



**Inside Passage Electric Cooperative,  
Inc.**

**Financial Statements, and RUS and  
Government Auditing Standards Reports  
Years Ended December 31, 2015 and 2014**

**Inside Passage Electric Cooperative, Inc.**

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Financial Statements, and RUS and Government Auditing Standards  
Reports

Years Ended December 31, 2015 and 2014

# Inside Passage Electric Cooperative, Inc.

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## 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 sheets as of December 31, 2015 and 2014, and the related statements of operations, equities and patronage capital, and cash flows for the years then ended, and the related notes to the financial statements.

#### *Management's Responsibility for the Financial Statements*

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

#### *Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our 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 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, 2015 and 2014, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated March 25, 2016, 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  
March 25, 2016

## Financial Statements

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# Inside Passage Electric Cooperative, Inc.

## Balance Sheets

<i>December 31,</i>	2015	2014
<b>Assets</b>		
<b>Utility Plant</b>		
Electric plant in service	\$ 20,925,867	\$ 19,171,926
Construction work in progress	126,253	23,786
<b>Total utility plant</b>	<b>21,052,120</b>	<b>19,195,712</b>
Less accumulated depreciation	(11,659,932)	(11,554,672)
<b>Net Utility Plant</b>	<b>9,392,188</b>	<b>7,641,040</b>
<b>Other Assets</b>		
Investments in associated organizations	1,255,120	1,157,874
Restricted cash:		
Consumer deposits	45,111	83,664
State of Alaska performance guarantees	13,600	13,600
Construction account	101	101
<b>Total Other Assets</b>	<b>1,313,932</b>	<b>1,255,239</b>
<b>Current Assets</b>		
Cash	711,943	962,924
Accounts receivable, less provision for doubtful accounts of \$28,207 (\$32,099 in 2014)	398,677	475,878
Grants receivable	-	51,482
Unbilled revenue	186,781	250,283
Materials and supplies inventory	250,788	302,563
Fuel inventory	219,579	430,359
Prepaid expenses	51,667	50,185
Other current and accrued assets	1,179	1,179
<b>Total Current Assets</b>	<b>1,820,614</b>	<b>2,524,853</b>
Deferred charges	63,939	28,000
<b>Total Assets</b>	<b>\$ 12,590,673</b>	<b>\$ 11,449,132</b>

*See accompanying notes to financial statements.*

# Inside Passage Electric Cooperative, Inc.

## Balance Sheets, continued

<i>December 31,</i>	2015	2014
<b>Equities and Liabilities</b>		
<b>Equities</b>		
Patronage capital	\$ 2,705,199	\$ 2,563,520
Other equities	3,886,177	3,886,177
<b>Total Equities</b>	6,591,376	6,449,697
<b>Long-Term Debt</b>		
RUS mortgage notes	3,837,056	4,149,676
Less current maturities	(320,678)	(312,617)
<b>Net Long-Term Debt</b>	3,516,378	3,837,059
<b>Current Liabilities</b>		
Current maturities of long-term debt	320,678	312,617
Line of credit payable	1,600,000	-
Accounts payable	144,310	177,599
Consumer deposits	45,110	80,313
Accrued payroll and related liabilities	62,381	66,791
<b>Total Current Liabilities</b>	2,172,479	637,320
<b>Deferred credits</b>	310,440	525,056
<b>Total Equities and Liabilities</b>	\$ 12,590,673	\$ 11,449,132

*See accompanying notes to financial statements.*

# Inside Passage Electric Cooperative, Inc.

## Statements of Operations

<i>Years Ended December 31,</i>	2015	2014
<b>Operating Revenues</b>	<b>\$ 4,860,161</b>	<b>\$ 5,759,039</b>
<b>Operating Expenses</b>		
Purchased power	80,354	84,636
Power production operations	2,650,381	3,266,202
Power production maintenance	271,532	338,863
Distribution operations	88,157	135,774
Distribution maintenance	34,584	17,411
Consumer accounts	167,799	194,282
Customer service and information	30,863	32,820
Administrative and general	1,030,130	1,033,734
Depreciation	427,665	496,503
Taxes	4,861	5,050
<b>Total Operating Expenses</b>	<b>4,786,326</b>	<b>5,605,275</b>
Operating margins before fixed charges	73,835	153,764
<b>Fixed Charges</b>		
Interest on long-term debt	(114,526)	(122,348)
Other deductions	(550)	(820)
<b>Total Fixed Charges</b>	<b>(115,076)</b>	<b>(123,168)</b>
Operating margins after fixed charges	(41,241)	30,596
<b>Nonoperating Margins</b>		
Patronage capital from associated organizations	140,596	134,997
Interest income	7,053	7,088
Rental income, net of rental expenses	34,325	31,309
Other nonoperating revenues	946	847
<b>Total Nonoperating Margins</b>	<b>182,920</b>	<b>174,241</b>
<b>Net Margins (Loss)</b>	<b>\$ 141,679</b>	<b>\$ 204,837</b>

