

Certified Public Accountants
& Consultants



Arab Electric Cooperative, Inc.
June 30, 2020
Financial Statements

Arab Electric Cooperative, Inc.

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Independent Auditor's Report

The Board of Trustees
Arab Electric Cooperative, Inc.
Arab, Alabama

Report on the Financial Statements

We have audited the accompanying financial statements of Arab Electric Cooperative, Inc. (the Cooperative), which comprise the balance sheets as of June 30, 2020 and 2019, and the related statements of revenue, changes in equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 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 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the 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 entity'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 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 financial statements referred to above present fairly, in all material respects, the financial position of Arab Electric Cooperative, Inc. as of June 30, 2020 and 2019, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Change in Accounting Principle

As discussed in Note 11 to the financial statements, the Cooperative adopted new accounting guidance FASB ASU 2014-09, *Revenue from Contracts with Customers* (Topic 606) as of July 1, 2019. Our opinion is not modified with respect to this matter.

Jackson Thornton & Co. PC

Montgomery, Alabama
September 21, 2020

Arab Electric Cooperative, Inc.
Balance Sheets
At June 30, 2020 and 2019

Assets

	2020	2019
Utility Plant		
Electric plant in service	\$ 51,745,760	\$ 50,558,497
Construction work-in-progress	229,253	198,945
	51,975,013	50,757,442
Less accumulated provision for depreciation	24,668,795	23,369,510
Net utility plant	27,306,218	27,387,932
Other Assets and Investments		
Investments in associated organizations	945,599	940,195
Advances to consumers	1,238,500	1,227,183
Total other assets and investments	2,184,099	2,167,378
Current Assets		
Cash and cash equivalents	10,110,198	1,878,715
Accounts receivable		
Customers, less provision for doubtful accounts of \$44,482 in 2020 and \$38,017 in 2019	2,245,654	2,810,061
Other	64,861	391,972
Unbilled revenue	1,846,737	
Prepaid power		4,979,073
Materials and supplies	815,002	723,523
Other current and accrued assets	302,111	349,496
Total current assets	15,384,563	11,132,840
Total assets	\$ 44,874,880	\$ 40,688,150

The accompanying notes are an integral part of these financial statements.

Equities and Liabilities

	<u>2020</u>	<u>2019</u>
Equities		
Memberships	\$ 120,646	\$ 119,986
Patronage capital	<u>38,799,636</u>	<u>35,675,168</u>
Total equities	<u>38,920,282</u>	<u>35,795,154</u>
Noncurrent Liabilities		
Tennessee Valley Authority advances	<u>1,219,362</u>	<u>1,222,972</u>
Total noncurrent liabilities	<u>1,219,362</u>	<u>1,222,972</u>
Current Liabilities		
Accounts payable		
Purchased power	587,598	
General	224,535	260,685
Paycheck Protection Program loan	431,990	
Consumer deposits	2,957,775	2,911,585
Accrued liabilities		
Taxes	467,330	452,074
Other	<u>66,008</u>	<u>45,680</u>
Total current liabilities	<u>4,735,236</u>	<u>3,670,024</u>
Total equities and liabilities	<u>\$ 44,874,880</u>	<u>\$ 40,688,150</u>

Arab Electric Cooperative, Inc.
Statements of Revenue
For the Years Ended June 30, 2020 and 2019

