

PRESQUE ISLE ELECTRIC & GAS CO-OP
REPORT ON FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2016 AND 2015

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**PRESQUE ISLE ELECTRIC & GAS CO-OP
BOARD OF DIRECTORS
DECEMBER 31, 2016**

John Brown	Chairperson
Allen Berg	Vice Chairperson
Sandra Borowicz	Secretary
Daryl Peterson	Treasurer
Kurt Krajniak	Director
Raymond Wozniak	Director
Sally Knopf	Director
David Smith	Director
Brentt Lucas	Director

President & Chief Executive Officer

Brian J. Burns



Independent Auditor's Report

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

Report on the Financial Statements

We have audited the accompanying financial statements of Presque Isle Electric & Gas Co-op as of December 31, 2016 and 2015, which comprises the balance sheet, related statements of income, retained earnings, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

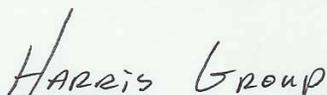
Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risk of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Presque Isle Electric & Gas Co-op as of December 31, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



Traverse City, Michigan
March 15, 2017

PRESQUE ISLE ELECTRIC & GAS CO-OP
BALANCE SHEETS
DECEMBER 31, 2016 AND 2015

	2016	2015
ASSETS		
UTILITY PLANT:		
In-Service – at cost	\$ 136,797,878	\$ 134,118,565
Construction work in progress	172,012	146,917
SUBTOTAL	136,969,890	134,265,482
Less accumulated depreciation and amortization	60,747,421	57,822,400
NET UTILITY PLANT	76,222,469	76,443,082
OTHER ASSETS AND INVESTMENTS		
Investments on associated organizations	24,733,009	25,439,018
CURRENT ASSETS:		
Cash and temporary cash investments	3,494,617	2,031,248
Accounts Receivable, less allowance for possible losses of \$118,000 in 2016 and 2015.	4,645,458	4,550,055
Materials and supplies (at average cost)	1,508,895	1,439,184
Other current assets	397,673	452,143
TOTAL CURRENT ASSETS	10,046,643	8,472,630
DEFERRED DEBITS	221,082	252,010
TOTAL ASSETS	\$ 111,223,203	\$ 110,606,740

The accompanying notes are an integral part of these statements.

	<u>2016</u>	<u>2015</u>
EQUITIES AND LIABILITIES		
EQUITIES:		
Memberships	\$ 268,545	\$ 261,005
Patronage capital	49,647,759	48,581,114
Other equities	<u>1,234,718</u>	<u>921,902</u>
TOTAL EQUITIES	<u>51,151,022</u>	<u>49,764,021</u>
LONG-TERM DEBT, NET OF CURRENT MATURITIES:		
Mortgage notes to National Rural Utilities Cooperative Finance Corporation (CFC)	50,609,285	46,629,653
Accrued post – retirement benefits	<u>2,436,845</u>	<u>2,360,963</u>
TOTAL LONG-TERM DEBT	<u>53,046,130</u>	<u>48,990,616</u>
CURRENT LIABILITIES:		
Current maturities of long-term debt	1,618,000	1,498,000
Line of credit	-	5,000,000
Accounts payable, purchased energy	2,279,843	2,162,865
Accounts payable, other	432,531	526,459
Patronage capital payable	18,047	11,310
Customer deposits	533,947	524,193
Accrued property taxes	514,337	494,441
Accrued interest	261,976	263,025
Accrued sick and vacation pay	631,841	618,500
Accrued other	<u>408,634</u>	<u>493,494</u>
TOTAL CURRENT LIABILITIES	<u>6,699,156</u>	<u>11,592,287</u>
DEFERRED CREDITS	<u>326,895</u>	<u>259,816</u>
TOTAL EQUITIES AND LIABILITIES	<u>\$ 111,223,203</u>	<u>\$ 110,606,740</u>

