POLK-BURNETT ELECTRIC COOPERATIVE
AND SUBSIDIARIES
CENTURIA, WI
CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2018 and 2017

and

REPORT OF INDEPENDENT
CERTIFIED PUBLIC ACCOUNTANTS

POLK-BURNETT ELECTRIC COOPERATIVE AND SUBSIDIARIES
CENTURIA,WISCONSIN

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Report of Independent Certified Public Accountants

Board of Directors
Polk-Burnett Electric Cooperative and Subsidiaries
Centuria, Wisconsin

We have audited the accompanying consolidated financial statements of Polk-Burnett Electric Cooperative and Subsidiaries which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of operations, members' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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 of 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 entity'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 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 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 materials respects, the financial position of Polk-Burnett Electric Cooperative and Subsidiaries as of December 31, 2018 and 2017 and the results of their operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Bauman Associates, Ltd.

CERTIFIED PUBLIC ACCOUNTANTS

Eau Claire, Wisconsin
February 18, 2019

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POLK-BURNETT ELECTRIC COOPERATIVE
CONSOLIDATED BALANCE SHEETS
December 31, 2018 and 2017

ASSETS	2018	2017
PLANT, PROPERTY, AND EQUIPMENT:		
Plant	$ 97,430,389	$ 94,094,520
Construction work in progress	428,901	860,150
Total	97,859,290	94,954,670
Less accumulated depreciation	26,419,845	24,336,122
Net plant, property, and equipment	71,439,445	70,618,548
INVESTMENTS:		
Investments in associated cooperatives	14,945,462	14,731,994
Notes receivable	180,000	216,000
Other investments	27,348	14,240
Total investments	15,152,810	14,962,234
CURRENT ASSETS:		
Cash and cash equivalents	3,358,033	2,547,701
Temporary cash investments	552,290	2,014,503
Accounts receivable (less accumulated provision for uncollectible accounts of $34,163 in 2018 and $68,588 in 2017)	2,398,641	2,336,377
Notes receivable - current portion	36,000	36,000
Materials and supplies	477,379	514,788
Prepayments	874,462	619,124
Total current assets	7,696,805	8,068,493
DEFERRED DEBITS	1,108,761	1,354,010
TOTAL ASSETS	$ 95,397,821	$ 95,003,285

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

EQUITIES AND LIABILITIES	2018	2017
EQUITIES:		
Patronage capital	$ 46,803,187	$ 46,612,777
Other equities	4,528,168	2,993,164
Total equities	51,331,355	49,605,941
LONG-TERM DEBT	32,397,844	34,089,008
CURRENT LIABILITIES:		
Current portion of long-term debt	1,691,163	1,614,934
Accounts payable	706,585	806,518
Accounts payable - billed power costs	1,825,589	2,049,872
Propane customer deposits	1,735,788	1,471,756
Other current liabilities	1,362,591	1,446,282
Total current liabilities	7,321,716	7,389,362
DEFERRED CREDITS	4,346,906	3,918,974
TOTAL EQUITIES AND LIABILITIES	$ 95,397,821	$ 95,003,285

POLK-BURNETT ELECTRIC COOPERATIVE
CONSOLIDATED STATEMENTS OF OPERATIONS
Years Ended December 31, 2018 and 2017

	2018	2017
OPERATING REVENUES	$ 37,519,790	$ 35,396,602
LESS COST OF GOODS SOLD	21,796,057	20,490,601
GROSS MARGINS	15,723,733	14,906,001
OPERATING EXPENSES:		
Operations	1,606,938	1,619,665
Maintenance	2,244,060	2,351,691
Customer accounts	773,771	870,331
Customer service and information	507,968	509,764
Sales	43,392	39,654
Administrative and general	2,684,864	2,683,022
Depreciation	3,129,225	2,861,164
Rent	1,800	1,800
Other	1,442,441	428,849
Total operating expenses	12,434,459	11,365,940
OPERATING MARGINS BEFORE CAPITAL CREDITS	3,289,274	3,540,061
CAPITAL CREDITS FROM OTHER COOPERATIVES	555,128	1,077,900
OPERATING MARGINS	3,844,402	4,617,961
NON-OPERATING MARGINS:		
Interest income	84,936	71,291
Finance charges	10,351	7,842
Gain on sale of property and equipment	74,422	17,409
Other non-operating income (expense)	415,630	909,493
Total non-operating margins	585,339	1,006,035
MARGINS BEFORE INTEREST AND INCOME TAX	4,429,741	5,623,996
INTEREST EXPENSE	1,394,973	1,477,801
INCOME TAX EXPENSE (BENEFIT)	157,272	(191,862)
NET MARGINS	$ 2,877,496	$ 4,338,057

