

**Choptank Electric Cooperative, Inc. and Subsidiary**  
**Consolidated Financial Statements**  
**December 31, 2019 and 2018**

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## **Independent Auditor's Report**

The Board of Directors  
Choptank Electric Cooperative, Inc. and Subsidiary  
Denton, Maryland

We have audited the accompanying consolidated financial statements of Choptank Electric Cooperative, Inc. and Subsidiary (the "Cooperative") which comprise the consolidated balance sheets as of December 31, 2019 and 2018 and the related consolidated statements of operations and comprehensive income, equities, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### **Management's Responsibility for the Consolidated Financial Statements**

The Cooperative's management is responsible for the preparation and fair presentation of these consolidated 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 consolidated 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 consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Cooperative's preparation and fair presentation of the consolidated 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 Cooperative'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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Choptank Electric Cooperative, Inc. and Subsidiary as of December 31, 2019 and 2018, and the results of its operations, changes in equities, and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Alamo, Jenkins & Cheatham*

Richmond, Virginia  
March 24, 2020

## Consolidated Balance Sheets

### Choptank Electric Cooperative, Inc. and Subsidiary

	December 31,	
	2019	2018
<b>Assets</b>		
Electric plant		
Electric plant	\$ 447,890,819	\$ 438,462,408
Less accumulated provision for depreciation and amortization	<u>134,689,642</u>	<u>126,645,199</u>
	313,201,177	311,817,209
Other property and investments		
Investments in associated organizations	69,264,290	67,963,468
Nonutility property, net	235,796	346,763
Other	<u>5,000</u>	<u>460,047</u>
	69,505,086	68,770,278
Current assets		
Cash and cash equivalents	542,210	530,658
Accounts receivable, net	19,588,471	19,844,543
Materials and supplies	9,280,897	9,386,521
Other current assets	<u>2,270,520</u>	<u>2,357,411</u>
	31,682,098	32,119,133
Deferred charges	1,623,173	9,909
Assets for postretirement benefits	4,501,763	
	<u></u>	<u></u>
	<u>\$ 420,513,297</u>	<u>\$ 412,716,529</u>

See Independent Auditor's Report and Notes to Consolidated Financial Statements

	December 31,	
	2019	2018
<b>Equities and Liabilities</b>		
Equities		
Patronage capital	\$ 150,217,350	\$ 141,067,321
Other equities	12,587,522	11,430,681
Accumulated other comprehensive income	7,286,080	3,043,861
Memberships	384,455	384,455
	<u>170,475,407</u>	<u>155,926,318</u>
Noncurrent liabilities		
Long-term debt	207,020,212	216,031,796
Other	359,000	2,334,412
	<u>207,379,212</u>	<u>218,366,208</u>
Current liabilities		
Bank advances	792,618	1,209,423
Accounts payable	20,656,859	15,922,919
Current portion of long-term debt	9,268,289	9,350,938
Other current and accrued liabilities	4,314,053	4,107,667
Credit lines	4,384,000	1,859,000
Consumer deposits	2,008,378	1,972,864
	<u>41,424,197</u>	<u>34,422,811</u>
Deferred credits	<u>1,234,481</u>	<u>4,001,192</u>
	<u>\$ 420,513,297</u>	<u>\$ 412,716,529</u>

## Consolidated Statements of Operations

### Choptank Electric Cooperative, Inc. and Subsidiary

	Year Ended December 31,	
	2019	2018
Operating revenues	\$ 146,220,668	\$ 146,083,381
Operating expenses		
Cost of power	83,391,325	82,978,064
Transmission	2,966	5,614
Distribution - operation	4,422,757	4,097,453
Distribution - maintenance	9,218,532	9,031,606
Power production - maintenance	14,386	
Consumer accounts	3,170,398	3,255,630
Customer service and informational	1,006,236	937,129
Sales expense	145,815	31,001
Administrative and general	8,012,182	6,808,259
Depreciation and amortization	13,884,850	13,871,318
Taxes	4,104,537	3,560,428
Interest	10,989,002	10,390,795
Other deductions	204,103	74,270
	<u>138,567,089</u>	<u>135,041,567</u>
Operating Margins Before Patronage Allocations	7,653,579	11,041,814
Patronage allocations	<u>2,574,836</u>	<u>2,164,278</u>
Net Operating Margins	10,228,415	13,206,092
Nonoperating income		
Dividend income	75,071	155,094
Gain from equity investment	283,107	473,660
Gain on disposition of assets	291,076	258,611
Interest income	78,106	95,650
Other	31,187	6,905
	<u>758,547</u>	<u>989,920</u>
Net Margins Before Income Taxes	10,986,962	14,196,012
Income tax expense - deferred	(99,000)	(208,000)
Net Margins	<u>\$ 10,887,962</u>	<u>\$ 13,988,012</u>

### Consolidated Statements of Comprehensive Income

Net margins	\$ 10,887,962	\$ 13,988,012
Other comprehensive income (loss)		
Net gain during period	4,950,808	890,617
Reclassification adjustment for gain realized in net margins, net	(708,589)	(22,898)
	<u>4,242,219</u>	<u>867,719</u>
Comprehensive Income	<u>\$ 15,130,181</u>	<u>\$ 14,855,731</u>