	<u>2020</u>		<u>2019</u>	
Operating Revenue				
Revenues from customers	\$ 34,065,290	97.04%	\$ 35,177,481	96.60%
Other	<u>1,037,832</u>	<u>2.96%</u>	<u>1,236,701</u>	<u>3.40%</u>
Total operating revenue	<u>35,103,122</u>	<u>100.00%</u>	<u>36,414,182</u>	<u>100.00%</u>
Operating Expenses				
Cost of power	25,363,622	72.25%	27,071,579	74.34%
Distribution - operations	864,586	2.46%	982,639	2.70%
Distribution - maintenance	1,974,475	5.62%	1,467,208	4.03%
Accounting and collections	931,762	2.65%	965,832	2.65%
Administrative and general	1,993,990	5.68%	1,811,247	4.97%
Depreciation	1,884,142	5.37%	1,652,247	4.54%
Taxes	<u>1,730,235</u>	<u>4.93%</u>	<u>1,725,932</u>	<u>4.74%</u>
Total operating expenses	<u>34,742,812</u>	<u>98.97%</u>	<u>35,676,684</u>	<u>97.97%</u>
Net Operating Income	360,310	1.03%	737,498	2.03%
Nonoperating Margins	<u>628,298</u>	<u>1.79%</u>	<u>181,179</u>	<u>0.50%</u>
Net Margins for the Year	<u><u>\$ 988,608</u></u>	<u><u>2.82%</u></u>	<u><u>\$ 918,677</u></u>	<u><u>2.53%</u></u>

The accompanying notes are an integral part of these financial statements.

Arab Electric Cooperative, Inc.
Statements of Changes in Equity
For the Years Ended June 30, 2020 and 2019

	Memberships	Patronage Capital	Total
Balance at June 30, 2018	\$ 121,056	\$ 34,756,491	\$ 34,877,547
Net margin		918,677	918,677
Memberships, net	(1,070)		(1,070)
Balance at June 30, 2019	119,986	35,675,168	35,795,154
Cumulative effect on prior years of change in accounting principle		1,921,184	1,921,184
Balance, As Restated, at July 1, 2019	119,986	37,596,352	37,716,338
Net margin		988,608	988,608
Utility tax refund		214,676	214,676
Memberships, net	660		660
Balance at June 30, 2020	<u>\$ 120,646</u>	<u>\$ 38,799,636</u>	<u>\$ 38,920,282</u>

The accompanying notes are an integral part of these financial statements.

Arab Electric Cooperative, Inc.
Statements of Cash Flows
For the Years Ended June 30, 2020 and 2019
Increase (Decrease) in Cash and Cash Equivalents

	<u>2020</u>	<u>2019</u>
Cash Flows From (Used For) Operating Activities		
Net margins	\$ 988,608	\$ 918,677
Adjustments to reconcile net margins to net cash provided by operating activities		
Depreciation and amortization	1,884,142	1,652,247
Bad debt expense	69,060	70,552
Decrease (increase) in operating assets and increase (decrease) in operating liabilities		
Accounts receivable	896,908	(357,674)
Prepaid power	4,979,073	(4,979,073)
Materials and supplies	(91,479)	(138,058)
Other current and accrued assets	47,382	(205,302)
Accounts payable	551,448	(350,167)
Consumer deposits	46,190	119,892
Accrued liabilities	35,584	14,932
Net cash from (used for) operating activities	<u>9,406,916</u>	<u>(3,253,974)</u>
Cash Flows From (Used For) Investing Activities		
Purchases of property and equipment	(1,816,165)	(2,490,032)
Proceeds from investments	8,333	1,731
Conservation loans receivable, net	(11,317)	84,941
Net cash used for investing activities	<u>(1,819,149)</u>	<u>(2,403,360)</u>
Cash Flows From (Used For) Financing Activities		
Proceeds from Paycheck Protection Program loan	431,990	
Utility tax refund	214,676	
Advance for conservation loans, net	(3,610)	(90,553)
Membership fees, net	660	(1,070)
Net cash from (used for) financing activities	<u>643,716</u>	<u>(91,623)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	8,231,483	(5,748,957)
Cash and Cash Equivalents at Beginning of Year	<u>1,878,715</u>	<u>7,627,672</u>
Cash and Cash Equivalents at End of Year	<u>\$ 10,110,198</u>	<u>\$ 1,878,715</u>

The accompanying notes are an integral part of these financial statements.

