

INDEPENDENT AUDITORS' REPORT

Board of Directors
Okanogan County Electric Cooperative, Inc.
Winthrop, Washington

We have audited the consolidated balance sheet of Okanogan County Electric Cooperative, Inc., and subsidiary as of December 31, 2010, and the related consolidated statements of revenue, equities, and cash flows for the year then ended. These financial statements are the responsibility of the Cooperative's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of Okanogan County Electric Cooperative, Inc., and subsidiary as of December 31, 2009, were audited by LeMaster & Daniels PLLC (whose practice became part of LarsonAllen LLP effective November 1, 2010), whose report dated February 12, 2010, expressed an unqualified opinion on those statements.

We conducted our audit 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 our audit provides a reasonable basis for our opinion.

In our opinion, the 2010 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Okanogan County Electric Cooperative, Inc., and subsidiary as of December 31, 2010, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was made for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The accompanying 2010 supplementary information on pages 14 and 15 is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic 2010 consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

The financial statements of Okanogan County Electric Cooperative, Inc., and subsidiary for the year ended December 31, 2009, were audited by LeMaster & Daniels PLLC (whose practice became part of LarsonAllen LLP effective November 1, 2010), whose report dated February 12, 2010, on the supplementary information stated such information had been subjected to the auditing procedures applied in the audit of the basic financial statements and expressed an unqualified opinion on the supplementary information.

LarsonAllen LLP
LarsonAllen LLP

Omak, Washington
February 23, 2011

Okanogan County Electric Cooperative, Inc.

Consolidated Balance Sheets

	December 31,	
	<u>2010</u>	<u>2009</u>
Assets		
<i>UTILITY PLANT, at cost:</i>		
Plant in service	\$ 12,515,650	\$ 12,080,497
Construction work in progress	70,559	80,202
Total utility plant	<u>12,586,209</u>	<u>12,160,699</u>
Less accumulated depreciation and amortization	3,421,239	3,145,823
Net utility plant	<u>9,164,970</u>	<u>9,014,876</u>
<i>OTHER ASSETS:</i>		
Investments in associated organizations	502,828	481,577
Notes receivable, net of current maturities	467,805	260,665
Total other assets	<u>970,633</u>	<u>742,242</u>
<i>CURRENT ASSETS:</i>		
Cash and cash equivalents	429,386	399,926
Receivables:		
Customers, less allowance for doubtful accounts of \$2,000 and \$700 for 2010 and 2009, respectively	696,712	750,074
Other	2,560	4,251
Materials and supplies, at average cost	430,463	389,591
Prepaid expenses	-	6,140
Current maturities, notes receivable	31,000	32,000
Total current assets	<u>1,590,121</u>	<u>1,581,982</u>
	<u>\$ 11,725,724</u>	<u>\$ 11,339,100</u>

See accompanying notes to consolidated financial statements.

Consolidated Balance Sheets

	December 31,	
	<u>2010</u>	<u>2009</u>
<i>Equities and Liabilities</i>		
<i>EQUITIES:</i>		
Memberships	\$ 14,875	\$ 14,555
Patronage capital	4,669,784	4,322,899
Total equities	<u>4,684,659</u>	<u>4,337,454</u>
<i>LONG-TERM DEBT:</i>		
Notes	5,960,754	5,978,639
Less current maturities	176,000	155,000
	<u>5,784,754</u>	<u>5,823,639</u>
<i>CURRENT LIABILITIES:</i>		
Current maturities of long-term debt	176,000	155,000
Accounts payable, purchased power	342,538	324,839
Accounts payable, other	241,606	192,530
Accrued vacation and sick leave	182,232	171,609
Patronage capital credits payable	143,340	138,344
Customer energy prepayments	39,248	45,533
Customer deposits	93,259	92,485
Accrued taxes	38,088	57,667
Total current liabilities	<u>1,256,311</u>	<u>1,178,007</u>
Total liabilities	<u>7,041,065</u>	<u>7,001,646</u>
<i>COMMITMENT AND CONTINGENCY</i>		
	<u>\$ 11,725,724</u>	<u>\$ 11,339,100</u>

Okanogan County Electric Cooperative, Inc.

