

**Choptank Electric Cooperative, Inc. and Subsidiary**  
**Consolidated Financial Statements**  
**December 31, 2018 and 2017**

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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, 2018 and 2017 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 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, 2018 and 2017, 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.

*Adams, Jenkins & Cheatham*

Richmond, Virginia  
March 20, 2019

## Consolidated Balance Sheets

### Choptank Electric Cooperative, Inc. and Subsidiary

	December 31,	
	2018	2017
<b>Assets</b>		
Electric plant		
Electric plant	\$ 438,462,408	\$ 420,347,663
Less accumulated provision for depreciation and amortization	<u>126,645,199</u>	<u>117,807,343</u>
	311,817,209	302,540,320
Other property and investments		
Investments in associated organizations	67,963,468	65,940,394
Nonutility property, net	346,763	336,413
Other	<u>460,047</u>	<u>463,257</u>
	68,770,278	66,740,064
Current assets		
Cash and cash equivalents	530,658	299,338
Accounts receivable, net	19,844,543	22,031,200
Materials and supplies	9,386,521	8,800,159
Other current assets	<u>2,357,411</u>	<u>1,913,056</u>
	32,119,133	33,043,753
Deferred charges	9,909	41,767
	<u>\$ 412,716,529</u>	<u>\$ 402,365,904</u>

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

	December 31,	
	<u>2018</u>	<u>2017</u>
<b>Equities and Liabilities</b>		
Equities		
Patronage capital	\$ 141,067,321	\$ 132,897,105
Other equities	11,430,681	10,247,401
Accumulated other comprehensive income	3,043,861	2,176,142
Memberships	384,455	384,455
	<u>155,926,318</u>	<u>145,705,103</u>
Noncurrent liabilities		
Long-term debt	216,031,796	211,823,992
Other	2,334,412	4,082,194
	<u>218,366,208</u>	<u>215,906,186</u>
Current liabilities		
Bank advances	1,209,423	1,212,706
Accounts payable	15,922,919	14,796,741
Current portion of long-term debt	9,350,938	9,744,861
Other current and accrued liabilities	4,107,667	3,709,873
Credit lines	1,859,000	1,620,000
Consumer deposits	1,972,864	2,082,629
	<u>34,422,811</u>	<u>33,166,810</u>
Deferred credits	<u>4,001,192</u>	<u>7,587,805</u>
	<u>\$ 412,716,529</u>	<u>\$ 402,365,904</u>

## Consolidated Statements of Operations and Comprehensive Income

### Choptank Electric Cooperative, Inc. and Subsidiary

	Year Ended December 31,	
	2018	2017
Operating revenues	\$ 146,083,381	\$ 122,145,060
Operating expenses		
Cost of power	82,978,064	69,715,322
Transmission	5,614	8,852
Distribution - operation	4,097,453	4,275,311
Distribution - maintenance	9,031,606	7,484,863
Power production - maintenance		6,973
Consumer accounts	3,255,630	3,688,126
Customer service and informational	937,129	907,359
Sales expense	31,001	70,656
Administrative and general	6,808,259	6,104,818
Depreciation and amortization	13,871,318	13,677,703
Taxes	3,560,428	3,571,077
Interest on long-term debt	10,139,985	9,388,036
Interest - other	250,810	262,047
Other deductions	74,270	80,685
	135,041,567	119,241,828
Operating Margins Before Patronage Allocations	11,041,814	2,903,232
Patronage allocations	2,164,278	3,464,830
Net Operating Margins	13,206,092	6,368,062
Nonoperating income (expense)		
Dividend income	155,094	99,187
Gain from equity investment	473,660	134,267
Gain on disposition of assets	258,611	99,798
Interest income	95,650	89,915
Other	6,905	(6,375)
	989,920	416,792
Net Margins Before Income Taxes	14,196,012	6,784,854
Income tax expense - deferred	(208,000)	\$ (52,000)
Net Margins	13,988,012	6,732,854
Other comprehensive income (loss)		
Net gain during period	890,617	6,010,475
Amortization of service cost	(22,898)	
	867,719	6,010,475
Comprehensive Income	\$ 14,855,731	\$ 12,743,329

