

Choptank Electric Cooperative, Inc. and Subsidiary
Consolidated Financial Statements
December 31, 2017 and 2016

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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, 2017 and 2016 and the related 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, 2017 and 2016, 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.

Change in Accounting Principle

We draw attention to Note A of the financial statements, which describes a change in accounting principle related to revenue recognition of unbilled revenue and wholesale power cost adjustment. The financial statements for 2016 have been retrospectively adjusted to reflect this change of accounting principle adopted in 2017. Our opinion is not modified with respect to this matter.

Alamo, Jenkins & Cheatham

Richmond, Virginia
March 26, 2018

Consolidated Balance Sheets

Choptank Electric Cooperative, Inc. and Subsidiary

	December 31,	
	2017	As Adjusted 2016
Assets		
Electric plant		
Electric plant	\$ 420,347,663	\$ 411,401,657
Less accumulated provision for depreciation and amortization	117,807,343	115,355,034
	<u>302,540,320</u>	<u>296,046,623</u>
Other property and investments		
Investments in associated organizations	65,940,394	65,062,294
Nonutility property, net	336,413	356,903
Other	463,257	441,179
	<u>66,740,064</u>	<u>65,860,376</u>
Current assets		
Cash and cash equivalents	299,338	138,060
Accounts receivable, net	22,031,200	16,908,651
Materials and supplies	8,800,159	6,327,060
Other current assets	1,913,056	1,773,650
	<u>33,043,753</u>	<u>25,147,421</u>
Deferred charges	41,767	670,141
	<u>\$ 402,365,904</u>	<u>\$ 387,724,561</u>

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

	December 31,	
	2017	As Adjusted 2016
Equities and Liabilities		
Equities		
Patronage capital	\$ 132,897,105	\$ 129,539,081
Other equities	10,247,401	9,621,687
Accumulated other comprehensive income (loss)	2,176,142	(3,834,333)
Memberships	384,455	384,455
	<u>145,705,103</u>	<u>135,710,890</u>
Noncurrent liabilities		
Long-term debt	211,823,992	207,087,289
Other	4,082,194	10,399,330
	<u>215,906,186</u>	<u>217,486,619</u>
Current liabilities		
Cash overdraft	1,212,706	
Accounts payable	14,796,741	15,504,149
Current portion of long-term debt	9,744,861	8,999,552
Other current and accrued liabilities	3,709,873	3,546,284
Credit lines	1,620,000	1,820,000
Consumer deposits	2,082,629	2,395,120
	<u>33,166,810</u>	<u>32,265,105</u>
Deferred credits	<u>7,587,805</u>	<u>2,261,947</u>
	<u>\$ 402,365,904</u>	<u>\$ 387,724,561</u>

Consolidated Statements of Operations and Comprehensive Income

Choptank Electric Cooperative, Inc. and Subsidiary

	Year Ended December 31,	
	2017	2016
Operating revenues	\$ 122,145,060	\$ 130,297,520
Operating expenses		
Cost of power	69,715,322	77,695,499
Transmission	8,852	6,577
Distribution - operation	4,275,311	3,894,600
Distribution - maintenance	7,484,863	6,789,806
Power production - maintenance	6,973	
Consumer accounts	3,688,126	4,223,784
Customer service and informational	803,047	751,168
Sales expense	70,656	122,665
Administrative and general	6,209,130	6,724,739
Depreciation and amortization	13,677,703	12,891,202
Taxes	3,571,077	3,464,921
Interest on long-term debt	9,388,036	9,376,116
Interest - other	262,047	515,258
Other deductions	80,685	181,688
	<u>119,241,828</u>	<u>126,638,023</u>
Operating Margins Before Patronage Allocations	2,903,232	3,659,497
Patronage allocations	3,464,830	2,524,814
Net Operating Margins	<u>6,368,062</u>	<u>6,184,311</u>
Nonoperating income (expense)		
Dividend income	99,187	102,015
Gain from equity investment	134,267	394,104
Gain on disposition of assets	99,798	1,041,860
Interest income	89,915	228,201
Other	(6,375)	(27,396)
	<u>416,792</u>	<u>1,738,784</u>
Net Margins Before Income Taxes	6,784,854	7,923,095
Income tax expense - deferred	(52,000)	
Net Margins	<u>6,732,854</u>	<u>7,923,095</u>
Other comprehensive income (loss)		
Net gain during period	6,010,475	329,787
Amortization of loss		159,400
	<u>6,010,475</u>	<u>489,187</u>
Comprehensive Income	<u>\$ 12,743,329</u>	<u>\$ 8,412,282</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, 2017 and 2016