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

POLK-BURNETT ELECTRIC COOPERATIVE
CONSOLIDATED STATEMENTS OF MEMBERS' EQUITY
Years Ended December 31, 2018 and 2017

	Patronage Capital	Accumulated Unallocated Non-operating Margins	Other Equities	Accumulated Margins of Subsidiaries	Total
Balance December 31, 2016	$ 44,741,374	$ 205,490	$ 634,232	$ 1,635,013	$ 47,216,109
Unallocated 2016 margins	(47,274)	47,274	-	-	-
Net margins (losses)	3,944,416	-	-	393,641	4,338,057
Retirement of capital credits	(2,025,739)	-	77,514	-	(1,948,225)
Balance December 31, 2017	46,612,777	252,764	711,746	2,028,654	49,605,941
Unallocated 2017 margins	(1,038,033)	1,038,033	-	-	-
Net margins (losses)	2,452,987	-	-	424,509	2,877,496
Retirement of capital credits	(1,224,544)	-	72,462	-	(1,152,082)
Balance December 31, 2018	$ 46,803,187	$ 1,290,797	$ 784,208	$ 2,453,163	$ 51,331,355

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

POLK-BURNETT ELECTRIC COOPERATIVE
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2018 and 2017

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net margins	$ 2,877,496	$ 4,338,057
Adjustments to reconcile net margins to net cash provided by operating activities:		
Depreciation	3,429,915	3,169,509
Non-cash portion of patronage capital received	(555,128)	(1,077,900)
Loss (Gain) on asset disposal	(74,422)	(17,409)
Regulatory liability deferrals	988,484	1,657,267
Regulatory liability deferral recognition	(500,000)	-
Asset impairment loss	1,030,959	-
Change in assets and liabilities:		
Decrease (increase) in accounts receivable	(62,264)	(200,413)
Decrease (increase) in materials and supplies	37,409	(30,148)
Decrease (increase) in other current assets	(255,338)	(9,699)
Increase (decrease) in deferred debits	245,249	185,171
Increase (decrease) in accounts payable	(339,092)	619,976
Increase (decrease) in propane customer deposits	264,032	(145,292)
Increase (decrease) in other current liabilities	(83,691)	(9,001)
Increase (decrease) in other deferred credits	(60,552)	(195,451)
Net cash provided by operating activities	6,943,057	8,284,667
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of property and equipment	79,100	32,186
Extension and replacement of plant	(6,137,990)	(5,474,388)
Contributions in aid of construction	866,417	601,532
Purchase of investments	(13,108)	-
Proceeds from investments	377,660	370,471
Net cash used in investing activities	(4,827,921)	(4,470,199)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payments on long-term debt	(1,614,935)	(1,533,101)
Retirements of patronage capital, net of gain	(1,152,082)	(1,948,225)
Net cash used in financing activities	(2,767,017)	(3,481,326)
Net decrease in cash and cash equivalents	(651,881)	333,142
Cash and cash equivalents at beginning	4,562,204	4,229,062
Cash and cash equivalents at end	$ 3,910,323	$ 4,562,204

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

POLK-BURNETT ELECTRIC COOPERATIVE
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2018 and 2017

	2018	2017
Supplemental disclosure of cash flow information:		
Cash payments during the year for:		
Interest paid	$ 1,407,612	$ 1,499,022
Income tax paid (received)	$ 70,945	$ 65,819
Supplemental disclosure of non-cash investing and financing activities:		
The Cooperative and its subsidiaries record patronage capital allocations from associated organizations as revenue and as investments in associated organizations as follows:		
Patronage capital allocations	$ 555,128	$ 1,077,900

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

Note 1 NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Business

Polk-Burnett Electric Cooperative and Subsidiaries' (the Cooperative) principal line of business is providing electric service to residential and business customers residing in six rural counties in west central Wisconsin. The Cooperative, through the Subsidiary, sells propane at rates which are determined by management. Electric rates charged to customers are established by the Board of Directors.

Financial Statement Presentation

As a member-elected Board of Director regulated entity, the Cooperative accounts for the financial effects of regulation in accordance with the Financial Accounting Standards Board Accounting Standards Codification 980 Regulated Operations (FASB ASC 980). This statement allows for the recording of a regulatory asset or liability for amounts that will be collected or refunded through the rate-making process in the future. The accounting policies followed by the Cooperative are subject to the Federal Energy Regulatory Commission's Uniform System of Accounts prescribed for Class A and B Electric Utilities. The accounting policies conform to accounting principles generally accepted in the United States of America as applied in the case of regulated electric utilities. The Cooperative uses the accrual method of accounting. The Cooperative believes, based on current regulatory circumstances, that its use of regulatory accounting is appropriate and in accordance with the provisions of FASB ASC 980.

