

ARTHUR ANDERSEN & Co.
MINNEAPOLIS, MINNESOTA

To the Members and the Board of Directors

Dairyland Power Cooperative:

We have examined the balance sheets of DAIRYLAND POWER COOPERATIVE (a Wisconsin cooperative) as of December 31, 1978 and December 31, 1977, and the related statements of revenues and expenses and patronage capital and sources of funds used for construction for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As discussed in Note 4 to the financial statements, on March 6, 1979, the Wisconsin Public Service Commission denied a certificate of need for construction of the Tyrone Energy Park nuclear generating plant. The Cooperative and the other participants have not determined what action will be taken and therefore the outcome of this matter is uncertain at this time.

As discussed in Note 10 to the financial statements, the Wisconsin Department of Revenue is challenging the Cooperative's method of determining its gross revenues license fee for the years 1973 through 1977. The Cooperative is contesting the Department of Revenue's assessment for additional license fees, however, the additional amount to be paid, if any, is not determinable at this time.

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In our report dated March 17, 1978, our opinion on the 1977 financial statements was unqualified; however, in view of the Commission's order and the Department of Revenue's assessment referred to above, which occurred subsequent to the date of our previous report, our present opinion on the 1977 financial statements, as expressed herein, is different from that expressed in our previous report.

In our opinion, subject to the effects of the outcome of the matters described in the preceding paragraphs, the accompanying financial statements present fairly the financial position of Dairyland Power Cooperative as of December 31, 1978 and December 31, 1977, and the results of its operations and sources of funds used for construction for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Arthur Andersen & Co.
ARTHUR ANDERSEN & CO.

Minneapolis, Minnesota,

March 23, 1979.

BALANCE SHEETS--DECEMBER 31, 1978

A S S E T S

	<u>1978</u>	<u>1977</u>
ELECTRIC PLANT (Notes 1, 2, 3, 4 and 6):		
Plant and equipment, at original cost	\$209,470,904	\$201,370,415
Accumulated depreciation	(88,009,424)	(80,563,315)
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	\$121,461,480	\$120,807,100
Construction work in progress-		
Tyrone Energy Park	7,486,879	4,600,783
John P. Madgett Station and other	161,353,248	106,600,060
Nuclear fuel, at amortized cost	10,290,670	10,980,183
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	\$300,592,277	\$242,988,126
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INVESTMENTS, at cost		
Capital term certificates of National Rural Utilities Cooperative Finance Corporation (Note 5)	\$ 8,792,372	\$ 8,147,394
Pollution Control Bond proceeds on deposit with trustee	2,941,655	-
Other investments, principally nonutility property	1,854,090	1,966,436
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Total investments	\$ 13,588,117	\$ 10,113,830
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CURRENT ASSETS:		
Cash	\$ 389,761	\$ 352,589
Accounts receivable-		
Energy sales	12,087,698	9,519,526
Other	1,446,874	659,772
Inventories, at average cost-		
Fossil fuels	40,294,051	25,179,681
Materials and supplies	2,534,703	1,888,389
Prepaid expenses	1,209,246	1,490,057
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Total current assets	\$ 57,962,333	\$ 30,090,014
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DEFERRED CHARGES	\$ 646,364	\$ 369,433
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	\$372,789,091	\$292,561,403
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The accompanying notes to financial statements are ar

AND DECEMBER 31, 1977

CAPITALIZATION AND LIABILITIES

	<u>1978</u>	<u>1977</u>
CAPITALIZATION:		
Long-term obligations, less current maturities included below (Notes 2, 3 and 6)-		
Long-term debt	\$250,704,197	\$187,490,523
Subscriptions to capital term certificates of National Rural Utilities Cooperative Finance Corporation, due in varying annual amounts to 1984 (Note 5)	2,663,378	3,083,739
Capitalized lease obligations principally at implicit interest rate of 7%, due in varying amounts to 1995	7,974,798	8,266,707
Total long-term obligations	\$261,342,373	\$198,840,969
Member and patron equities-		
Membership fees	\$ 8,839	\$ 8,495
Patronage capital (Notes 4, 8 and 10)	56,704,530	57,550,907
Total member and patron equities	\$ 56,713,369	\$ 57,559,402
Total capitalization	\$318,055,742	\$256,400,371
CURRENT LIABILITIES AND COMMITMENTS (Notes 3, 4 and 10)		
CURRENT LIABILITIES:		
Current maturities of long-term obligations	\$ 6,720,584	\$ 6,326,303
Accounts payable (Note 7)	22,000,000	9,100,000
Accounts payable-		
General	6,497,105	4,916,360
Construction	11,149,477	9,571,118
Accrued liabilities-		
Payroll and vacation pay	1,260,880	1,158,335
Taxes	1,118,904	847,366
Interest	1,435,473	404,826
Nuclear fuel reprocessing costs (Note 1)	2,285,974	1,712,838
Other	2,264,952	2,123,826
Total current liabilities	\$ 54,733,349	\$ 36,161,032
	\$372,789,091	\$292,561,403
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Integral part of these balance sheets

