

PRESQUE ISLE ELECTRIC & GAS CO-OP
REPORT ON FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2013 AND 2012

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**PRESQUE ISLE ELECTRIC & GAS CO-OP
BOARD OF DIRECTORS
DECEMBER 31, 2013**

John F. Brown	Chairperson
Allen L. Barr	Vice Chairperson
David W. Smith	Secretary
Daryl Peterson	Treasurer
Robert W. Wegmeyer	Director
Allan Berg	Director
Kurt Krajniak	Director
Raymond Wozniak	Director
Sally Knopf	Director

President & Chief Executive Officer

Brian J. Burns



Independent Auditor's Report

The Board of Directors
Presque Isle Electric & Gas Co-op
Onaway, Michigan

Report on the Financial Statements

We have audited the accompanying balance sheets of Presque Isle Electric & Gas Co-op as of December 31, 2013 and 2012, and the related statements of revenue, equities, and cash flows for the years then ended.

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. 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 risk 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 Presque Isle Electric & Gas Co-op as of December 31, 2013 and 2012, 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.

A rectangular box containing a handwritten signature in cursive script that reads 'HARRIS GROUP'.

Certified Public Accountants
March 3, 2014

PRESQUE ISLE ELECTRIC & GAS CO-OP
BALANCE SHEETS
DECEMBER 31, 2013 AND 2012

	2013	2012
ASSETS		
UTILITY PLANT:		
In-Service – at cost	\$ 126,568,486	\$ 123,970,759
Construction work in progress	1,526,265	946,713
SUBTOTAL	128,094,751	124,917,472
Less accumulated depreciation and amortization	51,744,886	48,585,345
NET UTILITY PLANT	76,349,865	76,332,127
OTHER ASSETS AND INVESTMENTS		
Investments on associated organizations	23,651,084	22,222,658
CURRENT ASSETS:		
Cash and temporary cash investments	1,647,495	2,708,663
Accounts Receivable, less allowance for possible losses of \$118,000 in 2013 and 2012.	4,542,215	5,119,420
Materials and supplies (at average cost)	1,277,856	1,286,667
Other current assets	360,230	328,171
TOTAL CURRENT ASSETS	7,827,796	9,442,921
DEFERRED DEBITS	317,964	197,416
TOTAL ASSETS	\$ 108,146,709	\$ 108,195,122

The accompanying notes are an integral part of these statements.

	<u>2013</u>	<u>2012</u>
EQUITIES AND LIABILITIES		
EQUITIES:		
Memberships	\$ 246,835	\$ 240,265
Patronage capital	42,547,162	39,987,376
Other equities	<u>(1,123,264)</u>	<u>(1,588,940)</u>
 TOTAL EQUITIES	 <u>41,670,733</u>	 <u>38,638,701</u>
LONG-TERM DEBT, NET OF CURRENT MATURITIES:		
Mortgage notes to National Rural Utilities Cooperative Finance Corporation (CFC)	50,387,301	50,555,379
Accrued post – retirement benefits	<u>3,799,472</u>	<u>3,616,570</u>
 TOTAL LONG-TERM DEBT	 <u>54,186,773</u>	 <u>54,171,949</u>
CURRENT LIABILITIES:		
Current maturities of long-term debt	2,153,000	2,006,000
CFC line of credit	5,200,000	7,278,699
Accounts payable, purchased energy	2,447,187	2,166,090
Accounts payable, other	349,515	1,080,625
Patronage capital payable	1,190	
Customer deposits	385,864	360,229
Accrued property taxes	468,758	456,917
Accrued interest	316,438	353,883
Accrued sick and vacation pay	559,672	549,340
Accrued other	<u>324,852</u>	<u>544,174</u>
 TOTAL CURRENT LIABILITIES	 <u>12,206,476</u>	 <u>14,795,957</u>
 DEFERRED CREDITS	 <u>82,727</u>	 <u>588,515</u>
 TOTAL EQUITIES AND LIABILITIES	 <u>\$ 108,146,709</u>	 <u>\$ 108,195,122</u>