PRESQUE ISLE ELECTRIC & GAS CO-OP
STATEMENTS OF REVENUE
FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
OPERATING REVENUES	\$ 43,134,964	\$ 43,840,025
OPERATING EXPENSES:		
Cost of energy	24,382,270	24,747,830
Distribution – operation	1,848,171	1,513,362
Distribution – maintenance	3,919,474	4,050,372
Consumers accounts	1,890,613	1,823,430
Customer service and information expense	672,529	568,117
Administrative and general	1,865,636	1,766,286
Depreciation and amortization	3,679,291	3,599,611
Taxes – property	1,123,240	1,084,466
Taxes – other	1,678	1,733
	39,382,902	39,155,207
TOTAL OPERATING EXPENSES		
OPERATING MARGIN BEFORE FIXED CHARGES	3,752,062	4,684,818
FIXED CHARGES:		
Interest	2,442,927	2,410,426
Other deductions	220	1,577
	2,443,147	2,412,003
TOTAL FIXED CHARGES		
OPERATING MARGINS AFTER FIXED CHARGES	1,308,915	2,272,815
CAPITAL CREDITS:		
Generation and transmission capital credits	1,908,599	1,752,797
Other capital credits	257,415	275,035
	2,166,014	2,027,832
TOTAL CAPITAL CREDITS		
NET OPERATING MARGINS	3,474,929	4,300,647

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, 2016 AND 2015
(Continued)

	2016	2015
NET OPERATING MARGINS (from previous page)	\$ 3,474,929	\$ 4,300,647
NON-OPERATING MARGINS:		
Interest and dividend income	52,123	52,949
Other expenses	(233,530)	(300,921)
TOTAL NON-OPERATING MARGINS	(181,407)	(247,972)
NET MARGINS	\$ 3,293,522	\$ 4,052,675

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, 2016 AND 2015

	<u>Memberships</u>	<u>Patronage Capital</u>	<u>Other Equities</u>	<u>Accumulated Other Comprehensive Loss</u>	<u>Total</u>
Balance, January 1, 2015	\$ 253,450	\$ 46,480,676	\$ 1,923,174	\$ (1,319,079)	\$ 47,266,221
Capital credits retired		(1,952,237)			(1,952,237)
Memberships retired	7,555				7,555
Other equity transactions			317,807		317,807
Net margin		4,052,675			4,052,675
Balance, December 31, 2015	261,005	48,581,114	2,240,981	(1,319,079)	49,764,021
Capital credits retired		(1,237,688)			(1,237,688)
Memberships issued (retired)	7,540				7,540
Other equity transactions		(989,189)	312,816		(676,373)
Net margin		3,293,522			3,293,522
Balance, December 31, 2016	<u>\$ 268,545</u>	<u>\$ 49,647,759</u>	<u>\$ 2,553,797</u>	<u>\$ (1,319,079)</u>	<u>\$ 51,151,022</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, 2016 AND 2015

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from consumers	\$ 43,064,510	\$ 44,361,588
Cash paid to suppliers and employees	(34,323,485)	(34,212,358)
Interest received	52,123	52,949
Interest paid	(2,444,196)	(2,576,993)
Taxes paid	(1,095,749)	(1,103,347)
	5,253,203	6,521,839
CASH FLOWS FROM INVESTING ACTIVITIES:		
Construction and acquisition of plant	(3,862,090)	(4,156,261)
(Increase) decrease in:		
Material inventory	(69,711)	16,095
Investments – associated organizations	1,882,834	549,611
	(2,048,967)	(3,590,555)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payment of debt	(1,500,368)	(2,022,647)
Advances of long term debt	5,600,000	-
Payments on line of credit - net	(5,000,000)	-
Memberships issued	7,540	7,555
Patronage capital retired	(1,237,688)	(1,952,237)
Increased (decrease) in:		
Consumer deposits	9,754	55,017
Deferred credits	67,079	382,705
Other equities	312,816	317,807
	(1,740,867)	(3,211,800)
NET INCREASE IN CASH AND CASH EQUIVALENTS	1,463,369	(280,516)
CASH AND CASH EQUIVALENTS, beginning of year	2,031,248	2,311,764
CASH AND CASH EQUIVALENTS, end of year	\$ 3,494,617	\$ 2,031,248

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, 2016 AND 2015
(Continued)

