </u> yes | <u> X</u> none reported |
| Noncompliance material to financial statements noted? | <u> </u> yes | <u> X</u> no |

State Financial Assistance

| | | |
|---|---------------|--------------------------|
| Internal control over major programs: | | |
| Material weakness(es) identified? | <u> </u> yes | <u> X</u> no |
| Significant deficiency(ies) identified? | <u> </u> yes | <u> X</u> none reported |

| | |
|---|------------|
| Type of auditor's report issued on compliance for major programs: | Unmodified |
|---|------------|

| | |
|---|-----------|
| Dollar threshold used to distinguish between a major program: | \$ 50,000 |
|---|-----------|

Section II - Financial Statement Findings Required to be Reported in Accordance with *Government Auditing Standards*

None noted.

Section III - State Award Findings and Questioned Costs

None noted.

Inside Passage Electric Cooperative, Inc.

Summary Schedule of Prior Audit Findings
Year Ended December 31, 2013

There were no prior audit findings.

Inside Passage Electric Cooperative, Inc.

Corrective Action Plan *Year Ended December 31, 2013*

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