

Pioneer Electric Cooperative, Inc.

JUNE 30, 2018

FINANCIAL STATEMENTS

PIONEER ELECTRIC COOPERATIVE, INC.
GREENVILLE, ALABAMA

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INDEPENDENT AUDITOR'S REPORT

The Board of Trustees
Pioneer Electric Cooperative, Inc.
Greenville, Alabama

Report on the Financial Statements

We have audited the accompanying financial statements of Pioneer Electric Cooperative, Inc., which comprise the balance sheets as of June 30, 2018 and 2017, and the related statements of revenue and patronage capital, and cash flows for the years then ended, and the related notes to 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 Pioneer Electric Cooperative, Inc. as of June 30, 2018 and 2017, 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.

Jackson Shernton & Co. PC

Montgomery, Alabama
August 30, 2018

PIONEER ELECTRIC COOPERATIVE, INC.
GREENVILLE, ALABAMA

BALANCE SHEETS
AT JUNE 30, 2018 AND 2017

ASSETS

	<u>2018</u>	<u>2017</u>
UTILITY PLANT:		
Electric plant in service	\$ 76,009,781	\$ 72,705,156
Construction work-in-progress	915	96,212
	<u>76,010,696</u>	<u>72,801,368</u>
Less: Accumulated provision for depreciation	26,882,139	25,634,083
Net utility plant	<u>49,128,557</u>	<u>47,167,285</u>
 OTHER ASSETS AND INVESTMENTS:		
Restricted cash	1,404,970	1,446,175
Investments in associated organizations	14,264,046	13,934,052
Investment in land and buildings	1,363,772	1,033,602
Total other assets and investments	<u>17,032,788</u>	<u>16,413,829</u>
 CURRENT ASSETS:		
Cash and cash equivalents	2,134,163	3,366,912
Accounts receivable:		
Customers, less provision for doubtful accounts of \$27,240 and \$42,180 for 2018 and 2017, respectively	1,220,559	1,089,358
Unbilled revenue	1,418,324	1,418,324
Other	269,677	322,613
Inventories	306,382	299,629
Prepays	133,103	144,280
Total current assets	<u>5,482,208</u>	<u>6,641,116</u>
 DEFERRED ASSETS:		
NRUCFC conversion fees	5,548,509	5,808,524
Prepaid pension		368,670
Other	256,399	380,594
Total deferred assets	<u>5,804,908</u>	<u>6,557,788</u>
 Total assets	 <u>\$ 77,448,461</u>	 <u>\$ 76,780,018</u>

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

LIABILITIES AND OTHER CREDITS

	<u>2018</u>	<u>2017</u>
EQUITIES:		
Patronage capital	\$ 24,115,055	\$ 43,588,072
Retained deficit		(21,965,864)
Other equities	<u>477,574</u>	<u>404,121</u>
Total equities	<u>24,592,629</u>	<u>22,026,329</u>
 LONG-TERM DEBT:		
Notes payable	43,818,689	45,167,181
Capital lease obligations	112,422	150,354
Less: Current maturities	<u>1,440,912</u>	<u>1,712,191</u>
Total long-term debt	<u>42,490,199</u>	<u>43,605,344</u>
 CURRENT LIABILITIES:		
Current maturities on long-term debt	1,440,912	1,712,191
Current portion of NRUCFC conversion fees	253,418	260,015
Current portion of postemployment benefits	12,600	22,254
Accounts payable:		
Purchased power	1,173,361	1,126,184
Trade	185,958	206,901
Customer deposits	1,189,505	1,210,858
Accrued liabilities:		
Taxes	198,261	350,579
Other	<u>511,242</u>	<u>456,759</u>
Total current liabilities	<u>4,965,257</u>	<u>5,345,741</u>
 OTHER LONG-TERM LIABILITIES:		
NRUCFC conversion fees, net of current maturities	5,295,091	5,548,509
Postemployment benefits, net of current maturities	<u>105,285</u>	<u>254,095</u>
Total other long-term liabilities	<u>5,400,376</u>	<u>5,802,604</u>
 Total liabilities and other credits	 <u>\$ 77,448,461</u>	 <u>\$ 76,780,018</u>

PIONEER ELECTRIC COOPERATIVE, INC.

