

**PRESQUE ISLE ELECTRIC & GAS CO-OP**  
**REPORT ON FINANCIAL STATEMENTS**  
**YEARS ENDED DECEMBER 31, 2011 AND 2010**

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**PRESQUE ISLE ELECTRIC & GAS CO-OP  
BOARD OF DIRECTORS  
DECEMBER 31, 2011**

|                     |                  |
|---------------------|------------------|
| John F. Brown       | Chairperson      |
| Allen L. Barr       | Vice Chairperson |
| David W. Smith      | Secretary        |
| Daryl Peterson      | Treasurer        |
| Robert W. Wegmeyer  | Director         |
| Allan Berg          | Director         |
| Bernice C. 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

We have audited the accompanying balance sheets of **Presque Isle Electric & Gas Co-op** as of December 31, 2011 and 2010, 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 and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and 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, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Certified Public Accountants  
March 15, 2012

**PRESQUE ISLE ELECTRIC & GAS CO-OP**  
**BALANCE SHEETS**  
**DECEMBER 31, 2011 AND 2010**

|   | 2011           | 2010           |
|---|----------------|----------------|
| <b>ASSETS</b>   |                |                |
| UTILITY PLANT:  |                |                |
| In-Service – at cost  | \$ 120,682,867 | \$ 117,331,926 |
| Construction work in progress   | 852,911        | 654,672        |
| SUBTOTAL  | 121,535,778    | 117,986,598    |
| Less accumulated depreciation and amortization  | 45,954,018     | 42,985,018     |
| NET UTILITY PLANT   | 75,581,760     | 75,001,580     |
| OTHER ASSETS AND INVESTMENTS  |                |                |
| Investments on associated organizations   | 20,885,708     | 20,330,630     |
| CURRENT ASSETS:   |                |                |
| Cash and temporary cash investments   | \$ 1,830,054   | 1,577,131      |
| Accounts Receivable, less allowance for possible losses of<br>\$118,000 in 2011 and 2010. | 4,725,144      | 4,910,699      |
| Materials and supplies (at average cost)  | 1,285,871      | 1,233,075      |
| Other current assets  | 292,889        | 122,217        |
| TOTAL CURRENT ASSETS  | 8,133,958      | 7,843,122      |
| DEFERRED DEBITS   | 155,512        | 177,497        |
| TOTAL ASSETS  | \$ 104,756,938 | \$ 103,352,829 |

The accompanying notes are an integral part of these statements.

|   | <u>2011</u>               | <u>2010</u>               |
|---|---------------------------|---------------------------|
| EQUITIES AND LIABILITIES  |                           |                           |
| EQUITIES:   |                           |                           |
| Memberships   | \$ 233,595                | \$ 227,440                |
| Patronage capital   | 38,937,908                | 37,823,325                |
| Other equities  | <u>(1,301,485)</u>        | <u>(1,571,251)</u>        |
| <br>TOTAL EQUITIES  | <br><u>37,870,018</u>     | <br><u>36,479,514</u>     |
| LONG-TERM DEBT, NET OF CURRENT MATURITIES:  |                           |                           |
| Mortgage notes to National Rural Utilities Cooperative<br>Finance Corporation (CFC) | 50,559,819                | 52,422,254                |
| Accrued post – retirement benefits  | <u>2,923,738</u>          | <u>2,815,152</u>          |
| <br>TOTAL LONG-TERM DEBT  | <br><u>53,483,557</u>     | <br><u>55,237,406</u>     |
| CURRENT LIABILITIES:  |                           |                           |
| Current maturities of long-term debt  | 1,888,300                 | 1,788,000                 |
| CFC line of credit  | 6,200,310                 | 5,056,478                 |
| Accounts payable, purchased energy  | 2,416,786                 | 2,305,001                 |
| Accounts payable, other   | 370,984                   | 315,305                   |
| Patronage capital payable   |                           |                           |
| Customer deposits   | 339,378                   | 303,186                   |
| Accrued property taxes  | 446,614                   | 438,153                   |
| Accrued interest  | 362,326                   | 357,993                   |
| Accrued sick and vacation pay   | 529,592                   | 563,326                   |
| Accrued other   | <u>432,519</u>            | <u>263,743</u>            |
| <br>TOTAL CURRENT LIABILITIES   | <br><u>12,986,809</u>     | <br><u>11,391,185</u>     |
| <br>DEFERRED CREDITS  | <br><u>416,554</u>        | <br><u>244,724</u>        |
| <br>TOTAL EQUITIES AND LIABILITIES  | <br><u>\$ 104,756,938</u> | <br><u>\$ 103,352,829</u> |