	Patronage Capital	Other Equities	Accumulated Other Comprehensive Income (Loss)	Memberships	Total
Balance, December 31, 2015, as previously reported	\$ 116,564,283	\$ 7,616,167	\$ (4,323,520)	\$ 384,455	\$ 120,241,385
Adjustment for the cumulative effect on prior years of retroactively applying a change in accounting principle	9,314,032				9,314,032
Balance, December 31, 2015, as adjusted	125,878,315	7,616,167	(4,323,520)	384,455	129,555,417
Net margins	6,249,415	1,673,680			7,923,095
Other comprehensive income			489,187		489,187
Retirement of capital credits	(2,588,649)	331,840			(2,256,809)
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	<u>\$ 132,897,105</u>	<u>\$10,247,401</u>	<u>\$ 2,176,142</u>	<u>\$ 384,455</u>	<u>\$ 145,705,103</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,	
	2017	2016
Cash Flows from Operating Activities		
Net margins	\$ 6,732,854	\$ 7,923,095
Adjustments to reconcile net margins to net cash provided by operating activities:		
Depreciation and amortization charged to operations	13,677,703	12,891,202
Income from equity investments (MACS)	(233,454)	(496,119)
Gain on disposition of assets	(99,798)	(1,041,860)
Noncash capital credit allocations	(3,464,830)	(2,524,814)
(Increase) decrease in:		
Accounts receivable	(5,122,549)	(765,971)
Other current assets	(139,406)	233,373
Deferred charges	628,374	(22,052)
Other property and investments	(22,078)	
Increase (decrease) in:		
Accounts payable	(707,408)	(1,914,733)
Other current and accrued liabilities	163,589	131,866
Deferred credits	5,325,858	160,786
Other noncurrent liabilities	210,935	885,996
Net Cash Provided by Operating Activities	16,949,790	15,460,769
Cash Flows from Investing Activities		
Investments in utility plant	(23,231,733)	(24,413,284)
Plant removal costs	(1,562,413)	(1,572,037)
Contributions in aid of construction	2,047,796	2,248,127
Proceeds from disposition of assets	183,312	1,842,364
Dividends received	99,187	102,015
Proceeds from retirement of investments in CTC's	152,716	71,103
Contributions to APBO plan assets, net	(517,596)	(517,596)
Proceeds from the sale of MACS stock	130,000	175,000
Net Cash Used by Investing Activities	(22,698,731)	(22,064,308)

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

	Year Ended December 31,	
	<u>2017</u>	<u>2016</u>
Cash Flows from Financing Activities		
Capital credits received from suppliers	2,477,108	1,255,190
Capital credits paid to members	(2,749,116)	(2,256,809)
Loan proceeds	14,000,000	25,159,184
Loan payments	(8,304,897)	(10,445,652)
Decrease in consumer deposits	(312,491)	(166,517)
Advances on lines of credit	12,250,000	56,600,000
Repayments on lines of credit	<u>(12,450,000)</u>	<u>(63,370,000)</u>
Net Cash Provided by Financing Activities	<u>4,910,604</u>	<u>6,775,396</u>
Net Increase (Decrease) in Cash and Cash Equivalents	(838,337)	171,857
Cash (overdraft) and cash equivalents - beginning of year	<u>138,060</u>	<u>(33,797)</u>
Cash (Overdraft) and Cash Equivalents - End of Year	<u>\$ (700,277)</u>	<u>\$ 138,060</u>
Non Cash Financing Activities		
Refinance of CFC debt to Farmer Mac	<u>\$ 24,000,000</u>	<u>\$</u>

Supplemental Disclosures

Choptank Electric Cooperative, Inc. and Subsidiary paid approximately \$9,439,000 and \$9,813,000 interest expense for the years ended December 31, 2017 and 2016, respectively.