See Independent Auditor's Report and Notes to Consolidated Financial Statements

## Consolidated Statements of Equities

### Choptank Electric Cooperative, Inc. and Subsidiary

#### Years Ended December 31, 2019 and 2018

	Patronage Capital	Other Equities	Accumulated Other Comprehensive Gain	Memberships	Total
Balance, December 31, 2017	\$ 132,897,105	\$ 10,247,401	\$ 2,176,142	\$ 384,455	\$ 145,705,103
Net margins	13,286,309	701,703			13,988,012
Other comprehensive income			867,719		867,719
Retirement of capital credits	<u>(5,116,093)</u>	<u>481,577</u>			<u>(4,634,516)</u>
Balance, December 31, 2018	141,067,321	11,430,681	3,043,861	384,455	155,926,318
Net margins	10,314,610	573,352			10,887,962
Other comprehensive income			4,242,219		4,242,219
Retirement of capital credits	<u>(1,164,581)</u>	<u>583,489</u>			<u>(581,092)</u>
Balance, December 31, 2019	<u>\$ 150,217,350</u>	<u>\$ 12,587,522</u>	<u>\$ 7,286,080</u>	<u>\$ 384,455</u>	<u>\$ 170,475,407</u>

See Independent Auditor's Report and Notes to Consolidated Financial Statements



## Consolidated Statements of Cash Flows

### Choptank Electric Cooperative, Inc. and Subsidiary

	Year Ended December 31,	
	2019	2018
<b>Cash Flows from Operating Activities</b>		
Net margins	\$ 10,887,962	\$ 13,988,012
Adjustments to reconcile net margins to net cash provided by operating activities:		
Depreciation and amortization charged to operations	13,884,850	13,871,318
Deferred income tax expense	99,000	208,000
Income from equity investments (MACS)	(358,178)	(628,754)
Gain on disposition of assets	(291,076)	(258,611)
Noncash capital credit allocations	(2,574,836)	(2,164,278)
(Increase) decrease in:		
Accounts receivable	256,072	2,186,657
Other current assets	86,891	(444,355)
Deferred charges	(1,613,264)	31,858
Other property and investments	455,047	3,210
Other noncurrent assets	(4,501,763)	
Increase (decrease) in:		
Accounts payable	4,733,940	1,126,178
Other current and accrued liabilities	206,386	397,794
Deferred credits	(2,865,711)	(3,794,613)
Other noncurrent liabilities	2,784,403	(360,977)
Net Cash Provided by Operating Activities	21,189,723	24,161,439
<b>Cash Flows from Investing Activities</b>		
Investments in utility plant	(15,243,503)	(24,294,438)
Plant removal costs	(1,535,616)	(1,736,370)
Contributions in aid of construction	1,689,677	2,143,247
Proceeds from disposition of assets	328,291	336,728
Dividends received	75,071	155,094
Proceeds from retirement of investments in CTC's	184,611	59,017
Contributions to APBO plan assets, net	(517,596)	(519,086)
Proceeds from the sale of MACS stock	164,050	200,000
Net Cash Used by Investing Activities	(14,855,015)	(23,655,808)

See Independent Auditor's Report and Notes to Consolidated Financial Statements

	Year Ended December 31,	
	2019	2018
<b>Cash Flows from Financing Activities</b>		
Capital credits received from suppliers	1,208,460	420,372
Capital credits paid to members	(581,092)	(4,634,516)
Loan payments	(9,094,233)	(9,186,119)
Bank advances, net	(416,805)	(3,283)
Decrease in consumer deposits	35,514	(109,765)
Advances on lines of credit	19,788,282	9,859,778
Repayments on lines of credit	(17,263,282)	(9,620,778)
Loan proceeds		13,000,000
Net Cash Used by Financing Activities	<u>(6,323,156)</u>	<u>(274,311)</u>
Net Increase in Cash and Cash Equivalents	11,552	231,320
Cash and cash equivalents - beginning of year	<u>530,658</u>	<u>299,338</u>
Cash and Cash Equivalents - End of Year	<u>\$ 542,210</u>	<u>\$ 530,658</u>
<b>Non Cash Financing Activities</b>		
Refinance of Farmer Mac debt to CFC	<u>\$ 23,444,371</u>	<u>\$ -</u>

### Supplemental Disclosures

Choptank Electric Cooperative, Inc. and Subsidiary paid approximately \$11,160,000 and \$10,319,000 interest expense for the years ended December 31, 2019 and 2018, respectively.

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2019 and 2018

##### Note A - Nature of Operations and Summary of Significant Accounting Policies

###### Nature of Operations

Choptank Electric Cooperative, Inc. (the “Cooperative”) is a non-profit electric transmission, production and distribution utility engaged in the retail sale of electricity and other related services to consumers located in the nine counties of Maryland’s Eastern Shore. The Cooperative’s rates are regulated by the Maryland Public Service Commission.

Choptank Services Corporation (CSC) is a wholly-owned subsidiary of the Cooperative which owned a 37.54% interest in Mid-Atlantic Cooperative Solutions, Inc., (MACS) as of December 31, 2019 and 2018. The investment is accounted for using the equity method (Note D). MACS is primarily a multi-fuel distributor supplying heating oil, kerosene, gasoline, diesel fuel, propane, and HVAC services to wholesale and retail customers throughout Pennsylvania, Maryland, Virginia, and Delaware.