DAIRYLAND POWER COOPERATIVE

STATEMENTS OF REVENUES AND EXPENSES AND PATRONAGE CAPITAL
FOR THE YEARS ENDED DECEMBER 31, 1978 AND DECEMBER 31, 1977

	1978	1977
<u>REVENUES AND EXPENSES</u>		
OPERATING REVENUES:		
Sales of electric energy	\$82,213,485	\$76,646,821
Other	19,755	17,188
Total operating revenues	\$82,233,240	\$76,664,009
OPERATING EXPENSES:		
Power generation-		
Fuel	\$33,040,161	\$34,580,026
Operation	5,412,069	4,928,027
Maintenance	5,769,027	3,999,391
Purchased and interchanged power	20,252,806	14,915,518
Transmission-		
Operation	538,300	511,332
Maintenance	1,217,988	1,002,696
Administrative and general-		
Operation	3,602,641	3,040,021
Maintenance	93,768	111,862
Depreciation and amortization (Note 1)	6,642,379	6,454,100
Taxes	2,801,947	2,561,910
Total operating expenses	\$79,371,086	\$72,104,883
Operating margin, before interest and other deductions	\$ 2,862,154	\$ 4,559,126
INTEREST AND OTHER DEDUCTIONS:		
Interest on-		
Long-term obligations	\$ 9,952,491	\$ 5,499,989
Short-term obligations	972,804	875,383
Allowance for borrowed funds used during construction (Note 1)	(7,825,728)	(3,745,206)
Other	18,352	9,787
Total interest and other deductions	\$ 3,117,919	\$ 2,639,953
Operating margin (deficit)	\$ (255,765)	\$ 1,919,173
NONOPERATING MARGIN (DEFICIT):		
Allowance for funds, other than borrowed funds, used during construction (Note 1)	\$ 1,121,072	\$ 1,452,636
Other	(274,168)	(32,841)
Net margin	\$ 591,139	\$ 3,338,968
<u>PATRONAGE CAPITAL</u>		
PATRONAGE CAPITAL BEGINNING OF YEAR	57,550,907	55,086,755
RETIREMENT OF CAPITAL CREDITS (Note 8)	(1,437,516)	(874,816)
PATRONAGE CAPITAL END OF YEAR, including margins assignable of \$591,139 in 1978 and \$3,338,968 in 1977	\$56,704,530	\$57,550,907

The accompanying notes to financial statements
are an integral part of these statements.

DAIRYLAND POWER COOPERATIVE

STATEMENTS OF SOURCES OF FUNDS USED FOR CONSTRUCTION
FOR THE YEARS ENDED DECEMBER 31, 1978 AND DECEMBER 31, 1977

	1978	1977
FUNDS GENERATED INTERNALLY:		
Net margins	\$ 591,139	\$ 3,338,968
Noncash items-		
Depreciation and amortization:		
Charged to operations	6,642,379	6,454,100
Charged to clearing and other accounts	1,029,592	1,037,751
Nuclear fuel amortization	689,513	27,638
Allowance for funds other than borrowed funds used during construction	(1,121,072)	(1,452,636)
	\$ 7,831,551	\$ 9,405,821
Funds generated from operations		
Retirement of capital credits	(1,437,516)	(874,816)
	\$ 6,394,035	\$ 8,531,005
Funds generated internally		
FUNDS OBTAINED FROM OUTSIDE SOURCES:		
Long-term borrowing from FFB and REA (Note 6)	\$ 55,464,174	\$49,654,000
Pollution Control Bond financing, less amounts on deposit with trustee	10,658,345	-
Short-term borrowing	12,900,000	8,600,000
Repayment of long-term obligations to REA	(5,456,279)	(5,174,324)
Reduction of other long-term debt	(291,909)	(273,720)
	\$ 73,274,331	\$52,805,956
Net funds obtained from outside sources		
OTHER SOURCES (USES) OF FUNDS:		
Purchase of capital term certificates, net of change in subscription	\$ (1,065,339)	\$ (440,128)
Decrease in other investments	112,346	16,264
Other, net	(276,587)	(105,828)
Changes in other working capital items-		
Cash	(37,172)	244,488
Accounts receivable	(3,355,274)	(669,769)
Inventories	(15,760,684)	3,098,424
Prepaid expense	280,811	(226,021)
Accounts payable	3,159,104	5,688,467
Accrued liabilities	2,118,992	621,437
	\$ (14,823,803)	\$ 8,227,334
Total other sources (uses) of funds		
FUNDS USED FOR CONSTRUCTION	\$ 64,844,563	\$69,564,295
<u>Add</u> - Allowance for funds other than borrowed funds used during construction	1,121,072	1,452,636
ELECTRIC PLANT ADDITIONS	\$ 65,965,635	\$71,016,931

