

FINANCIAL STATEMENTS WITH
REPORT OF INDEPENDENT AUDITORS

SAM RAYBURN G & T ELECTRIC
COOPERATIVE, INC.

December 31, 2010 and 2009

C O N T E N T S

Report of Independent Auditors 3

Financial Statements:

 Balance Sheets 4

 Statements of Revenue and Expenses 5

 Statements of Patronage Capital 6

 Statements of Cash Flows 7

Notes to Financial Statements..... 8

Independent Auditors' Report on Internal Control Over Financial
Reporting and on Compliance Based on an Audit of
Financial Statements Performed in Accordance with
Government Auditing Standards 16

REPORT OF INDEPENDENT AUDITORS

The Board of Directors
Sam Rayburn G & T Electric
Cooperative, Inc.
Nacogdoches, Texas

We have audited the accompanying balance sheets of Sam Rayburn G & T Electric Cooperative, Inc. (the "Cooperative") as of December 31, 2010 and 2009 and the related statements of revenue and expenses, patronage capital and cash flows for the years 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 audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards for financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. These 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 Sam Rayburn G & T Electric Cooperative, Inc. as of December 31, 2010 and 2009 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 15, 2011, on our consideration of the Cooperative's internal control over financial reporting and our tests of its compliance with certain laws, regulations, contracts and grants. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.


CERTIFIED PUBLIC ACCOUNTANTS

Lufkin, Texas
April 15, 2011

SAM RAYBURN G & T ELECTRIC COOPERATIVE, INC.
BALANCE SHEETS
December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
ASSETS		
Utility plant, net	\$ <u>22 216 199</u>	\$ <u>22 446 561</u>
Investments and Other Assets:		
Investments in associated organizations	18 142 606	13 225 431
Other investments whose use is limited	<u>2 428 902</u>	<u>3 193 839</u>
	<u>20 571 508</u>	<u>16 419 270</u>
Current Assets:		
Cash and cash equivalents - General funds	8 493 608	4 044 630
Accounts receivable - Member cooperatives	18 201 891	16 381 003
Accounts receivable - Other	9 375	9 375
Accrued interest receivable	2 279	298
Fuel stock	1 921 880	2 214 204
Materials and supplies	678 236	1 102 936
Prepaid expenses	<u>87 354</u>	<u>17 782</u>
	<u>29 394 623</u>	<u>23 770 228</u>
Deferred debits	<u>2 464 815</u>	<u>2 977 277</u>
	\$ <u>74 647 145</u>	\$ <u>65 613 336</u>
EQUITIES AND LIABILITIES		
Equity and Margin:		
Memberships	\$ 3 000	\$ 3 000
Patronage capital	<u>40 228 359</u>	<u>30 239 749</u>
	<u>40 231 359</u>	<u>30 242 749</u>
Long-term debt	<u>19 940 885</u>	<u>23 555 079</u>
Current Liabilities:		
Accounts payable - Purchased power	9 650 667	8 041 224
Accounts payable - Other	83 815	80 106
Accrued expenses	405 580	24 688
Derivative instruments	-	174 425
Current maturities of long-term debt	<u>4 334 839</u>	<u>3 387 091</u>
	<u>14 474 901</u>	<u>11 707 534</u>
Deferred credits	<u>-</u>	<u>107 974</u>
	\$ <u>74 647 145</u>	\$ <u>65 613 336</u>

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

SAM RAYBURN G & T ELECTRIC COOPERATIVE, INC.
 STATEMENTS OF REVENUE AND EXPENSES
 For the Years Ended December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Operating Revenue:		
Power sales	\$ 119 674 745	\$ 98 582 495
Operating Expenses:		
Purchased power	95 693 469	75 368 714
Power Generation:		
Fuel	10 657 980	10 484 259
Other production expenses	3 291 572	3 136 191
Load dispatching	37 952	58 692
Administrative and general	1 241 533	1 355 130
Depreciation	1 762 339	1 725 414
	<u>112 684 845</u>	<u>92 128 400</u>
OPERATING MARGIN BEFORE INTEREST EXPENSE	6 989 900	6 454 095
Interest expense	<u>2 109 204</u>	<u>2 258 632</u>
OPERATING MARGIN	4 880 696	4 195 463
Nonoperating Margins:		
Interest income	78 291	68 214
Generation and transmission capital credits	4 996 994	2 814 168
Capital credits - Associated organizations	<u>32 629</u>	<u>39 745</u>
NET MARGIN	<u>\$ 9 988 610</u>	<u>\$ 7 117 590</u>