**PRESQUE ISLE ELECTRIC & GAS CO-OP**  
**STATEMENTS OF REVENUE**  
**FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010**

|   | 2011          | 2010          |
|---|---------------|---------------|
| OPERATING REVENUES                          | \$ 40,303,746 | \$ 38,555,890 |
| OPERATING EXPENSES:                         |               |               |
| Cost of energy                              | 23,596,605    | 23,085,268    |
| Distribution – operation                    | 1,204,016     | 1,167,656     |
| Distribution – maintenance                  | 3,461,054     | 3,328,321     |
| Consumers accounts                          | 1,599,022     | 1,699,273     |
| Customer service and information expense    | 472,386       | 442,083       |
| Administrative and general                  | 1,641,310     | 1,600,432     |
| Depreciation and amortization               | 3,267,176     | 3,149,984     |
| Taxes – property                            | 1,016,906     | 1,002,340     |
| Taxes – other                               | 74,474        | 74,303        |
|   | 36,332,949    | 35,549,660    |
| TOTAL OPERATING EXPENSES                    |               |               |
| OPERATING MARGIN BEFORE FIXED CHARGES       | 3,970,797     | 3,006,230     |
| FIXED CHARGES:                              |               |               |
| Interest                                    | 3,151,240     | 3,183,335     |
| Other deductions                            |               | 509           |
|   | 3,151,240     | 3,183,844     |
| TOTAL FIXED CHARGES                         |               |               |
| OPERATING MARGINS AFTER FIXED CHARGES       | 819,557       | (177,614)     |
| CAPITAL CREDITS:                            |               |               |
| Generation and transmission capital credits | 1,106,541     |               |
| Other capital credits                       | 387,422       | 389,126       |
|   | 1,493,963     | 389,126       |
| TOTAL CAPITAL CREDITS                       |               |               |
| NET OPERATING MARGINS                       | 2,313,520     | 211,512       |

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, 2011 AND 2010**  
**(Continued)**

|  | <u>2011</u>         | <u>2010</u>       |
|--|---------------------|-------------------|
| NET OPERATING MARGINS (from previous page) | \$ 2,313,520        | \$ 211,512        |
| NON-OPERATING MARGINS:                     |                     |                   |
| Interest and dividend income               | 60,411              | 60,446            |
| Other                                      | <u>(295,732)</u>    | <u>(167,865)</u>  |
| TOTAL NON-OPERATING MARGINS                | <u>(235,321)</u>    | <u>(107,419)</u>  |
| NET MARGINS                                | <u>\$ 2,078,199</u> | <u>\$ 104,093</u> |

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, 2011 AND 2010**

|                                      | <u>Memberships</u> | <u>Patronage<br/>Capital</u> | <u>Other<br/>Equities</u> | <u>Accumulated<br/>Other<br/>Comprehensive<br/>Loss</u> | <u>Total</u>         |
|--------------------------------------|--------------------|------------------------------|---------------------------|---|----------------------|
| Balance, January 1, 2010             | \$ 221,615         | \$ 37,713,491                | \$ 788,009                | \$ (2,359,330)  | \$ 36,363,785        |
| Capital credits retired              |                    |                              |                           |   |                      |
| Memberships retired                  | 5,825              |                              |                           |   | 5,825                |
| Other equity transactions            |                    | 5,741                        | 70                        |   | 5,811                |
| Net margin                           |                    | <u>104,093</u>               |                           |   | <u>104,093</u>       |
| Balance, December 31, 2010           | 227,440            | 37,823,325                   | 788,079                   | (2,359,330)   | 36,479,514           |
| Capital credits retired              |                    | (963,309)                    | 269,459                   |   | (693,850)            |
| Memberships retired                  | 6,155              |                              |                           |   | 6,155                |
| Other equity transactions            |                    | (307)                        | 309                       |   |                      |
| Amortize other comprehensive<br>Loss |                    |                              |                           |   |                      |
| Net margin                           |                    | <u>2,078,199</u>             |                           |   | <u>2,078,199</u>     |
| Balance, December 31, 2011           | <u>\$ 233,595</u>  | <u>\$ 38,937,908</u>         | <u>\$ 1,057,845</u>       | <u>\$ (2,359,330)</u>                                   | <u>\$ 37,870,018</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, 2011 AND 2010**

