



REPORT OF INDEPENDENT AUDITORS
AND CONSOLIDATED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

ORCAS POWER & LIGHT COOPERATIVE
AND SUBSIDIARY

December 31, 2019 and 2018

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Report of Independent Auditors

To the Board of Directors
Orcas Power & Light Cooperative and Subsidiary

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Orcas Power & Light Cooperative and Subsidiary (collectively, the Cooperative), which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of revenues and margins, changes in patronage capital and other 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

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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 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 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 Orcas Power & Light Cooperative and Subsidiary as of December 31, 2019 and 2018, and the results of its consolidated operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Cooperative's consolidated financial statements. The consolidating balance sheets as of December 31, 2019 and 2018, and consolidating statements of revenues and margins for the years then ended (collectively, supplementary information) are presented for purposes of additional analysis and are 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 supplementary information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain other procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to 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 supplementary information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated May 11, 2020, on our consideration of the Cooperative's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Orcas Power & Light Cooperative's internal control over financial reporting and compliance.



Everett, Washington
May 11, 2020

Orcas Power & Light Cooperative and Subsidiary

Consolidated Balance Sheets

ASSETS

	December 31,	
	2019	2018
UTILITY PLANT, at cost		
Electric plant in service	\$ 144,301,229	\$ 136,469,139
Broadband plant in service	19,409,714	15,530,236
Construction work in progress	5,853,931	7,967,279
	<u>169,564,874</u>	<u>159,966,654</u>
Less accumulated depreciation and amortization	57,521,701	51,810,727
Net utility plant	<u>112,043,173</u>	<u>108,155,927</u>
INVESTMENTS AND OTHER ASSETS		
Investments in associated organizations	1,814,993	1,737,910
Goodwill	157,960	189,034
Total investments and other assets	<u>1,972,953</u>	<u>1,926,944</u>
CURRENT ASSETS		
Cash and cash equivalents	4,160,329	2,221,990
Cash and cash equivalents - board designated	538,698	530,765
Accounts receivable, net of allowance for doubtful accounts of \$65,671 and \$75,980 in 2019 and 2018	4,121,198	4,938,706
Interest receivable	24,279	6,316
Materials and supplies	4,029,998	4,538,603
Prepaid expenses	564,247	499,854
Total current assets	<u>13,438,749</u>	<u>12,736,234</u>
DEFERRED CHARGES	647,075	-
Total assets	<u>\$ 128,101,950</u>	<u>\$ 122,819,105</u>

Orcas Power & Light Cooperative and Subsidiary Consolidated Balance Sheets

EQUITIES, MARGINS, AND LIABILITIES

	December 31,	
	2019	2018
EQUITIES AND MARGINS		
Memberships	\$ 56,355	\$ 56,580
Patronage capital	42,747,665	41,668,217
Undistributed subsidiary losses	(11,412,680)	(9,571,004)
Donated and other equities	7,011,501	6,479,465
Total equities and margins	38,402,841	38,633,258
LONG-TERM DEBT, less current maturities		
RUS mortgage notes	49,959,161	47,256,888
CFC mortgage notes	8,029,709	8,300,502
Loan payable	22,500,000	19,000,000
Long-term lease liability	600,368	451,523
Total long-term debt	81,089,238	75,008,913
CURRENT LIABILITIES		
Accounts payable	2,057,595	2,766,120
Customer deposits	85,259	83,857
Accrued liabilities	1,018,158	1,156,654
Line of credit	3,305,000	2,850,000
Current maturities of long-term debt and leases	1,833,126	2,004,121
Total current liabilities	8,299,138	8,860,752
DEFERRED CREDITS		
Total equities, margins, and liabilities	\$ 128,101,950	\$ 122,819,105

Orcas Power & Light Cooperative and Subsidiary

Consolidated Statements of Revenues and Margins

	Years Ended December 31,	
	2019	2018
OPERATING REVENUES		
Electricity sales	\$ 30,822,724	\$ 29,168,455
Broadband sales	5,750,495	4,850,985
	36,573,219	34,019,440
OPERATING EXPENSES		
Cost of purchased power	9,262,362	9,053,663
Transmission	458,165	252,433
Distribution - operations	3,604,825	3,365,842
Distribution - maintenance	2,170,783	1,945,822
Consumer accounts	1,097,439	1,014,503
Broadband services	849,127	788,916
Administrative and general	7,789,803	7,802,531
Depreciation and amortization	6,342,511	5,743,082
Taxes	1,654,674	1,579,824
	33,229,689	31,546,616
Operating margins before fixed charges	3,343,530	2,472,824
FIXED CHARGES		
Interest on long-term debt	2,704,973	2,231,161
	638,557	241,663
Operating margins after fixed charges		
PATRONAGE CAPITAL CREDITS	125,254	143,090
	763,811	384,753
Net operating margins		
NONOPERATING MARGINS		
Interest income	123,252	97,091
Other income	2,186	24,473
	125,438	121,564
Total nonoperating margins		
NET MARGINS	\$ 889,249	\$ 506,317

Orcas Power & Light Cooperative and Subsidiary

Consolidated Statements of Changes in Patronage Capital and Other Equities

	<u>Memberships</u>	<u>Patronage Capital</u>	<u>Donated and Other Equities</u>	<u>Undistributed Subsidiary Equities</u>	<u>Total</u>
BALANCE, December 31, 2017	\$ 55,960	\$ 40,181,088	\$ 5,984,621	\$ (7,069,952)	\$ 39,151,717
Increase in memberships, net	620	-	-	-	620
Net margins (losses)	-	3,007,369	-	(2,501,052)	506,317
Donated and returned capital	-	-	494,844	-	494,844
Retirement of capital credits, net	-	(1,520,240)	-	-	(1,520,240)
BALANCE, December 31, 2018	56,580	41,668,217	6,479,465	(9,571,004)	38,633,258
Decrease in memberships, net	(225)	-	-	-	(225)
Net margins (losses)	-	2,730,925	-	(1,841,676)	889,249
Donated and returned capital	-	-	532,036	-	532,036
Retirement of capital credits, net	-	(1,651,477)	-	-	(1,651,477)
BALANCE, December 31, 2019	<u>\$ 56,355</u>	<u>\$ 42,747,665</u>	<u>\$ 7,011,501</u>	<u>\$ (11,412,680)</u>	<u>\$ 38,402,841</u>