Consolidated Statements of Revenue

	Years Ended	
	December 31,	
	2010	2009
<i>OPERATING REVENUE</i>	<u>\$ 6,520,875</u>	<u>\$ 6,297,133</u>
<i>OPERATING EXPENSES:</i>		
Cost of power	3,201,767	3,108,848
Distribution, operation	403,488	433,150
Distribution, maintenance	745,229	703,609
Customer accounts	265,129	253,549
Sales	1,433	1,922
Administrative and general	726,704	675,268
Depreciation and amortization	408,956	400,386
Taxes	178,131	167,585
	<u>5,930,837</u>	<u>5,744,317</u>
<i>OPERATING MARGINS BEFORE FIXED CHARGES AND OTHER INCOME</i>	590,038	552,816
<i>FIXED CHARGES:</i>		
Interest on long-term debt	<u>350,356</u>	<u>336,711</u>
<i>OPERATING MARGINS AFTER FIXED CHARGES</i>	239,682	216,105
<i>CAPITAL CREDITS</i>	<u>35,803</u>	<u>28,311</u>
<i>OPERATING MARGINS</i>	<u>275,485</u>	<u>244,416</u>
<i>NONOPERATING MARGINS:</i>		
Interest income	43,977	37,322
USDA grant	200,000	-
	<u>243,977</u>	<u>37,322</u>
<i>NET MARGINS BEFORE INCOME TAXES</i>	519,462	281,738
<i>FEDERAL INCOME TAX</i>	<u>-</u>	<u>14,798</u>
<i>NET MARGINS</i>	<u>\$ 519,462</u>	<u>\$ 266,940</u>

See accompanying notes to consolidated financial statements.

Okanogan County Electric Cooperative, Inc.

Consolidated Statements of Equities

Years Ended December 31, 2010 and 2009

	<u>Memberships</u>	<u>Patronage Capital</u>	<u>Total</u>
<i>BALANCES, DECEMBER 31, 2008</i>	\$ 14,860	\$ 4,251,357	\$ 4,266,217
<i>ADD (DEDUCT):</i>			
Decrease in memberships	(305)	-	(305)
Net margins	-	266,940	266,940
Retirement of capital credits	-	(195,398)	(195,398)
<i>BALANCES, DECEMBER 31, 2009</i>	14,555	4,322,899	4,337,454
<i>ADD (DEDUCT):</i>			
Increase in memberships	320	-	320
Net margins	-	519,462	519,462
Retirement of capital credits	-	(172,577)	(172,577)
<i>BALANCES, DECEMBER 31, 2010</i>	<u>\$ 14,875</u>	<u>\$ 4,669,784</u>	<u>\$ 4,684,659</u>

See accompanying notes to consolidated financial statements.

Okanogan County Electric Cooperative, Inc.

Consolidated Statements of Cash Flows

	Years Ended December 31,	
	<u>2010</u>	<u>2009</u>
<i>Increase (Decrease) in Cash and Cash Equivalents</i>		
<i>CASH FLOWS FROM OPERATING ACTIVITIES:</i>		
Net margins	\$ 519,462	\$ 266,940
Adjustments to reconcile net margins to net cash provided by operating activities:		
Depreciation and amortization	408,956	400,386
Patronage capital credits received	(35,803)	(28,311)
(Increase) decrease in assets:		
Receivables	55,053	(18,651)
Prepaid expenses	6,140	(6,140)
Increase (decrease) in liabilities:		
Accounts payable	66,775	(138,344)
Accrued expenses	(8,956)	59,124
Customer energy prepayments	(6,285)	8,895
Patronage capital credits payable	4,996	20,427
Net cash provided by operating activities	<u>1,010,338</u>	<u>564,326</u>
<i>CASH FLOWS FROM INVESTING ACTIVITIES:</i>		
Construction and acquisition of plant	(599,922)	(730,320)
Notes receivable advances	(245,057)	(62,741)
Notes receivable principal payments received	38,917	31,115
Investments purchased	(3,735)	(8,548)
Investments redeemed	18,287	14,519
Net cash used in investing activities	<u>(791,510)</u>	<u>(755,975)</u>
<i>CASH FLOWS FROM FINANCING ACTIVITIES:</i>		
Memberships received (redeemed)	320	(305)
Retirement of patronage capital	(172,577)	(195,398)
Proceeds from long-term debt	150,000	675,000
Principal payments on long-term debt	(167,885)	(148,642)
Customer deposits	774	2,653
Net cash provided by (used in) financing activities	<u>(189,368)</u>	<u>333,308</u>
<i>NET INCREASE IN CASH AND CASH EQUIVALENTS</i>	29,460	141,659
<i>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</i>	<u>399,926</u>	<u>258,267</u>
<i>CASH AND CASH EQUIVALENTS, END OF YEAR</i>	<u>\$ 429,386</u>	<u>\$ 399,926</u>