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

SAM RAYBURN G & T ELECTRIC COOPERATIVE, INC.
 STATEMENTS OF PATRONAGE CAPITAL
 For the Years Ended December 31, 2010 and 2009

	MEMBERSHIPS	PATRONAGE CAPITAL	UNALLOCATED DEFICIT	TOTAL
Balance, December 31, 2008	\$ 3 000	\$ 25 385 251	\$ (2 263 092)	\$ 23 125 159
Net margin	-	7 117 590	-	7 117 590
Balance, December 31, 2009	3 000	32 502 841	(2 263 092)	30 242 749
Net margin	-	9 988 610	-	9 988 610
Balance, December 31, 2010	\$ 3 000	\$ 42 491 451	\$ (2 263 092)	\$ 40 231 359

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

SAM RAYBURN G & T ELECTRIC COOPERATIVE, INC.
STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2010 and 2009

	2010	2009
Operating Activities:		
Net margin	\$ 9 988 610	\$ 7 117 590
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation	1 762 339	1 725 414
Patronage capital credits - Non-cash	(5 029 623)	(2 853 913)
Cash Provided by (Used for) the Change in:		
Accounts receivable - Member cooperatives	(1 820 888)	(665 167)
Accounts receivable - Other	-	(9 375)
Accrued interest receivable	(1 981)	1 433
Fuel and supplies inventories	717 024	308 762
Prepaid expense	(69 572)	39 306
Deferred debits	338 037	464 427
Accounts payable - Purchased power	1 609 443	385 447
Accounts payable - Other	3 709	(4 212)
Accrued expenses	380 892	(7 461)
Deferred credits	(107 974)	(677 970)
NET CASH PROVIDED BY OPERATING ACTIVITIES	7 770 016	5 824 281
Investing Activities:		
Capital expenditures	(1 531 977)	(1 060 697)
Proceeds from retirement of patronage capital credits	112 448	52 108
CFC Member capital securities	-	(500 000)
Other investments	764 937	(726 366)
NET CASH USED BY INVESTING ACTIVITIES	(654 592)	(2 234 955)
Financing Activities:		
Principal payments on long-term debt	(2 666 446)	(3 148 770)
NET CASH USED BY FINANCING ACTIVITIES	(2 666 446)	(3 148 770)
NET INCREASE IN CASH AND CASH EQUIVALENTS	4 448 978	440 556
Cash and cash equivalents - Beginning of year	4 044 630	3 604 074
CASH AND CASH EQUIVALENTS - END OF YEAR	\$ 8 493 608	\$ 4 044 630
Supplemental Disclosures of Cash Flow Information:		
Cash Paid During the Year for:		
Interest	\$ 1 256 980	\$ 1 807 166

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

SAM RAYBURN G & T ELECTRIC COOPERATIVE, INC.
NOTES TO FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations:

Sam Rayburn G & T Electric Cooperative, Inc. (the "Cooperative") is an electric generating and transmission cooperative formed and operating pursuant to the Texas Electric Cooperative Corporation Act. The Cooperative provides wholesale electric service to its member distribution cooperatives, Houston County Electric Cooperative, Inc., Jasper-Newton Electric Cooperative, Inc. and Sam Houston Electric Cooperative, Inc. ("Members").

The Cooperative was formed principally to provide dependable power to its Members at the lowest cost possible. In doing so, the Cooperative works closely with its Members in determining their power requirements.

Use of Estimates:

The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities. The estimates and assumptions used in the accompanying financial statements are based upon management's evaluation of the relevant facts and circumstances as of the date of the financial statements. Actual results may differ from the estimates and assumptions used in preparing the accompanying financial statements.