STATEMENTS OF REVENUE AND PATRONAGE CAPITAL
FOR THE YEARS ENDED JUNE 30, 2018 AND 2017

	2018		2017	
OPERATING REVENUES	\$ 28,654,958	100.00%	\$ 28,113,922	100.00%
OPERATING EXPENSES:				
Cost of power	13,810,444	48.20%	13,310,347	47.34%
Distribution - operations	1,479,610	5.16%	1,405,813	5.00%
Distribution - maintenance	2,786,246	9.72%	2,871,439	10.21%
Consumer accounts	1,369,474	4.78%	1,272,727	4.53%
Energy marketing and communications	320,465	1.12%	333,731	1.19%
Administrative and general	2,403,737	8.39%	2,343,116	8.33%
Depreciation	2,796,730	9.76%	2,689,503	9.57%
Taxes	101,405	0.35%	(51,070)	(0.18%)
Total operating expenses	25,068,111	87.48%	24,175,606	85.99%
OPERATING MARGINS	3,586,847	12.52%	3,938,316	14.01%
G & T AND OTHER CAPITAL CREDITS	429,488	1.50%	462,017	1.64%
NET OPERATING MARGINS	4,016,335	14.02%	4,400,333	15.65%
INTEREST EXPENSE	1,867,552	6.52%	1,885,865	6.71%
NONOPERATING MARGINS:				
Interest income	43,013	0.15%	29,439	0.10%
Other income	112,680	0.39%	54,823	0.19%
Total nonoperating margins	155,693	0.54%	84,262	0.29%
NET MARGINS FOR THE YEAR	\$ 2,304,476	8.04%	\$ 2,598,730	9.23%

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

PIONEER ELECTRIC COOPERATIVE, INC.

STATEMENTS OF CHANGES IN EQUITY
FOR THE YEARS ENDED JUNE 30, 2018 AND 2017

	<u>OTHER</u>	<u>RETAINED DEFICIT</u>	<u>PATRONAGE CAPITAL</u>	<u>TOTAL</u>
Balance, June 30, 2016	\$ 310,665	\$ (21,965,864)	\$ 41,691,429	\$ 20,036,230
Net margin			2,598,730	2,598,730
Patronage gains	93,456			93,456
Retirement of capital credits			<u>(702,087)</u>	<u>(702,087)</u>
Balance, June 30, 2017	404,121	(21,965,864)	43,588,072	22,026,329
Net margin			2,304,476	2,304,476
Patronage gains	73,453			73,453
Reclass deficit balance per settlement agreement		21,965,864	(21,965,864)	
Utility tax refund			329,850	329,850
Retirement of capital credits			<u>(141,479)</u>	<u>(141,479)</u>
Balance, June 30, 2018	<u>\$ 477,574</u>	<u>\$ -</u>	<u>\$ 24,115,055</u>	<u>\$ 24,592,629</u>

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

PIONEER ELECTRIC COOPERATIVE, INC.

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2018 AND 2017
Increase (Decrease) in Cash and Cash Equivalents

	<u>2018</u>	<u>2017</u>
CASH FLOWS FROM (USED FOR) OPERATING ACTIVITIES:		
Net margins	\$ 2,304,476	\$ 2,598,730
Adjustments to reconcile net margins to net cash provided by operating activities:		
Depreciation and amortization	2,796,730	2,689,503
Amortization of deferred charges	368,670	491,561
Bad debt expense	14,743	(21,042)
G & T and other capital credits	(429,488)	(462,017)
Decrease (increase) in operating assets and increase (decrease) in operating liabilities:		
Accounts receivable	(93,008)	158,794
Materials and supplies	(6,753)	29,471
Prepays	11,177	8,414
Other accrued assets	124,195	(210,281)
Accounts payable	26,234	(7,615)
Consumer deposits	(21,353)	11,300
Accrued liabilities	(256,299)	(121,346)
Net cash from operating activities	<u>4,839,324</u>	<u>5,165,472</u>
CASH FLOWS FROM (USED FOR) INVESTING ACTIVITIES:		
Purchase of property and equipment, net of salvage and cost of removal	(4,497,987)	(2,712,085)
Principal payments received on other notes receivable		76,691
Purchase of investment property	(330,170)	
Proceeds from investments	99,494	46,683
Net cash used for investing activities	<u>(4,728,663)</u>	<u>(2,588,711)</u>
CASH FLOWS FROM (USED FOR) FINANCING ACTIVITIES:		
Principal payments on notes payable	(1,386,424)	(1,538,901)
Payments on NRUCFC conversion fees	(260,015)	(264,898)
Increase in membership fees and other equity	403,303	93,456
Retirement of capital credits	(141,479)	(702,087)
Net cash used for financing activities	<u>(1,384,615)</u>	<u>(2,412,430)</u>
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(1,273,954)	164,331
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>4,813,087</u>	<u>4,648,756</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 3,539,133</u>	<u>\$ 4,813,087</u>
SUPPLEMENTAL CASH FLOWS INFORMATION:		
Restricted cash	\$ 1,404,970	\$ 1,446,175
Unrestricted cash	<u>2,134,163</u>	<u>3,366,912</u>
Totals	<u>\$ 3,539,133</u>	<u>\$ 4,813,087</u>
Cash paid for interest	<u>\$ 1,892,958</u>	<u>\$ 1,946,305</u>

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

PIONEER ELECTRIC COOPERATIVE, INC.
GREENVILLE, ALABAMA

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2018 AND 2017

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Nature of business - Pioneer Electric Cooperative, Inc. (the Cooperative) distributes electric power to consumers in rural central Alabama.