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Years Ended
December 31,

2010 2009

Supplemental Disclosures of Cash Flows Information:

Cash paid for interest	\$ 350,356	\$ 336,711
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Cash paid for income taxes	\$ 14,398	\$ 400
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Noncash Investing and Financing Activities:

NRUCFC certificates received in lieu of cash	\$ 35,803	\$ 28,311
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Okanogan County Electric Cooperative, Inc.

Notes to Consolidated Financial Statements

NOTE 1 – ORGANIZATION AND TAX STATUS:

Okanogan County Electric Cooperative, Inc. (the Cooperative) was incorporated in 1939 under the laws of the state of Washington for the purpose of supplying electric energy to its members. In 2000, the Cooperative began providing propane to its members. Effective January 1, 2003, the Board of Directors approved the transfer of the propane division to a wholly-owned taxable subsidiary, Okanogan County Energy, Inc. Assets and corresponding debt of approximately \$1,000,000 were transferred to the new subsidiary.

The consolidated financial statements include the accounts of the Cooperative and its subsidiary. All material intercompany accounts and transactions are eliminated in consolidation.

The Cooperative has qualified for exemption from federal income tax under Section 501(c)(12) of the Internal Revenue Code. The 2009 income tax provision relates to the taxable income of Okanogan County Energy, Inc.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

A summary of the Cooperative's significant accounting policies consistently applied in the preparation of the accompanying consolidated financial statements follows:

System of accounts and financial reporting – The accounting records and certain classifications and descriptions used in these consolidated financial statements are in accordance with the Uniform System of Accounts prescribed by the Rural Utilities Service (RUS).

Estimates – The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Utility plant – Additions to electric plant, betterments to existing property, and replacements of property are capitalized at cost. Cost includes the original cost of contracted services, direct labor and material, indirect charges for engineering supervision, and similar overhead items. Customer advances for construction and system access charge payments reduce additions to electric plant. The system access charge is based on panel size and distance from the substation.

Maintenance of property is charged to expense – The actual or average book cost of property replaced or renewed is removed from plant and such cost plus removal cost less salvage is charged to accumulated depreciation.

Depreciation – Provision for depreciation of utility plant is based on the estimated service lives of the respective properties using the straight-line method (see note 3).

Okanogan County Electric Cooperative, Inc.

Notes to Consolidated Financial Statements

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):

Investments in associated organizations – Investments in associated organizations consist of capital stock carried at cost plus capital certificates and other equities received as distributions of allocated earnings. The investments are carried at the stated amount of the allocation (see note 4).

Cash and cash equivalents – For purposes of the consolidated statements of cash flows, the Cooperative considers short-term investments with original maturities of three months or less and cash restricted for short-term investments to be cash equivalents. The Cooperative maintains cash in deposit accounts at financial institutions approved by the Board of Directors. Deposits at these financial institutions, at times, may exceed federally insured limits.

Trade receivables – Trade receivables are carried at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a monthly basis. Management determines the allowance for doubtful accounts by identifying troubled accounts and by using historical experience applied to an aging of accounts. Trade receivables are written off when deemed uncollectible. Recoveries of trade receivables previously written off are recorded when received.

A trade receivable is considered to be past due if any portion of the receivable balance is outstanding for more than 30 days. Interest is charged on trade receivables that are outstanding for more than 30 days and is recognized as it is charged. Interest is charged until the account is paid in full or written off.

Retirement plan – The Cooperative provides a defined contribution retirement plan for its regular full-time employees (see note 7).

Uncertainty in income tax – The financial statements do not include a provision for income taxes for Okanogan County Electric Cooperative, Inc., because the Cooperative is a tax-exempt organization. Okanogan County Energy, Inc., is a corporation and experienced a net loss during 2010, resulting in no federal income tax liability at December 31, 2010.

The Cooperative has not identified any uncertainty in income tax positions that would jeopardize the entities' status. The Cooperative's income tax returns are subject to review and examination by federal authorities. The tax returns are open to examination by federal authorities for the years 2007 to 2009.