Orcas Power & Light Cooperative and Subsidiary

Consolidated Statements of Cash Flows

	Years Ended December 31,	
	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Net margins	\$ 889,249	\$ 506,317
Adjustments to reconcile net margins to net cash from operating activities		
Depreciation and amortization	6,342,511	5,743,082
Changes in assets and liabilities		
Accounts receivable	817,508	(1,739,506)
Interest receivable	(17,963)	6,902
Prepaid expenses	(33,319)	(7,092)
Deferred charges	(647,075)	-
Accounts payable	(708,525)	(793,276)
Customer deposits	1,402	(3,361)
Accrued liabilities	(138,496)	(1,309,558)
Deferred credits	(5,449)	40,180
	6,499,843	2,443,688
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to utility plant, net	(11,549,281)	(16,959,932)
Change in materials and supplies	508,605	738,954
Change in investments	(77,083)	916,693
	(11,117,759)	(15,304,285)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments on long-term debt, net of cushion of credit adjustments	(2,225,511)	169,478
Proceeds from debt	8,134,841	10,000,000
Proceeds from line of credit	455,000	450,000
Cash contributions in aid of construction	1,319,524	2,965,876
Memberships, net	(225)	620
Retirements of patronage capital credits, net of donated and returned capital	(1,119,441)	(1,025,396)
	6,564,188	12,560,578
NET CHANGE IN CASH	1,946,272	(300,019)
CASH AND CASH EQUIVALENTS, beginning of year	2,752,755	3,052,774
CASH AND CASH EQUIVALENTS, end of year	\$ 4,699,027	\$ 2,752,755
SUPPLEMENTAL DISCLOSURES		
Cash paid for interest	\$ 2,833,018	\$ 2,837,791
Assets acquired through capital lease	\$ 155,892	\$ 137,020

Orcas Power & Light Cooperative and Subsidiary

Notes to Consolidated Financial Statements

Note 1 – Organization and Summary of Significant Accounting Policies

Organization – Orcas Power & Light Cooperative (OPALCO) is a power distribution and transmission cooperative organized in 1937 under the laws of the state of Washington for the purpose of supplying electric energy to its members. It serves 11,271 memberships, including 13,333 residential meters and 1,896 commercial and industrial meters distributing electricity to 20 islands in the San Juan archipelago, in Washington State. Substantially all revenues are derived from the sale and distribution of electric power. The Cooperative's board of directors has the authority to set rates and charges for commodities and services furnished.

During the October 2014 board meeting, the OPALCO management received a board directive to provide internet, phone, and emergency communication services to its members. As a result, on January 9, 2015, OPALCO formed a separate business entity, Island Network, LLC. The entity is a wholly owned (100%) subsidiary of OPALCO and is considered a for-profit limited liability corporation (LLC). Island Network, LLC was established to market the activity related to providing internet and communications to the members. On February 6, 2015, Island Network acquired 100% of the outstanding stock of a nonrelated corporation, Rock Island, Inc. and began doing business as Rock Island Communications. The acquisition was funded through debt obtained by OPALCO from National Rural Utilities Cooperative Finance Corporation (CFC) and then subsequently loaned to Island Network, LLC for the purpose of the acquisition and start-up working capital. The acquisition of Rock Island, Inc. included an existing customer base, some back-office and customer-facing staff, and a retail store in Friday Harbor, Washington.

Principles of consolidation – The consolidated financial statements include the financial results of OPALCO and its wholly owned subsidiary, Island Network, LLC (collectively, the Cooperative). OPALCO has accounted for the investment using the equity method. All significant intercompany accounts and transactions have been eliminated in consolidation.

Basis of accounting and presentation – The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as applied to regulated enterprises, which conform to policies prescribed by the United States Department of Agriculture, Rural Utilities Service (RUS).

Adopted accounting pronouncements – January 1, 2019, the Cooperative adopted ASU 2014-09, *Revenue from Contracts with Customers* (Topic 606), which created Topic 606 and superseded the revenue recognition requirements in Topic 605, *Revenue Recognition*, and most industry-specific guidance throughout the Industry Topics of the Codification. The Cooperative applied the modified retrospective transition method to its revenue contracts not yet completed as of January 1, 2019. As a result, amounts previously recorded prior to January 1, 2019, have not been retrospectively restated and are reported in accordance with historical accounting under Topic 605, while revenues for 2019 have been presented under Topic 606.

The Cooperative's transition to the new revenue standard did not result in a material adjustment to opening retained earnings and the Cooperative expects the adoption of the new standard to have an immaterial impact to its results of operations on an ongoing basis. In accordance with the new provisions of Topic 606, the Cooperative has included enhanced quantitative and qualitative disclosures, such as disaggregated revenues by member class. For further information regarding changes to the Cooperative's revenue recognition accounting policies, see Note 13.

Orcas Power & Light Cooperative and Subsidiary

Notes to Consolidated Financial Statements

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Utility plant – Plant in service is stated at original cost of construction or acquisition. Cost generally includes materials, labor, and overhead costs. The cost of additions, renewals, and improvements is capitalized. Repairs, maintenance, and minor replacements are charged to operating expense.

When property, which represents a retirement unit, is replaced or removed, the average cost of such property, together with removal cost, less salvage, is charged to accumulated depreciation. Management assesses impairment and the existence of asset retirement obligations annually, or as circumstances warrant. No impairment was recorded as of December 31, 2019 and 2018.

Depreciation rates have been applied on a straight-line basis. Transmission plant is depreciated using a composite rate of 2.75%, except for submarine cable, for which the rate is 2.86%. Distribution plant and broadband plant are depreciated using a composite rate of 3.17%.

General plant depreciation rates are as follows:

Structures and improvements	3.00%
Office furniture and equipment	5.19%
Transportation equipment	20.00%
Tools and equipment	15.00%
Power-operated equipment	30.00%
Communication equipment	10.00%–20.00%
Other general plant	20.00%
Computer network	20.00%–33.33%

Goodwill – Goodwill resulted from the acquisition of Rock Island, Inc. in February 2015. The acquisition was a 100% stock purchase of Rock Island, Inc. and included the customer base, employees, and retail store. Goodwill is being amortized over 10 years. Amortization expense was \$31,074 for the years ended December 31, 2019 and 2018.

Cash equivalents – The Cooperative considers all highly liquid investments with a maturity of three months or less to be cash equivalents. The board of directors of the Cooperative may designate certain amounts of cash and cash equivalents for future use at the board's discretion and approval. At year-end, board designated cash was \$538,698 and \$530,765 in 2019 and 2018, respectively.

Accounts receivable – Accounts receivable are recorded when invoices are issued and are written off when they are determined to be uncollectible. Accounts receivable are reviewed for collectibility on a regular basis, and an allowance for doubtful accounts is estimated considering the Cooperative's historical losses and review of specific accounts.

Materials and supplies – The inventory of materials and supplies consists primarily of items for construction and maintenance of electric plant and broadband plant and is valued at average unit cost.

Investments in associated organizations – The Cooperative's investments in associated organizations (Note 4) are stated at cost, plus patronage capital credits issued, less distributions received.