Principles of Consolidation

The consolidated financial statements include the accounts of Polk-Burnett Diversified Services, Inc. and its subsidiary Polk-Burnett Propane Services, Inc. as well as its affiliate Polk-Burnett Economic Development Corporation. All material intercompany transactions and accounts have been eliminated.

Concentrations of Credit Risk

Financial instruments which potentially subject the Cooperative to concentrations of credit risk consist principally of cash equivalents, accounts receivable and notes receivable. The Cooperative places its cash deposits and cash investment with high credit quality financial institutions and, by policy, generally limits the amount of credit exposure to any one financial institution. Concentrations of credit risk with respect to accounts receivable are limited due to the Cooperative's large number of customers. The Cooperative believes it is not exposed to any significant credit risks.

Note 1 NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Use of Estimates

The presentation 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 the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates in the financial statements are plant useful lives and the self-funded medical insurance reserve. Actual results could differ from those estimates.

Investments in Associated Cooperatives

Investments in associated cooperatives are recorded at cost plus undistributed allocated equities from other cooperatives. Patronage allocations are recognized in the year the allocation pertains to and are redeemable only at the option of the issuing cooperative.

Other Investments

Other investments are recorded at cost, which approximates fair market value.

General

The Cooperative maintains its books in conformance with the Uniform System of Accounts prescribed by the Rural Development Utilities Program (RDUP).

Cash and Cash Equivalents

The Cooperative considers all highly liquid cash instruments with a maturity of three months or less when purchased to be cash equivalents. Cash equivalents are stated at cost, which approximates fair market value.

Accounts Receivable

Receivables are stated at the amount the Cooperative expects to collect from outstanding balances. The Cooperative provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual accounts. Balances that are still outstanding after the Cooperative has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to the receivable accounts. Changes in the valuation allowance have not been material to the financial statements.

Note 1 NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Inventories

Electric materials and supplies are recorded at average unit cost and propane inventory is recorded at the lower of average unit cost or market. Balances as of December 31, 2018 and 2017 are:

	2018	2017
Electric materials and supplies	$ 298,571	$ 361,753
Propane inventory	178,808	153,035
Total	$ 477,379	$ 514,788

Plant, Maintenance and Depreciation

Plant, property, and equipment are recorded at cost. The cost of additions includes contracted work, direct labor, materials and allocable overheads. When units of property are retired, sold or otherwise disposed of in the ordinary course of business, their average book cost, less net salvage, is charged to accumulated depreciation. Included in accumulated depreciation are non-legal costs of removing plant. Repairs and the replacement and renewal of items determined to be less than units of property are charged to maintenance. Any gains or losses on utility and non-utility plant and equipment using individual unit depreciation are reflected in operations. Depreciation for electric distribution plant is computed on the straight-line composite rate method which expenses the cost of plant over their estimated useful lives. General plant depreciation rates have been applied on a straight-line unit basis which expenses the cost of plant over their estimated useful lives. Depreciation rates are adopted by the Board of Directors.

Asset Retirement Obligation

The FASB ASC requires entities to record the fair value of a liability for legal obligations associated with an asset retirement in the period in which the obligations are incurred. When the liability is initially recorded, the entity capitalizes the cost of the asset retirement obligation by increasing the carrying amount of the related long-lived asset. Over time, the liability is accrued to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. The Cooperative has determined it does not have a material legal obligation to remove long-lived assets as described by the FASB ASC, and accordingly has not recognized any asset retirement obligation costs in its financial statements for the years ended December 31, 2018 and 2017.

Note 1 NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Long-Lived Assets

Long-lived assets to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the related carrying amount may not be recoverable. When required, impairment losses on assets to be held and used are recognized based on the fair value of the asset. Long-lived assets to be disposed of are reported at the lower of carrying amount or their fair value less cost to sell.

Patronage Capital

Amounts received from the furnishing of electric energy in excess of operating costs and expenses are assigned to patrons on a patronage basis. Certain amounts received by the Cooperative from its other operations in excess of costs and expenses are allocated to its patrons on a patronage basis to the extent they are not needed to offset current or prior deficits. Dividends paid from the Cooperative's subsidiaries may be allocated to electric patrons on a patronage basis.

Revenue Recognition

Revenues are recognized based on products and services provided to customers each month. Electric customer meters are read and billed on a cycle basis. Electric revenue is recorded for services provided from the monthly meter-reading dates which may not be at month-end but are consistent from month to month for each cycle. The Cooperative does not provide an estimate for unbilled revenues at month end as the financial statement impact is minimal and the accounting treatment is consistent. The related power costs are recorded to the month-end.

