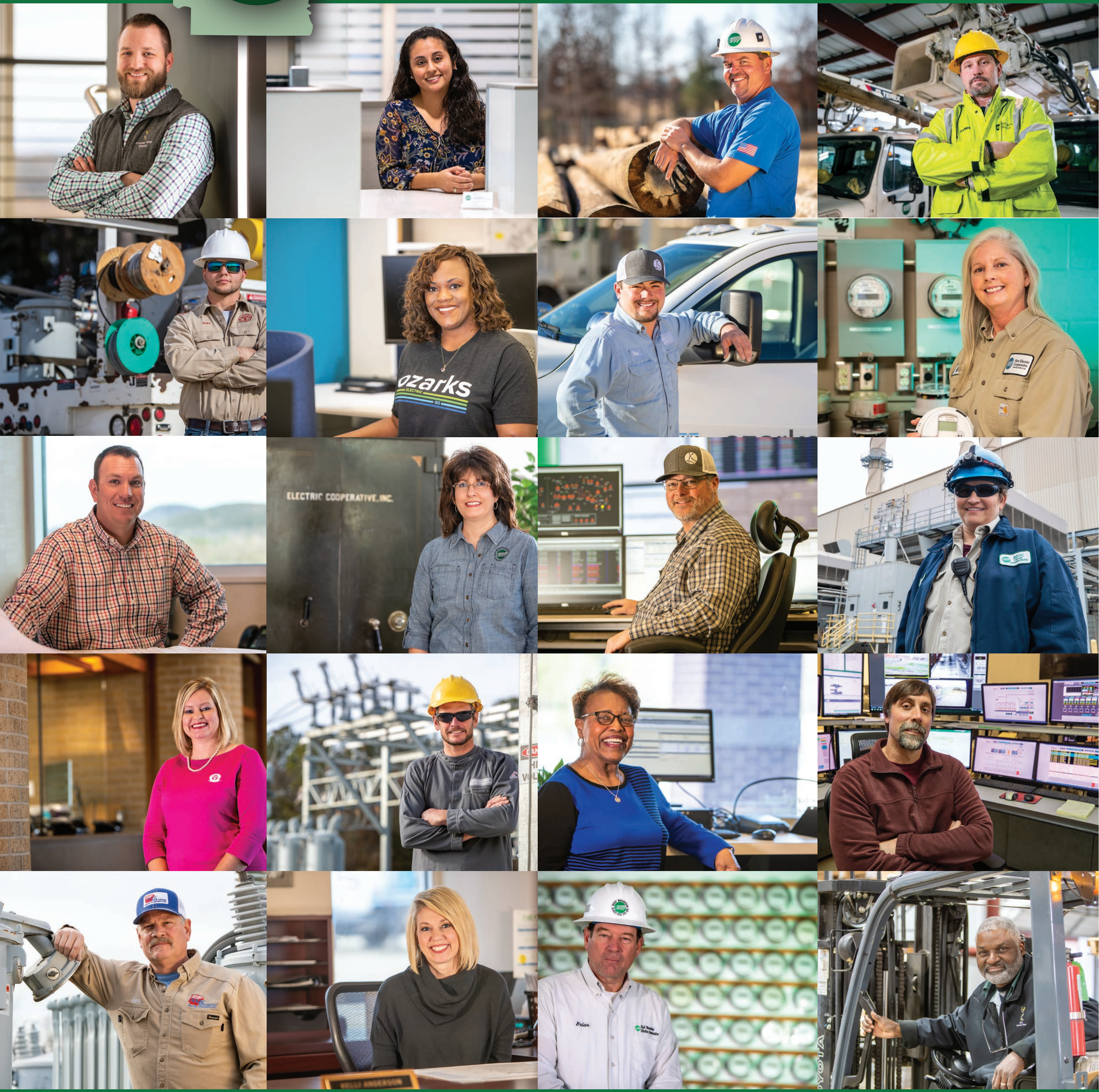
Electric Cooperatives of Arkansas

ONE MISSION. ONE PURPOSE.
ONE COOPERATIVE AT A TIME.