Orcas Power & Light Cooperative and Subsidiary

Notes to Consolidated Financial Statements

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Deferred charges – In 2019, OPALCO launched an on-bill financing program called Switch-It-Up to finance member energy efficiency & savings measures. The program operates as an opt-in utility energy conservation tariff. The current portion of financing receivables is included on the balance sheet with accounts receivable. The deferred charges, or deferred debit, represents the long-term financing receivable.

Compensated absences – Employees of the Cooperative accrue vacation ratably over the year based on tenure and are allowed to carry over to the following year up to one year of accumulated vacation, which is earned at a rate of 12 to 25 days per year. Employees are compensated for unused vacation pay upon separation from employment. Compensated absences in the amount of \$240,800 and \$234,285 are included in accrued liabilities as of December 31, 2019 and 2018, respectively.

Patronage capital – Net margins are assigned to patrons upon closing of each calendar year. Capital credits of deceased patrons are redeemed on a less-than-full-value basis and paid to the estate of the patron upon approval by the board of directors. In addition, business patrons may, at the discretion of the board of directors, receive a less-than-full-value cash settlement when they leave the system. Other capital distributions may be made at the discretion of the board of directors. Capital credits may be applied against delinquent accounts receivable balances upon approval by the board of directors. For the years ended December 31, 2019 and 2018, the board of directors approved a \$1.3 million patronage retirement, based on a 25-year first-in, first-out (FIFO) cycle.

Revenue recognition – OPALCO revenue is recognized when obligations under the terms of a contract with members are satisfied. Generally, this satisfaction of performance obligations and transfer of control occurs and revenues are recognized as electricity is consumed based upon monthly meter readings, assessment of base fees, and other monthly charges. The prices charged, and amount of consideration the Cooperative receives in exchange for its goods and services provided, are established and approved by the Cooperative's board of directors. The Cooperative recognizes revenue through the following steps: i) identifying the contract with the member; ii) identifying the performance obligations in the contract; iii) determining the transaction price; iv) allocating the transaction price to the performance obligations; and v) recognizing revenue when or as each performance obligation is satisfied.

In addition, the Cooperative records unbilled revenue for revenues from electric power delivered but not yet billed. OPALCO estimates and records unbilled revenue from electric power delivered, but not yet billed, for services provided to the end of the year. At December 31, 2019 and 2018, a contract asset representing unbilled revenue of \$1,272,107 and \$1,299,071, respectively, was included in the accounts receivable balance.

Broadband revenues are derived from subscription or usage-based agreements billed to its customers throughout the month based on contractually agreed terms. Generally, subscription agreements are month-to-month and are for a fixed price. Broadband revenues are recognized when all the following conditions are satisfied: (i) there is persuasive evidence of an arrangement; (ii) delivery has occurred; (iii) the fee is fixed or determinable, and (iv) collectability of the fee is reasonably assured. At December 31, 2019 and 2018, contract liabilities of \$230,264 and \$197,492, respectively, was included in accrued liabilities. For further information regarding changes to the Cooperative's revenue recognition accounting policies, see Note 13.

Orcas Power & Light Cooperative and Subsidiary

Notes to Consolidated Financial Statements

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Income tax status – OPALCO is exempt from income taxes under the provisions of Section 501(c)(12) of the Internal Revenue Code, except to the extent of unrelated business income, if any.

Island Network, LLC, has elected to be taxed as a C-corporation and is taxable for federal income tax purposes. For Island Network, LLC, income taxes are provided for the tax effects of transactions reported in the consolidated financial statements, consisting of taxes currently due plus deferred taxes.

Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for taxable temporary differences and deferred tax liabilities are recognized for deductible temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. Deferred tax assets relate primarily to net operating loss carryforwards, contributions in aid of construction, capitalized organization cost and accumulated amortization on the books. Deferred tax liabilities relate primarily to the use of accelerated depreciation for tax purposes. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

The Cooperative follows Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 740-10, *Income Taxes*, which relates to accounting for uncertain tax positions. The Cooperative records uncertain tax positions if the likelihood that the position will be sustained upon examination is less than 50%. As of December 31, 2019 and 2018, the Cooperative had no accrued amounts related to uncertain tax positions. Interest and penalties, if any, are recorded as interest expense and other expense, respectively.

Use of estimates – In preparing consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect certain reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses during the reporting period. These estimates include the allowance for doubtful accounts, unbilled revenue, and depreciation of plant. Actual results could differ from those estimates.

Concentration of credit risk – Financial instruments that potentially subject the Cooperative to concentrations of credit risk consist principally of cash and cash equivalents and trade accounts receivable. The Cooperative maintains its cash and cash equivalents in various financial institutions. At times, these balances exceed federally insured limits.

Credit is extended to customers generally without collateral requirements; however, the Cooperative requires deposits from some members upon connection, which is applied to unpaid bills in the event of default. Capital credits may be applied against delinquent accounts, upon approval by the board of directors.

Orcas Power & Light Cooperative and Subsidiary

Notes to Consolidated Financial Statements

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Recently issued accounting pronouncements – In February 2016, the FASB issued ASU No. 2016-02, *Leases*. The new standard establishes a right-of use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2020, with early adoption permitted. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Cooperative is evaluating the impact of the pending adoption of the new standard on the consolidated financial statements.

Subsequent events – Subsequent events are events or transactions that occur after the consolidated balance sheet date but before the consolidated financial statements are issued. The Cooperative recognizes in the consolidated financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the consolidated balance sheets, including the estimates inherent in the process of preparing the consolidated financial statements. The Cooperative's consolidated financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the consolidated balance sheets but arose after the consolidated balance sheet date and before the consolidated financial statements are available to be issued. The Cooperative has evaluated subsequent events through May 11, 2020, which is the date the consolidated financial statements are issued.

Note 2 – Cash and Cash Equivalents

The Cooperative holds various cash accounts in the normal conduct of its business. As of December 31, total cash and cash equivalents reported on the consolidated balance sheets were as follows:

	<u>2019</u>	<u>2018</u>
Petty cash funds	\$ 1,130	\$ 941
Cash in FDIC institutions	4,538,879	2,596,041
Cash in CoBank	<u>159,018</u>	<u>155,773</u>
	<u>\$ 4,699,027</u>	<u>\$ 2,752,755</u>

Orcas Power & Light Cooperative and Subsidiary

Notes to Consolidated Financial Statements

Note 3 – Plant in Service

Plant in service consisted of the following major classes at December 31:

	<u>2019</u>	<u>2018</u>
Generation	\$ 559	\$ 559
Transmission	34,304,853	34,005,954
Distribution	82,090,252	75,833,611
General plant	26,366,003	25,089,453
Broadband plant	19,409,714	15,530,236
Intangible plant	<u>1,539,562</u>	<u>1,539,562</u>
Total plant in service	<u>\$ 163,710,943</u>	<u>\$ 151,999,375</u>

The Cooperative assesses new members an amount equal to the estimated average cost of initial hookups. These contributions in aid of construction are credited to the appropriate work orders to offset the construction costs and are recorded as a reduction in gross plant in accordance with accounting requirements for RUS borrowers. Contributions in aid of construction in the amount of \$1,319,524 and \$2,965,876 were recorded during 2019 and 2018, respectively.