PRESQUE ISLE ELECTRIC & GAS CO-OP
STATEMENTS OF REVENUE
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

	2013	2012
OPERATING REVENUES	\$ 43,939,243	\$ 41,631,735
OPERATING EXPENSES:		
Cost of energy	24,899,061	24,306,322
Distribution – operation	1,519,269	1,513,065
Distribution – maintenance	3,297,875	4,441,219
Consumers accounts	1,763,288	1,771,749
Customer service and information expense	585,357	467,991
Administrative and general	1,615,161	1,677,928
Depreciation and amortization	3,434,323	3,354,875
Taxes – property	1,051,677	1,029,815
Taxes – other	2,582	2,433
TOTAL OPERATING EXPENSES	38,168,593	38,565,397
OPERATING MARGIN BEFORE FIXED CHARGES	5,770,650	3,066,338
FIXED CHARGES:		
Interest	2,929,232	3,055,897
Other deductions	2,057	
TOTAL FIXED CHARGES	2,931,289	3,055,897
OPERATING MARGINS AFTER FIXED CHARGES	2,839,361	10,441
CAPITAL CREDITS:		
Generation and transmission capital credits	1,761,560	1,568,655
Other capital credits	385,913	343,370
TOTAL CAPITAL CREDITS	2,147,473	1,912,025
NET OPERATING MARGINS	4,986,834	1,922,466

The accompanying notes are an integral part of these statements.

PRESQUE ISLE ELECTRIC & GAS CO-OP
STATEMENTS OF REVENUE
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012
(Continued)

	2013	2012
NET OPERATING MARGINS (from previous page)	\$ 4,986,834	\$ 1,922,466
NON-OPERATING MARGINS:		
Interest and dividend income	53,849	55,177
Other expenses	(182,159)	(122,626)
TOTAL NON-OPERATING MARGINS	(128,310)	(67,449)
NET MARGINS	\$ 4,858,524	\$ 1,855,017

The accompanying notes are an integral part of these statements.

PRESQUE ISLE ELECTRIC & GAS CO-OP
STATEMENT OF CHANGES IN PATRONAGE CAPITAL
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

	<u>Memberships</u>	<u>Patronage Capital</u>	<u>Other Equities</u>	<u>Accumulated Other Comprehensive Loss</u>	<u>Total</u>
Balance, January 1, 2012	\$ 233,595	\$ 38,937,908	\$ 1,057,845	\$ (2,359,330)	\$ 37,870,018
Capital credits retired		(836,173)			(836,173)
Memberships retired	6,670				6,670
Other equity transactions		30,624	243,854		274,478
Amortize other comprehensive Loss				(531,309)	(531,309)
Net margin		1,855,017			1,855,017
Balance, December 31, 2012	240,265	39,987,376	1,301,699	(2,890,639)	38,638,701
Capital credits retired		(2,311,924)			(2,311,924)
Memberships retired	6,570				6,570
Other equity transactions		13,186	465,676		478,862
Net margin		4,858,524			4,858,524
Balance, December 31, 2013	<u>\$ 246,835</u>	<u>\$ 42,547,162</u>	<u>\$ 1,767,375</u>	<u>\$ (2,890,639)</u>	<u>\$ 41,670,733</u>

The accompanying notes are an integral part of these statements.

PRESQUE ISLE ELECTRIC & GAS CO-OP
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from consumers	\$ 44,558,873	\$ 41,305,215
Cash paid to suppliers and employees	(33,994,979)	(32,439,419)
Interest received	53,849	55,178
Interest paid	(3,103,729)	(3,199,335)
Taxes paid	(1,232,024)	(1,268,823)
	6,281,990	4,452,816
CASH FLOWS FROM INVESTING ACTIVITIES:		
Construction and acquisition of plant	(3,799,589)	(4,148,486)
Plant removal costs		
(Increase) decrease in:		
Material inventory	8,811	(796)
Investments – associated organizations	719,047	575,075
	(3,071,731)	(3,574,207)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Advances	2,000,000	22,600,819
Payment of debt	(4,099,777)	(23,409,170)
Memberships issued	6,570	6,670
Patronage capital retired	(2,311,924)	(836,175)
Unclaimed patronage	13,186	
Increased (decrease) in:		
Consumer deposits	25,635	20,851
Deferred credits	(370,793)	306,956
Other equities	465,676	243,854
	(4,271,427)	(1,066,195)
NET INCREASE IN CASH AND CASH EQUIVALENTS	(1,061,168)	878,609
CASH AND CASH EQUIVALENTS, beginning of year	2,708,663	1,830,054
CASH AND CASH EQUIVALENTS, end of year	\$ 1,647,495	\$ 2,708,663

The accompanying notes are an integral part of these statements.