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.

Recognition revenue - Electric revenue and the related cost of power purchased are recognized when electricity is used by the ultimate consumer.

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

Taxes - The Cooperative collects gross receipts taxes from its members on behalf of the State of Alabama. Revenue is presented net of taxes collected in the statement of income and patronage capital.

Accounts receivable - The Cooperative extends credit to its customers who are primarily located in central Alabama. Trade receivables are carried at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a monthly basis. Management determines the allowance for doubtful accounts by identifying troubled accounts and by using historical experience applied to an aging of accounts. Trade receivables do not accrue interest. Trade receivables are written-off when deemed uncollectible. Recoveries of trade receivables previously written-off are recorded when received.

Inventories - Electric materials and supplies are priced at average historical cost. Cost is determined by the cumulative average of all costs on a first-in, first-out (FIFO) basis.

Electric plant - The Cooperative's costs associated with electric plant additions and improvements are capitalized based upon the RUS guidelines established in Bulletin 1767B-2. This results in the capitalization of direct costs such as labor and materials expense and also includes capitalization of indirect costs including labor, material charges, taxes, insurance, transportation, depreciation, pensions, and other related expenses. These costs are accumulated in work-in-process accounts and are capitalized to the proper plant accounts at the completion of the construction activity. Certain special equipment additions, as defined by RUS, are capitalized when purchased along with an estimated installation charge. The cost of depreciable property, when retired, is computed at the average unit cost along with removal costs less salvage. The net retirement cost is charged to accumulated depreciation. Maintenance and repairs, including minor items of property, are charged to maintenance expense as incurred.

Income tax status - The Cooperative is exempt from income taxes under Internal Revenue Code Section 501(c)(12).

PIONEER ELECTRIC COOPERATIVE, INC.
GREENVILLE, ALABAMA

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2018 AND 2017

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.

Investments - Investments in associated organizations represent cooperative capital credits from the Cooperative's suppliers and lenders. Investments in associated organizations are recorded at cost plus allocated equities. Investments in land and buildings are carried at the lower of cost or market value.

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.

Reclassification - Certain prior year amounts have been reclassified to conform to the current year presentation.

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 has approximately \$8,000 in uninsured cash at multiple financial institutions at June 30, 2018 and 2017. 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.

Restricted funds relate to industrial development revolving loan programs. Restricted balances were as follows:

	<u>2018</u>	<u>2017</u>
Intermediary relending program	\$ 426,297	\$ 467,502
RUS revolving loan fund	388,585	388,585
REDLG	460,993	460,993
RBEG revolving loan fund	<u>129,095</u>	<u>129,095</u>
Total restricted funds	<u>\$ 1,404,970</u>	<u>\$ 1,446,175</u>

PIONEER ELECTRIC COOPERATIVE, INC.
GREENVILLE, ALABAMA

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2018 AND 2017

NOTE 3 - UTILITY PLANT AND DEPRECIATION:

Listed below are the major classes of electric plant as of June 30, 2018 and 2017:

	2018 PLANT BALANCES	2017 PLANT BALANCES	ANNUAL DEPRECIATION RATE
Distribution plant	\$ 63,159,938	\$ 59,919,938	3.20 - 4.40%
General plant:			
Land and rights	243,797	243,797	
Structures and improvements	5,063,458	5,003,304	2.05%
Office furniture and equipment	2,774,832	2,655,209	7.00 - 14.28%
Transportation equipment	1,320,721	1,235,916	17.00%
Power operated equipment	2,498,977	2,657,669	6.72 - 17.00%
Communication equipment	550,592	550,592	8.00%
Other miscellaneous equipment	397,466	438,731	6.00 - 12.00%
Totals	<u>\$ 76,009,781</u>	<u>\$ 72,705,156</u>	

Electric plant is depreciated on a straight-line basis.