System of Accounts:

The Cooperative maintains its accounting records in accordance with the Federal Energy Regulatory Commission's Uniform System of Accounts as adopted by the USDA Rural Development's Rural Utilities Service ("RUS"), which conforms with U.S. generally accepted accounting principles in all material respects. The more significant accounting policies are described below.

Revenue Recognition:

Revenues from the sale of electricity are recorded based on billings to Members.

Cash Flow Statement:

Cash and cash equivalents, for purposes of the cash flows statement, consist of all cash accounts and short-term investments with original maturities of three months or less.

Accounts Receivable:

The Cooperative considers accounts receivable to be fully collectible; accordingly, no allowance for doubtful accounts has been established. If accounts become uncollectible, they will be charged to operations when that determination is made.

Utility Plant:

The utility plant is stated at original cost. The cost of additions to the electric plant includes contracted work, direct labor, materials, allocable overhead and interest on debt used for construction. The cost of maintenance and repairs, including renewals of minor items of property, is charged to operating expense. The cost of units replaced or retired, including cost of removal, net of any salvage value, is charged to accumulated depreciation.

Depreciation of the utility plant is provided on the composite straight-line method over the estimated useful lives of the various components. The method and rates are prescribed by RUS or as approved for rate-making purposes. The annual depreciation rates are:

Production plant	2.55%
Office building	2.00%
Load dispatching equipment	6.67%

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the sum of the expected future undiscounted cash flows is less than the carrying amount of the asset, a loss is recognized for the difference between the fair value and carrying value of the asset. At December 31, 2010 the Cooperative had not recognized any losses resulting from the impairment of long-lived assets.

Investments in Associated Organizations:

Investments in patronage capital credits of associated organizations are accounted for under the equity method. Patronage capital is recorded at the stated amount of the certificate when allocated by the associated organization.

Inventories:

Inventory consists of fuel stock (primarily coal) for operation of the electric plant. Fuel inventory is carried at weighted average cost. Material and supplies inventory used for the operation of the electric plant is valued at average cost and is stated at the lower of average cost or market.

Income Taxes:

The Cooperative is exempt from Federal income taxes under the provisions of Section 501(c)(12) of the Internal Revenue Code of 1986.

Comprehensive Income:

Professional standards have been established for the reporting and display of comprehensive income and its components in the financial statements. There were no items of other comprehensive income in 2010 and 2009, and thus, net income is equal to comprehensive income for each of those years.

Deferred Debits/Credits:

In accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 980: *Regulated Operations* (formerly FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*), certain costs have been capitalized as deferred assets that would otherwise be charged to expense. Such deferred assets are recorded when it is probable that future revenue in an amount at least equal to the capitalized costs will result from inclusion of those costs in future rates.

Derivative Instruments:

The accounting standards for derivative instruments and hedging activities require that all derivatives be recognized at fair value on the balance sheet, either as assets or liabilities, unless they meet the normal purchase, normal sales criteria. The changes in the fair value of recognized derivatives are recorded each period in current margins or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and the type of hedge transaction.

SAM RAYBURN G & T ELECTRIC COOPERATIVE, INC.
NOTES TO FINANCIAL STATEMENTS - CONTINUED

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

The Cooperative makes limited use of derivative instruments for the purpose of managing commodity price risk related to forecasted purchases of natural gas. The Cooperative's objective in using derivative instruments is to reduce the variability of the cash flows of the forecasted purchases of natural gas. At December 31, 2009, the Cooperative held over-the-counter natural gas swaps that expired monthly through May 2010 and financially settled against NYMEX futures. The Cooperative believes it is not practical to designate these contracts as cash flow hedges, as defined under ASC 815: *Derivatives and Hedging* (formerly FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*). Therefore, in accordance with ASC 815, the Cooperative adjusts the contracts to the current market value through the statement of revenue and expense. Unrealized gains and losses on derivative instruments outstanding as of December 31, 2009 are deferred on a net basis as a regulatory asset or liability in accordance with ASC 980: *Regulated Operations*. These amounts are subsequently reclassified as purchased power in the Statement of Revenue and Expense as the power is delivered and the contract settles. A current liability of \$174,425 was recognized on the Cooperative's Balance Sheet at December 31, 2009 for the mark-to-market adjustment and a corresponding regulatory asset was recognized. During the year ended December 31, 2010 and 2009, losses in the amounts of approximately \$672,000 and \$705,000, respectively were recognized in purchased power cost for derivative instruments. At December 31, 2010, the Cooperative did not hold any derivative instruments.