Arab Electric Cooperative, Inc.
Notes to Financial Statements
As of June 30, 2020 and 2019

Note 1 - Summary of Significant Accounting Policies

Organization and reporting entity - Arab Electric Cooperative, Inc. (the Cooperative) was incorporated as a public corporation in April 1947, under the provisions of Sections 31 to 59, inclusive, of title 18, Chapter 3 of the Code of Alabama of 1940 and is exempt from federal income taxes as a 501(c)(12) organization under the provisions of the Internal Revenue code. The Cooperative owns and operates the electric distribution systems in accordance with a contract between the Cooperative and the Tennessee Valley Authority (TVA) and purchases electric energy from the TVA for distribution to its customers. The Cooperative's customer base consists of residential, commercial, and industrial customers located in the Arab, Alabama area. The primary source of revenue is fees collected from customers for utility services. The Cooperative does not distribute net income to the members of the Cooperative in the form of patronage dividends. The Cooperative elects nine trustees from its membership to serve as the Board of Trustees.

Basis of accounting - The accounting records of the Cooperative are maintained in accordance with the Uniform System of Accounts prescribed by the Rural Utilities Service (RUS). As a result, the application of accounting principles generally accepted in the United States of America by the Cooperative differs in certain respects from the application of those principles by nonregulated enterprises. Such differences primarily concern the recognition of gains and losses on the retirement of assets. The more significant policies of the Cooperative are described below.

Regulation - As a regulated enterprise with a member-elected Board of Trustees, the Cooperative accounts for such regulation under professional accounting standards ASC 980, *Regulated Operations*. The accounting policies followed by the Cooperative are in conformity with generally accepted accounting principles as they apply to a regulated electric utility. The rates are regulated by the TVA and are designed to recover the cost of providing electric distribution to members of the Cooperative.

Utility plant - Utility plant is recorded at cost. Additions and improvements that extend the life of an asset are capitalized. Expenditures for repairs and maintenance are charged against income. Depreciation is computed on the composite rate method at rates recommended by the TVA. Retirements of utility plant have been charged to the accumulated depreciation accounts at the original cost of the assets plus cost of removal. Salvage value of the retired utility plant is credited to the accumulated depreciation accounts.

Investments - Investments in associated organizations represent cooperative capital credits from the Cooperative's suppliers and debt capital. Investments in associated organizations are recorded at cost.

Cash equivalents - The Cooperative considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Accounts receivable - The Cooperative extends unsecured credit to its customers in the ordinary course of business. Accounts receivable represent amounts due from local businesses and individuals predominantly located in the Arab, Alabama area. Trade receivables are carried at the original invoice amount less an estimate made for doubtful accounts based on a review of all outstanding amounts on a monthly basis. Trade receivables are written off when deemed uncollectible. Recoveries of trade receivables previously written off are recorded when received.

Inventories - Inventories of materials and supplies are priced at the lower of cost or market. Cost is determined by the average cost as computed using the first-in, first-out (FIFO) method.

Recognition of revenue from customers - The Cooperative has contractual agreements with its customers for the provision of electric services. In 2020, electric revenue was recognized when electricity was used by the ultimate consumer. In 2019, electric revenue was recognized when billed to the member. See Note 11 for the adoption of new accounting guidance related to this change. Customers are billed on a cycle basis throughout the month. Payment is due from customers within twenty days of the bill date.

Arab Electric Cooperative, Inc.
Notes to Financial Statements
As of June 30, 2020 and 2019

Income taxes - The Cooperative is exempt from income taxes under Internal Revenue Code Section 501(c)(12). Management evaluated the Cooperative's tax positions and concluded that the Cooperative had taken no uncertain tax positions that require adjustment to the financial statements.

