

Choptank Electric Cooperative, Inc. and Subsidiary
Consolidated Financial Statements
December 31, 2020 and 2019

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Financial Statements

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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, 2020 and 2019 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, 2020 and 2019, 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.

Allama, Jenkins & Cheatham

Richmond, Virginia
March 15, 2021

	December 31,	
	2020	2019
Equities and Liabilities		
Equities		
Patronage capital	\$ 152,538,744	\$ 150,217,350
Other equities	13,333,840	12,587,522
Accumulated other comprehensive income	8,292,713	7,286,080
Memberships	384,455	384,455
	<u>174,549,752</u>	<u>170,475,407</u>
Noncurrent liabilities		
Long-term debt	211,077,186	207,020,212
Other	691,803	359,000
	<u>211,768,989</u>	<u>207,379,212</u>
Current liabilities		
Bank advances	1,265,536	792,618
Accounts payable	14,066,912	20,656,859
Current portion of long-term debt	9,800,070	9,268,289
Other current and accrued liabilities	8,288,031	4,314,053
Credit lines	3,141,482	4,384,000
Consumer deposits	1,782,685	2,008,378
	<u>38,344,716</u>	<u>41,424,197</u>
Deferred credits	<u>1,737,604</u>	<u>1,234,481</u>
	<u>\$ 426,401,061</u>	<u>\$ 420,513,297</u>

Consolidated Statements of Operations

Choptank Electric Cooperative, Inc. and Subsidiary

	Year Ended December 31,	
	2020	2019
Operating revenues	\$ 134,543,699	\$ 146,220,668
Operating expenses		
Cost of power	74,787,807	83,391,325
Transmission	3,907	2,966
Distribution - operation	4,923,338	4,422,757
Distribution - maintenance	10,302,640	9,232,918
Consumer accounts	3,120,007	3,170,398
Customer service and informational	1,025,562	1,006,236
Sales expense	141,323	145,815
Administrative and general	5,597,164	8,012,182
Depreciation and amortization	14,653,234	13,884,850
Taxes	4,288,417	4,104,537
Interest	9,921,020	10,989,002
Other deductions	896,797	204,103
	<u>129,661,216</u>	<u>138,567,089</u>
Operating Margins Before Patronage Allocations	4,882,483	7,653,579
Patronage allocations	<u>2,086,767</u>	<u>2,574,836</u>
Net Operating Margins	6,969,250	10,228,415
Nonoperating income		
Dividend and interest income	199,688	153,177
Gain from equity investment	118,780	283,107
Gain on disposition of assets	100,051	291,076
Other	32,297	31,187
	<u>450,816</u>	<u>758,547</u>
Net Margins Before Income Taxes	7,420,066	10,986,962
Income tax expense - deferred		(99,000)
Net Margins	<u>\$ 7,420,066</u>	<u>\$ 10,887,962</u>

Consolidated Statements of Comprehensive Income

Net margins	\$ 7,420,066	\$ 10,887,962
Other comprehensive income (loss)		
Net gain during period	1,682,802	4,950,808
Reclassification adjustment for gain realized in net margins, net	<u>(676,169)</u>	<u>(708,589)</u>
	<u>1,006,633</u>	<u>4,242,219</u>
Comprehensive Income	<u>\$ 8,426,699</u>	<u>\$ 15,130,181</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, 2020 and 2019

