PRESQUE ISLE ELECTRIC & GAS CO-OP

REPORT ON FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2008 AND 2007

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PRESQUE ISLE ELECTRIC & GAS CO-OP
BOARD OF DIRECTORS
DECEMBER 31, 2008

Allan H. Bruder	Chairperson
Allen L. Barr	Vice-Chairperson
John F. Brown	Secretary
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President & Chief Executive Officer

Brian J. Burns

HARRIS GROUP
Certified Public Accountants

Independent Auditor's Report

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

We have audited the accompanying balance sheets of Presque Isle Electric & Gas Co-op as of December 31, 2008 and 2007, and the related statements of revenue and patronage capital, and cash flows for the years then ended. These financial statements are the responsibility of Presque Isle Electric & Gas Co-op's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Presque Isle Electric & Gas Co-op as of December 31, 2008 and 2007, 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.

Harris Group

Certified Public Accountants
March 17, 2009

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PRESQUE ISLE ELECTRIC & GAS CO-OP
BALANCE SHEETS
DECEMBER 31, 2008 AND 2007

	2008	2007
ASSETS		
UTILITY PLANT:		
In-Service – at cost	$ 109,100,400	$ 104,356,663
Construction work in progress	3,310,809	3,287,781
SUBTOTAL	112,411,209	107,644,444
Less accumulated depreciation and amortization	38,530,134	36,087,031
NET UTILITY PLANT	73,881,075	71,557,413
OTHER ASSETS AND INVESTMENTS		
Investments on associated organizations	18,341,057	16,565,274
CURRENT ASSETS:		
Cash and temporary cash investments	1,595,021	1,557,845
Accounts Receivable, less allowance for possible losses of $118,000 in 2008 and 2007, respectively	4,278,787	5,193,797
Materials and supplies (at average cost)	1,135,968	1,133,600
Other current assets	101,297	81,121
TOTAL CURRENT ASSETS	7,111,073	7,966,363
DEFERRED DEBITS	209,947	211,807
TOTAL ASSETS	$ 99,543,152	$ 96,300,857

The accompanying notes are an integral part of these statements.

		2008		2007
EQUITIES AND LIABILITIES				
EQUITIES:				
Memberships	$	216,930	$	211,940
Patronage capital		36,001,367		34,017,150
Other equities		787,517		685,216
TOTAL EQUITIES		37,005,814		34,914,306
LONG-TERM DEBT, NET OF CURRENT MATURITIES:				
Mortgage notes to National Rural Utilities Cooperative Finance Corporation (CFC)		50,340,759		51,878,588
Accrued post – retirement benefits		200,000		283,857
TOTAL LONG-TERM DEBT		50,540,759		52,162,445
CURRENT LIABILITIES:				
Current maturities of long-term debt		1,570,000		1,488,000
CFC line of credit		3,785,117		2,261,710
Accounts payable, purchased energy		2,611,486		2,457,261
Accounts payable, other		811,993		168,657
Patronage capital payable				97,589
Customer deposits		289,631		188,155
Accrued property taxes		486,655		474,549
Accrued interest		349,388		349,716
Accrued sick and vacation pay		558,000		629,521
Accrued other		349,159		468,559
TOTAL CURRENT LIABILITIES		10,811,429		8,583,717
DEFERRED CREDITS		1,185,150		640,389
TOTAL EQUITIES AND LIABILITIES	$	99,543,152	$	96,300,857

PRESQUE ISLE ELECTRIC & GAS CO-OP
STATEMENTS OF REVENUE AND PATRONAGE CAPITAL
FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

	2008	2007
OPERATING REVENUES	$ 37,692,739	$ 37,107,072
OPERATING EXPENSES:		
Cost of energy	23,805,832	23,561,349
Distribution – operation	1,650,258	1,555,144
Distribution – maintenance	2,240,483	2,202,625
Consumers accounts	1,562,239	1,442,160
Customer service and information expense	126,854	122,623
Administrative and general	1,558,051	1,579,550
Depreciation and amortization	2,886,528	2,686,304
Taxes – property	968,851	938,478
Taxes – other	56,356	194,683
TOTAL OPERATING EXPENSES	34,855,452	34,282,916
OPERATING MARGIN BEFORE FIXED CHARGES	2,837,287	2,824,156
FIXED CHARGES:		
Interest	3,049,462	3,014,634
Other deductions	998	509
TOTAL FIXED CHARGES	3,050,460	3,015,143
OPERATING MARGINS AFTER FIXED CHARGES	(213,173)	(190,987)
CAPITAL CREDITS:		
Generation and transmission capital credits	1,870,486	1,616,851
Other capital credits	389,219	393,997
TOTAL CAPITAL CREDITS	2,259,705	2,010,848
NET OPERATING MARGINS	2,046,532	1,819,861

The accompanying notes are an integral part of these statements.