2019 ANNUAL REPORT

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Arkansas Electric Cooperative Corporation

Independent Auditor’s Reports and Financial Statements

October 31, 2019 and 2018

Arkansas Electric Cooperative Corporation
October 31, 2019 and 2018

Contents

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Independent Auditor's Report

Board of Directors
Arkansas Electric Cooperative Corporation
Little Rock, Arkansas

Report on Financial Statements

We have audited the accompanying financial statements of Arkansas Electric Cooperative Corporation (AECC), which comprise the balance sheets as of October 31, 2019 and 2018, and the related statements of operations, members' equities and cash flows for the years ending October 31, 2019, 2018, and 2017, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of AECC as of October 31, 2019 and 2018, and the results of its operations and its cash flows for the years ending October 31, 2019, 2018, and 2017, in accordance with accounting principles generally accepted in the United States of America.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of deferred debits and deferred credits and schedule of investments are presented for purposes of additional analysis and are not a required part of the 2019 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 2019 financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the 2019 financial statements or to the 2019 financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the 2019 financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we also have issued our report dated February 4, 2020, on our consideration of AECC's internal control over financial reporting and 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 the 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 AECC's internal control over financial reporting and compliance.

BKD, LLP

Little Rock, Arkansas
February 4, 2020

Arkansas Electric Cooperative Corporation

Balance Sheets

October 31, 2019 and 2018

(In thousands)

Assets

	2019	2018
Utility Plant		
Electric plant in service	$ 2,589,608	$ 2,588,596
Construction work in progress	105,731	69,597
Total utility plant	2,695,339	2,658,193
Less accumulated depreciation	1,304,152	1,288,647
Net utility plant	1,391,187	1,369,546
Long-Term Investments		
Gas reserves – net of amortization	11,054	11,646
Deposit with Rural Utilities Service – restricted investment	35,981	48,038
Other	26,097	26,154
Total long-term investments	73,132	85,838
Current Assets		
Cash and cash equivalents	154,496	117,664
Accounts receivable – members	52,045	57,595
Fuel inventories and prepaid fuel supply	34,965	23,694
Material and supply inventories	25,904	23,016
Other current assets	25,110	33,167
Total current assets	292,520	255,136
Deferred Charges	40,260	58,445
Total	$ 1,797,099	$ 1,768,965

See Notes to Financial Statements

Liabilities and Members' Equity

	2019	2018
Members' Equities		
Membership fees	$ 2	$ 2
Patronage capital	365,483	374,978
Accumulated margins	121,933	107,749
Other equities	118,140	118,140
Total members' equities	605,558	600,869
Long-Term Debt		
Federal Financing Bank	623,213	579,166
CoBank, ACB	43,707	46,439
CoBank, ACB – unsecured	4,008	5,550
Series 2011A First Mortgage Obligation Senior Notes	58,500	62,000
Series 2011B First Mortgage Obligation Senior Notes	120,000	120,000
Total long-term debt	849,428	813,155
Current Liabilities		
Notes payable – members	133,267	116,519
Notes payable – related party	30,000	30,000
Notes payable – others	29,997	77,710
Accounts payable and other accrued liabilities	78,323	73,319
Current maturities of long-term debt	31,422	29,123
Accrued property taxes	7,839	7,603
Accrued interest	5,168	5,289
Total current liabilities	316,016	339,563
Deferred Credits	26,097	15,378
Commitments and Contingencies	-	-
Total	$ 1,797,099	$ 1,768,965

Arkansas Electric Cooperative Corporation

Statements of Operations

Years Ended October 31, 2019, 2018 and 2017

(In thousands)