Note 4 – Investments in Associated Organizations

Investments in associated organizations consisted of the following as of December 31:

	<u>2019</u>	<u>2018</u>
Capital term certificates of National Rural Utilities Cooperative Finance Corporation (CFC), interest from 3% to 5%, with maturities from 2020 through 2080	\$ 558,274	\$ 558,274
Capital term certificate from Pacific Northwest Generating Cooperative, interest at 0%, maturing in September 2028	502,560	502,560
Patronage capital credits in CFC	289,196	284,171
Patronage capital credits in National Information Solutions Cooperative (NISC)	111,854	105,941
Patronage capital in Federated Rural Electric Insurance Exchange	228,185	215,102
Patronage capital credits in Pacific Northwest Generating Cooperative	110,216	55,493
Patronage capital - others	<u>14,708</u>	<u>16,369</u>
Total investments in associated organizations	<u>\$ 1,814,993</u>	<u>\$ 1,737,910</u>

CFC capital term certificates are purchased as a condition of the mortgage agreements with CFC. The certificates are nonmarketable and may not be redeemed prior to maturity.

Orcas Power & Light Cooperative and Subsidiary

Notes to Consolidated Financial Statements

Note 5 – Related-Party Transactions

There is an intercompany loan between Island Network LLC and OPALCO for acquisition funding and transferred infrastructure and inventory from the Island Network Department to OPALCO. At December 31, 2019, OPALCO's investment in subsidiary of \$(9,279,459) represents the intercompany loan of \$2,133,221 less undistributed subsidiary losses of \$11,412,680. The liability and associated investment are eliminated upon consolidation.

During 2019 and 2018, OPALCO incurred \$79,346 and \$79,214, respectively, in interest income associated with advances taken by Rock Island Communications. This income has been eliminated upon consolidation.

During 2019 and 2018, OPALCO incurred \$240,129 and \$69,840 in costs associated with customer fees for internet services provided by Rock Island Communications. OPALCO also billed the subsidiary for the use of electricity in the amount of \$115,821 and \$94,920, respectively, and billed for use of OPALCO's communication infrastructure in the amount of \$89,976 and \$86,285, respectively. These intercompany balances have been eliminated upon consolidation.

Note 6 – Lines of Credit

The Cooperative has an unsecured perpetual line of credit for short-term financing with CFC in the amount of \$10,000,000. Interest on outstanding advances is based upon a variable rate. No amounts were outstanding at December 31, 2019 and 2018.

In January 2011, the Cooperative established an unsecured perpetual line of credit with CoBank in the amount of \$5,000,000. This line of credit was renewed in 2019, with a \$2,000,000 "Revolving Credit Commitment" and \$3,000,000 "Uncommitted Revolving Credit," with expiration in September 2020; no loan advances have been made on this account in 2019 or 2018.

In November 2019, Island Network, LLC executed an amendment to its existing revolving credit promissory note with CoBank increasing the total aggregate principal commitment from \$3,000,000 to \$3,500,000. Draws on the revolving credit promissory note are at variable interest rates measured at the time of advance. The loan term expires in September 2020, and is renewed each year at the discretion of CoBank. The note is guaranteed by OPALCO. Advances outstanding on the revolving credit promissory note were \$3,305,000 with an interest rate of 3.89% as of December 31, 2019, and \$2,850,000 as of December 31, 2018.

Orcas Power & Light Cooperative and Subsidiary

Notes to Consolidated Financial Statements

Note 7 – Long-Term Debt and Capital Lease Obligations

The Cooperative has long-term debt due to RUS and CFC. Substantially all assets of the Cooperative are pledged as security for the long-term debt, and the notes are subject to certain covenants. Long-term debt consisted of the following at December 31:

	<u>2019</u>	<u>2018</u>
Mortgages payable to RUS, quarterly installments of approximately \$342,000, including interest at rates ranging from 2.21% to 5.82%, maturing over various periods through December 2052.	\$ 51,328,647	\$ 48,621,727
Mortgages payable to CFC, quarterly installments of approximately \$68,000, including interest at rates ranging from 3.55% to 4.7%, maturing over various periods through 2039.	8,300,502	8,561,284
RUS Rural Energy Savings Program (RESP) loan, payable upon maturity, bearing 0% interest, maturing December 2029	232,000	-
RUS economic development loan, payable in monthly installments of \$667, bearing 0% interest, matured in 2019.	-	3,333
CoBank loan, payable in monthly interest only installments of approximately \$30,000. Interest rates ranging from 3.32% to 4.61%. Maturing over various periods through 2046.	<u>22,500,000</u>	<u>19,000,000</u>
Long-term debt	82,361,149	76,186,344
Capital lease obligations, stated at present value of future minimum lease payments	<u>561,215</u>	<u>826,690</u>
	82,922,364	77,013,034
Less current maturities of long-term debt and capital lease obligations	<u>1,833,126</u>	<u>2,004,121</u>
	<u>\$ 81,089,238</u>	<u>\$ 75,008,913</u>

Orcas Power & Light Cooperative and Subsidiary

Notes to Consolidated Financial Statements

Note 7 – Long-Term Debt and Capital Lease Obligations (continued)

The aggregate long-term debt and capital lease obligations maturing over the next five years are as follows:

2020	\$ 1,833,126
2021	1,942,751
2022	2,551,378
2023	2,874,360
2024	3,493,270
Thereafter	<u>70,227,479</u>
	<u>\$ 82,922,364</u>

Capital lease obligations – Outstanding capital leases collateralized by the related equipment consisted of the following as of December 31, 2019:

Originated	Entity	Type	Amount	Interest Rate	Maturity Date
2017	Island Network	Computer equipment	468,340	0.00%	February 2020
2017	Island Network	Computer equipment	271,847	0.00%	April 2020
2017	Island Network	Computer equipment	133,281	5.20%	July 2020
2019	Island Network	Computer equipment	80,347	2.11%	January 2022
2019	OPALCO	Computer equipment	37,619	0.00%	January 2022
2019	Island Network	Computer equipment	18,462	2.11%	February 2022
2018	Island Network	Vehicles	86,089	4.60%	March 2025
2018	Island Network	Vehicles	51,261	4.25%	October 2025
2017	Island Network	Construction equipment	368,914	4.30%	December 2025

Note 8 – Operating Lease Commitments

Operating leases – Island Network, LLC leases equipment under a five-year noncancelable operating lease expiring in May 2020.

