

**Choptank Electric Cooperative, Inc. and Subsidiary**  
**Consolidated Financial Statements**  
**December 31, 2016 and 2015**

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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, 2016 and 2015 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, 2016 and 2015, 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 13, 2017

## Consolidated Balance Sheets

### Choptank Electric Cooperative, Inc. and Subsidiary

	December 31,	
	2016	2015
<b>Assets</b>		
Electric plant		
Electric plant	\$ 411,401,657	\$ 389,720,815
Less accumulated provision for depreciation and amortization	115,355,034	107,912,798
	<u>296,046,623</u>	<u>281,808,017</u>
Other property and investments		
Investments in associated organizations	65,062,294	63,576,590
Nonutility property, net	356,903	446,675
Other	441,179	441,179
	<u>65,860,376</u>	<u>64,464,444</u>
Current assets		
Cash and cash equivalents	138,060	158,372
Accounts receivable, net	8,209,692	7,443,721
Materials and supplies	6,327,060	10,498,485
Other current assets	1,773,650	2,007,023
	<u>16,448,462</u>	<u>20,107,601</u>
Deferred charges	55,068	33,016
	<u>\$ 378,410,529</u>	<u>\$ 366,413,078</u>

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

	December 31,	
	<u>2016</u>	<u>2015</u>
<b>Equities and Liabilities</b>		
Equities		
Patronage capital	\$ 120,225,049	\$ 116,564,283
Other equities	9,621,687	7,616,167
Accumulated other comprehensive loss	(3,834,333)	(4,323,520)
Memberships	384,455	384,455
	<u>126,396,858</u>	<u>120,241,385</u>
Noncurrent liabilities		
Long-term debt	207,087,289	192,505,496
Other	10,399,330	10,520,117
	<u>217,486,619</u>	<u>203,025,613</u>
Current liabilities		
Cash overdraft		192,169
Accounts payable	15,504,149	17,418,882
Current portion of long-term debt	8,999,552	8,867,813
Other current and accrued liabilities	3,546,284	3,414,418
Credit lines	1,820,000	8,590,000
Consumer deposits	2,395,120	2,561,637
	<u>32,265,105</u>	<u>41,044,919</u>
Deferred credits	<u>2,261,947</u>	<u>2,101,161</u>
	<u>\$ 378,410,529</u>	<u>\$ 366,413,078</u>

## Consolidated Statements of Operations

### Choptank Electric Cooperative, Inc. and Subsidiary

	Year Ended December 31,	
	2016	2015
Operating revenues	\$ 130,297,520	\$ 139,235,846
Operating expenses		
Cost of power	77,695,499	83,916,332
Transmission	6,577	15,405
Distribution - operation	3,894,600	3,906,678
Distribution - maintenance	6,789,806	7,063,831
Consumer accounts	4,223,784	4,615,168
Customer service and informational	751,168	709,117
Sales expense	122,665	85,388
Administrative and general	6,724,739	7,908,131
Depreciation and amortization	12,891,202	12,265,832
Taxes	3,464,921	3,339,870
Interest on long-term debt	9,376,116	9,081,346
Interest - other	515,258	299,573
Other deductions	181,688	52,633
	<u>126,638,023</u>	<u>133,259,304</u>
Operating Margins Before Patronage Allocations	3,659,497	5,976,542
Patronage allocations	2,524,814	1,866,205
Net Operating Margins	<u>6,184,311</u>	<u>7,842,747</u>
Nonoperating income (expense)		
Dividend income	102,015	169,000
Gain from equity investment	394,104	165,410
Gain on disposition of assets	1,041,860	142,775
Interest income	228,201	87,501
Other	(27,396)	(12,809)
	<u>1,738,784</u>	<u>551,877</u>
Net Margins	<u>\$ 7,923,095</u>	<u>\$ 8,394,624</u>
<b>Statements of Comprehensive Income</b>		
Net margins	\$ 7,923,095	\$ 8,394,624
Other comprehensive income (loss)		
Net gain (loss) during period	329,787	(1,946,656)
Amortization of loss	159,400	159,400
	<u>489,187</u>	<u>(1,787,256)</u>
Comprehensive Income	<u>\$ 8,412,282</u>	<u>\$ 6,607,368</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, 2016 and 2015