###### Basis of Presentation

These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP), including GAAP for regulated operations.

The system of accounts of the Cooperative are maintained in accordance with the Uniform System of Accounts as prescribed by the Federal Energy Regulatory Commission (FERC).

###### Accounting Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

###### Income Taxes

The Cooperative has been granted exemption from income taxes under Internal Revenue Service Code Section 501(c)(12) of the Internal Revenue Code. The Cooperative evaluates the components of the annual test for compliance to maintain its filing status as a tax-exempt entity. In accordance with Accounting Standards Codification (ASC) Topic-740 for “uncertain tax positions”, the Cooperative had determined that it is more likely than not that their tax positions will be sustained upon examination by the Internal Revenue Service. CSC computes income taxes according to ASC Topic-740 Income Taxes. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences arising between the tax bases of assets and liabilities and their reported amounts. In accordance with ASC Topic-740 as it relates to uncertain tax positions, CSC has determined through evaluations that it is more likely than not that all of their tax positions would be sustained by the Internal Revenue Service.

###### Principles of Consolidation

The consolidated financial statements include the accounts of the Cooperative and its wholly-owned subsidiary, CSC. All significant intercompany accounts and transactions have been eliminated.

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2019 and 2018

##### Note A - Nature of Operations and Summary of Significant Accounting Policies - Continued

###### Electric Plant

Electric plant is stated at the original cost of construction, which includes the cost of contracted services, direct labor, materials and overhead items. Contributions from others toward the construction of electric plant are credited to the applicable plant accounts. When property, which represents a retirement unit, is replaced or removed, the average cost of such property as determined from the continuing property records is credited to electric plant and such cost, together with the cost of removal less salvage, is charged to the accumulated provision for depreciation.

Maintenance and repairs, including the removal and renewal of minor items of plant not comprising a retirement unit, are charged to the appropriate maintenance accounts, except that repairs of transportation and service equipment are charged to clearing accounts and redistributed to operating expense and other accounts.

###### Nonutility Property

Nonutility property and equipment is stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which range from seven to thirty-nine years. The cost of maintenance and repairs is charged to operations when incurred and renewals and betterments are capitalized. When properties are retired or otherwise disposed of, the related costs and allowance for depreciation are removed from the respective accounts and any gain or loss on disposition is reflected in income.

###### Depreciation

Provision for depreciation has been made by application of the straight-line composite method to the original cost, by groups of depreciable properties in service. Current depreciation rates, which are estimated to amortize the cost of plant over the service lives, were as follows:

Distribution and production plant	3.29 - 6.58%
General plant	3.00 - 20.00%
Transmission plant	3.29%

###### Cash and Cash Equivalents

The Cooperative and Subsidiary consider all highly liquid investments with a maturity of three months or less to be cash equivalents.

###### Material and Supplies

Inventories of the Cooperative consisted of materials and supplies and are generally used for construction, operation, and maintenance work and are generally not for resale. They are valued at the lower of market value or moving average unit cost.

###### Interest

Interest is recorded as interest income or expense as incurred.

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2019 and 2018

##### Note A - Nature of Operations and Summary of Significant Accounting Policies - Continued

###### Advertising Costs

Advertising costs were expensed as incurred.

###### Subsequent Events

Subsequent events have been evaluated through March 24, 2020, which is the date the consolidated financial statements were available to be issued.

###### Accounts Receivable

Accounts receivable from customers are recorded at the billed amount and do not bear interest. The Cooperative maintains an allowance based on the expected collectability of accounts receivable. The allowance is determined based on historical experience and other circumstances which may affect the ability of customers to meet their obligations. The Cooperative reviews its allowance for doubtful accounts on a monthly basis. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

###### Revenue Recognition

The Cooperative recognizes revenue when earned, that is, when electricity is used by customers on a monthly basis. The Cooperative's billing system bills customers on a cycle billing basis as opposed to a calendar month; therefore, the Cooperative estimates unbilled revenue on a monthly basis for power delivered but not billed to customers to calculated calendar month-end revenue amounts. See Note F for unbilled revenue recorded as of December 31, 2019 and 2018.

The Cooperative has analyzed the provisions of ASC Topic 606, *Revenue from Contracts with Customers*, and has concluded that no changes are necessary to conform to the new standard. Revenue from electricity is recorded when it is consumed, which complies with the requirements of ASC Topic 606. The Cooperative recognizes revenue from consumed electricity in the appropriate reporting period through its estimate of unbilled revenue.

###### Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers* (Topic 606), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU replaced most existing revenue recognition guidance in U.S. GAAP. In August 2015, the FASB issued ASU 2015-14, *Revenue from Contracts with Customers* (Topic 606) - *Deferral of the Effective Date*, which deferred the effective date of ASU 2014-09 to January 1, 2019. The Cooperative has elected to apply the new standard using the modified retrospective method. The new standard does not have a material impact on the consolidated financial statements.