Self-funded Health Insurance

The Cooperative has a self-funded health insurance plan which provides medical payments to employees and their dependents that are not covered by the high deductible insurance plan. The health care expense is based on actual claims paid, reinsurance premiums, administrative fees and unpaid claims at year end. All health care costs are expensed as incurred.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expenses were $43,392 and $39,641 for the years ended December 31, 2018 and 2017, respectively.

Note 1 NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Derivative Instruments and Hedging Activities

The Cooperative's policy is to not use freestanding derivatives and to not enter into contracts with terms that cannot be designated as normal purchases or sales. Management has determined that the Cooperative has no freestanding or embedded derivatives.

Income Taxes

The Cooperative has been granted tax exempt status by the Internal Revenue Service and the State of Wisconsin.

Polk-Burnett Diversified Services, Inc. and its subsidiary Polk-Burnett Propane Services, Inc. and Polk-Burnett Economic Development Corporation are taxable at the federal and state level, and a provision for income taxes is included in the financial statements. A deferred tax liability for Polk-Burnett Propane Services, Inc. is recorded for future tax consequences attributable to temporary differences between financial statement carrying amounts of assets and liabilities and their respective tax bases. Principally these differences relate to depreciation of property and equipment and operating loss carryforwards.

Date of Management Review

In preparing these financial statements, the Cooperative has evaluated events and transactions for potential recognition or disclosure through February 18, 2019, the date the financial statements were available to be issued.

Note 2 PLANT, PROPERTY, AND EQUIPMENT

The cost and composite depreciation rates for plant, property, and equipment are as follows:

	Composite Depreciation Rates %	2018	2017
Electric Utility Plant			
Intangible		$ 348	$ 348
Distribution	3.40%	77,333,135	74,624,469
General	4.33%	13,837,469	13,517,487
Total in service		91,170,952	88,142,304
Under construction		428,901	860,150
Less accumulated depreciation		(23,215,539)	(21,259,726)
Subtotal Electric Plant		68,384,314	67,742,728
Non-Utility Plant			
Non-Utility Plant	2.15%	1,039,247	1,039,247
Less accumulated depreciation		(446,632)	(424,251)
Total Non-Utility Plant		592,615	614,996
Total Electric Cooperative Plant		68,976,929	68,357,724
Propane Subsidiary Plant			
In service	4.42%	5,220,189	4,912,969
Less accumulated depreciation		(2,757,673)	(2,652,145)
Subtotal		2,462,516	2,260,824
Net plant, property, and equipment		$ 71,439,445	$ 70,618,548

The non-utility plant is held in the electric utility and is leased to the subsidiaries or held directly by the subsidiary.

Note 3 INVESTMENTS

Investments in Associated Cooperatives

	2018	2017
Patronage Capital Credits		
Dairyland Power Cooperative (DPC)	$ 11,707,719	$ 11,564,835
National Rural Utilities Cooperative Finance Corporation (CFC)	1,438,483	1,373,416
Federated Rural Electric Insurance Exchange	241,980	216,409
Rural Electric Supply Cooperative (RESCO)	198,397	204,534
Subtotal	13,586,579	13,359,194
CFC member capital securities (matures 1/9/44, 5.00%)	100,000	100,000
Capital Term Certificates of the National Rural Utilities Cooperative Finance Corporation		
Capital term certificates - maturities 10/1/2070-2080; interest rate, 5.0%	532,131	532,131
Loan term certificates - maturities 10/1/2020 - 2025; interest rate, 3.0%	47,900	47,900
Loan capital certificates - maturities 1/1/2018 to 11/1/2039 non-interest bearing	535,393	561,124
Subtotal	1,115,424	1,141,155
Other	143,459	131,645
Total	$ 14,945,462	$ 14,731,994

The investment in DPC consists primarily of capital credits for the Cooperative's share of DPC's operating margins that have been allocated but not received and its share of unallocated operating losses. Operating margins and losses are recognized based on the Cooperative's percentage of DPC's power output sold to its members each year, which approximates the Cooperative's ownership in DPC. The Cooperative's investment in DPC is recorded on the equity method. During 2018 and 2017, the Cooperative recognized income of $340,226 and $871,948, respectively, related to its portion of DPC's margin.

Investments in CFC represent undistributed capital credits allocated to the Cooperative as well as loan and capital term certificates. The certificates represent investments made pursuant to CFC borrowing requirements. During 2018 and 2017 the Cooperative recognized income of $130,134 and $134,933, respectively, related to its portion of CFC's margins.

All CFC securities are classified as held-to-maturity.