PRESQUE ISLE ELECTRIC & GAS CO-OP
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012
(Continued)

	<u>2013</u>	<u>2012</u>
RECONCILIATION OF NET MARGINS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net Margins	\$ 4,858,524	\$ 1,855,017
Adjustments to reconcile net margins to net cash provided by		
Operating activities:		
Depreciation and amortization	3,600,963	3,696,425
(Gain) loss on disposition of assets	180,888	134,815
G&T and other capital credits	(2,147,473)	(1,912,025)
(Increase) decrease in:		
Customer and other accounts receivable	577,205	(394,276)
Other current assets	(32,059)	(35,281)
Deferred debits	(120,548)	(41,904)
Amortization of debt discount	(134,995)	(134,995)
Increase (decrease) in:		
Accounts payable	(448,823)	458,945
Accrued property taxes	11,841	10,302
Accrued interest payable	(37,445)	(8,443)
Current and accrued liabilities – other	(26,088)	824,236
Total Adjustments	<u>1,423,466</u>	<u>2,597,799</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 6,281,990</u>	<u>\$ 4,452,816</u>
NON-CASH ITEMS – INVESTING & FINANCING		
Capital credits from associated organizations	\$ 2,147,473	\$ 1,912,025

The accompanying notes are an integral part of these statements.

PRESQUE ISLE ELECTRIC & GAS CO-OP
NOTES TO FINANCIAL STATEMENTS

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of the accounting policies adopted by Presque Isle Electric & Gas Co-op which have a significant effect on the financial statements.

Nature of Operations

Presque Isle Electric & Gas Co-op (Presque Isle) is a member-owned, not-for-profit corporation whose purpose is to provide electric service to its members. As a cooperative, all monies in excess of cost of providing electric service are capital, at the moment of receipt, and are credited to each member's capital account.

The process of preparing financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

Utility Plant

Additions, with a life expectancy of more than one year, are recorded at cost, less contributions in aid of construction received from customers. As items are retired or otherwise disposed of, the asset account is credited for the cost and the accumulated depreciation account is charged. The cost of removal, less salvage, is charged to the loss on disposition of utility plant account, and shown on the Statement of Revenue.

Investments

The carrying values of investments in associated organizations are stated at cost, adjusted for capital credits earned or retired. Short-term investments are stated at cost, which approximates market value.

Cash

For purposes of the statement of cash flows, Presque Isle considers all short-term debt securities purchased with a maturity of three months or less to be cash equivalents.

Consumer Energy Prepayments and Unbilled Revenues

Seasonal account billings are accounted for as deferred credits and recognized as income on a straight-line basis over a period of one year. There were no estimated net unbilled revenues for the year.

Accounts receivable

Accounts receivable consist primarily of amounts due from members for electric and gas service. An allowance for doubtful accounts has been estimated based on collection history. When a member's account becomes past due and uncollectible, the member's service is terminated. The Board of Directors approve all accounts charged off.

Regulation

In 2012, Presque Isle elected to become self-regulated under PA 167 of 2012. Electric accounting and rate matters are subject to the Board of Directors and membership approval.

PRESQUE ISLE ELECTRIC & GAS CO-OP
NOTES TO FINANCIAL STATEMENTS

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Materials and Supplies

Electrical and natural gas materials and supplies are valued at average cost. Merchandise held for resale is valued on the first-in, first-out basis.

Retirement Plan

Presque Isle has a retirement savings plan for substantially all employees. Under the terms of the plan, Presque Isle is required to contribute 10 to 16 percent of the employee's total base earnings to the retirement plan.

Flex Benefit Plan

Presque Isle has a Flexible Benefits Plan. The purpose of the plan is to provide eligible employees a choice between cash and the specified welfare benefits described in the plan. Pre-Tax Premium elections under the plan are intended to qualify for the exclusion from income provided in Section 125 of the Internal Revenue Code of 1986.

Contributions in Aid of Construction

Contributions in aid of construction are received from customers on electrical and gas installations and re-applied against the construction costs.