Derivative instruments are reported on the Balance Sheet at fair value. The measurement of fair value is based on actively quoted market prices and is considered a Level 1 fair value measurement.

Subsequent Events:

Management has evaluated subsequent events through April 15, 2011, the date the financial statements were available to be issued.

NOTE 2 - UTILITY PLANT

The following summarizes utility plant at December 31, 2010 and 2009:

	2010	2009
Utility Plant, at Cost:		
Production plant	\$ 69 192 776	\$ 67 660 798
Furniture and fixtures	1 192	1 192
Office building	208 818	208 818
Load dispatching equipment	105 410	105 410
	69 508 196	67 976 218
Less accumulated depreciation	(47 291 997)	(45 529 657)
	\$ 22 216 199	\$ 22 446 561

The Cooperative has a Joint Ownership Participation and Operating Agreement with Entergy-Gulf States. The Cooperative owns a 10% undivided ownership interest in Nelson Unit No. 6, a 550 MW coal-fired steam electric generating unit located near Westlake, Louisiana.

In connection with the Cooperative's ownership interest in Nelson Unit No. 6, the Cooperative receives its proportionate share of sulfur dioxide ("SO₂") allowances. Each allowance represents the right to emit one ton of SO₂ pollution in a specified calendar year. The allowances may be used to permit current emissions, sold on the open market, or held in reserve to cover emissions in future years. The Cooperative has the intention of holding these allowances for future use.

SAM RAYBURN G & T ELECTRIC COOPERATIVE, INC.
NOTES TO FINANCIAL STATEMENTS - CONTINUED

NOTE 3 - INVESTMENTS

Investments in associated organizations at December 31, 2010 and 2009 consisted of the following:

	2010	2009
Capital term certificates of the National Rural Utilities Cooperative Finance Corporation ("CFC")	\$ 183 480	\$ 183 480
Patronage capital - CFC	48 607	48 564
CFC Member Capital Securities	500 000	500 000
Memberships	6 110	6 110
Sam Rayburn Dam Electric Cooperative, Inc.	50 000	50 000
Patronage capital - National Bank for Cooperatives ("CoBank")	400 813	480 675
Patronage capital - East Texas Electric Cooperative, Inc.	16 953 596	11 956 602
	\$ 18 142 606	\$ 13 225 431

Capital credit and patronage capital allocations reported in the Statements of Revenue and Expenses in the amount of \$5,029,623 and \$2,853,913 for the fiscal years ended December 31, 2010 and 2009, respectively, represent Patronage Capital allocations from CFC, CoBank, and capital credits from a wholesale power supplier of the Cooperative, East Texas Electric Cooperative, Inc ("ETEC").

NOTE 4 - OTHER INVESTMENTS

In April of 2005 the Board of Directors approved a 0.4 mill/kWh adder on sales to Members to be collected from April 2005 through December 2011. The funds related to this adder are to be limited to use on capital improvements to maintain Nelson Unit No. 6. At December 31, 2010 and 2009, the Cooperative had \$2,428,902 and \$3,193,839 in funds with limited use. These funds are comprised of investments in commercial paper at CFC. Subsequent to December 31, 2010, the Board of Directors voted to eliminate the 0.4 mill/kWh adder on sales.

NOTE 5 - DEFERRED DEBITS/CREDITS

The following is a summary of the amounts recorded as deferred debits/credits as of December 31, 2010 and 2009:

	2010	2009
DEFERRED DEBITS		
Unamortized premiums of FFB notes (Note 7)	\$ 2 338 424	\$ 2 802 852
Unrealized loss on derivative instruments	-	174 425
Deferred fuel cost	126 391	-
	\$ 2 464 815	\$ 2 977 277
DEFERRED CREDITS		
Deferred fuel cost	\$ -	\$ 107 974
	\$ -	\$ 107 974

Unrealized gains and losses on derivative instruments are deferred in accordance with ASC 980: *Regulated Operations*. The unrealized gains and losses are subsequently reclassified and recorded as purchased power costs when the instruments settle.