The accompanying notes to financial statements
are an integral part of these statements

(1) Summary of Significant Accounting Policies-

Organization:

Dairyland Power Cooperative (the Cooperative) is an electric generation and transmission cooperative association organized under the laws of Wisconsin. The Cooperative provides wholesale electric service to member distribution cooperatives engaged in the retail sale of electricity to member consumers located in Wisconsin and parts of Minnesota, Iowa, and Illinois.

The accounting records of the Cooperative are maintained in accordance with the uniform system of accounts prescribed by the Rural Electrification Administration (REA).

Depreciation:

Depreciation is provided based on the straight-line method at rates which are designed to amortize the original cost of properties over their estimated useful lives. The provision for depreciation averaged _____ of depreciable plant balances for 1978 and 1977.

Amortization of Nuclear Fuel:

The cost of nuclear fuel is charged to fuel expense based on heat produced for the generation of electricity. The salvage value of fuel assemblies and cost of disposal of spent fuel are being recorded over the lives of individual assemblies based upon management's estimate of such amounts.

Income Taxes:

The Cooperative is exempt from Federal and state income taxes. Accordingly, no provision for such taxes has been made in the accompanying financial statements.

Allowance for Funds Used During Construction:

Allowance for funds used during construction represents the cost of borrowed funds and a return on other capital used for construction purposes and is capitalized as a component of electric plant. The amount of such allowance is determined by applying a rate to the balance of certain electric plant additions under construction. The rates used varied from 5% to 7-1/2% in 1978 and 3% to 7-1/2% in 1977, depending on the source of funds.

(1) Summary of Significant Accounting Policies (Continued)-

Property Additions:

The cost of renewals and betterments of units of property (as distinguished from minor items of property) is charged to utility plant accounts. The cost of units of property retired, sold, or otherwise disposed of, plus removal costs, less salvage, is charged to accumulated provision for depreciation. No profit or loss is recognized in connection with ordinary retirements of property units. Maintenance and repair costs and replacement and renewal of items less than units of property are charged to operating expenses.

(2) Nuclear Reactor-

The Cooperative has operated a nuclear generating facility under a provisional operating license which expired in 1975. The reactor is presently being operated under an informal extension of the provisional operating license. The Cooperative has applied for a permanent operating license and the license is expected to be granted in 1981.

(3) Construction and Commitments-

During 1974, the Cooperative commenced construction of a steam electric generating station, the John P. Madgett Station No. 6 (formerly Alma No. 6), near Alma, Wisconsin. The project will have a net generating capability of approximately 350 MW and is scheduled for completion in 1979. The total cost of the project is presently estimated to be \$173 million. The Cooperative has incurred costs totaling \$144 million through December 31, 1978 and related outstanding commitments aggregated approximately \$10 million at that date. The Cooperative has arranged long-term financing for substantially all of this project.

The Cooperative's 1979 estimated construction program is \$46 million. Financing of construction is expected to be provided by borrowings from the Federal Financial Bank (FFB) and short term lines of credit with the National Rural Utilities Cooperative Finance Corporation (NRUCFC). The budget includes approximately \$29 million for the completion of the John P. Madgett Station.

(4) Tyrone Energy Park-

The Cooperative, together with three other utilities, is a participant in the development of the Tyrone Energy Park, a 1,100 megawatt nuclear generating plant to be located in western Wisconsin. Under the construction and ownership agreement, the Cooperative is to have a 13% interest in the plant, however, its ownership commitment is presently limited to \$10 million. In the event the Cooperative does not increase its ownership commitment to its 13% interest as the plant development progresses, Northern States Power Company - Wisconsin (as the constructing company and 67.6% owner) may assume a portion of the Cooperative's ownership. The Nuclear Regulatory Commission has issued a permit authorizing construction of the project.

On March 6, 1979, the Public Service Commission of Wisconsin issued an order denying the application by the participants for a certificate of need for the proposed Tyrone Energy Park nuclear plant, and directing the joint owners to apply for a certificate to construct a smaller coal-fired plant. The participants have not had sufficient time to review the order to determine what action will be taken.