Income Taxes

The Cooperative is exempt from federal and state income taxes under Section 501(c)(12) of the Internal Revenue Code which provides, in part that the Cooperative derive at least 85 percent of its annual gross income from members to retain the exemption. The Cooperative expects to meet the requirements for the tax year ended December 31, 2013. Accordingly, no provision for income taxes has been made in the financial statements. The Cooperative's federal information returns for Calendar year 2010 and after are subject to examination by the Internal Revenue Service.

NOTE 2: ASSETS PLEDGED

Substantially all assets are pledged as collateral on long-term debt payable to the National Rural Utilities Cooperative Finance Corporation (CFC).

PRESQUE ISLE ELECTRIC & GAS CO-OP
NOTES TO FINANCIAL STATEMENTS

NOTE 3: ELECTRIC AND GAS PLANT AND DEPRECIATION RATES AND PROCEDURES

Major classes of electric and gas plant as of December 31, 2013 and 2012 consisted of:

	<u>2013</u>	<u>2012</u>
Intangible plant	\$ 1,025,191	\$ 1,025,480
Distribution plant	118,104,490	115,911,969
General plant	<u>7,438,805</u>	<u>7,033,310</u>
	126,568,486	123,970,759
Construction work in progress	<u>1,526,265</u>	<u>946,713</u>
TOTAL	<u><u>\$ 128,094,751</u></u>	<u><u>\$ 124,917,472</u></u>

NOTE 4: ELECTRIC AND GAS PLANT AND DEPRECIATION RATES AND PROCEDURES

Provision has been made for depreciation of the distribution plant at a straight-line rate of 10 to 50 years for all distribution plant additions.

General plant depreciation rates have been applied on a straight-line basis as follows for the year ended December 31, 2013:

	<u>Years</u>
Structures and improvements	10-50
Office furniture equipment	3-7
Transportation equipment	4-7
Power operated equipment	3-16
Other	4-5

Depreciation and amortization of electric and gas plant in service was charged as follows for the years ended December 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Charged to:		
Classified as depreciation and amortization	\$ 3,434,323	\$ 3,354,875
Classified in other operating expenses	166,640	130,102
	<u>3,600,963</u>	<u>3,484,977</u>
Charged to construction	<u>191,521</u>	<u>211,448</u>
TOTAL DEPRECIATION AND AMORTIZATION	<u><u>\$ 3,792,484</u></u>	<u><u>\$ 3,696,425</u></u>

PRESQUE ISLE ELECTRIC & GAS CO-OP
NOTES TO FINANCIAL STATEMENTS

NOTE 5: INVESTMENTS IN ASSOCIATED ORGANIZATIONS

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

	2013	2012
Wolverine Power Supply Coop. Inc. - capital credits	\$ 11,789,257	\$ 10,489,176
Wolverine Power Supply Coop. Inc. - PSDF	7,980,339	7,980,339
National Rural Utilities Cooperative Finance Corp.:		
Capital term certificates maturing October 1, 2020 through October 1, 2080 at interest rates between 3% and 7.50%	1,722,559	1,745,975
Patronage capital certificates	1,576,447	1,451,607
Other	582,482	555,560
 TOTAL	 \$ 23,651,084	 \$ 22,222,658

NOTE 6: CASH AND INVESTMENTS

Statements of Financial Accounting Standards (SFAS) No. 105 require disclosure of significant concentrations of credit risk arising from cash deposits in excess of federally insured limits.

	Per Institution	Per Book
Insured	\$ 932,851	\$ 932,851
Uninsured	945,284	714,452
 Cash in banks and credit union	 \$ 1,878,135	 1,647,303
 Working funds		 192
 Total per books		 \$ 1,648,495

PRESQUE ISLE ELECTRIC & GAS CO-OP
NOTES TO FINANCIAL STATEMENTS

NOTE 7: DEFERRED DEBITS

The Cooperative has recorded deferred debits in the following amounts:

	<u>2013</u>	<u>2012</u>
Prepaid tap fees	\$ 63,370	\$ 65,367
Prepaid years of service	190,839	66,245
Regulatory prepaid asset	4,100	6,150
Other deferred debits	<u>59,655</u>	<u>59,655</u>
 TOTAL	 <u>\$ 317,964</u>	 <u>\$ 197,416</u>

NOTE 8: MEMBERSHIPS

The following is a summary of changes in memberships for the years ended December 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Balance, beginning	\$ 240,265	\$ 233,595
Membership and subscriptions issued	<u>6,570</u>	<u>6,670</u>
 Balance, ending	 <u>\$ 246,835</u>	 <u>\$ 240,265</u>

Memberships have been adjusted to reflect the number of members currently receiving service. In accordance with the Co-op by-laws, memberships are not refunded when a member leaves the service area. The membership fee is transferred to donated capital when the member terminates service.