Note 3 INVESTMENTS (Continued)

Investments in Associated Cooperatives (Continued)

The investments in Federated Rural Electric Insurance Exchange and Rural Electric Supply Cooperative represent undistributed capital credits allocated to the Cooperative. The Cooperative purchases insurance and material and supplies from these two Cooperatives. During 2018 and 2017 Polk-Burnett recognized income of $41,186 and $28,898, respectively, from Federated and $25,984 and $19,872 respectively, from RESCO related to its portion of these Cooperative's margins.

Economic Development Note Receivable

In 2014, the Cooperative executed an interest-free loan in the amount of $360,000 to the Grantsburg Fire Association which will be repaid with ten annual payments of $36,000 beginning in December of 2015. $300,000 was funded with an interest free loan from the USDA and $60,000 was provided by the Cooperative. The Cooperative has $144,000 and $108,000 available as of December 31, 2018 and 2017, respectively, exclusively for this purpose.

Note 4 DEFERRED DEBITS

The balance of deferred debits consists of the following:

	2018	2017
NRECA RS Plan prepayment	$ 996,145	$ 1,234,716
Unamortized debt expense	112,616	119,294
	$ 1,108,761	$ 1,354,010

At the December 2012 meeting of the I&FS Committee of the NRECA Board of Directors, the Committee approved an option to allow participating cooperatives in the Retirement Security (RS) Plan (a defined benefit multiemployer pension plan) to make a prepayment and reduce future required contributions. The prepayment amount is a 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 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, for most cooperatives the billing rate is reduced by approximately 25%, retroactive to January 1, 2013. The 25% differential in billing rates is expected to continue for approximately 15 years. However changes in interest rates, asset returns and other plan experience different from that expected, plan assumption changes, and other factors may have an impact on the differential in billing rates and the 15 year period. On April 30, 2013 a prepayment of $2,385,677 ($2,129,726 Electric Cooperative and $255,951 Propane) was made to the NRECA RS Plan. The Cooperative is amortizing this amount over ten years.

Note 5 EQUITIES

Patronage Capital

	2018	2017
Assignable	$ 2,452,987	$ 3,944,416
Assigned to date	67,117,245	64,210,855
Subtotal	69,570,232	68,155,271
Retired to date	22,767,045	21,542,494
Total	$ 46,803,187	$ 46,612,777

The mortgage provisions restrict the retirement of patronage capital unless, after retirement, the total equity of the Cooperative equals at least 20% of the assets of the Cooperative. However, retirements (exclusive of any distributions to the estates of deceased patrons) can be made if such distributions do not exceed 30% of the preceding year's net consolidated margin. No distribution can be made if there is unpaid, when due, any installments of principal or interest on the notes.

Distributions to estates are made at the request of the estates. The retirement paid out is discounted, and the excess is retained by the Cooperative as a gain on retirement of capital credits. Patronage capital credits, arising from prior years' margins, are retired chronologically.

No interest shall be paid or payable to the patrons on any capital furnished by the patrons.

Other Equities

	2018	2017
Accumulated unallocated non-operating margins	$ 1,290,797	$ 252,764
Gain on early retirement of capital credits	784,208	711,746
Accumulated margins of subsidiaries	2,453,163	2,028,654
Total	$ 4,528,168	$ 2,993,164

Accumulated Unallocated Non-Operating Margins

Accumulated unallocated non-operating margins consist of non-operating margins less deficits from operating divisions.

Note 5 EQUITIES (Continued)

Gain on Early Retirements of Capital Credits

Gain on early retirement of capital credits consists of the discounted portion of capital credits paid to estates, due to early retirement.

Accumulated Margins of Subsidiaries

The accumulated margins of subsidiaries consist of the income, net of losses, from the wholly owned subsidiaries from their date of incorporation to December 31, 2018 and 2017.

Note 6 LONG-TERM DEBT AND LINE OF CREDIT

Long term debt is as follows:

	2018	2017
National Rural Utilities Cooperative Finance Corporation (CFC) Mortgage notes - interest rates of 3.20% to 7.60%, notes payable in quarterly installments with maturities at various dates from 2019 to 2046.	$ 31,761,013	$ 33,285,264
Farmer Mac notes serviced through CFC - interest rates of 3.98% payable in semi-annual installments with maturities at various dates from 2036 to 2037.	1,894,187	1,959,673
Rural Economic Development note payable, interest rate of zero percent unless used for unapproved purposes at which time interest at a rate established in 31 CFR 901.9 would begin to accumulate until repaid. No maturity as long as used for economic development, as stated.	300,000	300,000
National Cooperative Services Corporation (NCSC) note, interest rate of 3.85%, payable in quarterly installments and matures in 2023.	133,807	159,005
	34,089,007	35,703,942
Less amount due within one year	1,691,163	1,614,934
Total long-term debt	$ 32,397,844	$ 34,089,008

Substantially all assets are pledged to CFC and NCSC as a security on the mortgage notes. The notes mature from 18 to 40 years from the date of issuance. The notes payable to CFC contain provisions for changing the rate of interest at specified future dates.