	2016	2015
RECONCILIATION OF NET MARGINS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net Margins	\$ 3,293,522	\$ 4,052,675
Adjustments to reconcile net margins to net cash provided by Operating activities:		
Depreciation and amortization	3,838,364	3,719,132
(Gain) loss on disposition of assets	244,339	317,151
G&T and other capital credits	(2,166,014)	(2,027,832)
(Increase) decrease in:		
Customer and other accounts receivable	(95,403)	466,603
Other current assets	54,470	(54,566)
Deferred debits	30,928	32,977
Amortization of debt discount	-	(134,995)
Increase (decrease) in:		
Accounts payable	29,787	(91,288)
Accrued property taxes	19,896	(19,271)
Accrued interest payable	(1,049)	(29,995)
Current and accrued liabilities – other	4,363	291,248
Total Adjustments	1,959,681	2,469,164
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ 5,253,203	\$ 6,521,839
NON-CASH ITEMS – INVESTING & FINANCING		
Capital credits from associated organizations	\$ 2,166,014	\$ 2,027,832

The accompanying notes are an integral part of these statements.

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

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Nature of Operations

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

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

Utility Plant

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

Investments

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

Cash

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

Consumer Energy Prepayments and Unbilled Revenues

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

Accounts receivable

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

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

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Regulation

Electric accounting and rate matters are subject to the Board of Directors and membership approval. Natural gas accounting and rate matters are either subject to Home Rule approval pursuant to the Michigan Home Rule Statute or subject to the approval of the Michigan Public Service Commission.

Materials and Supplies

Electrical and natural gas materials and supplies are valued at average cost. Merchandise held for resale is valued at average cost.

Retirement Plan

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

Flex Benefit Plan

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

Contributions in Aid of Construction

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

Income Taxes

The Cooperative is exempt from federal and state income taxes under Section 501(c)(12) of the Internal Revenue Code which provides, in part that the Cooperative derive at least 85 percent of its annual gross income from members to retain the exemption. The Cooperative expects to meet the requirements for the tax year ended December 31, 2016. Accordingly, no provision for income taxes has been made in the financial statements. The Cooperative's federal information returns for Calendar year 2011 and after are subject to examination by the Internal Revenue Service.

NOTE 2: ASSETS PLEDGED

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

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

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

Major classes of electric and gas plant as of December 31, 2016 and 2015 consisted of:

	<u>2016</u>	<u>2015</u>
Intangible plant	\$ 1,021,015	\$ 1,021,015
Distribution plant	127,183,640	124,889,085
General plant	<u>8,593,222</u>	<u>8,208,465</u>
	136,797,878	134,118,565
Construction work in progress	<u>172,012</u>	<u>146,917</u>
TOTAL	<u><u>\$ 136,969,890</u></u>	<u><u>\$ 134,265,482</u></u>

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

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

General plant depreciation rates have been applied on a straight-line basis as follows for the year ended December 31, 2016:

	<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, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Charged to:		
Classified as depreciation and amortization	\$ 3,679,291	\$ 3,599,611
Classified in other operating expenses	<u>159,073</u>	<u>119,521</u>
	3,838,364	3,719,132
Charged to construction	<u>211,825</u>	<u>215,547</u>
TOTAL DEPRECIATION AND AMORTIZATION	<u><u>\$ 4,050,189</u></u>	<u><u>\$ 3,934,679</u></u>

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

NOTE 5: INVESTMENTS IN ASSOCIATED ORGANIZATIONS

Investments in associated organizations consisted of the following at December 31, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Wolverine Power Supply Coop. Inc. - capital credits	\$ 20,649,114	\$ 21,430,129
National Rural Utilities Cooperative Finance Corp.:		
Capital term certificates maturing October 1, 2020 through October 1, 2080 at interest rates between 3% and 7.50%	1,542,010	1,562,423
Patronage capital certificates	1,889,412	1,792,556
Other	<u>652,473</u>	<u>653,910</u>
 TOTAL	 <u>\$ 24,733,009</u>	 <u>\$ 25,439,018</u>

In 2016, Wolverine Power Supply Coop, Inc. restated its balance sheet for changes to methods of depreciation, the effect of this change was a reduction of the investment by \$989,189, this change is reflected as an equity transaction for 2016.