Use of estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Note 2 - Cash and Cash Equivalents

The Cooperative maintains cash and cash equivalents in various banks located in Alabama, which at times may exceed federally insured limits. The Cooperative had approximately, \$9,866,000 and \$1,798,000 of cash over the federally insured limit with one Alabama bank at June 30, 2020 and 2019, respectively. The Cooperative has entered into a master repurchase agreement with this bank to invest in obligations of the U.S. Treasury to provide security for deposits with the bank. Securities were pledged to insure deposits over \$250,000. The Cooperative has not experienced any losses in such accounts. The Cooperative believes it is not exposed to any significant credit risk on cash and cash equivalents.

Note 3 - Receivables from Contracts with Customers

Receivables and contract assets from contracts with customers for the years ended June 30, 2020 and 2019 were as follows:

	<u>2020</u>	<u>2019</u>	
	<u>End of Year</u>	<u>End of Year</u>	<u>Beginning of Year</u>
Receivables			
Customers	\$ 2,245,654	\$ 2,810,061	\$ 2,849,505
Contract Assets			
Unbilled revenue	1,846,737		
Total receivables and contract assets	<u>\$ 4,092,391</u>	<u>\$ 2,810,061</u>	<u>\$ 2,849,505</u>

Note 4 - Investments in Associated Organizations

Investments in associated organizations consist of the following at June 30, 2020 and 2019:

	<u>2020</u>	<u>2019</u>
Investment in NRUCFC capital term certificates	\$ 357,432	\$ 357,432
GRESKO patronage capital allocation	422,055	408,318
Other	166,112	174,445
Totals	<u>\$ 945,599</u>	<u>\$ 940,195</u>

Arab Electric Cooperative, Inc.
Notes to Financial Statements
As of June 30, 2020 and 2019

Note 5 - Utility Plant and Depreciation

Listed below are the major classes of the utility plant and estimated annual rates used to compute depreciation for financial reporting purposes as of June 30, 2020 and 2019:

	<u>Plant Balances</u>		<u>Annual</u>
	<u>2020</u>	<u>2019</u>	<u>Depreciation</u>
			<u>Rate</u>
Distribution Plant	\$ 47,757,768	\$ 47,023,906	2.0 - 6.0%
General Plant			
Structures	963,775	957,175	2.0%
Office furniture and equipment	255,650	204,771	4.0 - 10.0%
Transportation	1,949,987	1,573,701	15.0%
Communication	104,168	104,168	8.0%
Tools and work equipment	456,830	446,482	5.0%
Other miscellaneous equipment	69,669	60,381	4.0 - 10.0%
Land and rights	187,913	187,913	
Totals	<u>\$ 51,745,760</u>	<u>\$ 50,558,497</u>	

Note 6 - Purchased Power Payable and Prepaid Power

The Cooperative has an agreement with the TVA by which the Cooperative maintains an interest-bearing prepaid power account for purchases of electricity. At June 30, 2020, the Cooperative had deposits with the TVA totaling \$3,210,550, and a liability for purchased power of \$3,798,148. At June 30, 2019, the Cooperative had deposits with the TVA totaling \$9,419,427, and a liability for purchased power of \$4,440,354.

Note 7 - Paycheck Protection Program Loan

On March 27, 2020, Congress enacted the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) which established the Paycheck Protection Program (the Program). The Program was created to assist small businesses in paying their employees and certain other expenses during the COVID-19 crisis. The Cooperative applied for a loan under this Program and received from its bank an unsecured loan in the amount of \$431,990 on April 23, 2020. The loan is forgivable if the Cooperative meets certain criteria as established under the Program. The Cooperative will seek loan forgiveness in fiscal year 2021. The Cooperative anticipates there may be further guidance issued by the Small Business Administration (SBA), the U.S. Department of the Treasury, the bank, and other regulators related to the Program which could impact the loan and loan forgiveness. Any of the loan amount not forgiven under the Program will be due April 23, 2022 with interest at 1.0%. The loan is unsecured.