Through December 31, 1978, the Cooperative's expenditures for the project were \$7.5 million and additional commitments, had the project been cancelled, were \$2.5 million as of that date. In the event of termination of the project and to the extent costs are not otherwise recoverable, the Cooperative will seek (and management believes will receive) approval from the Rural Electrification Administration to recover such costs through increased rates in future years. In the event such approval is not received the costs incurred would be expensed. The ultimate effect of the outcome of this matter on the financial statements is not presently determinable.

(5) Investment in National Rural Utilities
Cooperative Finance Corporation-

The Cooperative has purchased or subscribed to purchase approximately \$8.8 million of unsecured subordinated capital term certificates to be issued by the National Rural Utilities Cooperative Finance Corporation. The certificates will bear interest at the rate of 3% per year and will mature in 2020, 2025, and 2030. Of the above amount, \$3.1 million will be purchased during the period 1979 to 1984 in annual installments approximating .8% of operating revenues, as defined.

NOTES TO
FINANCIAL
STATEMENTS
(Continued)

(6) Long-Term Obligation-

The Cooperative's long-term debt outstanding as of December 31, consists of the following:

	<u>1978</u>	<u>1977</u>
REA Obligations (2%)	\$120,919,931	\$123,761,650
REA Obligations (5%)	5,872,670	-
FFB Obligations (7.6% - 9.0%)	113,000,000	65,000,000
NRUCFC Obligations (prime plus 1%)	5,325,000	4,400,000
City of Alma, Wisconsin Pollution Control Bonds (4.3% - 6-1/8%)	13,600,000	-
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	\$256,717,601	\$193,161,650
Less Current Maturities	6,013,404	5,671,126
	-----	-----
Total Long-Term Debt	\$250,704,197	\$187,490,524
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Long-term obligations to the REA are payable in equal quarterly principal and interest installments to 2012.

Principal repayments on the long-term obligation to the Federal Financing Bank begin in 1983 and extend through 2012.

Interest on the NRUCFC obligation is due quarterly to 1982 and the principal is due in 1982.

The pollution control bonds are payable in increasing annual amounts in the years 1980 through 2008.

Substantially all of the Cooperative's assets are pledged as collateral for these obligations.

(6) Long-Term Obligation (Continued)-

Maturities of the Cooperative's long-term debt, subscriptions for capital term certificates and capitalized lease obligations, during each of next five years are as follows:

<u>Year</u>	<u>Amount</u>
1979	\$ 6,720,584
1980	6,947,301
1981	7,313,392
1982	12,625,339
1983	6,888,256

The remainder of the long-term obligations of \$227,568,085 at December 31, 1978, is due during the years 1984 to 2012.

(7) Lines of Credit-

To provide interim financing, the Cooperative has arranged lines of credit aggregating \$25,750,000, principally through NRUCFC. Substantially all borrowings are at an interest rate of prime plus 1/2%.

	<u>1978</u>	<u>1977</u>
	<u>(millions)</u>	
Average borrowing outstanding	\$ 9.7	\$ 3.7
Maximum amount outstanding	\$25.4	\$11.8
Weighted average interest rate at year-end	11.7%	8.25%
Weighted average interest rate for the year	9.9%	7.6%

There are no compensating balance requirements or fees relating to the lines of credit.

(8) Retirement of Capital Credits-

The Cooperative's Board of Directors has adopted the policy of retiring capital credits allocated to patron members on a "first-in, first-out" basis so that at all times the Cooperative will not retain as patronage capital any capital contributed or deposited more than twenty years prior to the current year. Accordingly, the 1957 capital credits were retired in 1977 and the 1958 capital credits were retired in 1978. Implementation of this policy is reviewed annually by the Board of Directors and no cash retirements are to be made which would impair the financial condition of the Cooperative or violate any terms of its agreements.

(9) Pension Plan-

Pension benefits for substantially all employees are provided through participation in the NRECA Retirement and Security Program. Pension cost was approximately \$825,000 in 1978 and \$735,000 in 1977. The Cooperative's policy is to fund pension costs accrued.

(10) Contingency-

The Wisconsin Department of Revenue has examined the Cooperative's method of determining gross revenue license fee for the years 1973 through 1976, and has assessed deficiencies and interest of approximately \$1.1 million for these years. The Cooperative estimates that additional license fees of approximately \$600,000 could be assessed for 1977 if the Department of Revenue's method of computing the license fee is applied to that year. These amounts have not been reflected in the accompanying financial statements. License fees for 1978 have been accrued on a new basis of assessment approved by the Wisconsin Department of Revenue.

The Cooperative, on the advice of legal counsel, is vigorously contesting the findings of the Department of Revenue and believes that any liability will be substantially reduced or eliminated; however, the outcome of this matter cannot presently be predicted.