Future minimum lease payments, under noncancelable operating leases, are as follows:

2020	\$ 147,902
2021	147,902
2022	81,902
2023	<u>75,902</u>
	<u>\$ 453,608</u>

Rent expense under the operating lease for the years ended December 31, 2019 and 2018, was \$114,837 and \$113,400.

Orcas Power & Light Cooperative and Subsidiary

Notes to Consolidated Financial Statements

Note 9 – Income Taxes

The components of the provision for income tax benefit (expense) are as follows as of December 31, 2019:

	<u>2019</u>	<u>2018</u>
Deferred income tax benefit (expense)		
Federal	\$ 378,561	\$ 379,609
Change in valuation allowance	<u>(378,561)</u>	<u>(379,609)</u>
Total income tax expense	<u>\$ -</u>	<u>\$ -</u>

The provision for income taxes differs from the amount computed by applying the current statutory federal income tax rate to earnings before taxes due to the effects of nondeductible items, the change in the valuation allowance, and prior-year over or under accruals.

The components of the net deferred tax asset (liability) recorded in the accompanying consolidated balance sheets at December 31 are as follows:

	<u>2019</u>	<u>2018</u>
Deferred tax assets		
Net operating loss carryforward	\$ 3,000,960	\$ 2,662,087
Allowance for bad debts	1,191	3,356
Capitalized organizational costs	8,960	8,960
Contribution timing differences	2,603	1,794
Accrued liabilities	<u>1,787</u>	<u>-</u>
	3,015,501	2,676,197
Less valuation allowance	<u>(2,358,052)</u>	<u>(1,979,491)</u>
Total deferred tax assets	<u>657,449</u>	<u>696,706</u>
Deferred tax liabilities		
Tax depreciation greater than book	(643,421)	(675,130)
Tax amortization greater than book	(2,937)	(2,340)
Change in prepaid insurance	<u>(11,091)</u>	<u>(19,236)</u>
Total deferred tax liabilities	<u>(657,449)</u>	<u>(696,706)</u>
Net deferred income tax asset (liability)	<u>\$ -</u>	<u>\$ -</u>

Island Network, LLC has federal net operating loss carryforwards of \$14,290,287, which begin to expire in 2035.

Orcas Power & Light Cooperative and Subsidiary

Notes to Consolidated Financial Statements

Note 10 – Deferred Credits

As of December 31, 2019 and 2018, amounts carried on the Cooperative's consolidated balance sheets as deferred credits consisted primarily of Project PAL funds of \$34,161 and \$39,524, respectively; the Member Owned Renewable Energy (MORE) Program funds of \$126,045 and \$139,002, respectively; and the Energy Assist Program for \$68,508 and \$54,110 for 2019 and 2018, respectively; and deferred revenue collected for the Decatur Community Solar array future maintenance costs, the excess contribution is being recognized on a straight line basis over the term of the community solar agreements, or 20 years, and carried a balance of \$78,697 and \$83,546 at December 31, 2019 and 2018, respectively.

Project PAL was developed to help qualifying OPALCO members pay their winter heating bills. Project PAL is primarily funded by members voluntarily rounding up their monthly power bills to the next whole dollar. Requests for assistance are evaluated and grants are awarded by a separate council made up of volunteer OPALCO members. The council, by unanimous vote, reserves the right to allow or deny any grants due to extenuating circumstances. Policy and guidelines are reviewed by a volunteer council on a regular basis.

The MORE Program was started in 2011. It is funded by voluntary contributions from Cooperative members for projects that promote sustainable, renewable energy. Once a year, Cooperative members who install renewable energy systems, such as a solar photovoltaic system or wind turbines, are offered an incentive based on the kWh production of their renewable energy system. Incentives are administered through an independent committee of Cooperative members. The member-owned generation facilities will allow the member generator to consume energy generated by their system, which will offset the amount of energy purchased by the Cooperative. All renewable energy systems are required to be preapproved by the engineering department prior to construction.

OPALCO's Energy Assist Program was started in 2016 to assist low income households with their OPALCO electric bills on a year-round basis. This is an OPALCO administered program that is meant to ease the affordability gap in San Juan County and support the community. The program is funded through rates as a separate line item on each co-op member's monthly bill. Members must be on the standard Residential rate and verify their qualification through another endorsed low-income assistance program to qualify for the Energy Assist Credit.

Note 11 – Pension Benefits

In 1954, the Cooperative adopted a retirement program available for all employees meeting length of service requirements. The program is a multi-employer plan administered by the National Rural Electric Cooperative Association (NRECA) and includes a noncontributory defined benefit pension and a contributory defined contribution 401(k) plan. Approximately 1,000 rural electric systems participate in each of these plans.

Defined benefit plan – The NRECA Retirement Security Plan (RS Plan) is a defined benefit pension plan qualified under Section 401 and tax-exempt under Section 501(a) of the Internal Revenue Code. It is a multi-employer plan under the accounting standards. The RS Plan sponsor's employer identification number is 53-0116145 and the Plan Number is 48009.

Orcas Power & Light Cooperative and Subsidiary

Notes to Consolidated Financial Statements

Note 11 – Pension Benefits (continued)

A unique characteristic of a multi-employer plan compared with 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.

Generally, all employees of the Cooperative are eligible to participate in the defined benefit plan after completing a year of eligible service. Employees are credited with meeting the year of eligible service after completing at least 1,000 hours of service in the first 12 consecutive months of employment or in the first calendar year in which 1,000 hours of service occur. There have been no significant changes that affect the comparability of 2019 and 2018 contributions.

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 RS Plan was 91.17% and 99.48% funded as of January 1, 2019 and 2018, respectively, based on the PPA funding target and PPA actuarial value of assets on those dates. The average increase in rates of compensation for the defined benefit plan as a whole for the year ended January 1, 2019, was 2.83%. The defined benefit plan used an assumed -4.95% return on plan assets in the most recent system-wide annual actuarial valuation. The defined benefit plan invests in equity and debt securities and cash equivalents.

The Cooperative’s contributions to the RS Plan in 2019 and in 2018 represented less than 5% of the total contributions made to the plan by all participating employers. The Cooperative makes monthly contributions to the RS Plan at the required contribution rate. Contributions made by the Cooperative were \$1,405,926 and \$1,341,035 for the years ended December 31, 2019 and 2018, respectively. Withdrawal from the RS Plan may result in the Cooperative having an obligation to the plan. The Cooperative does not currently intend to withdraw from the RS Plan, and, accordingly, no provision has been included in the accompanying consolidated financial statements.