*See accompanying notes to financial statements.*

## Inside Passage Electric Cooperative, Inc.

### Statements of Equities and Patronage Capital

*Years Ended December 31, 2015 and 2014*

	Patronage Capital				Total Patronage Capital	Total
	Other Equities	Assigned/ Assignable	Retained/ Retainable			
<b>Balance, January 1, 2014</b>	\$ 3,886,177	\$ 1,227,859	\$ 1,130,824	\$ 2,358,683	\$ 6,244,860	
Net margins	-	30,596	174,241	204,837	204,837	
<b>Balance, December 31, 2014</b>	3,886,177	1,258,455	1,305,065	2,563,520	6,449,697	
Net margins (Loss)	-	(41,241)	182,920	141,679	141,679	
<b>Balance, December 31, 2015</b>	\$ 3,886,177	\$ 1,217,214	\$ 1,487,985	\$ 2,705,199	\$ 6,591,376	

*See accompanying notes to financial statements.*

# Inside Passage Electric Cooperative, Inc.

## Statements of Cash Flows

<i>Years Ended December 31,</i>	2015	2014
<b>Cash Flows from Operating Activities</b>		
Cash received from customers	\$ 5,000,864	\$ 5,774,644
Cash paid to suppliers and employees	(4,109,347)	(5,178,046)
Other nonoperating income received	43,159	52,139
Interest paid on long-term debt and line of credit	(114,526)	(122,348)
<b>Net cash from operating activities</b>	<b>820,150</b>	<b>526,389</b>
<b>Cash Flows from (for) Investing Activities</b>		
Additions to plant	(2,667,576)	(6,526,119)
Grants received for construction	227,162	6,547,747
Funds received from associated organizations	43,350	174,901
<b>Net cash from (for) investing activities</b>	<b>(2,397,064)</b>	<b>196,529</b>
<b>Cash Flows from (for) Financing Activities</b>		
Principal payments on long-term debt	(312,620)	(204,799)
Draws on line of credit	1,600,000	-
<b>Net cash from (for) financing activities</b>	<b>1,287,380</b>	<b>(204,799)</b>
Increase (decrease) in cash and cash equivalents	(289,534)	518,119
<b>Cash and Cash Equivalents, beginning of year</b>	<b>1,060,289</b>	<b>542,170</b>
<b>Cash and Cash Equivalents, end of year</b>	<b>\$ 770,755</b>	<b>\$ 1,060,289</b>
<b>Reconciliation of Cash and Cash Equivalents to Balance Sheet:</b>		
Cash and cash equivalents:		
Current assets	\$ 711,943	\$ 962,924
Restricted cash	58,812	97,365
<b>Total Cash and Cash Equivalents</b>	<b>\$ 770,755</b>	<b>\$ 1,060,289</b>

*See accompanying notes to financial statements.*

# Inside Passage Electric Cooperative, Inc.

## Statements of Cash Flows, continued

<i>Years Ended December 31,</i>	2015	2014
<b>Reconciliation of Net Margins to Net Cash</b>		
<b>Flows from Operating Activities:</b>		
Net margins	\$ 141,679	\$ 204,837
Adjustments to reconcile net margins to net cash from operating activities:		
Depreciation	450,023	527,006
Income allocation from investments in associated organizations	(140,596)	(134,997)
(Increase) decrease in assets:		
Accounts receivable, net	77,201	28,535
Unbilled revenue	63,502	(12,930)
Materials and supplies inventory	51,775	(15,996)
Fuel inventory	210,780	64,441
Prepaid expenses	(1,482)	(5,083)
Deferred charges	(35,939)	(9,632)
Increase (decrease) in liabilities:		
Accounts payable	(33,289)	10,639
Accrued payroll and related liabilities	(4,410)	(22,035)
Consumer deposits	(35,203)	(4,675)
Deferred credits	76,109	(103,721)
<b>Net Cash from Operating Activities</b>	<b>\$ 820,150</b>	<b>\$ 526,389</b>

*See accompanying notes to financial statements.*

# Inside Passage Electric Cooperative, Inc.

## Notes to Financial Statements

December 31, 2015 and 2014

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### 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

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### *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:

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Production plant	0.12% to 6.49%
Distribution plant	1.52% to 10.27%
General plant	1.74% to 20.00%

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### *Capitalized Interest*

Interest associated with major development and construction projects is capitalized and included in the cost of the project. Interest capitalized for the years ended December 31, 2015 and 2014 amounted to \$22,993 and \$0, respectively.

### *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

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### *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.

The Cooperative maintains its cash and cash equivalents with First National Bank Alaska. Amounts held by the bank (bank balances) totaled \$903,442 and \$1,098,749 at December 31, 2015 and 2014, respectively. The balances insured by the Federal Deposit Insurance Corporation (FDIC) at December 31, 2015 and 2014 were limited to \$250,000, the excess amount was uninsured.

### *Reclassified Balances*

Certain 2014 balances have been reclassified to conform to the current year presentation.