PRESQUE ISLE ELECTRIC & GAS CO-OP
STATEMENTS OF REVENUE AND PATRONAGE CAPITAL
FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007
(Continued)

	2008	2007
NET OPERATING MARGINS (from previous page)	$ 2,046,532	$ 1,819,861
NON-OPERATING MARGINS:		
Interest and dividend income	63,854	82,248
Other	(126,169)	(205,189)
TOTAL NON-OPERATING MARGINS	(62,315)	(122,941)
NET MARGINS	1,984,217	1,696,920
PATRONAGE CAPITAL, beginning of year	34,017,150	32,289,209
Other equity transactions – assignment of sales tax refund		31,021
PATRONAGE CAPITAL, end of year	$ 36,001,367	$ 34,017,150

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, 2008 AND 2007

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from consumers	$ 38,680,294	$ 37,545,646
Cash paid to suppliers and employees	(30,135,333)	(29,937,037)
Interest received	63,854	82,248
Interest paid	(3,184,785)	(3,049,133)
Taxes paid	(1,419,253)	(1,463,567)
Net Cash Provided by Operating Activities	4,004,777	3,178,157
CASH FLOWS FROM INVESTING ACTIVITIES:		
Construction and acquisition of plant	(5,260,030)	(4,400,980)
Plant removal costs	(155,043)	(94,851)
Proceeds from sale of utility plant	9,816	25,000
(Increase) decrease in:		
Material inventory	(2,368)	(4,649)
Investments – associated organizations	251,671	680,634
Net Cash Used In Investing Activities	(5,155,954)	(3,794,846)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Advances from CFC	23,408,525	26,985,742
Payment of debt	(23,108,695)	(26,097,505)
Memberships issued	4,990	4,700
Increased (decrease) in:		
Consumer deposits	101,476	20,548
Deferred credits	679,756	173,998
Other equities	102,301	(2,240)
Sales tax refund to be assigned		31,021
Net cash Provided by Financing Activities	1,188,353	1,116,264
NET INCREASE IN CASH AND CASH EQUIVALENTS	37,176	499,575
CASH AND CASH EQUIVALENTS, beginning of year	1,557,845	1,058,270
CASH AND CASH EQUIVALENTS, end of year	$ 1,595,021	$ 1,557,845

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, 2008 AND 2007
(Continued)

	2008	2007
RECONCILIATION OF NET MARGINS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net Margins	$ 1,984,217	$ 1,696,920
Adjustments to reconcile net margins to net cash provided by Operating activities:		
Depreciation and amortization	2,946,138	2,746,911
(Gain) loss on disposition of assets	135,456	215,534
G&T and other capital credits	(2,259,705)	(2,010,848)
(Increase) decrease in:		
Customer and other accounts receivable	915,010	380,889
Other currents assets	(20,176)	48,176
Deferred debits	1,860	14,016
Amortization of debt discount	(134,995)	(134,995)
Increase (decrease) in:		
Accounts payable	699,972	(37,939)
Accrued property taxes	12,106	(133,004)
Accrued interest payable	(328)	100,496
Current and accrued liabilities – other	(274,778)	292,001
Total Adjustments	2,020,560	1,481,237
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 4,004,777	$ 3,178,157
NON-CASH ITEMS – INVESTING & FINANCING		
Capital credits from associated organizations	$ 2,259,705	$ 2,010,848

The accompanying notes are an integral part of these 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.

Organization

Presque Isle Electric & Gas Co-op (Presque Isle) is a non-profit organization generally exempt from income tax under Section 501(c)(12) of the United States Internal Revenue Code. Presque Isle is subject to the Michigan Business Tax Act of the State of Michigan.

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.

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Materials and Supplies

Electrical 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.

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).