Note 8 - Tennessee Valley Authority Energy Right Program

Under a contract with the TVA, the Cooperative manages and collects loan advances sponsored by the TVA to Cooperative customers to cover the cost of home insulation and energy conservation improvements. The loans to the consumer are interest-bearing and are generally paid over a 36 to 120-month period. The Cooperative remits the collections from the consumers on a monthly basis as required under the program. Total advances outstanding under the program were approximately \$1,219,362 and \$1,222,972 at June 30, 2020 and 2019, respectively.

Arab Electric Cooperative, Inc.
Notes to Financial Statements
As of June 30, 2020 and 2019

Note 9 - Accounting for Pensions

Defined benefit 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 multi-employer plan under the accounting standards. The RS Plan Sponsor's Employer Identification Number is 53-0116145 and the RS Plan Number is 333.

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

The Cooperative's contributions to the RS Plan in 2020 and 2019 represented less than 5% of the total contributions made to the RS Plan by all participating employers. The Cooperative made contributions to the RS Plan of \$718,381 and \$776,292 in 2020 and 2019, respectively.

For the RS Plan, a "zone status" determination is not required, and therefore not determined, under the Pension Protection Act (PPA) of 2006. In addition, the accumulated benefit obligations and plan assets are not determined or allocated separately by individual employer. In total, the RS Plan was over 80% funded at January 1, 2020 and January 1, 2019 based on the PPA funding target and PPA actuarial value of assets on those dates.

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

Note 10 - Commitments

The Cooperative has a contract with the Tennessee Valley Authority for the purchase of its electric power and energy requirements. The rates paid for such purchases are subject to annual review and adjustment. The contract requires a twenty year notice of cancellation to terminate the contract.

Note 11 - New Accounting Standards

The Financial Accounting Standards Board (FASB) issued new guidance that created Topic 606, *Revenue from Contracts with Customers*, in the Accounting Standards Codification (ASC). Topic 606 supersedes the revenue recognitions requirements in FASB ASC 605, *Revenue Recognition*, and requires the recognition of revenue when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services.

The Cooperative adopted the requirements of the new guidance as of July 1, 2019, utilizing the modified retrospective method of transition. As a result, the Cooperative recorded a cumulative adjustment to patronage capital as of July 1, 2019 to reflect the effect of the new guidance.

The impact of adopting the new guidance was an decrease in 2020 revenues of \$74,447.

Arab Electric Cooperative, Inc.
Notes to Financial Statements
As of June 30, 2020 and 2019

The modified retrospective method of transition requires the disclosure of the effect of applying the new guidance on each item included in the 2020 financial statements. Following are the line items from balance sheet as of June 30, 2020, that were affected, the amounts that would have been reported under former guidance, the effects of applying the new guidance, and the balance reported under the new guidance:

	<u>Amounts That Would Have Been Reported</u>	<u>Effects of Applying New Guidance</u>	<u>As Reported</u>
Assets			
Unbilled revenue		\$ 1,846,737	\$ 1,846,737
Equity			
Patronage capital	\$ 36,878,452	1,921,184	38,799,636

The following are the line items from the statement of revenues and statement of cash flows for the year ended June 30, 2020, that were affected, the amounts that would have been reported under the former guidance, the effects of applying the new guidance, and the amounts reported under the new guidance:

	<u>Amounts That Would Have Been Reported</u>	<u>Effects of Applying New Guidance</u>	<u>As Reported</u>
Revenues			
Revenues from customers	\$ 34,139,737	\$ (74,447)	\$ 34,065,290
Net margins	1,063,055	(74,447)	988,608
Cash Flows			
Net margins	1,063,055	(74,447)	988,608
Accounts receivable	822,461	74,447	896,908

Note 12 - Subsequent Events

The Cooperative has evaluated subsequent events through September 21, 2020, which is the date these financial statements were available to be issued. All subsequent events requiring recognition as of June 30, 2020, have been incorporated into these financial statements.