### *Subsequent Events*

The Cooperative has evaluated subsequent events through March 25, 2016, 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, 2015 and 2014 are as follows:

	2015	2014
Production plant	\$ 3,420,190	\$ 3,384,206
Distribution plant	13,204,665	13,483,009
General plant	2,505,139	2,304,712
Unclassified	1,795,873	-
Total electric plant in service	20,925,867	19,171,926
Construction work in progress	126,253	23,786
<b>Total Utility Plant</b>	<b>\$ 21,052,120</b>	<b>\$ 19,195,712</b>

Depreciation expense for the years ended December 31, 2015 and 2014 was as follows:

	2015	2014
Depreciation expense	\$ 427,665	\$ 496,503
Depreciation to clearing account	21,523	17,608
Depreciation of rental	835	12,895
<b>Total Depreciation</b>	<b>\$ 450,023</b>	<b>\$ 527,006</b>

# 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, 2015 and 2014:

	2015	2014
Alaska Rural Electric Cooperative Association (ARECA) Insurance Exchange - patronage capital credits	\$ 1,134,270	\$ 1,038,175
National Rural Utilities Cooperative Finance Corporation (NRUCFC):		
Capital term certificates	93,543	93,543
Patronage capital credits	16,621	16,562
Membership	1,000	1,000
<b>Total NRUCFC</b>	<b>111,164</b>	<b>111,105</b>
National Information Solutions Cooperative (NISC) patronage capital	9,686	8,594
<b>Total Investments in Associated Organizations</b>	<b>\$ 1,255,120</b>	<b>\$ 1,157,874</b>

### 4. Accounts Receivable

Accounts receivable at December 31, 2015 and 2014 consisted of the following:

	2015	2014
Consumer accounts	\$ 276,437	\$ 259,194
Power cost equalization (PCE)	121,624	163,674
Contract services	28,823	71,890
NRECA retirement	-	13,219
<b>Total accounts receivable</b>	<b>426,884</b>	<b>507,977</b>
Allowance for doubtful accounts	(28,207)	(32,099)
<b>Accounts Receivable, Net</b>	<b>\$ 398,677</b>	<b>\$ 475,878</b>

### 5. Deferred Charges

Deferred charges at December 31, 2015 and 2014 consisted of the following:

	2015	2014
<b>Community Based Rates Study</b>	<b>\$ 63,939</b>	<b>\$ 28,000</b>

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

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### 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:

	2015	2014
Two percent mortgage notes	\$ 2,722,308	\$ 2,978,400
Five percent mortgage notes	1,114,748	1,171,276
Total RUS mortgage notes	3,837,056	4,149,676
Less current maturities	(320,678)	(312,617)
<b>Net Long-Term Debt</b>	<b>\$ 3,516,378</b>	<b>\$ 3,837,059</b>

The notes are for 35-year periods and are scheduled to be fully repaid at various dates from 2016 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, 2015 follow:

#### *Year Ending December 31:*

2016	\$ 320,678
2017	314,988
2018	309,984
2019	277,677
2020	270,855
Thereafter	2,342,874
	<b>\$ 3,837,056</b>

### 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, 2015 and 2014, the outstanding balance due on the line of credit was \$1,600,000 and \$0, respectively.

# Inside Passage Electric Cooperative, Inc.

## Notes to Financial Statements

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### 8. Deferred Credits

Deferred credits at December 31, 2015 and 2014 consisted of the following:

	2015	2014
Special equipment costs	\$ 58,300	\$ 63,100
Deferred customer credit	33,080	32,681
Grant advance	-	290,825
Deferred maintenance	-	1,342
Customer advances for construction	1,925	73,941
Prepaid rent deposit	-	7,103
Cost of power adjustment	217,135	56,064
<b>Total Deferred Credits</b>	<b>\$ 310,440</b>	<b>\$ 525,056</b>

### 9. Employee Benefit Plans

#### *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 plan sponsor's Employer Identification Number is 53-0116145 and the Plan Number is 333. The Cooperative's contributions to the RS Plan in 2015 and in 2014 represented less than 5 percent of the total contributions made to the RS Plan by all participating employers. The Cooperative made contributions to the RS Plan of \$246,125 in 2015 and \$281,617 in 2014. There have been no significant changes that affect the comparability of 2015 and 2014 contributions.

For 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, 2015 and 2014 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.

# Inside Passage Electric Cooperative, Inc.

## Notes to Financial Statements

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### *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 2015 and 2014 were \$31,237 and \$26,648, respectively.

### **10. 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.

## RUS and Government Auditing Standards Reports



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## 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 balance sheet as of December 31, 2015, and the related statements of operations, equities 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 March 25, 2016. In accordance with *Government Auditing Standards*, we have also issued our report dated March 25, 2016, 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. No reports other than the reports referred to above 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  
March 25, 2016



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## 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, 2015, and the related statements of operations, equity 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 March 25, 2016.

### 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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses or significant deficiencies.

## 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  
March 25, 2016