	Patronage Capital	Other Equities	Accumulated Other Comprehensive Gain	Memberships	Total
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	150,217,350	12,587,522	7,286,080	384,455	170,475,407
Net margins	7,024,777	395,289			7,420,066
Other comprehensive income			1,006,633		1,006,633
Retirement of capital credits	<u>(4,703,383)</u>	<u>351,029</u>			<u>(4,352,354)</u>
Balance, December 31, 2020	<u>\$ 152,538,744</u>	<u>\$ 13,333,840</u>	<u>\$ 8,292,713</u>	<u>\$ 384,455</u>	<u>\$ 174,549,752</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,	
	2020	2019
Cash Flows from Operating Activities		
Net margins	\$ 7,420,066	\$ 10,887,962
Adjustments to reconcile net margins to net cash provided by operating activities:		
Depreciation and amortization charged to operations	14,653,234	13,884,850
Deferred income tax expense		99,000
Income from equity investments (MACS)	(231,386)	(358,178)
Gain on disposition of assets	(100,051)	(291,076)
Noncash capital credit allocations	(2,086,767)	(2,574,836)
(Increase) decrease in:		
Accounts receivable	(1,052,141)	256,072
Other current assets	(851,844)	86,891
Deferred charges	(3,246,750)	(1,613,264)
Other property and investments	(31,822)	455,047
Other noncurrent assets	(1,933,166)	(4,501,763)
Increase (decrease) in:		
Accounts payable	(6,589,947)	4,733,940
Other current and accrued liabilities	3,973,978	206,386
Deferred credits	503,123	(2,865,711)
Other noncurrent liabilities	1,339,436	2,784,403
Net Cash Provided by Operating Activities	11,765,963	21,189,723
Cash Flows from Investing Activities		
Investments in utility plant	(8,704,532)	(15,243,503)
Plant removal costs	(1,101,460)	(1,535,616)
Contributions in aid of construction	1,861,055	1,689,677
Proceeds from disposition of assets	131,057	328,291
Dividends received	112,606	75,071
Proceeds from retirement of investments in CTC's	124,205	184,611
Investment in Choptank Fiber, LLC	(2,000,000)	
Contributions to APBO plan assets, net		(517,596)
Proceeds from the sale of MACS stock	125,000	164,050
Net Cash Used by Investing Activities	(9,452,069)	(14,855,015)

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

	Year Ended December 31,	
	2020	2019
Cash Flows from Financing Activities		
Capital credits received from suppliers	555,335	1,208,460
Capital credits paid to members	(4,352,354)	(581,092)
Loan payments	(9,388,877)	(9,094,233)
Bank advances, net	472,918	(416,805)
Decrease in consumer deposits	(225,693)	35,514
Advances on lines of credit	16,800,000	19,788,282
Repayments on lines of credit	(18,042,518)	(17,263,282)
Loan proceeds	13,977,632	
Net Cash Used by Financing Activities	<u>(203,557)</u>	<u>(6,323,156)</u>
Net Increase in Cash and Cash Equivalents	2,110,337	11,552
Cash and cash equivalents - beginning of year	<u>542,210</u>	<u>530,658</u>
Cash and Cash Equivalents - End of Year	<u>\$ 2,652,547</u>	<u>\$ 542,210</u>
Non Cash Financing Activities		
Refinance of Farmer Mac debt to CFC	<u>\$ -</u>	<u>\$ 23,444,371</u>

Supplemental Disclosures

Choptank Electric Cooperative, Inc. and Subsidiary paid approximately \$9,957,000 and \$11,160,000 interest expense for the years ended December 31, 2020 and 2019, respectively.

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2020 and 2019

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 were regulated by the Maryland Public Service Commission until August 2020, at which time the Cooperative became Member Regulated.

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, 2020 and 2019. 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. 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, 2020 and 2019

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, 2020 and 2019

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 15, 2021, 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

As of January 1, 2019, the Cooperative adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606) using the retrospective method. The Cooperative evaluated and determined that ASC 606 did not have a material effect on the financial statements.

The Cooperative's primary source of revenue and accounts receivable is derived from implied contractual agreements with its customers for the provision of electric service. Electric revenue and the related cost of power are recognized when electricity is consumed, which complies with the requirements of ASC 606. The Cooperative recognizes revenue from consumed electricity in the appropriate reporting period through its estimation of unbilled revenue, on a monthly basis.

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2020 and 2019

Note B - Electric Plant

Listed below were the major classes of electric plant:

	December 31,	
	2020	2019
Distribution plant	\$ 387,399,709	\$ 379,711,785
General plant	53,924,849	52,160,932
Transmission plant	6,890,848	6,887,199
Production plant	1,377,362	1,345,469
Electric plant in service	449,592,768	440,105,385
Construction work in progress	3,259,646	7,785,434
	<u>\$ 452,852,414</u>	<u>\$ 447,890,819</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, 2020 and 2019. 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,	
	2020	2019
Buildings	\$ 207,193	\$ 203,328
Vehicles	36,244	36,244
	243,437	239,572
Less accumulated depreciation	179,046	164,037
	64,391	75,535
Land	160,261	160,261
	<u>\$ 224,652</u>	<u>\$ 235,796</u>