Defined contribution plan – Upon completion of 30 days of eligibility service, all eligible employees of the Cooperative may participate in the defined contribution plan and may elect to make pre-tax employee elective contributions up to 100% of the participant’s salary to a maximum of \$19,000. Upon completion of a year of eligible service, the Cooperative will match employee contributions equal to 100% of employee elective contributions, not to exceed 4% of an employee’s annual compensation. The Cooperative employer portion of the 401(k) plan contributions totaled \$176,509 and \$213,183 for the years ended December 31, 2019 and 2018, respectively.

Postemployment benefits – The Cooperative allows employees to remain in its medical plan after retirement, but the employee is required to pay the full group medical rate. Although a group rate includes a deemed subsidy for retirees, management has determined that the impact on financial position and results of operations is not material and has not recognized a liability for such benefit.

Orcas Power & Light Cooperative and Subsidiary Notes to Consolidated Financial Statements

Note 12 – Commitments and Contingencies

Power supply contracts – In October 2017, OPALCO entered into power sales contract with Pacific Northwest Generating Cooperative (PNGC) to provide the power supply through September 30, 2028. This contract supersedes the previous power sales contract with Bonneville Power Administration (BPA).

Union contract – The current collective bargaining agreement is in effective for the period January 1, 2019 through December 31, 2023. As of December 31, 2019, the Cooperative employed approximately 72% of its workforce under collective bargaining agreement.

Legal – In the normal course of business, the Cooperative is party to claims and matters of litigation. The ultimate outcome of these matters cannot presently be determined; however, in the opinion of management of the Cooperative, the resolution of these matters will not have a material adverse effect on the Cooperative's financial position, results of operations, or liquidity.

T-Mobile agreement – During 2015, Island Network, LLC established a long-term agreement with T-Mobile US to deploy LTE wireless capability throughout San Juan County. The nonmonetary agreement has an initial term of 10 years with extension options and includes the joint lease of FCC spectrum, transfer of infrastructure and equipment, and ongoing services. As the fair value of the assets agreement is not determinable within reasonable limits, the agreement, per GAAP, has not been quantified within the financial statements. The investment was made with the intention to assist Island Network, LLC in bringing a profitable product faster to market and serve a higher number of subscribers.

Note 13 – Revenue Recognition

The following table presents the Cooperative's revenue, disaggregated by member type for the year ended December 31:

	2019	2018
OPALCO		
Residential electric	\$ 22,563,266	\$ 21,167,464
Commercial electric, public lighting and other	8,259,458	8,000,991
Total	30,822,724	29,168,455
Island Network, LLC		
Broadband services	5,030,550	4,170,785
IT services	243,978	276,917
Other revenues	475,967	403,283
Total	5,750,495	4,850,985
	\$ 36,573,219	\$ 34,019,440

Orcas Power & Light Cooperative and Subsidiary

Notes to Consolidated Financial Statements

Note 13 – Revenue Recognition (continued)

OPALCO

Residential electric and commercial electric and public lighting

The Cooperative's primary revenue source is generated through the sale of electricity to members. Retail members are primarily classified as residential or commercial. Residential members include single family housing, multiple family housing (such as apartments, duplexes, and town homes), manufactured homes, and small farms. Commercial members consist of nonresidential members who accept energy deliveries at voltages equivalent to those delivered to residential members. Commercial members include most businesses, small industrial companies, and public street and highway lighting accounts.

The Cooperative's retail member prices are based on the Cooperative's cost of service and are approved by the Cooperative's Board of Directors. The Cooperative's obligation to sell electricity to retail members generally represents a single performance obligation representing a series of distinct goods that are substantially the same and have the same pattern of transfer to the member that is satisfied over time as members simultaneously receive and consume the benefits provided. The Cooperative applies the invoice method to measure its progress towards satisfactorily completing its performance obligations to transfer each distinct delivery of electricity in the series to the member.

Rock Island, Inc.

Rock Island's primary revenues are derived from three distinct revenue streams, broadband services (fiber optic, fixed wireless, and DSL), IT services, and other services provided to customers.

Broadband services

Revenue is generated from subscribers to high-speed internet and wireless internet services. Revenue is recognized as services are provided on a monthly basis. Subscription rates and related charges vary according to the services and features customers receive. Customers are typically billed in advance and pay on a monthly basis. While a portion of the customers are subject to contracts for their services, which are typically 1 to 2 years in length, based on the evaluation of the terms of these contracts, revenue is recognized for these services on a basis that is consistent with the customers that are not subject to contracts.

The obligation to sell broadband services generally represents a single performance obligation representing a series of distinct goods that are substantially the same and have the same pattern of transfer to the customer that is satisfied over time as customers simultaneously receive and consume the benefits provided.

Orcas Power & Light Cooperative and Subsidiary

Notes to Consolidated Financial Statements

Note 13 – Revenue Recognition (continued)

IT services

Revenue is generated from subscribers to a variety of our products and services which are offered to businesses. The service offerings for small business locations primarily include high-speed internet services that are similar to those provided to residential customers, as well as cloud-based cybersecurity services, wireless backup connectivity, advanced Wi-Fi solutions, and video monitoring services. Rock Island also offers Ethernet network services that connect multiple locations and provide higher downstream and upstream speed options to medium-sized customers and larger enterprises. In addition, Rock Island provides backhaul services to network operators to help them manage their network bandwidth.

Revenue is recognized as services are provided on a monthly basis. Substantially all of the customers are initially under contracts, with terms typically ranging from 1-3 years. Customers with contracts may only discontinue service in accordance with the terms of their contracts. We receive payments based on a billing schedule established in the contracts, which is typically on a monthly basis. If a contract is separated into more than one performance obligation, the total transaction price is allocated to each performance obligation in an amount based on the estimated relative standalone selling prices of the promised goods or services underlying each performance obligation.

Other revenues

Revenue is generated from subscribers for ancillary services and from affiliate partnership commissions. The ancillary service offerings consist of email, managed Wi-Fi, cybersecurity, and other services that can be sold to residential customers and are not dependent on subscribing to high-speed internet. Revenue is recognized as services are provided on a monthly basis. Subscription rates and related charges vary according to the services and features customers receive. Customers are typically billed in advance and pay on a monthly basis. Customers subscribing to ancillary services are seldom subject to contracts and therefore revenue is recognized for these services on a basis that is consistent with the customers that are not subject to contracts.

Rock Island's obligation to sell ancillary services generally represents a single performance obligation representing a series of distinct goods that are substantially the same and have the same pattern of transfer to the customer that is satisfied over time as customers simultaneously receive and consume the benefits provided.