NOTE 4 - INVESTMENTS IN ASSOCIATED ORGANIZATIONS:

Investments in associated organizations consisted of the following at June 30, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
PowerSouth patronage capital	\$ 9,343,057	\$ 9,149,080
NRUCFC patronage capital	1,929,233	1,840,479
Investment in NRUCFC capital term certificates	2,215,516	2,215,516
Other investments in associated organizations	<u>776,240</u>	<u>728,977</u>
Totals	<u>\$ 14,264,046</u>	<u>\$ 13,934,052</u>

PIONEER ELECTRIC COOPERATIVE, INC.
GREENVILLE, ALABAMA

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2018 AND 2017

NOTE 6 - NOTES PAYABLE AND LINES OF CREDIT:

<u>DESCRIPTION</u>	<u>2018</u>	<u>2017</u>
Mortgage notes payable - NRUCFC; fixed interest rates from 3.60% to 4.60%; notes due at various times up to December 2040; secured by all assets.	\$ 43,401,373	\$ 44,711,409
Notes payable - RUS; 1.00% interest; intermediary relending program; principal and interest due in installments until August 2030; secured by related economic development loans.	<u>417,316</u>	<u>455,772</u>
Total long-term notes payable	<u><u>\$ 43,818,689</u></u>	<u><u>\$ 45,167,181</u></u>

The Cooperative has covenants with its lenders relating to certain financial ratios.

Estimated maturities on long-term liabilities for the next five years are as follows:

June 30, 2019	\$ 1,440,912
June 30, 2020	1,488,884
June 30, 2021	1,544,107
June 30, 2022	1,601,848
June 30, 2023	1,662,223

Lines of credit - The Cooperative has two lines of credit with NRUCFC on which it may borrow up to \$12,500,000. One line of credit totals \$5,000,000 and may be used only for electric capital or operating needs. The other line of credit totals \$7,500,000 and may be used only for expenditures reimbursable by FEMA. As of June 30, 2018 and 2017, there were no outstanding balances on these lines of credit.

The Cooperative has an available unsecured line of credit with CoBank on which it may borrow up to a total of \$5,000,000. The balance outstanding was \$0 at June 30, 2018 and 2017.

The NRUCFC loan conversion fees are payable in quarterly payments, over a period of 30 years. These conversion fees have no carrying cost. The related deferred asset is being amortized over a period of 30 years. Amortization expense related to this deferred asset was \$260,015 and \$264,898 for 2018 and 2017, respectively.

PIONEER ELECTRIC COOPERATIVE, INC.
GREENVILLE, ALABAMA

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2018 AND 2017

NOTE 7 - 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 plan sponsor's Employer Identification Number is 53-0116145 and the 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.

At its December 2012 meeting, the I&FS Committee of the NRECA Board of Directors approved an option to allow participants in the RS Plan to make a contribution prepayment and reduce future required contributions. In 2013, the Cooperative made a prepayment of \$2,457,803 to the RS Plan. The Cooperative is amortizing this amount over five years. Amortization expense was \$368,670 and \$491,560 in 2018 and 2017, respectively.

The prepayment amount was calculated by NRECA as the Cooperative's share, as of January 1, 2013, of future contributions required to fund the RS Plan's unfunded value of benefits earned to date using RS Plan actuarial valuation assumptions. The prepayment amount will typically equal approximately 2.5 times a cooperative's annual RS Plan required contribution as of January 1, 2013. After making the prepayment, the billing rate for most cooperatives is reduced by approximately 25%, retroactive to January 1 of the year in which the amount is paid to the RS Plan. The 25% differential in billing rates is expected to continue for approximately 15 years from January 1, 2013. However, unexpected changes in interest rates, asset returns and other plan experience, plan assumption changes, and other factors may have an impact on the differential in billings and the 15 year period.

The Cooperative's contributions to the RS Plan in 2018 and in 2017 represented less than 5% of the total contributions made to the plan by all participating employers. The Cooperative made contributions to the plan of \$770,015 in 2018 and \$781,217 in 2017.

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, 2018 and January 1, 2017 based on the PPA funding target and PPA actuarial value of assets on those dates.

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

401(k) Plan - The Cooperative has a 401(k) plan for its employees. The total expense related to the 401(k) plan for the Cooperative was \$57,191 and \$59,435 for 2018 and 2017, respectively.

PIONEER ELECTRIC COOPERATIVE, INC.
GREENVILLE, ALABAMA

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2018 AND 2017

NOTE 8 - COMMITMENTS:

Under its wholesale power agreement, the Cooperative is committed to purchase its electric power and energy requirements from PowerSouth until December 31, 2055. The rates paid for such purchases are subject to periodic review.

NOTE 9 - SUBSEQUENT EVENTS:

The Cooperative has evaluated subsequent events through August 30, 2018, which is the date these financial statements were available to be issued. All subsequent events requiring recognition as of June 30, 2018, have been incorporated into these financial statements.