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2020 and 2019

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,	
	2020	2019
Patronage capital:		
Old Dominion Electric Cooperative (ODEC)	\$ 54,639,158	\$ 53,468,191
National Rural Utilities Cooperative Finance Corporation (CFC)	6,614,880	6,230,889
Other	772,143	795,669
	<u>62,026,181</u>	<u>60,494,749</u>
Capital Term Certificates:		
ZCTC's	1,895,141	1,949,046
SCTC's	1,414,331	1,414,331
LCTC's	315,300	385,600
	<u>3,624,772</u>	<u>3,748,977</u>
Other:		
MACS	4,244,194	4,250,414
Choptank Fiber, LLC	2,000,000	
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>7,014,344</u>	<u>5,020,564</u>
	<u>\$ 72,665,297</u>	<u>\$ 69,264,290</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.

The Cooperative formed Choptank Fiber, LLC, a wholly-owned subsidiary during 2020 to operate a broadband business within the Cooperative's membership territory. The Cooperative funded Choptank Fiber, LLC with an initial investment of \$2,000,000. This investment has been accounted for using the equity method of accounting.

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2020 and 2019

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,	
	2020	2019
Total assets	\$ 28,400,000	\$ 28,800,000
Total liabilities	\$ 17,100,000	\$ 17,500,000
Total members' equity	\$ 11,300,000	\$ 11,300,000
Total net income	\$ 616,000	\$ 968,000

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, 2020, the Cooperative had approximately \$2,400,000 of deposits that exceed the insured limits.

Note F - Accounts Receivable

Accounts receivable consisted of the following:

	December 31,	
	2020	2019
Unbilled revenue	\$ 11,718,602	\$ 11,481,914
Consumers	7,498,428	6,210,045
Other	2,173,582	2,121,976
	21,390,612	19,813,935
Less provision for uncollectible accounts	750,000	225,464
	<u>\$ 20,640,612</u>	<u>\$ 19,588,471</u>

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2020 and 2019

Note G - Deferred Charges

Deferred charges consisted of the following:

	December 31,	
	2020	2019
Qualifying PPP expenses	\$ 3,977,632	\$
Deferred power cost adjustment	841,985	1,424,056
Other	50,306	199,117
	<u>\$ 4,869,923</u>	<u>\$ 1,623,173</u>

Qualifying Payroll Protection Program (PPP) expenses represent expenses the Cooperative has deferred for ratemaking purposes in order to match the anticipated forgiveness of the PPP loan from CoBank expected to occur during 2021 (Note J).

Note H - Patronage Capital

Patronage capital consisted of the following:

	December 31,	
	2020	2019
Assigned	\$ 145,513,967	\$ 139,902,740
Assignable	7,024,777	10,314,610
	<u>\$ 152,538,744</u>	<u>\$ 150,217,350</u>

Note I - Other Equities

Other equities consisted of the following:

	December 31,	
	2020	2019
Nonoperating income	\$ 7,166,380	\$ 6,771,090
Retired capital credits - gain	5,934,363	5,583,335
Donated capital	232,397	232,397
Other	700	700
	<u>\$ 13,333,840</u>	<u>\$ 12,587,522</u>

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2020 and 2019

Note J - Long-Term Debt

Long-term debt consisted of the following:

	December 31,	
	2020	2019
CFC, Mortgage notes	\$ 195,332,198	\$ 193,654,750
Federal Agriculture Mortgage Corporation (Farmer Mac), Mortgage notes	21,567,426	22,633,751
CoBank, Paycheck Protection Program loan	3,977,632	
	220,877,256	216,288,501
Less current portion	9,800,070	9,268,289
	<u>\$ 211,077,186</u>	<u>\$ 207,020,212</u>

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

<u>Year Ending December 31,</u>	
2021	\$ 9,800,070
2022	10,126,059
2023	10,409,703
2024	10,585,385
2025	17,089,590
Thereafter	162,866,449
	<u>\$ 220,877,256</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, 2020 and 2019, 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 2.59% to 7.45%. The maturity dates of the notes range up to 35 years, beginning November 2021 through February 2050. Principal and interest installments were due quarterly in the amount of approximately \$5,892,000. The Cooperative had approximately \$24,300,000 in unadvanced funds available from CFC as of December 31, 2020.