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2017 and 2016

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 38.77% and 39.67% interest in Mid-Atlantic Cooperative Solutions, Inc., (MACS) as of December 31, 2017 and 2016, 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).

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 than not that all of their tax positions would be sustained by the Internal Revenue Service. Tax years for the Cooperative and CSC ending on or after December 31, 2014 remain subject to examination by federal and state taxing authorities.

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2017 and 2016

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.

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2017 and 2016

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

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.

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 26, 2018, which is the date the financial statements were available to be issued.

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2017 and 2016

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

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 deferral charge as applicable. The Cooperative had a cumulative over-recovery of power cost of \$5,654,514 at December 31, 2017, which was included in deferred credits. The Cooperative had a cumulative under-recovery of power cost of \$615,073 at December 31, 2016, which was included in deferred charges.

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.

Accounting Changes

During 2017, management and the Board of Directors of the Cooperative changed the way they accounted for unbilled revenue by electing to recognize revenue for utility service rendered to customers, but not yet billed to customers until the subsequent year. As a result of this accounting change for unbilled revenue, accounts receivable and patronage capital increased approximately \$8,699,000 for the year ending December 31, 2016.

During 2017, management and the Board of Directors of the Cooperative also elected to record the over or under collection of wholesale power costs. As a result of this accounting change for wholesale power cost adjustment, deferred charges and patronage capital increased approximately \$615,000 for the year ending December 31, 2016.

The financial statements for the year ending December 31, 2016 have been adjusted to reflect these accounting changes as follows:

As of December 31, 2016, accounts receivable was originally reported as \$8,209,692, deferred charges was originally reported as \$55,068, patronage capital was reported as \$120,225,049. As a result of this accounting change, accounts receivable has been adjusted to \$16,908,651, deferred charges has been adjusted to \$670,141 and patronage capital has been adjusted to \$129,539,081.

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2017 and 2016

Note B - Electric Plant

Listed below were the major classes of electric plant:

	December 31,	
	2017	2016
Distribution plant	\$ 356,233,898	\$ 348,793,610
General plant	47,707,780	46,131,532
Transmission plant	5,973,765	5,972,739
Production plant	1,142,268	
Electric plant in service	411,057,711	400,897,881
Construction work in progress	9,289,952	10,503,776
	<u>\$ 420,347,663</u>	<u>\$ 411,401,657</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, 2017 and 2016. 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,	
	2017	2016
Buildings	\$ 397,046	\$ 397,046
Less accumulated depreciation	272,792	252,302
	124,254	144,744
Land	212,159	212,159
	<u>\$ 336,413</u>	<u>\$ 356,903</u>

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2017 and 2016

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,	
	2017	2016
Patronage capital:		
Old Dominion Electric Cooperative (ODEC)	\$ 51,194,423	\$ 50,660,014
National Rural Utilities Cooperative Finance Corporation (CFC)	5,485,950	5,062,294
Other	704,978	675,283
	<u>57,385,351</u>	<u>56,397,591</u>
Capital Term Certificates:		
ZCTC's	2,192,674	2,345,390
SCTC's	1,414,331	1,414,331
LCTC's	385,600	385,600
	<u>3,992,605</u>	<u>4,145,321</u>
Other:		
MACS	3,792,288	3,749,232
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>4,562,438</u>	<u>4,519,382</u>
	<u>\$ 65,940,394</u>	<u>\$ 65,062,294</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, 2017 and 2016

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 38.77% ownership interest in MACS and the MACS ESOP holds 22.46%. Total assets of MACS were approximately \$30,100,000 and \$30,800,000 at December 31, 2017 and 2016, respectively. Total liabilities were approximately \$20,300,000 and \$21,300,000 at December 31, 2017 and 2016, respectively. Total equity was approximately \$9,800,000 and \$9,500,000 at December 31, 2017 and 2016, respectively. MACS's net profit for the years ended December 31, 2017 and 2016 was approximately \$600,000 and \$1,300,000, 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, 2017, the Cooperative had no of deposits that exceed the insured limits.