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, 2018 and 2017

	Patronage Capital	Other Equities	Accumulated Other Comprehensive Gain (Loss)	Memberships	Total
Balance, December 31, 2016	\$ 129,539,081	\$ 9,621,687	\$ (3,834,333)	\$ 384,455	\$ 135,710,890
Net margins	6,435,727	297,127			6,732,854
Other comprehensive income			6,010,475		6,010,475
Retirement of capital credits	(3,077,703)	328,587			(2,749,116)
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	(5,116,093)	481,577			(4,634,516)
Balance, December 31, 2018	<u>\$ 141,067,321</u>	<u>\$11,430,681</u>	<u>\$ 3,043,861</u>	<u>\$ 384,455</u>	<u>\$ 155,926,318</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,	
	2018	2017
<b>Cash Flows from Operating Activities</b>		
Net margins	\$ 13,988,012	\$ 6,732,854
Adjustments to reconcile net margins to net cash provided by operating activities:		
Depreciation and amortization charged to operations	13,871,318	13,677,703
Deferred income tax expense	208,000	52,000
Income from equity investments (MACS)	(628,754)	(233,454)
Gain on disposition of assets	(258,611)	(99,798)
Noncash capital credit allocations	(2,164,278)	(3,464,830)
(Increase) decrease in:		
Accounts receivable	2,186,657	(5,122,549)
Other current assets	(444,355)	(139,406)
Deferred charges	31,858	628,374
Other property and investments	3,210	(22,078)
Increase (decrease) in:		
Accounts payable	1,126,178	(707,408)
Other current and accrued liabilities	397,794	163,589
Deferred credits	(3,794,613)	5,273,858
Other noncurrent liabilities	(360,977)	210,935
Net Cash Provided by Operating Activities	24,161,439	16,949,790
<b>Cash Flows from Investing Activities</b>		
Investments in utility plant	(24,294,438)	(23,231,733)
Plant removal costs	(1,736,370)	(1,562,413)
Contributions in aid of construction	2,143,247	2,047,796
Proceeds from disposition of assets	336,728	183,312
Dividends received	155,094	99,187
Proceeds from retirement of investments in CTC's	59,017	152,716
Contributions to APBO plan assets, net	(519,086)	(517,596)
Proceeds from the sale of MACS stock	200,000	130,000
Net Cash Used by Investing Activities	(23,655,808)	(22,698,731)

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

	Year Ended December 31,	
	2018	2017
<b>Cash Flows from Financing Activities</b>		
Capital credits received from suppliers	420,372	2,477,108
Capital credits paid to members	(4,634,516)	(2,749,116)
Loan proceeds	13,000,000	14,000,000
Loan payments	(9,186,119)	(8,304,897)
Bank advances, net	(3,283)	999,615
Decrease in consumer deposits	(109,765)	(312,491)
Advances on lines of credit	9,859,778	12,250,000
Repayments on lines of credit	(9,620,778)	(12,450,000)
Net Cash Provided (Used) by Financing Activities	<u>(274,311)</u>	<u>5,910,219</u>
Net Increase in Cash and Cash Equivalents	231,320	161,278
Cash and cash equivalents - beginning of year	<u>299,338</u>	<u>138,060</u>
Cash and Cash Equivalents - End of Year	<u>\$ 530,658</u>	<u>\$ 299,338</u>
<b>Non Cash Financing Activities</b>		
Refinance of CFC debt to Farmer Mac		<u>\$ 24,000,000</u>

### Supplemental Disclosures

Choptank Electric Cooperative, Inc. and Subsidiary paid approximately \$10,319,000 and \$9,439,000 interest expense for the years ended December 31, 2018 and 2017, respectively.

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2018 and 2017

#### 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% and 38.77% interest in Mid-Atlantic Cooperative Solutions, Inc., (MACS) as of December 31, 2018 and 2017, respectively. 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).

##### Reclassifications

Certain reclassifications have been made to the 2017 financial statements to conform to the 2018 presentation.

##### 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. AUSCO 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.

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2018 and 2017

##### 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	2.00 - 20.00%
Transmission plant	3.29%

###### 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.

###### 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.

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2018 and 2017

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

##### 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.

##### Accounts Receivable

The Cooperative provides for uncollectible accounts monthly, based on a percentage of sales which past experience has indicated will be uncollectible. When accounts are deemed to be uncollectible, they are charged against the provision for uncollectible accounts.

##### Interest

Interest is recorded as interest income or expense as incurred.