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, 2020 and 2019. There was an outstanding balance on the CFC line of credit of \$2,200,000 at 2.25% interest rate at December 31, 2020, and an outstanding balance of \$3,200,000 at 2.85% interest rate at December 31, 2019. CSC had a line of credit with CoBank in the amount of \$2,800,000. There was an outstanding balance of \$941,482 at 2.45% interest rate and \$1,184,000 at 3.89% interest rate at December 31, 2020 and 2019, respectively.

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2020 and 2019

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% (1.245% to 1.445% as of December 31, 2020). 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 \$747,000.

During 2020, the Federal Government enacted legislation allowing companies to borrow money through the Small Business Administration (SBA) to extend employment for those that might be adversely affected by COVID-19. The program is known as the Payroll Protection Program (PPP). Under this program a company can apply for funds to use to continue to employ personnel through the downturn experienced during the COVID-19 epidemic. The program allows for a forgiveness of the loan amount if the company can demonstrate that they incurred qualifying expenses in a prescribed time frame, in this case 24 weeks.

The Cooperative applied for and was granted a loan of \$3,977,632 and has received the funds. Currently the balance is reflected in Long-Term Debt. The Cooperative believes they will have sufficient qualifying expenses to obtain full forgiveness within the 24-week period. If the amount is forgiven, the Cooperative will credit the amount to the income statement. If some or all of the amount is not forgiven, that amount will be carried as debt for a period not to exceed two years. The qualifying expenses have been recorded as a regulatory asset (Note G) and will be recognized at the time the loan is forgiven.

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 multiple employer 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 multiple employer 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 2020 and in 2019 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 \$993,000 in 2020 and \$2,676,000 in 2019.

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2020 and 2019

Note K - Employee Benefits - Continued

Pension Plan - Continued

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, 2020 and over 80% funded on January 1, 2019 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.

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, 2020 and 2019, the Cooperative’s required contribution to the Plan and its net pension cost was approximately \$2,509,000 and \$473,000, respectively.

Effective April 1, 2020, the Cooperative transitioned from the RS Plan to a defined contribution 401(k) plan. The intent is to provide a sustainable retirement plan that allows the Cooperative to remain competitive for talent in the electric utility industry, while balancing the need for predictable costs associated with the plan. The RS Plan benefits have been frozen and employees will no longer accrue additional benefits under the plan. The new 401(k) plan provides for non-elective Cooperative contributions based on a tiered schedule, with tiers varying based on age and years of service.

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 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 (71%), bond funds (26%) and other (3%) at December 31, 2020. Investments in plan assets were allocated between equities (72%), bond funds (27%) and other (1%) at December 31, 2019.

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2020 and 2019

Note K - Employee Benefits - Continued

Other Postretirement Employee Benefits - Continued

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.

The following tables set forth the accumulated postretirement plan's benefit obligation (APBO), fair value of plan assets, and funded status as of December 31, 2020 and 2019:

	December 31,	
	2020	2019
APBO	\$ 16,001,966	\$ 15,510,095
Change in fair value of plan assets:		
Fair value of plan assets at beginning of year	19,375,858	16,628,039
Actual return on plan assets	3,061,037	2,515,223
Contributions		517,596
Withdrawals		(285,000)
Fair value of plan assets at end of year	<u>22,436,895</u>	<u>19,375,858</u>
Funded status	6,434,929	3,865,763
Less current portion		(636,000)
	<u>\$ 6,434,929</u>	<u>\$ 4,501,763</u>

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

	Year Ended December 31,	
	2020	2019
Interest cost on benefit obligations	\$ 542,264	\$ 603,214
Service cost, benefits earned during the period	185,961	176,526
Expected return on plan assets	(961,043)	(738,884)
Amortization of deferred cost	(676,169)	(708,589)
	<u>\$ (908,987)</u>	<u>\$ (667,733)</u>

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2020 and 2019

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,	
	2020	2019
Unrealized gain on plan assets	\$ 3,748,478	\$ 4,841,839
Unrecognized actuarial gain	4,544,235	2,444,241
	<u>\$ 8,292,713</u>	<u>\$ 7,286,080</u>