	Patronage Capital	Other Equities	Accumulated Other Comprehensive Loss	Memberships	Total
Balance, December 31, 2014	\$ 111,780,333	\$ 6,788,993	\$ (2,536,264)	\$ 384,455	\$ 116,417,517
Net margins	7,913,714	480,910			8,394,624
Other comprehensive loss			(1,787,256)		(1,787,256)
Retirement of capital credits	<u>(3,129,764)</u>	<u>346,264</u>			<u>(2,783,500)</u>
Balance, December 31, 2015	116,564,283	7,616,167	(4,323,520)	384,455	120,241,385
Net margins	6,249,415	1,673,680			7,923,095
Other comprehensive income			489,187		489,187
Retirement of capital credits	<u>(2,588,649)</u>	<u>331,840</u>			<u>(2,256,809)</u>
Balance, December 31, 2016	<u>\$ 120,225,049</u>	<u>\$ 9,621,687</u>	<u>\$ (3,834,333)</u>	<u>\$ 384,455</u>	<u>\$ 126,396,858</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,	
	2016	2015
<b>Cash Flows from Operating Activities</b>		
Net margins	\$ 7,923,095	\$ 8,394,624
Adjustments to reconcile net margins to net cash provided by operating activities:		
Depreciation and amortization charged to operations	12,891,202	12,265,832
Income from equity investments (MACS)	(496,119)	(334,410)
Gain on disposition of assets	(1,041,860)	(142,775)
Noncash capital credit allocations	(2,524,814)	(1,866,205)
(Increase) decrease in:		
Accounts receivable	(765,971)	(1,533,159)
Other current assets	233,373	289,192
Deferred charges	(22,052)	791,823
Increase (decrease) in:		
Accounts payable	(1,914,733)	6,754,959
Other current and accrued liabilities	131,866	(285,765)
Deferred credits	160,786	(353,371)
Other noncurrent liabilities	885,996	1,211,114
Net Cash Provided by Operating Activities	15,460,769	25,191,859
<b>Cash Flows from Investing Activities</b>		
Investments in utility plant	(24,413,284)	(30,871,328)
Plant removal costs	(1,572,037)	(1,316,665)
Contributions in aid of construction	2,248,127	1,740,848
Proceeds from disposition of assets	1,842,364	70,407
Dividends received	102,015	169,000
Proceeds from retirement of investments in CTC's	71,103	111,342
Contributions to APBO plan assets, net	(517,596)	(517,596)
Proceeds from the sale of MACS stock	175,000	242,487
Net Cash Used by Investing Activities	(22,064,308)	(30,371,505)

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

	Year Ended December 31,	
	2016	2015
<b>Cash Flows from Financing Activities</b>		
Capital credits received from suppliers	1,255,190	407,344
Capital credits paid to members	(2,256,809)	(2,783,500)
Loan proceeds	25,159,184	16,500,000
Loan payments	(10,445,652)	(8,211,777)
Increase (decrease) in consumer deposits	(166,517)	114,110
Advances on lines of credit	56,600,000	23,820,000
Repayments on lines of credit	(63,370,000)	(26,797,898)
Net Cash Provided by Financing Activities	<u>6,775,396</u>	<u>3,048,279</u>
Net Increase (Decrease) in Cash and Cash Equivalents	171,857	(2,131,367)
Cash (overdraft) and cash equivalents - beginning of year	<u>(33,797)</u>	<u>2,097,570</u>
Cash (Overdraft) and Cash Equivalents - End of Year	<u>\$ 138,060</u>	<u>\$ (33,797)</u>

### Supplemental Disclosures

Choptank Electric Cooperative, Inc. and Subsidiary paid approximately \$9,813,000 and \$9,384,000 interest expense for the years ended December 31, 2016 and 2015, respectively.

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2016 and 2015

##### Note A - Significant Accounting Policies

###### Nature of Operations

Choptank Electric Cooperative, Inc. (the “Cooperative”) is a non-profit electric transmission 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 39.67% and 40.81% interest in Mid-Atlantic Cooperative Solutions, Inc., (MACS) as of December 31, 2016 and 2015, 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.