##### Advertising Costs

Advertising costs were expensed as incurred.

##### Subsequent Events

Subsequent events have been evaluated through March 20, 2019, which is the date the financial statements were available to be issued.

##### Revenue Recognition and Accounts Receivable

Revenue is recognized at the time energy is delivered to consumers on a monthly basis.

The billing rate schedules of the Cooperative contain provisions to either increase or decrease the consumers' billings from the base level billing schedules dependent upon the wholesale power cost from the supplier of electric energy purchased for resale. Any amounts collected over or under the Cooperatives monthly power costs are recorded as a deferred credit or deferred charge as applicable. The Cooperative had a cumulative over-recovery of power cost of \$1,846,874 and \$5,654,514 at December 31, 2018 and 2017, respectively, which was included in deferred credits.

The Cooperative provides for uncollectible accounts monthly, based on a percentage of sales which past experience has indicated will be uncollectible. When accounts are deemed to be uncollectible, they are charged against the provision for uncollectible accounts.

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2018 and 2017

##### Note B - Electric Plant

Listed below were the major classes of electric plant:

	December 31,	
	2018	2017
Distribution plant	\$ 367,791,532	\$ 356,233,898
General plant	50,789,020	47,707,780
Transmission plant	6,052,068	5,973,765
Production plant	1,142,268	1,142,268
Electric plant in service	425,774,888	411,057,711
Construction work in progress	12,687,520	9,289,952
	<u>\$ 438,462,408</u>	<u>\$ 420,347,663</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, 2018 and 2017. 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,	
	2018	2017
Buildings	\$ 397,046	\$ 397,046
Vehicles	36,244	
	433,290	397,046
Less accumulated depreciation	298,686	272,792
	134,604	124,254
Land	212,159	212,159
	<u>\$ 346,763</u>	<u>\$ 336,413</u>

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2018 and 2017

##### 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,	
	2018	2017
Patronage capital:		
Old Dominion Electric Cooperative (ODEC)	\$ 52,459,055	\$ 51,194,423
National Rural Utilities Cooperative Finance Corporation (CFC)	5,910,243	5,485,950
Other	759,075	704,978
	<u>59,128,373</u>	<u>57,385,351</u>
Capital Term Certificates:		
ZCTC's	2,133,657	2,192,674
SCTC's	1,414,331	1,414,331
LCTC's	385,600	385,600
	<u>3,933,588</u>	<u>3,992,605</u>
Other:		
MACS	4,131,357	3,792,288
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>4,901,507</u>	<u>4,562,438</u>
	<u>\$ 67,963,468</u>	<u>\$ 65,940,394</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, 2018 and 2017

##### 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 Adams Utility Service Company (AUSCO) each hold a 37.54% ownership interest in MACS and the MACS ESOP holds 24.92%. Total assets of MACS were approximately \$30,900,000 and \$30,100,000 at December 31, 2018 and 2017, respectively. Total liabilities were approximately \$19,900,000 and \$20,300,000 at December 31, 2018 and 2017, respectively. Total equity was approximately \$11,000,000 and \$9,800,000 at December 31, 2018 and 2017, respectively. MACS's net profit for the years ended December 31, 2018 and 2017 was approximately \$960,000 and \$600,000, respectively.

##### 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, 2018, the Cooperative had approximately \$211,000 of deposits that exceed the insured limits.

##### Note F - Accounts Receivable

Accounts receivable consisted of the following:

	December 31,	
	2018	2017
Unbilled Revenue	\$ 11,638,285	\$ 10,234,935
Consumers	6,627,671	5,888,001
Other	1,806,634	6,161,895
	20,072,590	22,284,831
Less provision for uncollectible accounts	228,047	253,631
	<u>\$ 19,844,543</u>	<u>\$ 22,031,200</u>

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2018 and 2017

##### Note G - Deferred Charges

Deferred charges consisted of the following:

	December 31,	
	2018	2017
Other	\$ 9,909	\$ 38,002
Unamortized debt expense		3,765
	<u>\$ 9,909</u>	<u>\$ 41,767</u>

##### Note H - Patronage Capital

Patronage capital consisted of the following:

	December 31,	
	2018	2017
Assigned	\$ 127,781,012	\$ 126,461,378
Assignable	13,286,309	6,435,727
	<u>\$ 141,067,321</u>	<u>\$ 132,897,105</u>