Subsequent events – Subsequent events have been evaluated through February 23, 2011, which is the date the consolidated financial statements were available to be issued.

Okanogan County Electric Cooperative, Inc.

Notes to Consolidated Financial Statements

NOTE 3 – UTILITY PLANT:

Listed below are the major classes of utility plant:

	<u>December 31,</u>	
	<u>2010</u>	<u>2009</u>
Distribution plant	\$ 7,972,812	\$ 7,644,503
General plant	<u>4,542,838</u>	<u>4,435,994</u>
Total plant in service	12,515,650	12,080,497
Construction work in progress	<u>70,559</u>	<u>80,202</u>
	<u>\$12,586,209</u>	<u>\$12,160,699</u>

Provision has been made for depreciation of distribution plant at a straight-line composite rate of 2.86% per annum.

General plant depreciation rates have been applied on a straight-line basis and are as follows:

Structures and improvements	2.5%
Office furniture and equipment	20.0
Computer	20.0
Transportation equipment	14.3
Tools and equipment	14.3
Tanks	3.3

NOTE 4 – INVESTMENTS IN ASSOCIATED ORGANIZATIONS:

Investments consisted of the following:

	<u>December 31,</u>	
	<u>2010</u>	<u>2009</u>
Capital term certificate of the National Rural Utilities Cooperative Finance Corporation (NRUCFC)	\$ 172,637	\$ 169,287
Capital term certificate of the Pacific Northwest Generating Cooperative	242,462	242,462
Patronage allocations	80,979	63,078
Stock in associated organizations	<u>6,750</u>	<u>6,750</u>
	<u>\$ 502,828</u>	<u>\$ 481,577</u>

Okanogan County Electric Cooperative, Inc.

Notes to Consolidated Financial Statements

NOTE 5 – PATRONAGE CAPITAL:

Patronage capital consisted of the following:

	<u>December 31,</u>	
	<u>2010</u>	<u>2009</u>
Margins:		
Assignable	\$ 519,462	\$ 266,940
Assigned	<u>6,118,332</u>	<u>5,846,677</u>
	6,637,794	6,113,617
Less retired	<u>1,968,010</u>	<u>1,790,718</u>
	<u>\$ 4,669,784</u>	<u>\$ 4,322,899</u>

Under provisions of long-term debt agreements, until the total of equities and margins equals or exceeds 30% of the total assets of the Cooperative, the retirement of patronage capital credits is generally limited to 25% of the patronage capital or margins of the Cooperative for the preceding calendar year. The equities and margins of the Cooperative represent 40% of total assets at December 31, 2010. Capital credit retirements in the amounts of \$172,577 and \$195,398 were paid in 2010 and 2009, respectively.

NOTE 6 – LONG-TERM DEBT:

Substantially all assets are pledged as security for the mortgage notes payable to NRUCFC. Following is a summary of outstanding long-term debt:

	<u>December 31,</u>	
	<u>2010</u>	<u>2009</u>
Payable to the National Rural Utilities Cooperative Finance Corporation, interest at 3.25% to 7.55%	\$ 5,807,002	\$ 5,801,484
Other notes payable, interest at 5%	<u>153,752</u>	<u>177,155</u>
	<u>\$ 5,960,754</u>	<u>\$ 5,978,639</u>

Principal and interest installments related to the NRUCFC notes of approximately \$123,000 are due quarterly. The notes are scheduled to be fully repaid at various times through 2049. The principal and interest on the other notes amount to \$2,600 monthly and mature in 2012.

Okanogan County Electric Cooperative, Inc.

Notes to Consolidated Financial Statements

NOTE 6 – LONG-TERM DEBT (continued):

The loan agreements with NRUCFC impose certain restrictions upon the Cooperative relating to the purchase, sale, construction, and maintenance of distribution plant, as well as future financing and retirement of patronage capital. These notes are secured by all assets of the Cooperative.

Principal maturities of long-term debt for the five succeeding years are as follows:

<u>Years Ending December 31,</u>	<u>Amount</u>
2011	\$ 176,000
2012	276,000
2013	168,000
2014	177,000
2015	186,000

NOTE 7 – EMPLOYEE BENEFIT PLANS:

The Cooperative's employees are members of the National Rural Electric Cooperative Association Savings Plan, 401(k) plan. The Cooperative's contributions were \$30,306 and \$31,359 in 2010 and 2009, respectively.