Rock Island maintains partnerships with several affiliate companies that entitle Rock Island to compensation for referrals of the customers to the affiliates. Referral revenues come in the form of sales commissions pursuant to activities in our retail store in Friday Harbor, and also from referral sales to residential and small business customers for VOIP services provided by partners. Revenue is recognized as commissions are settled from the partners in the month related to the sales activity for that particular service.

Orcas Power & Light Cooperative and Subsidiary

Notes to Consolidated Financial Statements

Note 14 – Subsequent Events

In January 2020, OPALCO made a long-term Rural Energy Savings Program (RESP) loan draw with the RUS in the amount of \$500,000 at an interest rate of 0%.

In March 2020, OPALCO made a long-term loan advance draw with the RUS in the amount of \$3,100,000 at an interest rate of 1.58%.

COVID-19 Virus – On March 11, 2020, the World Health Organization officially declared COVID-19, the disease caused by the novel coronavirus, a pandemic. Management is closely monitoring the evolution of this pandemic, including how it may affect the economy and general population. Given the dynamic nature of these circumstances and potential business disruption, the Cooperative could experience a significant short-term impact to operations. Management will continue to monitor the situation closely, but given the uncertainty about the situation, it is unable to estimate the impact to the financial statements.

In April 2020, OPALCO obtained a Payroll Protection Program (PPP) Loan under the CARES Act in the amount of \$1,790,016 at an interest rate of 1.00%.

In April 2020, Island Network LLC obtained a Payroll Protection Program (PPP) Loan under the CARES Act in the amount of \$521,085 at an interest rate of 1.00%.

Supplementary Information

Orcas Power & Light Cooperative

Consolidating Balance Sheet

December 31, 2019

	OPALCO	Island Network, LLC	Eliminating Entries	Consolidated Total
ASSETS				
Electric plant in service	\$ 144,301,229	\$ -	\$ -	\$ 144,301,229
Broadband plant in service	-	19,409,714	-	19,409,714
Construction work in progress	5,015,317	838,614	-	5,853,931
	149,316,546	20,248,328	-	169,564,874
Less accumulated depreciation and amortization	53,456,306	4,065,395	-	57,521,701
Net utility plant	95,860,240	16,182,933	-	112,043,173
INVESTMENTS AND OTHER ASSETS				
Investments in associated organizations	1,814,993	-	-	1,814,993
Investment in subsidiary (Note 5)	(9,279,459)	-	9,279,459	-
Goodwill	-	157,960	-	157,960
Total investments and other assets	(7,464,466)	157,960	9,279,459	1,972,953
CURRENT ASSETS				
Cash and cash equivalents	3,928,583	231,746	-	4,160,329
Cash and cash equivalents - board designated	538,698	-	-	538,698
Accounts receivable, net of allowance for doubtful accounts of \$65,671 in 2019	3,910,241	242,374	(31,417)	4,121,198
Interest receivable	24,279	-	-	24,279
Materials and supplies	3,006,903	1,023,095	-	4,029,998
Prepaid expenses	452,012	112,235	-	564,247
Total current assets	11,860,716	1,609,450	(31,417)	13,438,749
DEFERRED CHARGES	647,075	-	-	647,075
TOTAL ASSETS	\$ 100,903,565	\$ 17,950,343	\$ 9,248,042	\$ 128,101,950
EQUITIES AND MARGINS				
Memberships	\$ 56,355	\$ -	\$ -	\$ 56,355
Patronage capital	42,747,665	-	-	42,747,665
Undistributed subsidiary losses	(11,412,680)	(11,412,680)	11,412,680	(11,412,680)
Donated and other equities	7,011,501	-	-	7,011,501
Total equity and margins	38,402,841	(11,412,680)	11,412,680	38,402,841
LONG-TERM DEBT, less current maturities				
RUS mortgage notes	49,959,161	-	-	49,959,161
CFC mortgage notes	8,029,709	-	-	8,029,709
Loan payable	-	22,500,000	-	22,500,000
Payable to OPALCO (Note 5)	-	2,133,221	(2,133,221)	-
Long-term lease liability	251,562	348,806	-	600,368
Total long-term debt	58,240,432	24,982,027	(2,133,221)	81,089,238
CURRENT LIABILITIES				
Accounts payable	1,622,227	466,785	(31,417)	2,057,595
Customer deposits	85,259	-	-	85,259
Accrued liabilities	583,736	434,422	-	1,018,158
Line of credit - CoBank	-	3,305,000	-	3,305,000
Current maturities of long-term debt	1,658,337	174,789	-	1,833,126
Total current liabilities	3,949,559	4,380,996	(31,417)	8,299,138
DEFERRED CREDITS	310,733	-	-	310,733
EQUITIES, MARGINS, AND LIABILITIES	\$ 100,903,565	\$ 17,950,343	\$ 9,248,042	\$ 128,101,950

Orcas Power & Light Cooperative
Consolidating Balance Sheet
December 31, 2018

	OPALCO	Island Network, LLC	Eliminating Entries	Consolidated Total
ASSETS				
Electric plant in service	\$ 136,469,139	\$ -	\$ -	\$ 136,469,139
Broadband plant in service	-	15,530,236	-	15,530,236
Construction work in progress	6,790,804	1,176,475	-	7,967,279
	143,259,943	16,706,711	-	159,966,654
Less accumulated depreciation and amortization	49,148,193	2,662,534	-	51,810,727
Net utility plant	94,111,750	14,044,177	-	108,155,927
INVESTMENTS AND OTHER ASSETS				
Investments in associated organizations	1,737,910	-	-	1,737,910
Investment in subsidiary (Note 5)	(7,444,503)	-	7,444,503	-
Goodwill	-	189,034	-	189,034
Total investments and other assets	(5,706,593)	189,034	7,444,503	1,926,944
CURRENT ASSETS				
Cash and cash equivalents	2,041,535	180,455	-	2,221,990
Cash and cash equivalents - board designated	530,765	-	-	530,765
Accounts receivable, net of allowance for doubtful accounts of \$75,980 in 2018	4,501,319	494,433	(57,046)	4,938,706
Interest receivable	6,316	-	-	6,316
Materials and supplies	3,045,487	1,493,116	-	4,538,603
Prepaid expenses	384,378	115,476	-	499,854
Total current assets	10,509,800	2,283,480	(57,046)	12,736,234
TOTAL ASSETS	\$ 98,914,957	\$ 16,516,691	\$ 7,387,457	\$ 122,819,105
EQUITIES AND MARGINS				
Memberships	\$ 56,580	\$ -	\$ -	\$ 56,580
Patronage capital	41,668,217	-	-	41,668,217
Undistributed subsidiary losses	(9,571,004)	(9,571,004)	9,571,004	(9,571,004)
Donated and other equities	6,479,465	-	-	6,479,465
Total equity and margins	38,633,258	(9,571,004)	9,571,004	38,633,258
LONG-TERM DEBT, less current maturities				
RUS mortgage notes	47,256,888	-	-	47,256,888
CFC mortgage notes	8,300,502	-	-	8,300,502
Loan payable	-	19,000,000	-	19,000,000
Payable to OPALCO (Note 5)	-	2,126,501	(2,126,501)	-
Long-term lease liability	-	451,523	-	451,523
Total long-term debt	55,557,390	21,578,024	(2,126,501)	75,008,913
CURRENT LIABILITIES				
Accounts payable	1,979,818	843,348	(57,046)	2,766,120
Customer deposits	83,857	-	-	83,857
Accrued liabilities	691,055	465,599	-	1,156,654
Line of credit - CoBank	-	2,850,000	-	2,850,000
Current maturities of long-term debt	1,653,397	350,724	-	2,004,121
Total current liabilities	4,408,127	4,509,671	(57,046)	8,860,752
DEFERRED CREDITS	316,182	-	-	316,182
EQUITIES, MARGINS, AND LIABILITIES	\$ 98,914,957	\$ 16,516,691	\$ 7,387,457	\$ 122,819,105