##### Note I - Other Equities

Other equities consisted of the following:

	December 31,	
	2018	2017
Nonoperating income	\$ 6,197,738	\$ 5,496,035
Retired capital credits - gain	4,999,846	4,518,269
Donated capital	232,397	232,397
Other	700	700
	<u>\$ 11,430,681</u>	<u>\$ 10,247,401</u>

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2018 and 2017

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

Long-term debt consisted of the following:

	December 31,	
	2018	2017
CFC, Mortgage notes	\$ 178,252,635	\$ 172,845,302
Federal Agriculture Mortgage Corporation (Farmer Mac), Mortgage notes	47,130,099	48,723,551
	225,382,734	221,568,853
Less current portion	9,350,938	9,744,861
	<u>\$ 216,031,796</u>	<u>\$ 211,823,992</u>

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

<u>Year Ending December 31,</u>	
2019	\$ 9,350,938
2020	9,419,208
2021	9,725,008
2022	10,047,148
2023	10,326,984
Thereafter	176,513,448
	<u>\$ 225,382,734</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, 2018 and 2017, 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 3.50% to 7.45%. The maturity dates of the notes range up to 35 years, beginning November 2019 through August 2048. Principal and interest installments were due quarterly in the amount of approximately \$5,729,000. The Cooperative had \$57,700,000 in unadvanced funds available from CFC as of December 31, 2018.

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2018 and 2017

##### 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% (3.449% to 3.649% as of December 31, 2018). 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 \$1,531,000.

The Cooperative had lines of credit with CoBank and CFC in the amount of \$12,000,000 and \$20,000,000, respectively. There was no balance outstanding on the Cobank line of credit at December 31, 2018 and 2017. There was an outstanding balance on the CFC line of credit of \$500,000 at 3.35% interest rate. There was no balance outstanding on the CFC line of credit at December 31, 2017. CSC had a line of credit with CoBank in the amount of \$2,800,000. There was an outstanding balance of \$1,359,000 at 4.61% interest rate and \$1,620,000 at 3.67% interest rate at December 31, 2018 and 2017, respectively.

##### Note K - Other Noncurrent Liabilities

Other noncurrent liabilities consisted of the following:

	December 31,	
	2018	2017
Other postretirement benefits	\$ 1,248,426	\$ 3,250,176
Accrued sick leave	634,404	581,568
Accrued vacation leave	191,582	198,450
Other	260,000	52,000
	<u>\$ 2,334,412</u>	<u>\$ 4,082,194</u>

The Cooperative provides certain health care and life insurance benefits for retired employees. A slight majority of employees are eligible to participate when they reach normal retirement age while working for the Cooperative. Employees hired after October 16, 1996, are not eligible. The plan is contributory, with retirees sharing in the cost of dependent coverage.

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 (50%), bond funds (38%) and other (12%) at December 31, 2018. Investments were allocated between equities (75%) and other (25%) at December 31, 2017.

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2018 and 2017

##### Note K - Other Noncurrent Liabilities - 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.

The Cooperative recognizes the funded status of its other postretirement medical, dental and vision benefit programs as a liability in its balance sheet and recognizes changes in the funded status as a component of other comprehensive income in the year in which the changes occur in accordance with ASC Topic 715. The funded status is measured as the difference between the fair value of the plan's assets and the benefit obligation.

The following sets forth the benefit obligation with the funded status of the plan:

	December 31,	
	2018	2017
Change in accumulated postretirement benefit obligation (APBO):		
APBO at beginning of year	\$ 21,193,376	\$ 24,541,699
Interest cost	852,500	836,700
Service cost	289,800	301,700
Benefit payments	(634,500)	(498,724)
Net actuarial gain	(3,152,803)	(3,987,999)
APBO at end of year	<u>18,548,373</u>	<u>21,193,376</u>
Change in fair value of plan assets:		
Fair value of plan assets at beginning of year	17,443,200	14,217,711
Actual return on plan assets	(1,334,248)	2,707,893
Contributions	519,087	517,596
Fair value of plan assets at end of year	<u>16,628,039</u>	<u>17,443,200</u>
Funded status (net APBO)	(1,920,334)	(3,750,176)
Less current portion	<u>(671,908)</u>	<u>(500,000)</u>
	<u>\$ (1,248,426)</u>	<u>\$ (3,250,176)</u>