###### 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.

###### 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 tax under Internal Revenue Service Code Section 501(c)(12). The Cooperative evaluates the filing positions in all federal and state jurisdictions where it is required to file income tax returns, including its status as a tax-exempt electric cooperative entity. The Cooperative believes its income tax filing positions, including its status as a tax-exempt entity will be sustained and does not anticipate any adjustment that will result in a material change to its financial position. Tax filings ending on or after December 31, 2013 remain subject to examination by federal and state taxing authorities.

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2016 and 2015

##### Note A - 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:

Transmission plant	3.29%
Distribution plant	3.29 - 6.58%
General plant	2.00 - 20.00%

###### Revenue Recognition

Revenue is recognized at the time customers are billed.

Due to the dates customer meters are read, billings lag behind actual consumer usage each month. These unbilled amounts are not recorded by the Cooperative as revenue until the following month when actually billed. Management estimated total unbilled revenues were approximately \$8,699,000 and \$7,861,000 at December 31, 2016 and 2015, respectively.

## **Notes to Consolidated Financial Statements**

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

#### **December 31, 2016 and 2015**

##### **Note A - 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 13, 2017, 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, 2016 and 2015

##### Note B - Electric Plant

Listed below were the major classes of electric plant:

	December 31,	
	2016	2015
Distribution plant	\$ 348,793,610	\$ 324,794,613
General plant	46,131,532	37,797,322
Transmission plant	5,972,739	5,943,963
Electric plant in service	400,897,881	368,535,898
Construction work in progress	10,503,776	21,184,917
	<u>\$ 411,401,657</u>	<u>\$ 389,720,815</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, 2016 and 2015. 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,	
	2016	2015
Buildings	\$ 397,046	\$ 457,263
Less accumulated depreciation	252,302	253,748
	<u>144,744</u>	<u>203,515</u>
Land	212,159	243,160
	<u>\$ 356,903</u>	<u>\$ 446,675</u>

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2016 and 2015

##### 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,	
	2016	2015
Patronage capital:		
Old Dominion Electric Cooperative (ODEC)	\$ 50,660,014	\$ 49,809,873
National Rural Utilities Cooperative Finance Corporation (CFC)	5,062,294	4,671,290
Other	675,283	646,804
	<u>56,397,591</u>	<u>55,127,967</u>
Capital Term Certificates:		
ZCTC's	2,345,390	2,416,493
SCTC's	1,414,331	1,414,331
LCTC's	385,600	385,600
	<u>4,145,321</u>	<u>4,216,424</u>
Other:		
MACS	3,749,232	3,462,049
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>4,519,382</u>	<u>4,232,199</u>
	<u>\$ 65,062,294</u>	<u>\$ 63,576,590</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, 2016 and 2015

##### 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 39.67% ownership interest in MACS. Total assets of MACS were approximately \$30,800,000 and \$29,200,000 at December 31, 2016 and 2015, respectively. Total liabilities were approximately \$21,300,000 and \$20,700,000 at December 31, 2016 and 2015, respectively. Total equity was approximately \$9,500,000 and \$8,500,000 at December 31, 2016 and 2015, respectively. MACS's net profit for the years ended December 31, 2016 and 2015 was approximately \$660,000 and \$816,000, 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, 2016, the Cooperative had approximately \$34,000 of deposits that exceed the insured limits.

##### Note F - Accounts Receivable

Accounts receivable consisted of the following:

	December 31,	
	2016	2015
Consumers	\$ 5,006,333	\$ 5,476,468
Other	3,461,061	2,218,700
	8,467,394	7,695,168
Less provision for uncollectible accounts	257,702	251,447
	<u>\$ 8,209,692</u>	<u>\$ 7,443,721</u>

##### Note G - Deferred Charges

Deferred charges consisted of the following:

	December 31,	
	2016	2015
Other	\$ 40,004	\$ 6,652
Unamortized debt expense	15,064	26,364
	<u>\$ 55,068</u>	<u>\$ 33,016</u>

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2016 and 2015

##### Note H - Patronage Capital

Patronage capital consisted of the following:

	December 31,	
	2016	2015
Assigned	\$ 113,975,634	\$ 108,650,569
Assignable	6,249,415	7,913,714
	<u>\$ 120,225,049</u>	<u>\$ 116,564,283</u>

##### Note I - Other Equities

Other equities consisted of the following:

	December 31,	
	2016	2015
Retired capital credits - gain	\$ 4,189,682	\$ 3,857,875
Nonoperating income	5,198,908	3,525,195
Donated capital	232,397	232,397
Other	700	700
	<u>\$ 9,621,687</u>	<u>\$ 7,616,167</u>

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

Long-term debt consisted of the following:

	December 31,	
	2016	2015
CFC, Mortgage notes	\$ 190,339,430	\$ 174,402,723
Federal Agriculture Mortgage Corporation (Farmer Mac), Mortgage notes	25,747,411	26,757,495
St. Michael's Utility Commission note		213,091
	<u>216,086,841</u>	<u>201,373,309</u>
Less current portion	<u>8,999,552</u>	<u>8,867,813</u>
	<u>\$ 207,087,289</u>	<u>\$ 192,505,496</u>

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2016 and 2015

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

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

<u>Year Ending December 31,</u>	
2017	\$ 8,999,552
2018	9,179,805
2019	9,092,952
2020	9,113,003
2021	9,391,234
Thereafter	<u>170,310,295</u>
	<u>\$ 216,086,841</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, 2016 and 2015, 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 2.50% to 7.45%. The maturity dates of the notes range up to 35 years, beginning August 2017 through November 2046. Principal and interest installments were due quarterly in the amount of approximately \$5,886,000. The Cooperative had \$84,700,000 in unadvanced funds available from CFC as of December 31, 2016.

Long-term debt payable to Farmer Mac is represented by mortgage notes bearing interest at a variable rate based on one month LIBOR plus 1.1% (1.717% as of December 31, 2016). The notes have 15-30 year terms and mature at various dates through 2042. Interest and principal payments are due semi-annually in the amount of approximately \$709,000.

Long-term debt payable to St. Michael's Utility Commission was represented by a note, the balance was paid in full during October 2016.

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, 2016. There was a balance of \$6,590,000 on the CoBank line and no balance outstanding on the CFC line of credit at December 31, 2015. CSC had a line of credit with CoBank in the amount of \$2,800,000. There was an outstanding balance of \$1,820,000 and \$2,000,000 at December 31, 2016 and 2015, respectively.

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2016 and 2015

##### Note K - Other Noncurrent Liabilities

Other noncurrent liabilities consisted of the following:

	December 31,	
	2016	2015
Other postretirement benefits	\$ 9,639,888	\$ 9,785,405
Accrued sick leave	576,107	553,536
Accrued vacation leave	183,335	181,176
	<u>\$ 10,399,330</u>	<u>\$ 10,520,117</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 (73%), bond funds (1%), and other (26%) at December 31, 2016. Investments were allocated between equities (67%), bond funds (4%), and other (29%) at December 31, 2015.

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.

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2016 and 2015

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

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

	December 31,	
	2016	2015
Change in accumulated postretirement benefit obligation (APBO):		
APBO at beginning of year	\$ 23,639,247	\$ 21,287,787
Interest cost	933,800	933,800
Service cost	444,900	444,900
Benefit payments	(476,248)	(345,153)
Net actuarial loss		1,317,913
APBO at end of year	<u>24,541,699</u>	<u>23,639,247</u>
Change in fair value of plan assets:		
Fair value of plan assets at beginning of year	13,220,842	13,204,315
Actual return on plan assets	479,273	(501,069)
Contributions	517,596	517,596
Fair value of plan assets at end of year	<u>14,217,711</u>	<u>13,220,842</u>
Funded status (net APBO)	(10,323,988)	(10,418,405)
Less current portion	<u>(684,100)</u>	<u>(633,000)</u>
	<u>\$ (9,639,888)</u>	<u>\$ (9,785,405)</u>

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

	Year Ended December 31,	
	2016	2015
Interest cost on benefit obligations	\$ 933,800	\$ 933,800
Service cost, benefits earned during the period	444,900	444,900
Amortization of actuarial loss	159,400	159,400
Return on plan assets	<u>(299,384)</u>	<u>(286,123)</u>
	<u>\$ 1,238,716</u>	<u>\$ 1,251,977</u>