Deferred fuel cost represents the difference between the actual monthly fuel costs and the fuel factor computed by the Cooperative. The deferred amount is recorded monthly by the Cooperative and is accumulated in a designated deferred account. On a monthly basis, the Cooperative reconciles the deferred account and refunds or collects the difference from its Members.

SAM RAYBURN G & T ELECTRIC COOPERATIVE, INC.
NOTES TO FINANCIAL STATEMENTS - CONTINUED

NOTE 6 - PATRONAGE CAPITAL

The details of Patronage Capital and Unallocated Deficit at December 31, 2010 and 2009 are as follows:

	2010	2009
Patronage Capital:		
Assignable	\$ 9 988 610	\$ 7 117 590
Assigned	47 885 117	40 767 527
	57 873 727	47 885 117
Retired	(15 382 276)	(15 382 276)
Unallocated deficit	(2 263 092)	(2 263 092)
	\$ 40 228 359	\$ 30 239 749

The by-laws of the Cooperative provide that all amounts received and receivable from the furnishing of electric energy in excess of the sum of operating costs and expenses are to be assigned to Members' patronage capital credit accounts on a patronage basis. The by-laws permit the offsetting of current year operating margins against operating deficits of prior years.

The by-laws also provide that nonoperating margins be used initially to offset any losses incurred during the current or any prior fiscal year. Upon recovery of any losses, a fund in the amount of \$400,000 shall be accumulated from these remaining nonoperating margins and funded each year, if necessary, to maintain the \$400,000 balance and to the extent not needed for that purpose allocated to the Members' patronage capital credit accounts on a patronage basis. Subsequent to the year ended December 31, 2010, the Cooperative amended its by-law concerning patronage capital to eliminate the requirement that a \$400,000 fund be maintained out of nonoperating margins and to clarify how the Board may deal with losses. The amended by-law provides the Board the ability to allocate losses to Members, offset losses with margins from future years, or offset losses with certain nonoperating margins from current or future years.

Under provision of the agreements relating to RUS mortgage notes, until the total of equities and margins equal or exceed 40% of total assets, the distribution of capital contributed by members in each year is limited generally to 25% of patronage capital and margins of the preceding year provided that, after giving effect to such distribution, the total equity will equal or exceed 20% of total assets. For the years ending December 31, 2010 and 2009, no patronage capital was retired.

NOTE 7 - LONG-TERM DEBT

Long-term debt at December 31, 2010 and 2009 consisted of the following:

	2010	2009
First mortgage note payable to Federal Financing Bank ("FFB"), guaranteed by RUS, due in quarterly installments through 2016 at 6.574%	\$ 21 934 062	\$ 24 018 664
CoBank, secured by certain common facilities at the Nelson Unit No. 6, due in quarterly installments through 2014 at a fixed interest rate of 3.55% at December 31, 2010.	2 341 662	2 923 506
	24 275 724	26 942 170
Less current maturities	4 334 839	3 387 091
	\$ 19 940 885	\$ 23 555 079

SAM RAYBURN G & T ELECTRIC COOPERATIVE, INC.
NOTES TO FINANCIAL STATEMENTS - CONTINUED

NOTE 7 - LONG-TERM DEBT - CONTINUED

Under the terms of the loan agreement between FFB and RUS, all advances were subject to the approval of RUS. The maturity date of each advance could not be less than two years, nor more than seven years, after the date of the advance; provided, however, at the option of the borrower, such maturity dates could be extended for a period of thirty-four years from the end of the year in which advances were made. Interest on each advance would be based on the respective rate established at the time of the advance or at time of extension.

In 1985, the Cooperative refinanced the short-term advances from the FFB. As a result, premium cost of \$2,311,616 was incurred and paid. The premium cost is being systematically amortized as an adjustment to interest expense over the life of the related long-term debt.