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2019 and 2018

##### Note B - Electric Plant

Listed below were the major classes of electric plant:

	December 31,	
	2019	2018
Distribution plant	\$ 379,711,785	\$ 367,791,532
General plant	52,160,932	50,789,020
Transmission plant	6,887,199	6,052,068
Production plant	1,345,469	1,142,268
Electric plant in service	440,105,385	425,774,888
Construction work in progress	7,785,434	12,687,520
	<u>\$ 447,890,819</u>	<u>\$ 438,462,408</u>

The Cooperative followed the guidance as set forth in the ASC Topic 410, Asset Retirement and Environmental Obligations in determining it had no legal asset retirement obligations for the years ended December 31, 2019 and 2018. Regarding non-legal retirement obligations, the Cooperative follows the regulatory principle of inter-generational cost allocation by including net salvage (gross salvage less cost of removal) as a component of depreciation rates.

##### Note C - Nonutility Property

Nonutility property consisted of the following:

	December 31,	
	2019	2018
Buildings	\$ 203,328	\$ 397,046
Vehicles	36,244	36,244
	239,572	433,290
Less accumulated depreciation	164,037	298,686
	75,535	134,604
Land	160,261	212,159
	<u>\$ 235,796</u>	<u>\$ 346,763</u>

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2019 and 2018

##### Note D - Investments in Associated Organizations

Investments in associated organizations are primarily composed of patronage capital assigned from associated organizations. Investments in associated organizations consisted of the following:

	December 31,	
	2019	2018
Patronage capital:		
Old Dominion Electric Cooperative (ODEC)	\$ 53,468,191	\$ 52,459,055
National Rural Utilities Cooperative Finance Corporation (CFC)	6,230,889	5,910,243
Other	795,669	759,075
	<u>60,494,749</u>	<u>59,128,373</u>
Capital Term Certificates:		
ZCTC's	1,949,046	2,133,657
SCTC's	1,414,331	1,414,331
LCTC's	385,600	385,600
	<u>3,748,977</u>	<u>3,933,588</u>
Other:		
MACS	4,250,414	4,131,357
TEC Trading, Inc.	740,000	740,000
Investment in building - Virginia, Maryland, Delaware Association of Electric Cooperatives (VMDAEC)	27,920	27,920
Membership fees	2,230	2,230
	<u>5,020,564</u>	<u>4,901,507</u>
	<u>\$ 69,264,290</u>	<u>\$ 67,963,468</u>

The capital term certificates invested in CFC are unsecured and subordinated. The SCTC's and LCTC's bear interest at an annual rate of 5.00% and 3.00%, respectively. The ZCTC's are non-interest bearing. The capital term certificates are required to be maintained under the note agreement with CFC and are similar to compensating bank balances.

The investment in TEC Trading, Inc. represents an unconsolidated joint venture with other members of ODEC. The Cooperative has a non-controlling ownership interest that has been accounted for under the cost method.

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2019 and 2018

##### Note D - Investments in Associated Organizations - Continued

CSC's ownership in MACS has been accounted for using the equity method of accounting in accordance with ASC Topic 323. CSC and AUSCO each hold a 37.54% ownership interest in MACS and the MACS ESOP holds 24.92%.

The following condensed statements summarize the approximate financial position and results of operations of MACS:

	December 31,	
	2019	2018
Total assets	\$ 28,800,000	\$ 30,900,000
Total liabilities	\$ 17,500,000	\$ 19,900,000
Total members' equity	\$ 11,300,000	\$ 11,000,000
Total net income	\$ 968,000	\$ 960,000

##### Note E - Concentrations of Credit Risk

The Cooperative places its cash on deposit with financial institutions located in the United States of America, which are insured by the Federal Deposit Insurance Corporation (FDIC). The FDIC provides insurance coverage for up to \$250,000 of cash held by the Cooperative in each separate FDIC insured bank and savings institution. From time to time, the Cooperative may have amounts on deposit in excess of the insured limits. As of December 31, 2019, the Cooperative had approximately \$320,000 of deposits that exceed the insured limits.

##### Note F - Accounts Receivable

Accounts receivable consisted of the following:

	December 31,	
	2019	2018
Unbilled revenue	\$ 11,481,914	\$ 11,638,285
Consumers	6,210,045	6,627,671
Other	2,121,976	1,806,634
	19,813,935	20,072,590
Less provision for uncollectible accounts	225,464	228,047
	<u>\$ 19,588,471</u>	<u>\$ 19,844,543</u>



## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2019 and 2018

##### Note G - Deferred Charges

Deferred charges consisted of the following:

	December 31,	
	2019	2018
Deferred power cost adjustment	\$ 1,424,056	\$
Other	199,117	9,909
	<u>\$ 1,623,173</u>	<u>\$ 9,909</u>

##### Note H - Patronage Capital

Patronage capital consisted of the following:

	December 31,	
	2019	2018
Assigned	\$ 139,902,740	\$ 127,781,012
Assignable	10,314,610	13,286,309
	<u>\$ 150,217,350</u>	<u>\$ 141,067,321</u>

##### Note I - Other Equities

Other equities consisted of the following:

	December 31,	
	2019	2018
Nonoperating income	\$ 6,771,090	\$ 6,197,738
Retired capital credits - gain	5,583,335	4,999,846
Donated capital	232,397	232,397
Other	700	700
	<u>\$ 12,587,522</u>	<u>\$ 11,430,681</u>

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2019 and 2018

##### Note J - Long-Term Debt

Long-term debt consisted of the following:

	December 31,	
	2019	2018
CFC, Mortgage notes	\$ 193,654,750	\$ 178,252,635
Federal Agriculture Mortgage Corporation (Farmer Mac), Mortgage notes	22,633,751	47,130,099
	216,288,501	225,382,734
Less current portion	9,268,289	9,350,938
	<u>\$ 207,020,212</u>	<u>\$ 216,031,796</u>

Approximate future maturities of long-term debt were as follows:

<u>Year Ending December 31,</u>	
2020	\$ 9,268,289
2021	9,589,108
2022	9,908,550
2023	10,185,446
2024	10,353,157
Thereafter	<u>166,983,951</u>
	<u>\$ 216,288,501</u>

Substantially all of the Cooperative's assets have been pledged as collateral for the long-term debt to CFC and Farmer Mac. Under the terms of the loan agreements with CFC and Farmer Mac, there are certain restrictions which include requirements to maintain an average debt service coverage ratio of 1.35. As of December 31, 2019 and 2018, the Cooperative was in compliance with all covenants and restrictions.

Long-term debt payable to CFC is represented by mortgage notes with rates ranging from 3.25% to 7.45%. The maturity dates of the notes range up to 35 years, beginning November 2020 through August 2048. Principal and interest installments were due quarterly in the amount of approximately \$5,966,000. The Cooperative had approximately \$34,300,000 in unadvanced funds available from CFC as of December 31, 2019.

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2019 and 2018

##### Note J - Long-Term Debt - Continued

Long-term debt payable to Farmer Mac is represented by mortgage notes bearing interest at a variable rate based on one month LIBOR plus 1.1% (2.802% to 3.002% as of December 31, 2019). The notes have 15 to 30-year terms and mature at various dates through 2047. Interest and principal payments are due semi-annually in the amount of approximately \$528,000.

The Cooperative had lines of credit with CoBank and CFC in the amount of \$5,000,000 and \$20,000,000, respectively. There was no balance outstanding on the Cobank line of credit at December 31, 2019 and 2018. There was an outstanding balance on the CFC line of credit of \$3,200,000 at 2.85% interest rate at December 31, 2019, and an outstanding balance of \$500,000 at 3.35% interest rate at December 31, 2018. CSC had a line of credit with CoBank in the amount of \$2,800,000. There was an outstanding balance of \$1,184,000 at 3.89% interest rate and \$1,359,000 at 4.61% interest rate at December 31, 2019 and 2018, respectively.

##### Note K - Employee Benefits

The Cooperative participates in employee benefit plans, which provides certain healthcare and other welfare benefits to active and retired employees.

##### Pension Plan

The Retirement Security Plan (RS Plan), sponsored by the National Rural Electric Cooperative Association (NRECA), is a defined benefit pension plan qualified under Section 401 and tax-exempt under Section 501(a) of the Internal Revenue Code. It is considered a multiemployer plan under the accounting standards.

The plan sponsor's Employer Identification Number is 53-0116145 and the Plan Number is 333.

A unique characteristic of a multiemployer plan compared to a single employer plan is that all plan assets are available to pay benefits of any plan participant. Separate asset accounts are not maintained for participating employers. This means that assets contributed by one employer may be used to provide benefits to employees of other participating employers.

The Cooperative's contributions to the RS Plan in 2019 and in 2018 represented less than 5 percent of the total contributions made to the plan by all participating employers. The Cooperative made contributions to the plan of approximately \$2,676,000 in 2019 and \$2,718,000 in 2018.

For the RS Plan, a "zone status" determination is not required, and therefore not determined, under the Pension Protection Act (PPA) of 2006. In addition, the accumulated benefit obligations and plan assets are not determined or allocated separately by individual employer. In total, the RS Plan was over 80% funded on January 1, 2019 and over 80% funded on January 1, 2018 based on the PPA funding target and PPA actuarial value of assets on those dates.

Because the provisions of the PPA do not apply to the RS Plan, funding improvement plans and surcharges are not applicable. Future contribution requirements are determined each year as part of the actuarial valuation of the plan and may change as a result of plan experience.

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2019 and 2018

##### Note K - Employee Benefits - Continued

###### Deferred Income Plan - Continued

In addition to the NRECA Retirement and Security Program, substantially all employees of the Cooperative are eligible to participate in the NRECA SelectRE Plan; a defined contribution multi-employer deferred income plan qualified under Section 401(k) of the Internal Revenue Code. For the years ended December 31, 2019 and 2018, the Cooperative's required contribution to the Plan and its net pension cost was approximately \$473,000 and \$456,000, respectively.

###### Other Postretirement Employee Benefits

The Cooperative provides medical coverage to certain retirees and their dependents who were hired prior to October 16, 1996. The plan is contributory with retirees sharing in the cost of dependent coverage. For employees retiring after October 15, 2015, the Cooperative pays 80% of the HMO (or 74% of the PPO or HD plan) premiums for retirees and spouses. In 2021, the Cooperative will reduce the contribution percentage to 74% of all premiums until December 31, 2024.

The long-term return on plan assets was determined by taking the expected annual rates of return for each asset class based on the ten-year history. The Cooperative's investment strategy with respect to plan assets is designed to achieve a moderate level of overall portfolio risk in keeping with its desired risk objective, which is established after careful consideration of plan liabilities, plan funded status and the Cooperative's overall financial condition. The portfolio's target asset allocation is 44% foundation funds, 52% dynamic funds and 4% alternative funds. Investments in plan assets were allocated between equities (72%), bond funds (27%) and other (1%) at December 31, 2019. Investments in plan assets were allocated between equities (50%), bond funds (38%) and other (12%) at December 31, 2018.