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

Major classes of electric and gas plant as of December 31, 2008 and 2007 consisted of:

	2008	2007
Intangible plant	$ 1,025,332	$ 991,786
Distribution plant	102,200,431	98,215,906
General plant	5,874,637	5,148,971
	109,100,400	104,356,663
Construction work in progress	3,310,809	3,287,781
TOTAL	$ 112,411,209	$ 107,644,444

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

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, 2008:

	Years
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, 2008 and 2007:

	2008	2007
Charged to:		
Classified as depreciation and amortization	$ 2,886,528	$ 2,686,304
Classified in other operating expenses	59,610	60,067
	2,946,138	2,746,371
Charged to construction	243,270	218,658
TOTAL DEPRECIATION AND AMORTIZATION	$ 3,189,408	$ 2,965,029

NOTE 5: INVESTMENTS IN ASSOCIATED ORGANIZATIONS

Investments in associated organizations consisted of the following at December 31, 2008 and 2007:

	2008	2007
Wolverine Power Supply Coop. Inc. - capital credits	$ 9,361,124	$ 9,143,585
Wolverine Power Supply Coop. Inc. - PSDF	6,073,576	4,633,272
National Rural Utilities Cooperative Finance Corp.:		
Capital term certificates maturing December 1, 2015 through October 1, 2080 at interest rates between 0% and 5%	1,679,323	1,697,644
Patronage capital certificates	928,553	847,380
Other	298,481	243,392
TOTAL	$ 18,341,057	$ 16,565,273

NOTE 6: SHORT-TERM INVESTMENTS - RESTRICTED

On March 20, 1984, the Michigan Public Service Commission issued its opinion and order in Case No. U-7901, directing Michigan's Rural Electric Cooperatives to maintain power supply cost recovery over-collections and refundable contributions in restricted accounts to be used only for the purpose for which they are intended.

In order to accomplish the objectives of the Commission, a non-complex mechanism acceptable to CFC and a workable approach acceptable to Presque Isle Electric & Gas Co-op, Inc., on December 17, 1985, entered into an agreement with CFC to escrow power supply cost recovery over-collections and refundable contributions. A monthly certification is to be included with the monthly form advising CFC as to amounts included in the special funds representing power supply cost recovery over-collections and refundable contributions.

Presque Isle is to provide CFC a copy of the monthly certification described above which will serve as notice to CFC as to the amount below which the fund should not fall. Under the provisions of the agreement with CFC when the amount of deposits held by CFC falls below the level set forth in the latest available certification furnished CFC, CFC will advise the Commission if Presque Isle has not remedied the deficiency within three business days of notification by CFC to Presque Isle.

There were no amounts required to be restricted as of December 31, 2008 and 2007.

NOTE 7: 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	$ 669,505	$ 671,671
Uninsured	1,063,917	922,350
Cash in banks, credit union & CFC	$ 1,733,422	1,594,021
Working funds		1,000
Total per books		$ 1,595,021

NOTE 8: DEFERRED DEBITS

The Cooperative has recorded deferred debits in the following amounts:

	2008	2007
Prepaid tap fees	$ 74,792	$ 77,034
Prepaid years of service	121,067	134,773
Regulatory prepaid asset	14,088	
TOTAL	$ 209,947	$ 211,807

NOTE 9: MEMBERSHIPS

The following is a summary of changes in memberships for the years ended December 31, 2008 and 2007:

	2008	2007
Balance, beginning	$ 211,940	$ 207,240
Membership and subscriptions issued	5,705	6,070
Adjustment	(715)	(1,370)
Balance, ending	$ 216,930	$ 211,940

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 10: PATRONAGE CAPITAL

Patronage capital balances as of December 31, 2008 and 2007 consisted of:

	2008	2007
Assignable	$ 1,984,217	$ 1,696,920
Sales tax refund assignable		31,021
Assigned to date	38,164,033	36,436,092
	40,148,250	38,164,033
Less retirements to date	4,146,883	4,146,883
Balance	$ 36,001,367	$ 34,017,150

NOTE 10: PATRONAGE CAPITAL - continued

Under the provisions of the Mortgage Agreement, until the equities and margins equal or exceed thirty 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 37.1% and 36.3% of the total assets for the years 2008 and 2007, respectively. There were capital credits retired of $0 during 2008 or 2007, respectively.