NOTE 9: PATRONAGE CAPITAL

Patronage capital balances as of December 31, 2013 and 2012 consisted of:

	<u>2013</u>	<u>2012</u>
Assignable	\$ 4,858,524	\$ 1,855,017
Assigned to date	<u>45,903,117</u>	<u>44,048,100</u>
	45,903,117	45,903,117
Less retirements to date	<u>3,355,955</u>	<u>5,915,741</u>
 Balance	 <u>\$ 42,547,162</u>	 <u>\$ 39,987,376</u>

PRESQUE ISLE ELECTRIC & GAS CO-OP
NOTES TO FINANCIAL STATEMENTS

NOTE 9: PATRONAGE CAPITAL - continued

Under the provisions of the Mortgage Agreement, until the equities and margins equal or exceed twenty percent of the total assets of the Cooperative, the return to patrons of capital contributed by them is limited generally to twenty-five percent of the patronage capital or margins received by the Cooperative in the next preceding year. The equities and margins of Presque Isle represent 38.5% and 35.7% of the total assets for the years 2013 and 2012, respectively. There were capital credits retired of \$2,311,924 and \$836,173 during 2013 or 2012, respectively.

NOTE 10: MORTGAGE NOTES

Long-term debt is composed of 2.95 percent to 6.65 percent mortgage notes payable to the National Rural Utilities Cooperative Finance Corporation (CFC). All mortgage notes to CFC will be re-priced and the interest rate adjusted accordingly during the next 10 years in accordance with the policy and procedure governing such re-pricing. The notes are for 35 year periods each, with principal and interest installments due either quarterly or semiannually. The notes are scheduled to be fully repaid at various times from December 2015 through November 2047.

There were unadvanced loan funds available at December 31, 2013 in the amount of \$15,500,000.

Detail of the long-term debt is as follows:

	<u>2013</u>	<u>2012</u>
National Rural Utilities Cooperative Finance Corporation mortgage notes bearing interest at 2.95% to 6.65% per annum for 2013 and 2012	\$ 52,540,301	\$ 52,561,379
	52,540,301	52,561,379
Less current maturities	<u>2,153,000</u>	<u>2,006,000</u>
TOTAL LONG-TERM DEBT	<u>\$ 50,387,301</u>	<u>\$ 50,555,379</u>

Maturities of long-term debt for each of the next five years are as follows:

2014	\$	2,153,000
2015	\$	2,246,000
2016	\$	1,474,000
2017	\$	1,508,000
2018	\$	1,954,000

**PRESQUE ISLE ELECTRIC & GAS CO-OP
NOTES TO FINANCIAL STATEMENTS**

NOTE 11: LINE OF CREDIT

Presque Isle had available a short-term line of credit from CFC for 2013 and 2012 of \$8,000,000, with a revolving credit and term of sixty months. The agreement requires that within 360 days of the first advance, the cooperative will reduce to zero for a period of at least five consecutive business days amounts outstanding. The Cooperative was in compliance with this provision during 2013 and 2012. Balance available at December 31, 2013 and 2012 was \$8,000,000. The outstanding balance at December 31, 2013 and 2012 was \$-0-.

Additionally, Presque Isle has an \$8,000,000 unsecured revolving line-of-credit agreement with CoBank. Interest on outstanding borrowings is payable monthly and is computed at 2.93% at December 31, 2013. Presque Isle had an outstanding balance of \$5,200,000 for 2013 and \$7,278,699 in 2012.