The fair value of plan assets is based on market quotes as of the end of the year, which uses Level 1 inputs that are quoted prices in active markets for identical assets.

No specific adjustments were made for the Medicare Prescription Drug, Improvement, and Modernization Act because the Cooperative does not receive material amounts of employee subsidy available under Medicare Part D.

Approximate expected employer contribution for year ending December 31, 2020 is \$518,000.

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2019 and 2018

#### Note K - Employee Benefits - Continued

##### Other Postretirement Employee Benefits - Continued

The following tables set forth the accumulated postretirement plan's benefit obligation (APBO), fair value of plan assets, and funded status as December 31, 2019 and 2018:

	December 31,	
	2019	2018
APBO	\$ 15,510,095	\$ 18,548,373
Change in fair value of plan assets:		
Fair value of plan assets at beginning of year	16,628,039	17,443,200
Actual return on plan assets	2,515,223	(1,334,248)
Contributions	517,596	519,087
Withdrawals	(285,000)	
Fair value of plan assets at end of year	<u>19,375,858</u>	<u>16,628,039</u>
Funded status	3,865,763	(1,920,334)
Less current portion	<u>(636,000)</u>	<u>(671,908)</u>
	<u>\$ 4,501,763</u>	<u>\$ (1,248,426)</u>

The following shows the components of the net periodic benefit costs included in the consolidated statement of operations:

	Year Ended December 31,	
	2019	2018
Interest cost on benefit obligations	\$ 603,214	\$ 852,500
Service cost, benefits earned during the period	176,526	289,800
Return on plan assets	(738,884)	(929,429)
Amortization of deferred cost	<u>(708,589)</u>	<u>(22,898)</u>
	<u>\$ (667,733)</u>	<u>\$ 189,973</u>

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2019 and 2018

##### Note K - Employee Benefits - Continued

##### Other Postretirement Employee Benefits - Continued

Amounts recognized in accumulated comprehensive income that relate to the APBO and plan assets were as follows:

	December 31,	
	2019	2018
Unrealized gain on plan assets	\$ 4,841,839	\$ 2,375,959
Unrecognized actuarial gain	2,444,241	667,902
	<u>\$ 7,286,080</u>	<u>\$ 3,043,861</u>

The following sets forth certain disclosure requirements and actuarial assumptions used:

	December 31,	
	2019	2018
Assumptions and effects:		
Medical trend rate		
Under 65	6.80%	6.60%
65 and older	4.70%	4.70%
Ultimate trend rate	5.00%	5.00%
Year ultimate trend rate achieved	2026	2025
Discount rate	3.65%	4.65%
Expected return on asset	4.96%	4.37%
Measurement date	1/1/2019	1/1/2018
Effect of a 1% increase in health care cost trend rate on:		
APBO	\$ 2,015,000	\$ 3,211,000
Interest plus service cost components	\$ 101,000	\$ 198,000

Estimated future benefit payments are shown net of employee contributions:

<u>Year Beginning January 1,</u>		
2020	\$	654,000
2021	\$	622,000
2022	\$	633,000
2023	\$	704,000
2024	\$	797,000
2025 - 2029	\$	4,928,000

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2019 and 2018

##### Note L - Deferred Credits

Deferred credits consisted of the following:

	December 31,	
	2019	2018
Unclaimed capital credits	\$ 1,195,084	\$ 1,557,319
Other	39,397	596,999
Deferred power cost adjustment		1,846,874
	<u>\$ 1,234,481</u>	<u>\$ 4,001,192</u>

##### Note M - Commitments

###### Purchased Power

The Cooperative, as a member of ODEC, an organization composed of electric cooperatives in Virginia, Maryland and Delaware, has entered into a long-term contract with ODEC for the acquisition of wholesale power through ODEC as have other members of the organization. The cost of wholesale power purchases may increase or decrease based upon rates established by the Board of Directors of ODEC and is regulated by FERC.

###### Labor Contract

The Cooperative and Local Union No. 1307 of the International Brotherhood of Electrical Workers (IBEW) have a labor agreement in effect January 1, 2020 through December 31, 2024, which covers approximately 108 of the 163 employees of the Cooperative. The agreement covers substantially all operation, maintenance and administrative personnel. As of December 31, 2019, Union employees performed work based on the previous agreement between the Cooperative and the IBEW.

###### Conditional Guarantee, Keep Well Agreement, and Indemnity & Contribution Agreement

CSC and AUSCO, as equal majority owners of MACS outstanding stock shares, entered a joint Keep Well Agreement dated March 27, 2008, to agree to maintain a 25% Equity/Assets ratio in MACS under financing terms with the lender. A counterpart joint Contribution Agreement of same date was also entered between the two parent cooperatives to the MACS majority owners assuring that the respective subsidiaries will comply with the terms of the Keep Well Agreement.