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2016 and 2015

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

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

	December 31,	
	2016	2015
Unrealized gain on plan assets	\$ 908,612	\$ 578,825
Unrecognized actuarial loss	(4,742,945)	(4,902,345)
	<u>\$ (3,834,333)</u>	<u>\$ (4,323,520)</u>
	December 31,	
	2016	2015
Assumptions and effects:		
Medical trend rate		
Under 65	10.00%	10.00%
65 and older	8.00%	8.00%
Ultimate trend rate	5.00%	5.00%
Year ultimate trend rate achieved	2025	2025
Discount rate	4.25%	4.25%
Expected return on asset	3.90%	3.90%
Measurement date	1/1/2015	1/1/2015
Effect of a 1% increase in health care cost trend rate on:		
APBO	\$ 4,500,000	\$ 4,500,000
Interest plus service cost components	\$ 290,000	\$ 290,000

Estimated future benefit payments are shown net of employee contributions:

Year Beginning January 1,

2017	\$ 684,100
2018	\$ 678,100
2019	\$ 732,300
2020	\$ 756,100
2021	\$ 779,900
2022 - 2026	\$ 4,921,800

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.

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2016 and 2015

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

Approximate expected contribution for year ending December 31, 2017:

Employer	\$517,596
Employee	-

The estimated net loss for the plan that is expected to amortize from regulatory assets into net periodic benefit cost and accumulated other comprehensive income over the next fiscal year is anticipated to be the following as of December 31, 2016:

Expected amortization of net loss	<u>\$ (159,400)</u>
-----------------------------------	---------------------

##### Note L - Deferred Credits

Deferred credits consisted of the following:

	December 31,	
	<u>2016</u>	<u>2015</u>
Unclaimed capital credits	\$ 1,405,479	\$ 1,113,458
Deferred deposits for construction	846,620	981,308
Other	<u>9,848</u>	<u>6,395</u>
	<u>\$ 2,261,947</u>	<u>\$ 2,101,161</u>

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2016 and 2015

##### 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 112 of the 161 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 2016 and in 2015 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 \$2,673,000 in 2016 and \$2,589,000 in 2015. There have been no significant changes that affect the comparability of 2016 and in 2015 contributions.

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2016 and 2015

##### 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, 2016 and January 1, 2015 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, 2016 and 2015, the Cooperative’s required contribution to the Plan and its net pension cost was approximately \$441,000 and \$456,000, 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, 2016 and 2015

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

###### Investments in Associated Organizations

Fair value of capital term certificates and member capital certificates was determined by computing the present value of estimated future cash flows, discounted at the long-term treasury rate of 3.06% and 3.01% for the years ending December 31, 2016 and 2015, 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 5.85% for the years ending December 31, 2016 and 2015.

###### 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,			
	2016		2015	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets:				
Investments in associated organizations:				
Capital term certificates	\$ 4,145,321	\$ 4,157,000	\$ 4,216,424	\$ 4,221,000
Liabilities:				
Long-term debt including current portion	\$ 216,086,841	\$ 217,400,000	\$ 201,373,309	\$ 208,800,000

## Notes to Consolidated Financial Statements

### Choptank Electric Cooperative, Inc. and Subsidiary

#### December 31, 2016 and 2015

##### 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, 2016 and 2015, and our report thereon dated March 13, 2017, 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 25-27 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 13, 2017