|   | 2011                | 2010                |
|---|---------------------|---------------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>        |                     |                     |
| Cash received from consumers                        | \$ 40,434,565       | \$ 38,424,665       |
| Cash paid to suppliers and employees                | (31,220,331)        | (30,889,184)        |
| Interest received                                   | 60,411              | 60,446              |
| Interest paid                                       | (3,281,902)         | (3,306,910)         |
| Taxes paid  | (1,311,519)         | (1,317,696)         |
|   | <u>4,681,224</u>    | <u>2,971,321</u>    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>        |                     |                     |
| Construction and acquisition of plant               | (3,774,458)         | (3,731,081)         |
| Plant removal costs                                 | (37,657)            | (284,571)           |
| (Increase) decrease in:                             |                     |                     |
| Material inventory                                  | (52,796)            | (120,146)           |
| Investments – associated organizations              | 938,885             | 192,242             |
|   | <u>(2,926,026)</u>  | <u>(3,943,556)</u>  |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>        |                     |                     |
| Advances  | 21,443,831          | 25,521,230          |
| Payment of debt                                     | (22,062,135)        | (24,150,880)        |
| Memberships issued                                  | 6,155               | 5,825               |
| Patronage capital retired                           | (963,309)           |                     |
| Increased (decrease) in:                            |                     |                     |
| Consumer deposits                                   | 36,195              | 32,114              |
| Deferred credits                                    | 306,825             | (414,396)           |
| Other equities                                      | (269,837)           | (71)                |
|   | <u>(1,502,275)</u>  | <u>993,822</u>      |
| <b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>    | 252,923             | 21,587              |
| <b>CASH AND CASH EQUIVALENTS, beginning of year</b> | <u>1,577,131</u>    | <u>1,555,544</u>    |
| <b>CASH AND CASH EQUIVALENTS, end of year</b>       | <u>\$ 1,830,054</u> | <u>\$ 1,577,131</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, 2011 AND 2010**  
**(Continued)**

|   | 2011         | 2010         |
|---|--------------|--------------|
| RECONCILIATION OF NET MARGINS TO NET CASH PROVIDED BY OPERATING ACTIVITIES: |              |              |
| Net Margins   | \$ 2,078,199 | \$ 104,093   |
| Adjustments to reconcile net margins to net cash provided by                |              |              |
| Operating activities:   |              |              |
| Depreciation and amortization   | 3,608,124    | 3,490,932    |
| (Gain) loss on disposition of assets  | 163,103      | 177,564      |
| G&T and other capital credits   | (1,493,963)  | (389,126)    |
| (Increase) decrease in:   |              |              |
| Customer and other accounts receivable                                      | 185,595      | (193,433)    |
| Other current assets  | (170,672)    | (2,989)      |
| Deferred debits   | 21,985       | 30,185       |
| Amortization of debt discount   | (134,995)    | (134,995)    |
| Increase (decrease) in:   |              |              |
| Accounts payable  | 167,426      | (218,969)    |
| Accrued property taxes  | 8,461        | (51,171)     |
| Accrued interest payable  | 4,333        | 11,420       |
| Current and accrued liabilities – other                                     | 243,628      | 147,810      |
| Total Adjustments   | 2,603,025    | 2,867,228    |
| NET CASH PROVIDED BY OPERATING ACTIVITIES                                   | \$ 4,681,224 | \$ 2,971,321 |
| NON-CASH ITEMS – INVESTING & FINANCING                                      |              |              |
| Capital credits from associated organizations                               | \$ 1,493,963 | \$ 389,126   |

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.

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.