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2019 and 2018

##### Note N - Deferred Income Taxes

Deferred income taxes have been provided for in the financial statements to recognize among other things CSC's effects of net operating losses and the utilization of the equity method of accounting related to its investment in MACS. CSC had net operating loss carryforwards of approximately \$2,211,000. CSC's total deferred tax assets and liabilities consisted of the following:

	December 31,	
	2019	2018
Total deferred tax assets	\$ 641,000	\$ 665,000
Total deferred tax liabilities	<u>(1,000,000)</u>	<u>(925,000)</u>
Net deferred tax liability	<u>\$ (359,000)</u>	<u>\$ (260,000)</u>

Deferred income taxes result from temporary differences between income for financial reporting purposes and taxable income. These differences arose principally from accelerated tax depreciation, tax amortization of goodwill, certain insurance reserves and net operating losses.

The income tax provision could differ from the expense that would result from applying federal statutory rates to income before income taxes because the Company is subject to state income taxes, and also uses marginal federal tax rates to compute deferred taxes.

Provision for federal and state taxes in the statement of income consisted of the following components:

	December 31,	
	2019	2018
Deferred:		
Federal	\$ (93,060)	\$ (195,520)
State	<u>(5,940)</u>	<u>(12,480)</u>
	<u>\$ (99,000)</u>	<u>\$ (208,000)</u>



## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2019 and 2018

##### Note O - Financial Instruments Carried at Cost

In accordance with GAAP, the Cooperative is required to disclose the fair value of financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using discounted cash flow analysis. This technique involves subjective judgment and is significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. As a result, the derived fair value estimates cannot be substantiated by comparison to independent markets, and in many cases, could not be realized in immediate settlement of the instrument. Accordingly, the following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it was practicable to estimate that value:

##### Cash and Cash Equivalents

The carrying amount of cash and cash equivalents approximates fair value due to the short maturity of these instruments.

##### Accounts Receivable

The carrying amount of accounts receivable approximates fair value due to the short period of time amounts are outstanding.

##### Investments in Associated Organizations

Fair value of capital term certificates and member capital certificates were determined by computing the present value of estimated future cash flows, discounted at the long-term treasury rate of 2.39% and 3.02% for the years ending December 31, 2019 and 2018, respectively. The fair value of patronage capital is not determinable since no legal obligation exists to retire capital credits. The fair value of the cost and equity method investments are not estimated since there are no identified events or changes in circumstances that may have a significant adverse effect on the fair value and it is not practicable to estimate fair value. The carrying value of memberships approximates fair value.

##### Accounts Payable

The carrying amount of accounts payable approximates fair value due to the short period of time amounts are outstanding.

##### Long-Term Debt

The carrying amount of the Cooperative's fixed long-term debt includes certain interest rates that are below quoted market prices for the same or similar issues. Therefore, the fair value of fixed long-term debt is estimated based on current market prices for the same or similar issues offered for debt of the same and remaining maturities which was 4.19% and 5.90% for the years ending December 31, 2019 and 2018, respectively.

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2019 and 2018

##### Note O - Financial Instruments Carried at Cost - Continued

###### Consumer Deposits

The carrying amount approximates fair value due to the relatively short maturity of the deposits.

The estimated fair values of the financial instruments were as follows:

	December 31,			
	2019		2018	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets:				
Investments in associated organizations:				
Capital term certificates	\$ 3,748,977	\$ 4,417,000	\$ 3,933,588	\$ 4,062,000
Liabilities:				
Long-term debt including current portion	\$ 216,288,501	\$ 269,500,000	\$ 225,382,734	\$ 224,300,000

##### Note P - Related Party Transactions

The Cooperative was a member of the following organizations and conducted business transactions during the current and prior years as set forth below:

###### CFC

The Cooperative was a member of CFC, a national financing organization and, as explained in Notes D and J, had investment assets and a line of credit at various interest rates and maturities.

###### CoBank

The Cooperative and CSC were members of CoBank, a national financing organization and, as explained in Notes D and J had investment assets, lines of credit and a mortgage note payable at various interest rates and maturities.

###### ODEC

The Cooperative, as a member of ODEC, an organization composed of electric cooperatives, has entered into a contract for the acquisition of wholesale power. The cost of wholesale power to members is determined by the Board of Directors of ODEC and is regulated by the FERC. Additionally, as explained in Note D, the Cooperative had an investment in ODEC.

## **Notes to Consolidated Financial Statements**

### **Choptank Electric Cooperative, Inc. and Subsidiary**

#### **December 31, 2019 and 2018**

##### **Note P - Related Party Transactions - Continued**

###### CSC

The Cooperative provides certain administrative services to the CSC in addition to having certain members of management serve on the Board of Directors.

###### VMDAEC

The Cooperative was a member of the Virginia, Maryland, Delaware Association of Electric Cooperatives, an association organized to service rural electrification in those three state areas by providing group efforts on a regional basis in public and member relations, government affairs, human resource development, technical services and legal services. Additionally, as explained in Note D, the Cooperative had an investment in the Association.

##### **Note Q - Other**

In early March 2020, the Governor of Maryland declared a state of emergency as COVID-19 spread throughout the state. Subsequently, he ordered statewide closures of certain non-essential businesses. The Cooperative is considered essential and as such continues to operate, but many employees are working remotely. As of the date of the financial statements, there is no known material effect on the Cooperative related to COVID-19.