## Consolidating Balance Sheets

### Choptank Electric Cooperative, Inc. and Subsidiary

December 31, 2016

	Choptank Electric Cooperative, Inc.	CSC	Eliminations	Total
<b>Assets</b>				
Electric plant				
Electric plant	\$ 411,401,657	\$	\$	\$ 411,401,657
Less accumulated provision for depreciation and amortization	<u>115,355,034</u>	<u></u>	<u></u>	<u>115,355,034</u>
	296,046,623			296,046,623
Other property and investments				
Investments in associated organizations	61,069,544	3,992,750		65,062,294
Nonutility property, net	356,903			356,903
Other	<u>2,663,137</u>	<u></u>	<u>(2,221,958)</u>	<u>441,179</u>
	64,089,584	3,992,750	(2,221,958)	65,860,376
Current assets				
Cash and cash equivalents	82,120	55,940		138,060
Accounts receivable, net	8,212,137		(2,445)	8,209,692
Materials and supplies	6,327,060			6,327,060
Other current assets	<u>1,773,544</u>	<u>106</u>	<u></u>	<u>1,773,650</u>
	16,394,861	56,046	(2,445)	16,448,462
Deferred charges	55,068			55,068
	<u></u>	<u></u>	<u></u>	<u></u>
	<u>\$ 376,586,136</u>	<u>\$ 4,048,796</u>	<u>\$ (2,224,403)</u>	<u>\$ 378,410,529</u>

See Independent Auditor's Report on Consolidating Information

	Choptank Electric Cooperative, Inc.	CSC	Eliminations	Total
<b>Equities and Liabilities</b>				
Equities				
Patronage capital	\$ 120,225,049	\$	\$	\$ 120,225,049
Retained earnings		126,958	(126,958)	
Other equities	9,621,687	2,095,000	(2,095,000)	9,621,687
Accumulated other comprehensive loss	(3,834,333)			(3,834,333)
Memberships	384,455			384,455
	<u>126,396,858</u>	<u>2,221,958</u>	<u>(2,221,958)</u>	<u>126,396,858</u>
Noncurrent liabilities				
Long-term debt	207,087,289			207,087,289
Other	10,399,330			10,399,330
	<u>217,486,619</u>			<u>217,486,619</u>
Current liabilities				
Accounts payable	15,499,756	6,838	(2,445)	15,504,149
Current portion of long-term debt	8,999,552			8,999,552
Other current and accrued liabilities	3,546,284			3,546,284
Credit lines		1,820,000		1,820,000
Consumer deposits	2,395,120			2,395,120
	<u>30,440,712</u>	<u>1,826,838</u>	<u>(2,445)</u>	<u>32,265,105</u>
Deferred credits	<u>2,261,947</u>			<u>2,261,947</u>
	<u>\$ 376,586,136</u>	<u>\$ 4,048,796</u>	<u>\$ (2,224,403)</u>	<u>\$ 378,410,529</u>

## Consolidating Statements of Operations

### Choptank Electric Cooperative, Inc. and Subsidiary

#### Year Ended December 31, 2016

	Choptank Electric Cooperative, Inc.	CSC	Eliminations	Total
Operating revenues	\$ 130,297,520	\$	\$	\$ 130,297,520
Operating expenses				
Cost of power	77,695,499			77,695,499
Transmission	6,577			6,577
Distribution - operation	3,894,600			3,894,600
Distribution - maintenance	6,789,806			6,789,806
Consumer accounts	4,223,784			4,223,784
Customer service and informational	751,168			751,168
Sales expense	122,665			122,665
Administrative and general	6,690,864	33,875		6,724,739
Depreciation and amortization	12,891,202			12,891,202
Taxes	3,464,921			3,464,921
Interest on long-term debt	9,376,116			9,376,116
Interest - other	461,377	53,881		515,258
Other deductions	181,688			181,688
	<u>126,550,267</u>	<u>87,756</u>	<u></u>	<u>126,638,023</u>
Operating Margins (Loss) Before Patronage Allocations	3,747,253	(87,756)		3,659,497
Patronage allocations	<u>2,502,162</u>	<u>22,652</u>	<u></u>	<u>2,524,814</u>
Net Operating Margins (Loss)	6,249,415	(65,104)		6,184,311
Nonoperating income (expense)				
Dividend income		102,015		102,015
Gain from equity investment		394,104		394,104
Gain on disposition of assets	973,781	68,079		1,041,860
Interest income	228,201			228,201
Other	(27,396)			(27,396)
Income from subsidiary	499,094		(499,094)	
	<u>1,673,680</u>	<u>564,198</u>	<u>(499,094)</u>	<u>1,738,784</u>
Net Margins	<u>\$ 7,923,095</u>	<u>\$ 499,094</u>	<u>\$ (499,094)</u>	<u>\$ 7,923,095</u>

See Independent Auditor's Report on Consolidating Information