**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.

**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, 2011 and 2010 consisted of:

|                               | <u>2011</u>           | <u>2010</u>           |
|-------------------------------|-----------------------|-----------------------|
| Intangible plant              | \$ 1,025,480          | \$ 1,025,480          |
| Distribution plant            | 112,770,473           | 109,749,475           |
| General plant                 | <u>6,886,914</u>      | <u>6,556,970</u>      |
|                               | 120,682,867           | 117,319,925           |
| Construction work in progress | <u>852,911</u>        | <u>654,673</u>        |
| TOTAL                         | <u>\$ 121,535,778</u> | <u>\$ 117,986,598</u> |

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

**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, 2011:

|                             | <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, 2011 and 2010:

|   | <u>2011</u>                | <u>2010</u>                |
|---|----------------------------|----------------------------|
| Charged to:                                 |                            |                            |
| Classified as depreciation and amortization | \$ 3,267,176               | \$ 3,149,984               |
| Classified in other operating expenses      | 132,805                    | 139,753                    |
|   | <u>3,399,981</u>           | <u>3,289,737</u>           |
| Charged to construction                     | 212,518                    | 201,195                    |
|   | <u>212,518</u>             | <u>201,195</u>             |
| <b>TOTAL DEPRECIATION AND AMORTIZATION</b>  | <u><u>\$ 3,612,499</u></u> | <u><u>\$ 3,490,932</u></u> |

**NOTE 5: INVESTMENTS IN ASSOCIATED ORGANIZATIONS**

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

|  | <u>2011</u>                 | <u>2010</u>                 |
|--|-----------------------------|-----------------------------|
| Wolverine Power Supply Coop. Inc. - capital credits  | \$ 9,302,060                | \$ 9,517,385                |
| Wolverine Power Supply Coop. Inc. - PSDF   | 7,980,339                   | 7,352,748                   |
| National Rural Utilities Cooperative Finance Corp.:  |                             |                             |
| Capital term certificates maturing October 1, 2020 through<br>October 1, 2080 at interest rates between 3% and 7.50% | 1,767,552                   | 1,788,697                   |
| Patronage capital certificates   | 1,340,347                   | 1,199,398                   |
| Other  | 495,410                     | 472,402                     |
|  | <u>495,410</u>              | <u>472,402</u>              |
| <b>TOTAL</b>   | <u><u>\$ 20,885,708</u></u> | <u><u>\$ 20,330,630</u></u> |

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

**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, 2011 and 2010.

**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.

|                                   | <u>Per Institution</u> | <u>Per Book</u>     |
|-----------------------------------|------------------------|---------------------|
| Insured                           | \$ 884,444             | \$ 671,260          |
| Uninsured                         | <u>1,157,294</u>       | <u>1,157,294</u>    |
| Cash in banks, credit union & CFC | <u>\$ 2,041,738</u>    | 1,828,554           |
| Working funds                     |                        | <u>1,500</u>        |
| Total per books                   |                        | <u>\$ 1,830,054</u> |

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

**NOTE 8: DEFERRED DEBITS**

The Cooperative has recorded deferred debits in the following amounts:

|                          | <u>2011</u>           | <u>2010</u>           |
|--------------------------|-----------------------|-----------------------|
| Prepaid tap fees         | \$ 67,363             | \$ 69,359             |
| Prepaid years of service | 79,950                | 93,656                |
| Regulatory prepaid asset | <u>8,199</u>          | <u>14,482</u>         |
| <br>TOTAL                | <br><u>\$ 155,512</u> | <br><u>\$ 177,497</u> |

**NOTE 9: MEMBERSHIPS**

The following is a summary of changes in memberships for the years ended December 31, 2011 and 2010:

|                                     | <u>2011</u>           | <u>2010</u>           |
|-------------------------------------|-----------------------|-----------------------|
| Balance, beginning                  | \$ 227,440            | \$ 221,615            |
| Membership and subscriptions issued | 6,155                 | 5,825                 |
| Adjustment                          |                       |                       |
| <br>Balance, ending                 | <br><u>\$ 233,595</u> | <br><u>\$ 227,440</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 10: PATRONAGE CAPITAL**

Patronage capital balances as of December 31, 2011 and 2010 consisted of:

|                              | <u>2011</u>              | <u>2010</u>              |
|------------------------------|--------------------------|--------------------------|
| Assignable                   | \$ 2,078,199             | \$ 104,093               |
| Assigned to date             | <u>41,969,901</u>        | <u>41,866,115</u>        |
| <br>Less retirements to date | <br>44,048,100           | <br>41,970,208           |
|                              | <u>5,110,192</u>         | <u>4,146,883</u>         |
| <br>Balance                  | <br><u>\$ 38,937,908</u> | <br><u>\$ 37,823,325</u> |



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

**NOTE 10: 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 35.9% and 35.3% of the total assets for the years 2011 and 2010, respectively. There were capital credits retired of \$963,309 and \$0 during 2011 or 2010, respectively.