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2018 and 2017

#### Note K - Other Noncurrent Liabilities - Continued

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

	Year Ended December 31,	
	2018	2017
Interest cost on benefit obligations	\$ 852,500	\$ 836,700
Service cost, benefits earned during the period	289,800	301,700
Return on plan assets	(929,429)	(746,400)
Amortization of deferred cost	(22,898)	
	<u>\$ 189,973</u>	<u>\$ 392,000</u>

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

	December 31,	
	2018	2017
Unrealized gain on plan assets	\$ 2,375,959	\$ 2,930,088
Unrecognized actuarial gain (loss)	667,902	(753,946)
	<u>\$ 3,043,861</u>	<u>\$ 2,176,142</u>

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

	December 31,	
	2018	2017
Assumptions and effects:		
Medical trend rate		
Under 65	6.60%	7.50%
65 and older	4.70%	6.15%
Ultimate trend rate	5.00%	5.00%
Year ultimate trend rate achieved	2025	2028
Discount rate	4.65%	4.17%
Expected return on asset	4.37%	5.25%
Measurement date	1/1/2019	1/1/2017
Effect of a 1% increase in health care cost trend rate on:		
APBO	\$ 3,211,000	\$ 3,800,000
Interest plus service cost components	\$ 198,000	\$ 223,000

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2018 and 2017

##### Note K - Other Noncurrent Liabilities - Continued

Estimated future benefit payments are shown net of employee contributions:

<u>Year Beginning January 1,</u>		
2019	\$	672,000
2020	\$	692,000
2021	\$	715,000
2022	\$	757,000
2023	\$	807,000
2024 - 2028	\$	5,254,000

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

Approximate expected contribution for year ending December 31, 2019:

Employer	\$519,000
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##### Note L - Deferred Credits

Deferred credits consisted of the following:

	<u>December 31,</u>	
	<u>2018</u>	<u>2017</u>
Wholesale power cost adjustment (WPCA)	\$ 1,846,874	\$ 5,654,514
Unclaimed capital credits	1,557,319	1,335,795
Other	596,999	597,496
	<u>\$ 4,001,192</u>	<u>\$ 7,587,805</u>

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2018 and 2017

#### 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 have a labor agreement in effect through October 15, 2020, which covers approximately 105 of the 157 employees of the Cooperative. The agreement covers substantially all operation, maintenance and administrative personnel.

##### 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.

#### Note N - Retirement Plans

##### 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 2018 and in 2017 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 \$2,718,000 in 2018 and \$2,708,000 in 2017.

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2018 and 2017

##### Note N - Retirement Plans - 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 percent funded on January 1, 2018 and over 80% funded on January 1, 2017 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.

##### Deferred Income Plan

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, 2018 and 2017, the Cooperative’s required contribution to the Plan and its net pension cost was approximately \$456,000 and \$450,000, respectively.

##### Note O - Fair Value of Financial Instruments

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.

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2018 and 2017

##### Note O - Fair Value of Financial Instruments - Continued

###### 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 3.02% and 2.74% for the years ending December 31, 2018 and 2017, 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 5.90% and 5.50% for the years ending December 31, 2018 and 2017, respectively.

###### 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,			
	2018		2017	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets:				
Investments in associated organizations:				
Capital term certificates	\$ 3,933,588	\$ 4,062,000	\$ 3,992,605	\$ 4,299,000
Liabilities:				
Long-term debt including current portion	\$ 225,382,734	\$ 224,300,000	\$ 221,568,853	\$ 227,200,000

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2018 and 2017

#### 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, a line of credit, and mortgage notes payable 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.