Note 6 LONG-TERM DEBT AND LINE OF CREDIT (Continued)

Approximate annual principal payments on the existing long-term debt for the next five years are:

2019	$	1,691,163
2020	$	1,751,712
2021	$	1,846,992
2022	$	1,948,005
2023	$	1,704,414

Un-advanced loan funds of $7,400,000 are available to the Cooperative from CFC. The mortgage agreement with CFC requires, among other provisions, that the Cooperative maintain certain annual debt service coverage levels. The Cooperative was in compliance with the annual debt service coverage covenant at December 31, 2018.

Line of Credit

The Cooperative has a perpetual line of credit agreement with the National Rural Utilities Cooperative Finance Corporation providing the Cooperative with loans up to $5.0 million on a revolving basis. Interest is payable quarterly at rates established by CFC, which are not to exceed the lowest prime rate as published in the "Money Rates" column of *The Wall Street Journal* plus 1% or lesser rate as fixed by CFC. The rate was 3.75% at December 31, 2018. The agreement provides that combined borrowing on this and any other line of credit shall not exceed $5.0 million. Outstanding advances in any single calendar year may not exceed the prior calendar year's plant additions plus one-twelfth of annual operations and maintenance expenses. Any advances must be paid in full within 360 days of the advance or remain as long-term debt as the Cooperative can convert its line of credit to long-term at the discretion of the Board of Directors.

The Cooperative has a revolving line of credit with CoBank providing the Cooperative with loans up to $1.0 million on a revolving basis. Interest is payable monthly at rates established by CoBank. The rate was 3.81% at December 31, 2018. The term of the commitment is up to and including July 31, 2019. The commitment will be renewed for an additional year if the lender provides the borrower a renewal notice. The unpaid principal is due on the last day of the term of the commitment.

The Cooperative guarantees, through its propane subsidiary, a perpetual line of credit agreement with the NCSC providing the Cooperative with loans up to $3.0 million on a revolving basis. Interest is payable quarterly at rates established by NCSC, which are not to exceed the lowest prime rate as published in the "Money Rates" column of *The Wall Street Journal* plus 1% or lesser rate as fixed by NCSC. The rate was 4.4% at December 31, 2018. The agreement provides that combined borrowing on this and any other line of credit shall not exceed the prior calendar year's plant additions plus one-twelfth of annual operations and maintenance expenses. Any advances must be paid in full within 360 days of the advance and remain at a zero balance for at least five consecutive business days. The Cooperative did not have any outstanding balance on the line of credit as of December 31, 2018 and 2017.

Note 7 OTHER CURRENT LIABILITIES

Other current liabilities consist of the following:

	2018	2017
Electric customer deposits	$ 177,935	$ 183,175
Taxes other than income	50,185	75,499
Accrued interest	245,186	257,825
Accrued payroll	249,565	265,385
Self-funded health insurance	12,148	66,106
Accrued employee vacations	570,899	585,878
Income tax payable	18,819	2,428
State tax collections payable	37,854	9,986
Total	$ 1,362,591	$ 1,446,282

Note 8 DEFERRED CREDITS

The balance of deferred credits consists of the following:

	2018	2017
Unclaimed patronage capital retirement refunds, and general fund checks	$ 368,282	$ 423,490
Deferred gain on RDUP buy out, net of amortization	117,734	141,686
Regulatory liability	3,214,782	2,726,298
Customer advances for construction	-	30,500
Deferred tax liability (See note 9)	633,000	597,000
Other deferred credit	13,108	-
Total	$ 4,346,906	$ 3,918,974

In 1995 and 1996, the Cooperative refinanced its RDUP debt of $9.3 million with funds from CFC and RDUP discounting the debt $1,396,538. The discount is being amortized over the remaining lives of the original notes using the effective interest rate amortization method. The amortization amounted to $23,952 for 2018 and $16,814 for 2017 and was credited to interest expense and the accumulated amortization is $1,278,804 and $1,254,852 at December 31, 2018 and 2017, respectively. The deferred gain on refinancing has been deferred in accordance with the FASB ASC.

In January 2013, Dairyland Power Cooperative received settlement proceeds from a lawsuit it filed against the United States Government and decided to refund 50% of the total settlement back to its member cooperatives. The portion of the settlement proceeds received in 2013 by the Cooperative totaled $1,069,031 and was recorded as a regulatory liability. The Cooperative intends to use the regulatory liability to offset costs as part of the future process of setting rates.