**NOTE 11: MORTGAGE NOTES**

Long-term debt is composed of 4.85 percent to 6.65 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 semiannually. The notes are scheduled to be fully repaid at various times from June 2013 through February 2045.

There were unadvanced loan funds available at December 31, 2011 in the amount of \$19,500,000.

Detail of the long-term debt is as follows:

|  | <u>2011</u>          | <u>2010</u>          |
|--|----------------------|----------------------|
| National Rural Utilities Cooperative Finance Corporation mortgage notes bearing interest at 4.85% to 6.65% per annum for 2011 and 2010 | \$ 52,448,119        | \$ 54,210,254        |
|  | 52,448,119           | 54,210,254           |
| Less current maturities  | <u>1,888,300</u>     | <u>1,788,000</u>     |
| <b>TOTAL LONG-TERM DEBT</b>  | <u>\$ 50,559,819</u> | <u>\$ 52,422,254</u> |

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

|      |    |           |
|------|----|-----------|
| 2012 | \$ | 1,888,300 |
| 2013 | \$ | 1,981,900 |
| 2014 | \$ | 2,080,900 |
| 2015 | \$ | 2,199,200 |
| 2016 | \$ | 1,396,900 |

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

**NOTE 12: LINE OF CREDIT**

Presque Isle had available a short-term line of credit from CFC for 2011 and 2010 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 2011 and 2010. Balance available at December 31, 2011 and 2010 was \$8,000,000. The outstanding balance at December 31, 2011 and 2010 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 3.05% at December 31, 2011. Presque Isle had an outstanding balance of \$6,200,310 for 2011 and \$5,056,478 in 2010.

**NOTE 13: DEFERRED CREDITS**

Following is a summary of the amounts recorded as deferred credits as of December 31, 2011 and 2010:

|  | 2011       | 2010       |
|--|------------|------------|
| Deferred gain from extinguishments of debt | \$ 539,982 | \$ 604,978 |
| Customer energy prepayments                | (123,428)  | (360,254)  |
| TOTAL                                      | \$ 416,554 | \$ 244,724 |

**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 \$383,070 in 2011 and \$399,385 in 2010.

**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.

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

**NOTE 15: POWER SUPPLY COST RECOVERY CLAUSE - continued**

Presque Isle's balance sheets reflect an amount due to member-consumers for over collections in the amounts of \$(193,144) and \$(120,017) at December 31, 2011 and 2010, 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 from member-consumers for under collections in the amounts of \$5,928 and \$13,816 for the years ended December 31, 2011 and 2010, 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 2011 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, 2011 is as follows:

|   | 2011           | 2010           |
|---|----------------|----------------|
| (Accrued) post-retirement benefit costs, beginning  | \$ (2,815,152) | \$ (2,707,397) |
| Net periodic post-retirement benefit (costs)        | (315,967)      | (313,693)      |
| Contributions made                                  | 207,381        | 205,938        |
| (Accrued) post-retirement benefit cost, end of year | \$ (2,923,738) | \$ (2,815,152) |

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

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

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

|   | <u>2011</u>       | <u>2010</u>       |
|---|-------------------|-------------------|
| Interest cost                             | \$ 148,665        | \$ 148,665        |
| Early buyout cost                         | 2,274             |                   |
| Net amortization and deferral             | <u>165,028</u>    | <u>165,028</u>    |
| Net periodic post-retirement benefit cost | <u>\$ 315,967</u> | <u>\$ 313,693</u> |

For measurement purposes a 10.0% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2011; 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 \$122,019 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 \$106,201 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: 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>2011</u>       | <u>2010</u>      |
|--|-------------------|------------------|
| Cash portion                               | \$ 82,050         | \$ 28,750        |
| Health insurance portion                   | <u>128,447</u>    | <u>20,232</u>    |
| Total early retirement incentive liability | <u>\$ 210,497</u> | <u>\$ 49,982</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, 2011. 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 2011 presentation.

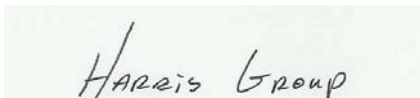
**NOTE 20: SUBSEQUENT EVENTS**

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, 2011, the most recent statement of financial position presented herein, through March 15, 2012 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 \$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.

A handwritten signature in cursive script that reads 'HARRIS GROUP' is placed on a light green rectangular background.

Certified Public Accountants  
March 15, 2012