##### 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.

## **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, 2018 and 2017, and our report thereon dated March 20, 2019, which expressed an unmodified opinion on those 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 26-28 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 20, 2019

## Consolidating Balance Sheets

### Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2018

	Choptank Electric Cooperative, Inc.	CSC	Eliminations	Total
<b>Assets</b>				
Electric plant				
Electric plant	\$ 438,462,408	\$	\$	\$ 438,462,408
Less accumulated provision for depreciation and amortization	126,645,199			126,645,199
	<u>311,817,209</u>			<u>311,817,209</u>
Other property and investments				
Investments in associated organizations	63,594,139	4,369,329		67,963,468
Nonutility property, net	315,923	30,840		346,763
Other	3,248,404		(2,788,357)	460,047
	<u>67,158,466</u>	<u>4,400,169</u>	<u>(2,788,357)</u>	<u>68,770,278</u>
Current assets				
Cash and cash equivalents	518,266	12,392		530,658
Accounts receivable, net	19,844,543			19,844,543
Materials and supplies	9,386,521			9,386,521
Other current assets	2,357,299	112		2,357,411
	<u>32,106,629</u>	<u>12,504</u>		<u>32,119,133</u>
Deferred charges	9,909			9,909
	<u>\$ 411,092,213</u>	<u>\$ 4,412,673</u>	<u>\$ (2,788,357)</u>	<u>\$ 412,716,529</u>

See Independent Auditor's Report on Consolidating Information

	Choptank Electric Cooperative, Inc.	CSC	Eliminations	Total
<b>Equities and Liabilities</b>				
Equities				
Patronage capital	\$ 141,067,321	\$	\$	\$ 141,067,321
Retained earnings		693,357	(693,357)	
Other equities	11,430,681	2,095,000	(2,095,000)	11,430,681
Accumulated other comprehensive income	3,043,861			3,043,861
Memberships	384,455			384,455
	<u>155,926,318</u>	<u>2,788,357</u>	<u>(2,788,357)</u>	<u>155,926,318</u>
Noncurrent liabilities				
Long-term debt	216,031,796			216,031,796
Other	2,074,412	260,000		2,334,412
	<u>218,106,208</u>	<u>260,000</u>		<u>218,366,208</u>
Current liabilities				
Bank advances	1,209,423			1,209,423
Accounts payable	15,917,603	5,316		15,922,919
Current portion of long-term debt	9,350,938			9,350,938
Other current and accrued liabilities	4,107,667			4,107,667
Credit lines	500,000	1,359,000		1,859,000
Consumer deposits	1,972,864			1,972,864
	<u>33,058,495</u>	<u>1,364,316</u>		<u>34,422,811</u>
Deferred credits	<u>4,001,192</u>			<u>4,001,192</u>
	<u>\$ 411,092,213</u>	<u>\$ 4,412,673</u>	<u>\$ (2,788,357)</u>	<u>\$ 412,716,529</u>

## Consolidating Statements of Operations

### Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2018

	Choptank Electric Cooperative, Inc.	CSC	Eliminations	Total
Operating revenues	\$ 146,083,381	\$	\$	\$ 146,083,381
Operating expenses				
Cost of power	82,978,064			82,978,064
Transmission	5,614			5,614
Distribution - operation	4,097,453			4,097,453
Distribution - maintenance	9,031,606			9,031,606
Consumer accounts	3,255,630			3,255,630
Customer service and informational	937,129			937,129
Sales expense	31,001			31,001
Administrative and general	6,775,167	33,092		6,808,259
Depreciation and amortization	13,871,318			13,871,318
Taxes	3,560,428			3,560,428
Interest on long-term debt	10,139,985			10,139,985
Interest - other	183,513	67,297		250,810
Other deductions	74,270			74,270
	<u>134,941,178</u>	<u>100,389</u>		<u>135,041,567</u>
Operating Margins (Loss) Before Patronage Allocations	11,142,203	(100,389)		11,041,814
Patronage allocations	<u>2,144,106</u>	<u>20,172</u>		<u>2,164,278</u>
Net Operating Margins (Loss)	13,286,309	(80,217)		13,206,092
Nonoperating income (expense)				
Dividend income		155,094		155,094
Gain from equity investment		473,660		473,660
Gain on disposition of assets	194,086	64,525		258,611
Interest income	95,650			95,650
Other	(1,853)	8,758		6,905
Income from subsidiary	413,820		(413,820)	
	<u>701,703</u>	<u>702,037</u>	<u>(413,820)</u>	<u>989,920</u>
Net Margins Before Income Taxes	13,988,012	621,820	(413,820)	14,196,012
Income tax expense - deferred		(208,000)		(208,000)
Net Margins	<u>\$ 13,988,012</u>	<u>\$ 413,820</u>	<u>\$ (413,820)</u>	<u>\$ 13,988,012</u>

See Independent Auditor's Report on Consolidating Information