Note F - Accounts Receivable

Accounts receivable consisted of the following:

	December 31,	
	2017	As Adjusted 2016
Unbilled Revenue	\$ 10,234,935	\$ 8,698,959
Consumers	5,888,001	5,006,333
Other	6,161,895	3,461,061
	<u>22,284,831</u>	<u>17,166,353</u>
Less provision for uncollectible accounts	<u>253,631</u>	<u>257,702</u>
	<u>\$ 22,031,200</u>	<u>\$ 16,908,651</u>

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2017 and 2016

Note G - Deferred Charges

Deferred charges consisted of the following:

	December 31,	
	2017	As Adjusted 2016
Other	38,002	40,004
Unamortized debt expense	3,765	15,064
Wholesale power cost adjustment (WPCA)		615,073
	<u>\$ 41,767</u>	<u>\$ 670,141</u>

Note H - Patronage Capital

Patronage capital consisted of the following:

	December 31,	
	2017	As Adjusted 2016
Assigned	\$ 126,461,378	\$ 123,289,666
Assignable	6,435,727	6,249,415
	<u>\$ 132,897,105</u>	<u>\$ 129,539,081</u>

Note I - Other Equities

Other equities consisted of the following:

	December 31,	
	2017	2016
Nonoperating income	\$ 5,496,035	\$ 5,198,908
Retired capital credits - gain	4,518,269	4,189,682
Donated capital	232,397	232,397
Other	700	700
	<u>\$ 10,247,401</u>	<u>\$ 9,621,687</u>

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2017 and 2016

Note J - Long-Term Debt

Long-term debt consisted of the following:

	December 31,	
	2017	2016
CFC, Mortgage notes	\$ 172,845,302	\$ 190,339,430
Federal Agriculture Mortgage Corporation (Farmer Mac), Mortgage notes	48,723,551	25,747,411
	221,568,853	216,086,841
Less current portion	9,744,861	8,999,552
	<u>\$ 211,823,992</u>	<u>\$ 207,087,289</u>

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

<u>Year Ending December 31,</u>	
2018	\$ 9,744,861
2019	9,307,846
2020	9,337,757
2021	9,626,300
2022	9,930,118
Thereafter	<u>173,621,971</u>
	<u>\$ 221,568,853</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, 2017 and 2016, 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 2.75% to 7.45%. The maturity dates of the notes range up to 35 years, beginning November 2018 through November 2047. Principal and interest installments were due quarterly in the amount of approximately \$3,486,000. The Cooperative had \$70,700,000 in unadvanced funds available from CFC as of December 31, 2017.

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2017 and 2016

Note J - Long-Term Debt - Continued

Long-term debt payable to Farmer Mac is represented by mortgage notes bearing interest at a variable rate based on one month LIBOR plus 1.1% (2.461% and 2.661% as of December 31, 2017). The notes have 15-30 year terms and mature at various dates through 2047. Interest and principal payments are due semi-annually in the amount of approximately \$1,405,000.

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 and CFC line of credit at December 31, 2017 and 2016. CSC had a line of credit with CoBank in the amount of \$2,600,000. There was an outstanding balance of \$1,620,000 at 3.67% interest rate and \$1,820,000 at 2.87% interest rate at December 31, 2017 and 2016, respectively.

Note K - Other Noncurrent Liabilities

Other noncurrent liabilities consisted of the following:

	December 31,	
	2017	2016
Other postretirement benefits	\$ 3,250,176	\$ 9,639,888
Accrued sick leave	581,568	576,107
Accrued vacation leave	198,450	183,335
Other	52,000	
	<u>\$ 4,082,194</u>	<u>\$ 10,399,330</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 (75%) and other (25%) at December 31, 2017. Investments were allocated between equities (73%), bond funds (1%), and other (26%) at December 31, 2016.