In 1994, the Cooperative refinanced the first mortgage note payable to FFB in the amount of \$51,534,492, as guaranteed by the RUS. As a result of this refinancing, premium costs of \$8,722,692 were incurred. The premium cost is being systematically amortized as an adjustment to interest expense over the life of the related long-term debt. Upon completion of all refinancing, the systematic amortization of all premiums associated with the refinancing causes the effective rate on the FFB debt to be approximately 7%.

Substantially all assets are pledged as collateral for the above-mentioned debt to the RUS and FFB.

The approximate annual maturities of long-term debt are as follows:

2011	\$	4 335 000
2012		3 901 000
2013		4 189 000
2014		3 843 000
2015		3 879 000

The Cooperative has a \$12,000,000 line of credit with CFC that carries a variable interest rate and matures in July 2011. At December 31, 2010 and 2009, no funds were advanced or owed under this line of credit.

The Cooperative also has an additional line of credit of \$10,000,000 with CoBank that carries a variable interest rate and matures on October 31, 2011. At December 31, 2010 and 2009, no funds were advanced or owed under this line of credit.

NOTE 8 - POWER CONTRACTS

The Cooperative has wholesale power contracts with each of its Members which require the Members to buy and receive from the Cooperative all their power and energy requirements at specified delivery points and require the Cooperative to sell and deliver power in satisfaction of such requirements. The contracts extend to December 31, 2044, and thereafter, until the expiration of six months after notice of cancellation by either the Cooperative or the Members. The power sales by the Cooperative to the Members for the years ended December 31, 2010 and 2009 were \$119,674,745 and \$98,582,495, respectively.

The Cooperative, along with ETEC and Tex-La Electric Cooperative of Texas, Inc. ("Tex-La"), is a party to wholesale power contracts with Entergy Texas, Inc. The contracts commenced January 1, 2010 and terminate on December 31, 2014.

SAM RAYBURN G & T ELECTRIC COOPERATIVE, INC.
NOTES TO FINANCIAL STATEMENTS - CONTINUED

NOTE 8 - POWER CONTRACTS - CONTINUED

The Cooperative also purchases power from the Southwestern Power Administration ("SWPA"), an agency of the Department of Energy, through Sam Rayburn Dam Electric Cooperative, Inc. ("SRDEC"). SRDEC has entered into a contract whereby the Cooperative acquired an entitlement to the hydroelectric output of the Sam Rayburn Hydroelectric Plant. In the event that SRDEC is not able to receive enough power (primarily as a result of inadequate rainfall) to cover operating costs (primarily entitlement to SWPA), the Cooperative is obligated to absorb 66-2/3 percent of the deficiency. The Members of the Cooperative are also members of SRDEC.

Sam Rayburn Municipal Power Agency ("Agency") and the Cooperative have an agreement for the Agency to sell to the Cooperative a 24.89% share (1.49 MW) of the output of the Robert Douglass Willis Hydropower Project (the "Project") with the term of the agreement expiring December 2021. Under the assignment arrangement, the Cooperative will pay 24.89% of all the Project costs and expenses, including debt service. The assignment arrangement provides that the Cooperative is to receive 24.89% of any power made available to the Agency from the Project each month. In accordance with the arrangement, the Cooperative paid the Agency \$770,878 and \$730,287 in 2010 and 2009, respectively, for its share of the Project's costs and expenses.

The Cooperative is a member of ETEC. ETEC was formed by the Cooperative, Tex-La Electric Cooperative of Texas, Inc. ("Tex-La"), and Northeast Texas Electric Cooperative, Inc. for the purpose of developing power supply alternatives and coordinating these alternatives with the power supply requirements of its members. The Cooperative has a wholesale power contract (the "Contract") with ETEC whereby ETEC supplies wholesale power to the Cooperative over and above the power the Cooperative receives from Nelson Unit No. 6 and SWPA. During 2010 and 2009, the Cooperative paid \$88,314,228 and \$69,247,853, respectively to ETEC for the purchase of wholesale power. At December 31, 2010 and 2009, \$7,670,185 and \$6,870,208, respectively, was due to ETEC for wholesale power purchased.