NOTE 12: DEFERRED CREDITS

Following is a summary of the amounts recorded as deferred credits as of December 31, 2013 and 2012:

	2013	2012
Deferred gain from extinguishments of debt	\$ 269,991	\$ 404,987
Customer energy prepayments	(187,264)	183,528
TOTAL	\$ 82,727	\$ 588,515

NOTE 13: RETIREMENT PLAN

Retirement plan benefits for substantially all employees are provided through participation in a defined contribution SelectRE pension plan with 401k option with cash and deferred arrangement of the National Rural Electric Cooperative Association (NRECA) and its member systems. The income earned by funds while held under the plan is tax-exempt under Code Sections 401 and 501 of the Internal Revenue Code. Contributions to the savings program, which are based on a percentage of the employees' compensation were \$310,347 in 2013 and \$311,343 in 2012.

NOTE 14: POWER SUPPLY COST RECOVERY CLAUSE

On October 12, 1982, the Governor of the State of Michigan signed PA 304 of 1982 into law creating the Power Supply Cost Recovery Clause (PSCR), a power cost recovery mechanism.

Wolverine Power Supply Cooperative, Inc. (Wolverine) and the member-distribution Cooperatives including Presque Isle, obtained authority to implement and apply PSCR clauses and monthly factors. Presque Isle's monthly factor may not exceed 24.18 mills per KWH for the current period.

Due to fluctuations in market conditions, over-collections or under-collections could result between the generation cooperative and distribution cooperative as well as between the distribution cooperatives and their member-consumers.

The PSCR clause includes provisions whereby power cost recovery over-collections must be remedied by refunds and power cost recovery under-collections must be remedied by additional collections.

**PRESQUE ISLE ELECTRIC & GAS CO-OP
NOTES TO FINANCIAL STATEMENTS**

NOTE 14: POWER SUPPLY COST RECOVERY CLAUSE - continued

Presque Isle's balance sheets reflect an amount (due to)/from member-consumers for under/(over) collections in the amounts of \$(402,671) and \$95,904 at December 31, 2013 and 2012, respectively. These amounts are included in the accounts receivable balance.

On September 1, 2009, Presque Isle Electric & Gas Co-op implemented a new rate setting mechanism for its natural gas operations in 34 of its 36 franchised jurisdictions. This included a Gas Cost Recovery (GCR) mechanism. Due to fluctuations in market conditions, over-collections and under-collections of natural gas supply costs could result between the distribution cooperative and its member-consumers.

The GCR mechanism includes provisions whereby gas cost recovery over-collections must be remedied by refunds and gas cost recovery under-collections must be remedied by additional collections. Presque Isle's balance sheet reflects an amount due (to)/from member-consumers for under collections in the amounts of \$(91,416) and \$(189,560) for the years ended December 31, 2013 and 2012, respectively. This amount is recorded in accounts receivable.

NOTE 15: POST-RETIREMENT BENEFITS OTHER THAN PENSIONS

The cooperative has chosen to recognize the accounting method required by the Statement of Financial Accounting Standards No. 106 for Employer's Accounting for Post-retirement Benefits Other Than Pensions. The statement requires a transition from accounting, for these benefits, on a pay-as-you go (cash basis) to recognizing the benefit cost as they are earned (accrual basis). The change in accounting method requires the accounting for costs incurred to date but unpaid, which is called the Transition amount. This amount may be either expensed in the year of transition or it may be amortized over either the benefit period or twenty-years.

The plan sponsored by the company is a defined benefit post-retirement plan that covers all employees who retire from the cooperative before April 1, 1997 after (i) attainment of age 55 and completion of 30 years of service, or (ii) attainment of age 62. Spouses of pensioners are also insured until the pensioner's death.

At the end of 2013 there were no active participants and the accounting rules of the Financial Accounting Standards Board Statement No. 88 regarding curtailment must be recognized. The reconciliation of the funded status at December 31, 2013 is as follows:

	2013	2012
(Accrued) post-retirement benefit costs, beginning	\$ (3,616,570)	\$ (2,923,738)
Net periodic post-retirement benefit (costs)	(351,109)	(351,109)
Contributions made	168,207	189,586
Valuation adjustment	-	(531,309)
(Accrued) post-retirement benefit cost, end of year	\$ (3,799,472)	\$ (3,616,570)

PRESQUE ISLE ELECTRIC & GAS CO-OP
NOTES TO FINANCIAL STATEMENTS

NOTE 15: POST-RETIREMENT BENEFITS OTHER THAN PENSIONS - continued

Net periodic post-retirement benefit cost includes the following components:

	<u>2013</u>	<u>2012</u>
Interest cost	\$ 127,263	\$ 127,263
Net amortization and deferral	<u>223,846</u>	<u>223,846</u>
Net periodic post-retirement benefit cost	<u>\$ 351,109</u>	<u>\$ 351,109</u>

For measurement purposes a 9.0% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2013; the rate was assumed to decrease gradually to an ultimate rate of 5.0% per annum. The health care cost trend rate assumption has a significant effect on the amounts reported. To illustrate, increasing the assumed health care cost trend rates by 1 percentage point in each year would increase the accumulated post-retirement benefit obligation \$162,634 and the aggregate of the service and interest cost components of the net periodic benefit cost by \$13,969. Decreasing the assumed health care cost trend rates by 1 percentage point in each year would decrease the accumulated post-retirement benefit obligation \$136,391 and the aggregate of the service and interest cost components of the net periodic benefit cost by \$12,274.

The weighted-average discount rate used in determining the accumulated post-retirement benefit obligation was 5.71 percent.

NOTE 16: EARLY RETIREMENT INCENTIVE

The cooperative has made available at different times certain voluntary separation incentives to encourage early retirement. The incentive consists of two distinct benefits: a monthly cash payment and a continuation of health care benefits, both for a period of no longer than 48 months. The cash portion consists of a monthly payment equal to \$10 for each full-year of service that the employee has with the Cooperative. The health care benefit consists of a continuation of the existing health insurance being provided to the employee by the Cooperative, with the employee being liable for the costs of continuing coverage for their spouse and dependents. There are five employees who have opted to receive this early retirement incentive. The Cooperative has accrued a liability to account for this contractual obligation. The obligation is detailed below:

	<u>2013</u>	<u>2012</u>
Cash portion	\$ 34,900	\$ 62,589
Health insurance portion	<u>33,602</u>	<u>106,932</u>
Total early retirement incentive liability	<u>\$ 68,502</u>	<u>\$ 169,521</u>

PRESQUE ISLE ELECTRIC & GAS CO-OP
NOTES TO FINANCIAL STATEMENTS

NOTE 17: FLEX BENEFIT PLAN - under Section 125 of the Internal Revenue Code

The Flexible Benefit Plan is for the benefit of substantially all employees who have been employed for at least 30 days. The Cooperative has elected to offer to eligible employees the following Benefit Plans and Policies subject to the terms and conditions of the plan: (1) Disability Income - Short-Term (A&S); (2) Cancer Insurance; (3) Intensive Care Insurance; (4) Accident Insurance; and (5) Medical Care Expense Reimbursement, not to exceed \$1,200 per plan year. The maximum Pre-Tax Premiums a participant can contribute via the Salary Redirection Agreement is the aggregate cost of the applicable Benefit Plans or Policies selected minus any Nonelective Contributions made by the employer. It is intended that such Pre-Tax Premium accounts shall, for tax purposes, constitute an employer contribution.

NOTE 18: LETTERS OF CREDIT

The Co-op has a letter of credit outstanding to the Sequent Energy for \$1,500,000 at December 31, 2013. This letter of credit is required in order to mitigate counter party risk in natural gas purchase transactions. This also is a risk management tool for the Co-op with respect to mark to market issues.

NOTE 19: RECLASSIFICATION OF AMOUNTS

Certain amounts previously reported have been reclassified to conform to the 2013 presentation.

NOTE 20: SUBSEQUENT EVENTS

In preparing these financial statements, management has evaluated, for potential recognition or disclosure, significant events or transactions that occurred during the period subsequent to December 31, 2013, the most recent statement of financial position presented herein, through March 3, 2014, the issuance date of the accompanying financial statements. No significant such events or transactions were identified.



AUDITORS' CERTIFICATION REGARDING LOAN FUND EXPENDITURES

During the period of this audit, Presque Isle Electric & Gas Co-op received \$2,000,000 in long-term loan fund advances from CFC on loans controlled by the 100% CFC Mortgage and Loan Agreement. Based on our review of construction work orders and other plant accounting records created during the audit period, it is our opinion that these CFC loan funds were expended for purposes contemplated in the Loan Agreements on such loans.

A handwritten signature in dark ink that reads 'HARRIS GROUP' in all capital letters, written in a cursive style.

Certified Public Accountants
March 3, 2014