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2017 and 2016

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,	
	2017	2016
Change in accumulated postretirement benefit obligation (APBO):		
APBO at beginning of year	\$ 24,541,699	\$ 23,639,247
Interest cost	836,700	933,800
Service cost	301,700	444,900
Benefit payments	(498,724)	(476,248)
Net actuarial gain	(3,987,999)	
APBO at end of year	<u>21,193,376</u>	<u>24,541,699</u>
Change in fair value of plan assets:		
Fair value of plan assets at beginning of year	14,217,711	13,220,842
Actual return on plan assets	2,707,893	479,273
Contributions	517,596	517,596
Fair value of plan assets at end of year	<u>17,443,200</u>	<u>14,217,711</u>
Funded status (net APBO)	(3,750,176)	(10,323,988)
Less current portion	(500,000)	(684,100)
	<u>\$ (3,250,176)</u>	<u>\$ (9,639,888)</u>

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2017 and 2016

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,	
	2017	2016
Interest cost on benefit obligations	\$ 836,700	\$ 933,800
Service cost, benefits earned during the period	301,700	444,900
Return on plan assets	(746,400)	(299,384)
Amortization of actuarial loss		159,400
	<u>\$ 392,000</u>	<u>\$ 1,238,716</u>

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

	December 31,	
	2017	2016
Unrealized gain on plan assets	\$ 2,930,088	\$ 908,612
Unrecognized actuarial loss	(753,946)	(4,742,945)
	<u>\$ 2,176,142</u>	<u>\$ (3,834,333)</u>

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

	December 31,	
	2017	2016
Assumptions and effects:		
Medical trend rate		
Under 65	7.50%	10.00%
65 and older	6.15%	8.00%
Ultimate trend rate	5.00%	5.00%
Year ultimate trend rate achieved	2028	2025
Discount rate	4.25%	4.25%
Expected return on asset	5.25%	3.90%
Measurement date	1/1/2017	1/1/2015
Effect of a 1% increase in health care cost trend rate on:		
APBO	\$ 3,800,000	\$ 4,500,000
Interest plus service cost components	\$ 223,000	\$ 290,000

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2017 and 2016

Note K - Other Noncurrent Liabilities - Continued

Estimated future benefit payments are shown net of employee contributions:

<u>Year Beginning January 1,</u>		
2018	\$	634,500
2019	\$	665,100
2020	\$	693,600
2021	\$	723,200
2022	\$	770,000
2023 - 2027	\$	4,975,700

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, 2018:

Employer	\$517,596
Employee	-

Note L - Deferred Credits

Deferred credits consisted of the following:

	<u>December 31,</u>	
	<u>2017</u>	<u>2016</u>
Wholesale power cost adjustment (WPCA)	\$ 5,654,514	\$
Unclaimed capital credits	1,335,795	1,405,479
Deferred deposits for construction	587,208	846,620
Other	10,288	9,848
	<u>\$ 7,587,805</u>	<u>\$ 2,261,947</u>

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2017 and 2016

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 156 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 2017 and in 2016 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 \$2,708,000 in 2017 and \$2,673,000 in 2016. There have been no significant changes that affect the comparability of 2017 and in 2016 contributions.

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2017 and 2016

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 at January 1, 2017 and January 1, 2016 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, 2017 and 2016, the Cooperative’s required contribution to the Plan and its net pension cost was approximately \$450,000 and \$441,000, 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, 2017 and 2016

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 2.74% and 3.06% for the years ending December 31, 2017 and 2016, 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 5.50% and 5.85% for the years ending December 31, 2017 and 2016, 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,			
	2017		2016	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets:				
Investments in associated organizations:				
Capital term certificates	\$ 3,992,605	\$ 4,299,000	\$ 4,145,321	\$ 4,157,000
Liabilities:				
Long-term debt including current portion	\$ 221,568,853	\$ 227,200,000	\$ 216,086,841	\$ 217,400,000

Notes to Consolidated Financial Statements

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2017 and 2016

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, 2017 and 2016, and our report thereon dated March 26, 2018, which expressed an unmodified opinion on those financial statements, appears on page 1. 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 26, 2018

Consolidating Balance Sheets

Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2017

	Choptank Electric Cooperative, Inc.	CSC	Eliminations	Total
Assets				
Electric plant				
Electric plant	\$ 420,347,663	\$	\$	\$ 420,347,663
Less accumulated provision for depreciation and amortization	117,807,343			117,807,343
	<u>302,540,320</u>			<u>302,540,320</u>
Other property and investments				
Investments in associated organizations	61,899,697	4,040,697		65,940,394
Nonutility property, net	336,413			336,413
Other	2,837,793		(2,374,536)	463,257
	<u>65,073,903</u>	<u>4,040,697</u>	<u>(2,374,536)</u>	<u>66,740,064</u>
Current assets				
Cash and cash equivalents	288,601	10,737		299,338
Accounts receivable, net	22,031,228		(28)	22,031,200
Materials and supplies	8,800,159			8,800,159
Other current assets	1,912,946	110		1,913,056
	<u>33,032,934</u>	<u>10,847</u>	<u>(28)</u>	<u>33,043,753</u>
Deferred charges	41,767			41,767
	<u>\$ 400,688,924</u>	<u>\$ 4,051,544</u>	<u>\$ (2,374,564)</u>	<u>\$ 402,365,904</u>