## **Supplementary Information**



**Independent Auditor's Report on Consolidating Information**

The Board of Directors  
Choptank Electric Cooperative, Inc. and Subsidiary  
Denton, Maryland

We have audited the consolidated financial statements of Choptank Electric Cooperative, Inc. and Choptank Services Corporation as of and for the years ended December 31, 2019 and 2018, and our report thereon dated March 24, 2020, which expressed an unmodified opinion on those consolidated financial statements, appears on pages 1-2. Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information on pages 27-29 is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual companies, and it is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

*Adams, Jenkins & Cheatham*

Richmond, Virginia  
March 24, 2020

## Consolidating Balance Sheets

### Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2019

	Choptank Electric Cooperative, Inc.	CSC	Eliminations	Total
<b>Assets</b>				
Electric plant				
Electric plant	\$ 447,890,819	\$	\$	\$ 447,890,819
Less accumulated provision for depreciation and amortization	<u>134,689,642</u>			<u>134,689,642</u>
	313,201,177			313,201,177
Other property and investments				
Investments in associated organizations	64,799,338	4,464,952		69,264,290
Nonutility property, net	212,161	23,635		235,796
Other	<u>2,972,040</u>		<u>(2,967,040)</u>	<u>5,000</u>
	67,983,539	4,488,587	(2,967,040)	69,505,086
Current assets				
Cash and cash equivalents	516,949	25,261		542,210
Accounts receivable, net	19,588,471			19,588,471
Materials and supplies	9,280,897			9,280,897
Other current assets	<u>2,270,408</u>	<u>112</u>		<u>2,270,520</u>
	31,656,725	25,373		31,682,098
Deferred charges	1,623,173			1,623,173
Assets for postretirement benefits	4,501,763			4,501,763
	<u>\$ 418,966,377</u>	<u>\$ 4,513,960</u>	<u>\$ (2,967,040)</u>	<u>\$ 420,513,297</u>

See Independent Auditor's Report on Consolidating Information

	Choptank Electric Cooperative, Inc.	CSC	Eliminations	Total
<b>Equities and Liabilities</b>				
Equities				
Patronage capital	\$ 150,217,350	\$	\$	\$ 150,217,350
Retained earnings		872,040	(872,040)	
Other equities	12,587,522	2,095,000	(2,095,000)	12,587,522
Accumulated other comprehensive income	7,286,080			7,286,080
Memberships	384,455			384,455
	<u>170,475,407</u>	<u>2,967,040</u>	<u>(2,967,040)</u>	<u>170,475,407</u>
Noncurrent liabilities				
Long-term debt	207,020,212			207,020,212
Other		359,000		359,000
	<u>207,020,212</u>	<u>359,000</u>		<u>207,379,212</u>
Current liabilities				
Bank advances	792,618			792,618
Accounts payable	20,652,939	3,920		20,656,859
Current portion of long-term debt	9,268,289			9,268,289
Other current and accrued liabilities	4,314,053			4,314,053
Credit lines	3,200,000	1,184,000		4,384,000
Consumer deposits	2,008,378			2,008,378
	<u>40,236,277</u>	<u>1,187,920</u>		<u>41,424,197</u>
Deferred credits	<u>1,234,481</u>			<u>1,234,481</u>
	<u>\$ 418,966,377</u>	<u>\$ 4,513,960</u>	<u>\$ (2,967,040)</u>	<u>\$ 420,513,297</u>

## Consolidating Statements of Operations

### Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2019

	Choptank Electric Cooperative, Inc.	CSC	Eliminations	Total
Operating revenues	\$ 146,220,668	\$	\$	\$ 146,220,668
Operating expenses				
Cost of power	83,391,325			83,391,325
Transmission	2,966			2,966
Distribution - operation	4,422,757			4,422,757
Distribution - maintenance	9,218,532			9,218,532
Power production - maintenance	14,386			14,386
Consumer accounts	3,170,398			3,170,398
Customer service and informational	1,006,236			1,006,236
Sales expense	145,815			145,815
Administrative and general	7,970,969	41,213		8,012,182
Depreciation and amortization	13,884,850			13,884,850
Taxes	4,104,537			4,104,537
Interest	10,931,105	57,897		10,989,002
Other deductions	204,103			204,103
	<u>138,467,979</u>	<u>99,110</u>		<u>138,567,089</u>
Operating Margins (Loss) Before Patronage Allocations	7,752,689	(99,110)		7,653,579
Patronage allocations	<u>2,561,921</u>	<u>12,915</u>		<u>2,574,836</u>
Net Operating Margins (Loss)	10,314,610	(86,195)		10,228,415
Nonoperating income (expense)				
Dividend income		75,071		75,071
Gain from equity investment		283,107		283,107
Gain on disposition of assets	291,076			291,076
Interest income	78,106			78,106
Other	25,487	5,700		31,187
Income from subsidiary	178,683		(178,683)	
	<u>573,352</u>	<u>363,878</u>	<u>(178,683)</u>	<u>758,547</u>
Net Margins Before Income Taxes	10,887,962	277,683	(178,683)	10,986,962
Income tax expense - deferred		(99,000)		(99,000)
Net Margins	<u>\$ 10,887,962</u>	<u>\$ 178,683</u>	<u>\$ (178,683)</u>	<u>\$ 10,887,962</u>

See Independent Auditor's Report on Consolidating Information