NOTE 11: MORTGAGE NOTES

Long-term debt is composed of 4.30 percent to 6.45 percent mortgage notes payable to the National Rural Utilities Cooperative Finance Corporation (CFC). All mortgage notes to CFC will be repriced and the interest rate adjusted accordingly during the next 10 years in accordance with the policy and procedure governing such repricing. The notes are for 35 year periods each, with principal and interest installments due either quarterly or monthly. The notes are scheduled to be fully repaid at various times from September 2010 through February 2038.

There were unadvanced loan funds available at December 31, 2008 in the amount of $26,000,000.

Detail of the long-term debt is as follows:

	2008	2007
National Rural Utilities Cooperative Finance Corporation mortgage notes bearing interest at 5.00% to 6.65% per annum for 2008 and 2007	$ 51,910,759	$ 53,366,588
	51,910,759	53,366,588
Less current maturities	1,570,000	1,488,000
TOTAL LONG-TERM DEBT	$ 50,340,759	$ 51,878,588

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

2009	$	1,570,000
2010	$	1,654,000
2011	$	1,738,000
2012	$	1,835,000
2013	$	1,925,000

NOTE 12: LINE OF CREDIT

Presque Isle has available a short-term line of credit from CFC of $6,400,000 for both 2008 and 2007 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 2008 and 2007. Balance available at December 31, 2008 and 2007 was $2,614,883 and $4,138,290. The outstanding balance at December 31, 2008 and 2007 was $3,785,117 and $2,261,710, respectively.

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 4.0% at December 31, 2008. Presque Isle had an outstanding balance of $-0- for 2008 and $-0- in 2007.

NOTE 13: DEFERRED CREDITS

Following is a summary of the amounts recorded as deferred credits as of December 31, 2008 and 2007:

	2008	2007
Deferred gain from extinguishments of debt	$ 944,969	$ 1,079,964
Customer energy prepayments	240,181	(439,575)
TOTAL	$ 1,185,150	$ 640,389

NOTE 14: 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 $675,951 in 2008 and $695,733 in 2007.

NOTE 15: 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.

NOTE 15: POWER SUPPLY COST RECOVERY CLAUSE - continued

Presque Isle's balance sheets reflect an amount due from/(to) member-consumers for under/(over) collections in the amounts of $(748,547) and $60,888 at December 31, 2008 and 2007, respectively. These amounts are included in the accounts receivable balance.

On September 1, 2007, 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 from member-consumers for over collections in the amounts of $(53,181) and $49,373 for the years ended December 31, 2008 and 2007, respectively. This amount is recorded in accounts receivable.

NOTE 16: 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 2008 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, 2008 is as follows:

	2008	2007
(Accrued) post-retirement benefit costs, beginning	$ (283,857)	$ (284,930)
Net periodic post-retirement benefit (costs)	(133,886)	(50,000)
Buyout cost	17,158	(133,734)
Contributions made	200,585	184,807
(Accrued) post-retirement benefit cost, end of year	$ (200,000)	$ (283,857)

NOTE 16: POST-RETIREMENT BENEFITS OTHER THAN PENSIONS - continued

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

	2008	2007
Interest cost	$ 113,720	$ 29,834
Net amortization and deferral	20,166	20,166
Net periodic post-retirement benefit cost	$ 133,886	$ 50,000

For measurement purposes a 13.0% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2008; the rate was assumed to decrease gradually to an ultimate rate of 3.5% 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 $122,940 and the aggregate of the service and interest cost components of the net periodic benefit cost by $8,299. Decreasing the assumed health care cost trend rates by 1 percentage point in each year would decrease the accumulated post-retirement benefit obligation $111,396 and the aggregate of the service and interest cost components of the net periodic benefit cost by $7,519.

The weighted-average discount rate used in determining the accumulated post-retirement benefit obligation was 7.5 percent.

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 State of Michigan for $100,000 at December 31, 2008. In order to maintain status as a licensed Alternative Gas Supplier in the State of Michigan the Michigan Public Service Commission requires this letter of credit.

The Co-op has a letter of credit outstanding to the WPS Energy for $2,000,000 at December 31, 2008. 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 2008 presentation.

HARRIS GROUP
Certified Public Accountants

AUDITORS' CERTIFICATION REGARDING LOAN FUND EXPENDITURES

During the period of this audit, Presque Isle Electric & Gas Co-op received $-0- 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.

Harris Group

Certified Public Accountants
March 17, 2009

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