Orcas Power & Light Cooperative
Consolidating Statement of Revenues and Margins
Year Ended December 31, 2019

	OPALCO	Island Network, LLC	Eliminating Entries	Consolidated Total
OPERATING REVENUES				
Electricity sales	\$ 30,938,545	\$ -	\$ (115,821)	\$ 30,822,724
Broadband sales	-	5,990,624	(240,129)	5,750,495
Total operating revenues	<u>30,938,545</u>	<u>5,990,624</u>	<u>(355,950)</u>	<u>36,573,219</u>
OPERATING EXPENSES				
Cost of purchased power	9,262,362	-	-	9,262,362
Transmission	458,165	-	-	458,165
Distribution - operations	3,604,825	-	-	3,604,825
Distribution - maintenance	2,170,783	-	-	2,170,783
Consumer accounts	1,097,439	-	-	1,097,439
Broadband services	-	1,054,924	(205,797)	849,127
Administrative and general	3,846,904	4,183,028	(240,129)	7,789,803
Depreciation and amortization	4,923,805	1,418,706	-	6,342,511
Taxes	1,444,843	209,831	-	1,654,674
Total operating expenses	<u>26,809,126</u>	<u>6,866,489</u>	<u>(445,926)</u>	<u>33,229,689</u>
Operating margins before fixed charges	4,129,419	(875,865)	89,976	3,343,530
FIXED CHARGES				
Interest on long-term debt	1,820,581	963,738	(79,346)	2,704,973
Operating margins after fixed charges	2,308,838	(1,839,603)	169,322	638,557
PATRONAGE CAPITAL CREDITS				
Net operating margins	<u>2,434,092</u>	<u>(1,839,603)</u>	<u>169,322</u>	<u>763,811</u>
NONOPERATING MARGINS				
Interest income	202,598	-	(79,346)	123,252
Other income	94,235	(2,073)	(89,976)	2,186
Total nonoperating margins	<u>296,833</u>	<u>(2,073)</u>	<u>(169,322)</u>	<u>125,438</u>
Net operating and nonoperating margins	<u>2,730,925</u>	<u>(1,841,676)</u>	<u>-</u>	<u>889,249</u>
LOSS FROM SUBSIDIARY	<u>(1,841,676)</u>	<u>-</u>	<u>1,841,676</u>	<u>-</u>
NET MARGINS	<u>\$ 889,249</u>	<u>\$ (1,841,676)</u>	<u>\$ 1,841,676</u>	<u>\$ 889,249</u>

Orcas Power & Light Cooperative
Consolidating Statement of Revenues and Margins
Year Ended December 31, 2018

	OPALCO	Island Network, LLC	Eliminating Entries	Consolidated Total
OPERATING REVENUES				
Electricity sales	\$ 29,263,375	\$ -	\$ (94,920)	\$ 29,168,455
Broadband sales	-	4,920,825	(69,840)	4,850,985
Total operating revenues	<u>29,263,375</u>	<u>4,920,825</u>	<u>(164,760)</u>	<u>34,019,440</u>
OPERATING EXPENSES				
Cost of purchased power	9,053,663	-	-	9,053,663
Transmission	252,433	-	-	252,433
Distribution - operations	3,365,842	-	-	3,365,842
Distribution - maintenance	1,945,822	-	-	1,945,822
Consumer accounts	1,014,503	-	-	1,014,503
Broadband services	-	970,121	(181,205)	788,916
Administrative and general	3,602,127	4,270,244	(69,840)	7,802,531
Depreciation and amortization	4,528,224	1,214,858	-	5,743,082
Taxes	1,365,016	214,808	-	1,579,824
Total operating expenses	<u>25,127,630</u>	<u>6,670,031</u>	<u>(251,045)</u>	<u>31,546,616</u>
Operating margins before fixed charges	4,135,745	(1,749,206)	86,285	2,472,824
FIXED CHARGES				
Interest on long-term debt	1,547,868	762,507	(79,214)	2,231,161
Operating margins after fixed charges	2,587,877	(2,511,713)	165,499	241,663
PATRONAGE CAPITAL CREDITS				
Net operating margins	<u>2,730,967</u>	<u>(2,511,713)</u>	<u>165,499</u>	<u>384,753</u>
NONOPERATING MARGINS				
Interest income	176,305	-	(79,214)	97,091
Other income	100,097	10,661	(86,285)	24,473
Total nonoperating margins	<u>276,402</u>	<u>10,661</u>	<u>(165,499)</u>	<u>121,564</u>
Net operating and nonoperating margins	<u>3,007,369</u>	<u>(2,501,052)</u>	<u>-</u>	<u>506,317</u>
LOSS FROM SUBSIDIARY				
	<u>(2,501,052)</u>	<u>-</u>	<u>2,501,052</u>	<u>-</u>
NET MARGINS				
	<u>\$ 506,317</u>	<u>\$ (2,501,052)</u>	<u>\$ 2,501,052</u>	<u>\$ 506,317</u>

Report Required by *Government Auditing Standards*

Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

To the Board of Directors
Orcas Power & Light Cooperative and Subsidiary

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Orcas Power & Light Cooperative and Subsidiary (collectively, the Cooperative) as of and for the year ended December 31, 2019, and the related notes to the consolidated financial statements, which collectively comprise the Cooperative's consolidated financial statements, and have issued our report thereon dated May 11, 2020.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered the Cooperative's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Cooperative's internal control. Accordingly, we do not express an opinion on the effectiveness of the Cooperative's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Cooperative's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Everett, Washington

May 11, 2020