NOTE 9 - RELATED PARTY TRANSACTIONS

The Cooperative, Tex-La, and ETEC share facilities and personnel. The Cooperative reimburses Tex-La for its proportionate share of the related expenses and equipment purchases. The total amount paid or payable for the years ended December 31, 2010 and 2009 was \$120,268 and \$109,273, respectively, for shared expenses. The Members of the Cooperative are also Members of Tex-La.

The Cooperative has various electrical facilities operating agreements with its member distribution cooperatives for the operation and maintenance of certain telemetering equipment.

NOTE 10 - RATE MATTERS

In 1999, the Texas Legislature approved Senate Bill 7, which provided for the restructuring of the Texas electric industry for the purpose of creating a competitive electric power market. The legislation provided that the pricing and supply of the generation of electricity would be unregulated beginning in January 2002. Under special provisions for cooperatives, the Cooperative's rates for the sale of wholesale power are no longer regulated by the Public Utility Commission of Texas ("PUCT"). Similarly, the rates of the Members for the sale of electricity are no longer regulated by the PUCT. The law permits cooperatives' boards of directors to set rates.

SAM RAYBURN G & T ELECTRIC COOPERATIVE, INC.
NOTES TO FINANCIAL STATEMENTS - CONTINUED

NOTE 10 - RATE MATTERS - CONTINUED

Investor-owned utilities in the Electric Reliability Council of Texas ("ERCOT") were required to allow their retail customers to select generation suppliers of electricity as of January 2002. The law gives cooperatives' boards of directors sole authority to allow, or not allow, generating suppliers to attempt to sell electricity to retail customers of a cooperative. Allowing retail customer choice is called "opting in". Even if a cooperative's board decides to opt in, retail customers will continue to use the transmission and distribution facilities of the Cooperative's Members. The Cooperative will closely monitor whether any of its Members will decide to opt in and thus evaluate the potential effects of a change in generation sales. The law allows the Cooperative to recover stranded costs if it experiences a loss of load which would impair payment of debt service and payment of purchased power fixed charges. As of December 31, 2010, none of the Cooperative's Members have elected to opt in.

NOTE 11 - COMMITMENTS AND CONTINGENCIES

The electric utility industry is subject to standards and procedures under government laws and regulations related to environmental and other matters. These standards and procedures are subject to change and uncertainties and as a result, outcomes are not predictable with assurance. The Cooperative is unaware of any noncompliance with current governmental laws and regulations related to environmental matters.

In the normal course of business, the Cooperative may be involved in various claims and litigation. In the opinion of management and the Cooperative's legal counsel, there is no pending or threatened litigation against the Cooperative.

NOTE 12 - CONCENTRATION OF CREDIT RISK

The Cooperative's financial instruments that are exposed to concentrations of credit risk consist primarily of cash equivalents and accounts receivable.

The Cooperative places its cash and cash equivalents on deposit with financial institutions in the United States of America. The Federal Deposit Insurance Corporation (FDIC) insurance coverage limit is \$250,000 for substantially all depository accounts. Also, the FDIC temporarily provides unlimited coverage for non-interest bearing transaction accounts through December 31, 2012. At various times during the year, cash balances may exceed insured limits. The Cooperative has not experienced any losses in such accounts.

The Cooperative's accounts receivable are subject to concentration of credit risk due to the Cooperative's customer base. Substantially all of the accounts receivable balance is due from the Cooperative's three Members. The Cooperative believes the risk of loss related to this credit risk is remote.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL
REPORTING AND ON COMPLIANCE BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

The Board of Directors
Sam Rayburn G & T Electric Cooperative, Inc.
Nacogdoches, Texas

We have audited the financial statements of Sam Rayburn G & T Electric Cooperative, Inc. as of and for the years ended December 31, 2010 and 2009 and have issued our report thereon dated April 15, 2011. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Cooperative's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion of the effectiveness of the Cooperative's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Cooperative's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance

As part of obtaining reasonable assurance about whether Sam Rayburn G & T Electric Cooperative, Inc.'s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the audit committee, management, the Rural Utilities Service and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties.

Lufkin, Texas
April 15, 2011


CERTIFIED PUBLIC ACCOUNTANTS