As of 2008, all employees of the Cooperative participate in the National Rural Electric Cooperative Association (NRECA) Retirement and Security Program, a defined-benefit pension plan qualified under Section 401 and tax exempt under Section 501(a) of the Internal Revenue Code. The Cooperative makes annual contributions to the program equal to the amounts accrued for pension expense. In this multiemployer plan, which is available to all member cooperatives of NRECA, the accumulated benefits and plan assets are not determined or allocated separately by individual employer. Pension expense for 2010 and 2009 was \$328,003 and \$236,487, respectively.

NOTE 8 – COMMITMENT AND CONTINGENCY:

Pacific Northwest Generating Cooperative (PNGC) is the principal supplier of electric power and energy to the Cooperative. PNGC is a "joint operating entity" formed for the purpose of buying the Slice product from Bonneville Power Administration (BPA) and reselling the power to its members. The contract with PNGC expires in 2028. The rates paid for such purchases are subject to review at any time.

The Cooperative has an unused perpetual line of credit with NRUCFC that provides that the Cooperative may borrow up to \$1,000,000 if certain conditions are met. The line is automatically renewed annually. Interest on such borrowings is at the prime rate plus 1%.

Okanogan County Electric Cooperative, Inc.

Notes to Consolidated Financial Statements

NOTE 9 – CREDIT RISK CONCENTRATION:

The Cooperative operates in Okanogan County of Washington State. The Cooperative grants credit to its members, all of whom are located in this region.

The Cooperative maintains its cash accounts in institutions located in Twisp and Winthrop, Washington. Balances on deposit may occasionally exceed amounts insured by the Federal Deposit Insurance Corporation.

NOTE 10 – RELATED-PARTY TRANSACTIONS:

The Board of Directors and its related entities purchase electric power and propane from the Cooperative. None of these related-party transactions were considered material, either individually or in the aggregate.

NOTE 11 – NOTES RECEIVABLE:

In 1998 the Cooperative received a grant of \$204,000 from the United States Department of Agriculture (USDA) to establish a revolving loan fund (RLF). During 2010, the Cooperative received another grant from the USDA in the amount of \$200,000 for the RLF program. In addition to the grants received, the Cooperative has contributed \$100,000 to the RLF since inception. The purpose of the RLF is to finance approved rural economic development projects. The repayment terms on these loans vary from four to ten years. Loans made to these organizations are noninterest bearing; however, a small administration fee is charged. In addition, the Cooperative entered into an agreement with a local internet service provider to construct a fiber line between Twisp and Winthrop. The agreement provided for the payment of the project under a ten-year note receivable bearing interest at 7.6% with a maturity date of 2018.

The total notes receivable balances at December 31, 2010 and 2009, were \$498,805 and \$292,665, respectively, including \$31,000 and \$32,000, respectively, classified as current.

SUPPLEMENTARY INFORMATION

Okanogan County Electric Cooperative, Inc.

Statements of Revenue – Electric

	Years Ended	
	December 31,	
	<u>2010</u>	<u>2009</u>
<i>OPERATING REVENUE</i>	<u>\$ 4,677,262</u>	<u>\$ 4,327,322</u>
<i>OPERATING EXPENSES:</i>		
Cost of power	2,091,603	2,084,879
Distribution, operation	73,405	84,210
Distribution, maintenance	732,693	674,079
Customer accounts	265,129	253,549
Administrative and general	559,826	518,538
Depreciation and amortization	298,234	289,870
Taxes	147,591	131,529
	<u>4,168,481</u>	<u>4,036,654</u>
<i>OPERATING MARGINS BEFORE FIXED CHARGES AND OTHER INCOME</i>	508,781	290,668
<i>FIXED CHARGES:</i>		
Interest on long-term debt	<u>254,599</u>	<u>239,111</u>
<i>OPERATING MARGINS AFTER FIXED CHARGES</i>	254,182	51,557
<i>CAPITAL CREDITS</i>	<u>35,803</u>	<u>28,311</u>
<i>OPERATING MARGINS</i>	<u>289,985</u>	<u>79,868</u>
<i>NONOPERATING MARGINS:</i>		
Interest income	42,347	35,971
USDA grant	200,000	-
	<u>242,347</u>	<u>35,971</u>
<i>NET MARGINS</i>	<u>\$ 532,332</u>	<u>\$ 115,839</u>

See accompanying independent auditors' report.