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

	December 31,	
	2020	2019
Assumptions and effects:		
Medical trend rate		
Under 65	6.65%	6.80%
65 and older	4.80%	4.70%
Ultimate trend rate	5.00%	5.00%
Year ultimate trend rate achieved	2029	2026
Discount rate	3.00%	3.65%
Expected return on asset	4.60%	4.96%
Measurement date	1/1/2020	1/1/2019
Effect of a 1% increase in health care cost trend rate on:		
APBO	\$ 2,321,000	\$ 2,015,000
Interest plus service cost components	\$ 106,000	\$ 101,000

Estimated future benefit payments are shown net of employee contributions:

<u>Year Beginning January 1,</u>	
2021	\$ 601,000
2022	\$ 612,000
2023	\$ 678,000
2024	\$ 765,000
2025	\$ 855,000
2026 - 2030	\$ 4,897,000

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2020 and 2019

Note L - Deferred Credits

Deferred credits consisted of the following:

	December 31,	
	2020	2019
Unclaimed capital credits	\$ 1,739,381	\$ 1,195,084
Other	(1,777)	39,397
	<u>\$ 1,737,604</u>	<u>\$ 1,234,481</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, 2020, 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, 2020 and 2019

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 \$2,280,000. CSC's total deferred tax assets and liabilities consisted of the following:

	December 31,	
	2020	2019
Total deferred tax assets	\$ 641,000	\$ 641,000
Total deferred tax liabilities	<u>(1,000,000)</u>	<u>(1,000,000)</u>
Net deferred tax liability	<u>\$ (359,000)</u>	<u>\$ (359,000)</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,	
	2020	2019
Deferred:		
Federal	\$ -	\$ (93,060)
State	<u>-</u>	<u>(5,940)</u>
	<u>\$ -</u>	<u>\$ (99,000)</u>

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2020 and 2019

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 1.65% and 2.39% for the years ending December 31, 2020 and 2019, 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 3.57% and 4.19% for the years ending December 31, 2020 and 2019, respectively.

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2020 and 2019

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,			
	2020		2019	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets:				
Investments in associated organizations:				
Capital term certificates	\$ 3,624,772	\$ 5,042,000	\$ 3,748,977	\$ 4,417,000
Liabilities:				
Long-term debt including current portion	\$ 220,877,256	\$ 280,600,000	\$ 216,288,501	\$ 269,500,000

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, 2020 and 2019

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 - COVID-19

In December 2019, a novel strain of coronavirus (COVID-19) surfaced in Wuhan, China and has spread around the world, with resulting business and social disruption. COVID-19 was declared a Public Health Emergency of International Concern by the World Health Organization on January 30, 2020. The COVID-19 pandemic is having widespread, rapidly evolving, and unpredictable impacts on global society, economies, financial markets, and business practices. The Cooperative to date has not seen significant disruption or significant operational restrictions, but the substantial uncertainty and the nature and degree of the pandemic and resulting effects over time could result in disruption or restriction on the Cooperative's ability to operate normally. The Cooperative's members are also affected by the outbreak, which could delay their power bill payments. Cooperative plant construction projects may be delayed or cancelled and certain management accounting estimates and assumptions could be affected by the future uncertainty. The Cooperative may also experience difficulties with suppliers or with vendors in their supply chain, which could have negative effects on operations. Overall, the future impact of the pandemic with respect to the Cooperative's territory is difficult to predict and could adversely impact its overall operations in the future.

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, 2020 and 2019, and our report thereon dated March 15, 2021, 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 15, 2021