NOTE 6: CASH AND INVESTMENTS

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

	<u>Per Institution</u>	<u>Per Book</u>
Insured	\$ 1,071,238	\$ 1,071,238
Uninsured	<u>2,649,954</u>	<u>2,421,879</u>
 Cash in banks and credit union	 <u>\$ 3,718,192</u>	 3,493,117
 Working funds		 <u>1,500</u>
 Total per books		 <u>\$ 3,494,617</u>

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

NOTE 7: DEFERRED DEBITS

The Cooperative has recorded deferred debits in the following amounts:

	<u>2016</u>	<u>2015</u>
Prepaid tap fees	\$ 57,382	\$ 59,378
Prepaid years of service	104,045	132,977
Other deferred debits	<u>59,655</u>	<u>59,655</u>
TOTAL	<u><u>\$ 221,082</u></u>	<u><u>\$ 252,010</u></u>

NOTE 8: MEMBERSHIPS

The following is a summary of changes in memberships for the years ended December 31, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Balance, beginning	\$ 261,005	\$ 253,450
Membership and subscriptions issued	<u>7,540</u>	<u>7,555</u>
Balance, ending	<u><u>\$ 268,545</u></u>	<u><u>\$ 261,005</u></u>

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

NOTE 9: PATRONAGE CAPITAL

Patronage capital balances as of December 31, 2016 and 2015 consisted of:

	<u>2016</u>	<u>2015</u>
Assignable	\$ 3,293,522	\$ 4,052,675
Adjustment-WPSC prior depreciation	(989,189)	-
Assigned to date	<u>59,556,371</u>	<u>55,503,696</u>
	61,860,704	59,556,371
Less retirements to date	<u>12,212,945</u>	<u>10,975,257</u>
Balance	<u><u>\$ 49,647,759</u></u>	<u><u>\$ 48,581,114</u></u>

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

NOTE 9: PATRONAGE CAPITAL - continued

Under the provisions of the Mortgage Agreement, until the equities and margins equal or exceed twenty percent of the total assets of the Cooperative, the return to patrons of capital contributed by them is limited generally to twenty-five percent of the patronage capital or margins received by the Cooperative in the next preceding year. The equities and margins of Presque Isle represent 45.9% and 45.0% of the total assets for the years 2016 and 2015, respectively. There were capital credits retired of \$1,237,688 and \$1,952,237 during 2016 and 2015, respectively.

NOTE 10: MORTGAGE NOTES

Long-term debt is composed of 2.65 percent to 6.65 percent mortgage notes payable to the National Rural Utilities Cooperative Finance Corporation (CFC). All mortgage notes to CFC will be re-priced and the interest rate adjusted accordingly during the next 10 years in accordance with the policy and procedure governing such re-pricing. The notes are for 35 year periods each, with principal and interest installments due either quarterly or semiannually. The notes are scheduled to be fully repaid at various times from March 2017 through November 2047.

There were unadvanced loan funds available at December 31, 2016 in the amount of \$9,900,000.

Detail of the long-term debt is as follows:

	2016	2015
National Rural Utilities Cooperative Finance Corporation mortgage notes bearing interest at 2.65% to 6.65% per annum for 2016 and 2015	\$ 52,227,285	\$ 48,127,653
	52,227,285	48,127,653
Less current maturities	1,618,000	1,498,000
TOTAL LONG-TERM DEBT	\$ 50,609,285	\$ 46,629,653

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

2017	\$	1,618,000
2018	\$	1,707,480
2019	\$	1,792,373
2020	\$	1,881,932
2021	\$	1,887,312

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

NOTE 11: LINE OF CREDIT

Presque Isle had available a short-term line of credit from CFC for 2016 and 2015 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 2016 and 2015. Balance available at December 31, 2016 and 2015 was \$8,000,000. The outstanding balance at December 31, 2016 and 2015 was \$-0-.

Additionally, Presque Isle has an \$8,000,000 unsecured revolving line-of-credit agreement with CoBank. Interest on outstanding borrowings is payable monthly and is computed at 2.87% at December 31, 2016. Presque Isle had an outstanding balance of \$0 for 2016 and \$5,000,000 in 2015.

Presque Isle also had an \$8,000,000 unsecured promissory note from Wolverine Power Supply Cooperative. Interest on advances was charged at 1.25% plus monthly LIBOR. The balance on December 31, 2016 was \$0. The note expired December 31, 2016.