See Independent Auditor's Report on Consolidating Information

	Choptank Electric Cooperative, Inc.	CSC	Eliminations	Total
Equities and Liabilities				
Equities				
Patronage capital	\$ 132,897,105	\$	\$	\$ 132,897,105
Retained earnings		279,536	(279,536)	
Other equities	10,247,401	2,095,000	(2,095,000)	10,247,401
Accumulated other comprehensive income	2,176,142			2,176,142
Memberships	384,455			384,455
	<u>145,705,103</u>	<u>2,374,536</u>	<u>(2,374,536)</u>	<u>145,705,103</u>
Noncurrent liabilities				
Long-term debt	211,823,992			211,823,992
Other	4,030,194	52,000		4,082,194
	<u>215,854,186</u>	<u>52,000</u>		<u>215,906,186</u>
Current liabilities				
Cash over draft	1,212,706			1,212,706
Accounts payable	14,791,761	5,008	(28)	14,796,741
Current portion of long-term debt	9,744,861			9,744,861
Other current and accrued liabilities	3,709,873			3,709,873
Credit lines		1,620,000		1,620,000
Consumer deposits	2,082,629			2,082,629
	<u>31,541,830</u>	<u>1,625,008</u>	<u>(28)</u>	<u>33,166,810</u>
Deferred credits	<u>7,587,805</u>			<u>7,587,805</u>
	<u>\$ 400,688,924</u>	<u>\$ 4,051,544</u>	<u>\$ (2,374,564)</u>	<u>\$ 402,365,904</u>

Consolidating Statements of Operations

Choptank Electric Cooperative, Inc. and Subsidiary

Year Ended December 31, 2017

	Choptank Electric Cooperative, Inc.	CSC	Eliminations	Total
Operating revenues	\$ 122,145,060	\$	\$	\$ 122,145,060
Operating expenses				
Cost of power	69,715,322			69,715,322
Transmission	8,852			8,852
Distribution - operation	4,275,311			4,275,311
Distribution - maintenance	7,484,863			7,484,863
Power production - maintenance	6,973			6,973
Consumer accounts	3,688,126			3,688,126
Customer service and informational	803,047			803,047
Sales expense	70,656			70,656
Administrative and general	6,179,396	29,734		6,209,130
Depreciation and amortization	13,677,703			13,677,703
Taxes	3,571,077			3,571,077
Interest on long-term debt	9,388,036			9,388,036
Interest - other	204,554	57,493		262,047
Other deductions	80,685			80,685
	<u>119,154,601</u>	<u>87,227</u>		<u>119,241,828</u>
Operating Margins (Loss)				
Before Patronage Allocations	2,990,459	(87,227)		2,903,232
Patronage allocations	<u>3,445,268</u>	<u>19,562</u>		<u>3,464,830</u>
Net Operating Margins (Loss)	6,435,727	(67,665)		6,368,062
Nonoperating income (expense)				
Dividend income		99,187		99,187
Gain from equity investment		134,267		134,267
Gain on disposition of assets	61,009	38,789		99,798
Interest income	89,915			89,915
Other	(6,375)			(6,375)
Income from subsidiary	152,578		(152,578)	
	<u>297,127</u>	<u>272,243</u>	<u>(152,578)</u>	<u>416,792</u>
Net Margins Before Income Taxes	6,732,854	204,578	(152,578)	6,784,854
Income tax expense - deferred		(52,000)		(52,000)
Net Margins	<u>\$ 6,732,854</u>	<u>\$ 152,578</u>	<u>\$ (152,578)</u>	<u>\$ 6,732,854</u>

See Independent Auditor's Report on Consolidating Information