Consolidating Balance Sheets

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2020

	Choptank Electric Cooperative, Inc.	CSC	Eliminations	Total
Assets				
Electric plant				
Electric plant	\$ 452,852,414	\$	\$	\$ 452,852,414
Less accumulated provision for depreciation and amortization	<u>146,245,642</u>			<u>146,245,642</u>
	306,606,772			306,606,772
Other property and investments				
Investments in associated organizations	68,230,177	4,435,120		72,665,297
Nonutility property, net	208,223	16,429		224,652
Other	<u>3,185,421</u>		<u>(3,148,599)</u>	<u>36,822</u>
	71,623,821	4,451,549	(3,148,599)	72,926,771
Current assets				
Cash and cash equivalents	2,646,733	5,814		2,652,547
Accounts receivable, net	20,647,016		(6,404)	20,640,612
Materials and supplies	9,147,143			9,147,143
Other current assets	<u>3,122,252</u>	<u>112</u>		<u>3,122,364</u>
	35,563,144	5,926	(6,404)	35,562,666
Deferred charges	4,869,923			4,869,923
Assets for postretirement benefits	6,434,929			6,434,929
	<u>\$ 425,098,589</u>	<u>\$ 4,457,475</u>	<u>\$ (3,155,003)</u>	<u>\$ 426,401,061</u>

See Independent Auditor's Report on Consolidating Information

	Choptank Electric Cooperative, Inc.	CSC	Eliminations	Total
Equities and Liabilities				
Equities				
Patronage capital	\$ 152,538,744	\$	\$	\$ 152,538,744
Retained earnings		1,053,599	(1,053,599)	
Other equities	13,333,840	2,095,000	(2,095,000)	13,333,840
Accumulated other comprehensive income	8,292,713			8,292,713
Memberships	384,455			384,455
	<u>174,549,752</u>	<u>3,148,599</u>	<u>(3,148,599)</u>	<u>174,549,752</u>
Noncurrent liabilities				
Long-term debt	211,077,186			211,077,186
Other	332,803	359,000		691,803
	<u>211,409,989</u>	<u>359,000</u>		<u>211,768,989</u>
Current liabilities				
Bank advances	1,265,536			1,265,536
Accounts payable	14,064,922	1,990		14,066,912
Current portion of long-term debt	9,800,070			9,800,070
Other current and accrued liabilities	8,288,031	6,404	(6,404)	8,288,031
Credit lines	2,200,000	941,482		3,141,482
Consumer deposits	1,782,685			1,782,685
	<u>37,401,244</u>	<u>949,876</u>	<u>(6,404)</u>	<u>38,344,716</u>
Deferred credits	<u>1,737,604</u>			<u>1,737,604</u>
	<u>\$ 425,098,589</u>	<u>\$ 4,457,475</u>	<u>\$ (3,155,003)</u>	<u>\$ 426,401,061</u>

Consolidating Statements of Operations

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2020

	Choptank Electric Cooperative, Inc.	CSC	Eliminations	Total
Operating revenues	\$ 134,543,699	\$	\$	\$ 134,543,699
Operating expenses				
Cost of power	74,787,807			74,787,807
Transmission	3,907			3,907
Distribution - operation	4,923,338			4,923,338
Distribution - maintenance	10,302,640			10,302,640
Consumer accounts	3,120,007			3,120,007
Customer service and informational	1,025,562			1,025,562
Sales expense	141,323			141,323
Administrative and general	5,561,323	35,841		5,597,164
Depreciation and amortization	14,653,234			14,653,234
Taxes	4,288,417			4,288,417
Interest	9,889,523	31,497		9,921,020
Other deductions	896,797			896,797
	<u>129,593,878</u>	<u>67,338</u>		<u>129,661,216</u>
Operating Margins (Loss) Before Patronage Allocations	4,949,821	(67,338)		4,882,483
Patronage allocations	<u>2,074,956</u>	<u>11,811</u>		<u>2,086,767</u>
Net Operating Margins (Loss)	7,024,777	(55,527)		6,969,250
Nonoperating income (expense)				
Dividend and interest income	87,082	112,606		199,688
Gain from equity investment		118,780		118,780
Gain on disposition of assets	100,051			100,051
Other	26,597	5,700		32,297
Income from subsidiary	181,559		(181,559)	
	<u>395,289</u>	<u>237,086</u>	<u>(181,559)</u>	<u>450,816</u>
Net Margins Before Income Taxes	<u>7,420,066</u>	<u>181,559</u>	<u>(181,559)</u>	<u>7,420,066</u>
Net Margins	<u>\$ 7,420,066</u>	<u>\$ 181,559</u>	<u>\$ (181,559)</u>	<u>\$ 7,420,066</u>

See Independent Auditor's Report on Consolidating Information