NOTE 12: DEFERRED CREDITS

Following is a summary of the amounts recorded as deferred credits as of December 31, 2016 and 2015:

	2016	2015
Under-collection of 2016 WPSC PSCR Costs	\$ 281,835	\$ 257,537
Deferred gain from extinguishments of debt	-	-
Customer energy prepayments	45,060	2,279
TOTAL	\$ 326,895	\$ 259,816

NOTE 13: RETIREMENT PLAN

Retirement plan benefits for substantially all employees are provided through participation in a defined contribution SelectRE pension plan with 401k option with cash and deferred arrangement of the National Rural Electric Cooperative Association (NRECA) and its member systems. The income earned by funds while held under the plan is tax-exempt under Code Sections 401 and 501 of the Internal Revenue Code. Contributions to the savings program, which are based on a percentage of the employees' compensation, were \$437,149 in 2016 and \$367,644 in 2015.

NOTE 14: POWER SUPPLY COST RECOVERY CLAUSE

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

Wolverine Power Supply Cooperative, Inc. (Wolverine) and the member-distribution Cooperatives including Presque Isle, obtained authority to implement and apply PSCR clauses and monthly factors. Presque Isle's monthly factor may not exceed -1.31 mills per KWH for the current period.

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

NOTE 14: POWER SUPPLY COST RECOVERY CLAUSE - continued

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's balance sheets reflect an amount (due to)/from member-consumers for under/(over) collections in the amounts of \$67,941 and \$(113,551) at December 31, 2016 and 2015, respectively. These amounts are included in the accounts receivable balance.

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

The GCR mechanism includes provisions whereby gas cost recovery over-collections must be remedied by refunds and gas cost recovery under-collections must be remedied by additional collections. Presque Isle's balance sheet reflects an amount due (to)/from member-consumers for under collections in the amounts of \$140,152 and \$355,670 for the years ended December 31, 2016 and 2015, respectively. This amount is recorded in accounts receivable.

NOTE 15: POST-RETIREMENT BENEFITS OTHER THAN PENSIONS

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

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

At the end of 2016 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, 2016 is as follows:

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

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

	2016	2015
(Accrued) post-retirement benefit costs, beginning	\$ (2,360,963)	\$ (2,289,627)
Net periodic post-retirement benefit (costs)	(183,835)	(183,835)
Contributions made	107,953	112,499
Valuation adjustment	-	-
(Accrued) post-retirement benefit cost, end of year	\$ (2,436,845)	\$ (2,360,963)

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

	2016	2015
Interest cost	\$ 88,006	\$ 88,006
Net amortization and deferral	95,829	95,829
Net periodic post-retirement benefit cost	\$ 183,835	\$ 183,835

For measurement purposes a 9.0% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2016; the rate was assumed to decrease gradually to an ultimate rate of 5.0% per annum. The health care cost trend rate assumption has a significant effect on the amounts reported. To illustrate, increasing the assumed health care cost trend rates by 1 percentage point in each year would increase the accumulated post-retirement benefit obligation \$162,634 and the aggregate of the service and interest cost components of the net periodic benefit cost by \$13,969. Decreasing the assumed health care cost trend rates by 1 percentage point in each year would decrease the accumulated post-retirement benefit obligation \$136,391 and the aggregate of the service and interest cost components of the net periodic benefit cost by \$12,274.

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

NOTE 16: 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.

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

NOTE 17: LETTERS OF CREDIT

The Co-op has a letter of credit outstanding to CFC for \$1,500,000 at December 31, 2016. 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 18: RECLASSIFICATION OF AMOUNTS

Certain amounts previously reported have been reclassified to conform to the 2016 presentation.

NOTE 19: 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, 2016, the most recent statement of financial position presented herein, through March 15, 2017, 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 \$5,600,000 in long-term loan fund advances from CFC on loans controlled by the 100% CFC Mortgage and Loan Agreement. Based on our review of construction work orders and other plant accounting records created during the audit period, it is our opinion that these CFC loan funds were expended for purposes contemplated in the Loan Agreements on such loans.

A handwritten signature in dark blue ink that reads 'HARRIS GROUP'. The signature is written in a cursive, slightly slanted style.

Certified Public Accountants
March 15, 2017