Note 8 DEFERRED CREDITS (Continued)

In 2016, Dairyland Power Cooperative received $73.5 million of settlement proceeds from a lawsuit it filed against the United States Government and decided to refund approximately $47.6 million of the total settlement back to its member cooperatives. The portion of the settlement proceeds received in 2017 by the Cooperative totaled $2,657,267 and $1,657,267 and was recorded as a regulatory liability. The remaining $1 million was recorded as non-operating margins in 2017. The Cooperative intends to use the regulatory liability to offset costs as part of the future process of setting rates. The Cooperative recognized $500,000 of this deferral during the year ended December 31, 2018.

In 2018, the board resolved to defer $988,484 of the Cooperative's revenue to offset anticipated service costs in future periods. The deferral will be recognized over a four-year period starting in 2019 and going through 2022.

Note 9 INCOME TAXES

The provision for income tax expense (benefit) includes the following components:

	2018	2017
Current expense (benefit)		
Federal	$ 85,358	$ 65,128
State	35,914	10,010
Deferred income tax expense (benefit)		
Federal	26,000	(266,000)
State	10,000	(1,000)
Total	$ 157,272	$ (191,862)

Deferred income taxes based upon timing differences resulting primarily from net operating losses and depreciation are summarized as follows:

	2018	2017	2016
Deferred income tax assets	$ -	$ -	$ -
Deferred income tax liabilities	633,000	597,000	864,000
	633,000	597,000	864,000
Less - valuation allowance	-	-	-
Net deferred income tax liability	$ 633,000	$ 597,000	$ 864,000

Deferred income tax expense (benefit) was impacted significantly in 2017 by the Tax Cuts and Jobs Act (the "Tax Act") which was enacted in 2017 by the U.S. government. The most significant impact of the Tax Act was to lower the federal corporate tax rate which resulted in an approximately $262,000 decrease in the deferred tax liability for the Cooperative during 2017 than what would have been under the old rates.

Note 10 SELF-FUNDED HEALTH INSURANCE

The Cooperative has a self-funded program for employee health insurance. Stop-loss insurance coverage limits the Cooperative's risk to a maximum of $45,000 per insured individual and approximately $744,546 for all insured in the aggregate. The plan is administered and claims are validated by a benefits management company. All claims are expensed on the accrual basis when the benefits management company becomes aware of their validity. A liability of $12,148 and $66,105 as of December 31, 2018 and 2017, respectively, has been recorded to cover potential claims that may have occurred but which the benefits management company has not yet become aware of at December 31, 2018 and 2017.

Actual medical claims paid by the Cooperative for medical and prescription benefits was $317,266 and $582,903 in 2018 and 2017, respectively. The Cooperative offers a high deductible plan with deductibles of $2,000 and $3,000 for single plans and $4,000 and $6,000 for family plans.

Note 11 EMPLOYEE BENEFITS

Multi-employer Defined Benefit Pension Plan

The Cooperative participates in two pension plans covering union and nonunion employees through participation in the National Rural Electric Company Association (NRECA) Retirement and Security Program, a defined benefit pension plan qualified under Section 401 and tax exempt under 501(a) of the Internal Revenue Code. It is 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 made contributions to the plan of $803,455 and $814,070 in 2018 and 2017, respectively, and represent less than 5 percent of the total contributions made to the plan by all participating employers. There have been no significant changes that affect the comparability of 2018 and 2017 contributions. The Cooperative is required to make contributions for those employees covered by the collective bargaining agreement through April 30, 2020.

In 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 Retirement Security Plan was over 80 percent funded on January 1, 2018 and January 1, 2017, based on the PPA funding target and PPA actuarial value of assets on those dates.

Note 11 EMPLOYEE BENEFITS (Continued)

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.

Defined Contributions Plan

The Cooperative has a NRECA 401(k) defined contribution savings plan for employees who meet certain age and service requirements The Cooperative matches employee contributions up to 1.0% for union employees and 6.0% for non-union employees' compensation into the plan. Non-union employees have to contribute 6% to get the employer’s 6% contribution. Savings plan expense was $154,419 in 2018 and $154,581 in 2017.

Other Plans

The Cooperative also provides employees with medical and dental insurance coverage, short-term and long-term disability, and life insurance, which are funded by employer and employee contributions. Along with these benefits, they also fund contributions to a health savings account for each employee. The Cooperative's cost related to these benefits was $568,228 and $741,603 in 2018 and 2017, respectively.

Compensated Absences

The cost of compensated absences (vacation, sick leave taken, and holidays) was $510,126 and $558,174 in 2018 and 2017, respectively.

Note 12 RELATED PARTY TRANSACTIONS AND COMMITMENTS

Purchased Power Agreement

Polk-Burnett Electric Cooperative is a member of Dairyland Power Cooperative (DPC) which is an electric generation and transmission cooperative. The Cooperative obtained most of its purchased power from DPC for the years ended December 31, 2018 and 2017. The Cooperative also purchases solar output from SoCore Energy. In 2018 and 2017, the Cooperative's total purchased power was $18,755,516 and $18,316,353 respectively.

Under its wholesale power agreement, the Cooperative is committed to purchase its electric power and energy requirements from DPC until December 31, 2060. The rates paid to DPC are subject to periodic review.

Note 12 RELATED PARTY TRANSACTIONS AND COMMITMENTS (Continued)

Management Consulting, Accounting and Other Services to Propane Subsidiary

Polk-Burnett Electric Cooperative has an agreement with the Propane subsidiary, whereby the Cooperative furnishes management consulting, accounting, building and office space, and bulk facility maintenance and other related products and services as may be required by them. Compensation for such services is at cost. The agreement is to continue in force for one year and is automatically renewable for successive one year terms unless, either party, sixty days prior to the expiration of any contract term notifies the other of its desire to renegotiate the substantial provisions of the agreement or terminate the contract. The total costs charged to the subsidiary under the agreements amounted to $43,007 and $32,675 per year in 2018 and 2017, respectively. This activity has been eliminated in the consolidated financial statements.

Lease of Office and Bulk Plant Facilities to Propane Subsidiary

The Cooperative leases office space and bulk plant facilities to the Propane subsidiary. The annual base rent is $15,600 in 2018 and 2017, plus taxes, other than real estate assessments, insurance premiums and utility services. The base rent shall increase each year by an amount equal to the amount of the increase in real estate tax due and payable during the succeeding year. The lease is effective January 1, 2014 and the office space and bulk plant facilities have a five year term. The office space and bulk plant facilities shall automatically renew for successive five year periods upon like terms unless either party, no later than ninety days prior to the first or any subsequent termination date, notifies the other party in writing of its intention of non-renewal. The total costs charged to the subsidiary under the agreements amounted to $15,996 and $15,600 in 2018 and 2017, respectively. This activity has been eliminated in the consolidated financial statements.

Other Related Party Transactions

The Cooperative purchased $13,291 and $9,151 in propane from the Propane subsidiary and had a balance of $0 in propane deposits at year end in 2018 and 2017.

The Cooperative also charges interest to subsidiaries for the use of funds. No interest was charged in 2018 or 2017.

Substation Operating Lease Commitment

In August 2002 the Cooperative entered into an agreement to lease a substation from another rural electric cooperative under a non-cancelable operating lease agreement. The lease agreement currently requires a monthly base lease payment of $1,439 and expires August 10, 2032.

Note 12 RELATED PARTY TRANSACTIONS AND COMMITMENTS (Continued)

Substation Operating Lease Commitment (Continued)

The annual rent expense under this agreement was $17,268 for 2018 and 2017. Scheduled future minimum lease payments under the lease agreement are as follows:

Year Ending December 31,		
2019	$	17,268
2020		17,268
2021		17,268
2022		17,268
2023		17,268
Thereafter		148,217
	$	234,557

Propane Contract Commitments

At December 31, 2018, Polk-Burnett Propane Services, Inc., has contracted for approximately 1,597,591 gallons of propane gas purchases with suppliers and had 1,086,875 gallons deliverable to prepaid contract members. No gains or losses on these contracts are included in the financial statements.

Note 13 CASH AND CASH EQUIVALENTS

At December 31, 2018 and 2017, cash and cash equivalents as defined in Note 1 consists of:

	2018	2017
Cash - general	$ 3,358,033	$ 2,547,701
Temporary cash investments	552,290	2,014,503
Total	$ 3,910,323	$ 4,562,204

Note 14 CONTINGENT LIABILITY

The Cooperative is the defendant in litigation involving a former general manager. The Cooperative strongly denies the claims in the case and has no plans to seek an out-of-court settlement. If the Cooperative were to lose the case the damages owed to the former general manager could range from a nominal amount to over $500,000. It is possible that the Cooperative will incur a liability from this lawsuit. An estimate of this liability cannot currently be made.

Note 15 METER IMPAIRMENT

In 2018 the Cooperative recorded a $1,030,959 impairment loss on installed solid state meters and advanced metering infrastructure (AMI) that will be replaced with a current technology. Due to unexpected changes in meter technology, the Cooperative's meter reading system became obsolete much sooner than expected. The impairment loss was calculated by determining the meter cost that could reasonably be recovered through depreciation rates during the life of the meter replacement project. The remaining carrying value of the meters was recognized as an impairment loss. The impairment loss is reflected in other operating expenses on the Consolidated Statement of Operations.