	2019	2018	2017
Operating Revenues	$ 790,706	$ 827,494	$ 796,094
Operating Expenses			
Operation and maintenance – generation	301,363	326,760	314,040
Power purchased	187,853	178,877	168,649
Operation and maintenance – transmission	134,415	148,027	145,620
Administrative and general	34,103	32,471	30,146
Depreciation	61,335	54,148	57,274
Interest	53,573	51,274	47,619
Total operating expenses	772,642	791,557	763,348
Margin from Electric Operations	18,064	35,937	32,746
Other (Loss) Gain – Net	(846)	(464)	1,708
Interest Income – Net	4,944	3,460	3,534
AMT Tax Refund	2,527	-	-
Net Margin	$ 24,689	$ 38,933	$ 37,988

Arkansas Electric Cooperative Corporation
Statements of Members' Equities
Years Ended October 31, 2019, 2018 and 2017
(In thousands)

	Membership Fees	Patronage Capital	Accumulated Margins	Other Equities	Total Members' Equities
Balance – November 1, 2016	$ 2	$ 378,183	$ 67,768	$ 118,140	$ 564,093
Net margin	-	-	37,988	-	37,988
Allocation of patronage capital	-	18,211	(18,211)	-	-
Redemption of patronage capital	-	(20,145)	-	-	(20,145)
Balance – October 31, 2017	2	376,249	87,545	118,140	581,936
Net margin	-	-	38,933	-	38,933
Allocation of patronage capital	-	18,729	(18,729)	-	-
Redemption of patronage capital	-	(20,000)	-	-	(20,000)
Balance – October 31, 2018	2	374,978	107,749	118,140	600,869
Net margin	-	-	24,689	-	24,689
Allocation of patronage capital	-	10,505	(10,505)	-	-
Redemption of patronage capital	-	(20,000)	-	-	(20,000)
Balance – October 31, 2019	$ 2	$ 365,483	$ 121,933	$ 118,140	$ 605,558

Arkansas Electric Cooperative Corporation
Statements of Cash Flows
Years Ended October 31, 2019, 2018 and 2017
(In thousands)

	2019	2018	2017
Operating Activities			
Net margin	$ 24,689	$ 38,933	$ 37,988
Adjustments to reconcile net margin to net cash provided by operating activities:			
Depreciation	61,335	54,148	57,274
Loss on sale of coal	-	-	45
Amortization of gas reserves	592	603	739
Allocation of patronage from associated organization	(722)	(1,062)	(877)
Interest income on deposits with RUS – cushion of credit	(4,091)	(3,123)	(3,175)
Changes in operating assets and liabilities:			
Accounts receivable – members	5,550	2,558	(5,675)
Fuel inventories and prepaid fuel supply	(11,271)	3,287	14,469
Material and supply inventories	(2,888)	(17)	224
Other current assets	8,057	195	17,987
Deferred charges	17,930	15,726	9,751
Accounts payable and other accrued liabilities	2,501	(27,428)	(10,529)
Other deferred credits	10,439	(160)	850
Net cash provided by operating activities	112,121	83,660	119,071
Investing Activities			
Purchase of other investments	(321)	(403)	(1,623)
Sales of other investments	1,379	1,201	1,050
Deposits to RUS – restricted investment	(55,000)	-	-
Withdrawals from RUS – restricted investment	71,148	20,594	22
Capital expenditures	(80,102)	(66,634)	(69,950)
Net cash used in investing activities	(62,896)	(45,242)	(70,501)
Financing Activities			
Net borrowings (payments) on notes payable, members	16,749	11,840	(40,814)
Net payments on notes payable, other	(47,713)	(22,124)	(80)
Principal payments on long-term debt	(102,169)	(28,728)	(29,449)
Redemption of patronage capital	(20,000)	(20,000)	(20,145)
Proceeds from long-term debt	140,740	-	-
Net cash used in financing activities	(12,393)	(59,012)	(90,488)
Increase (Decrease) in Cash and Cash Equivalents	36,832	(20,594)	(41,918)
Cash and Cash Equivalents – Beginning of Year	117,664	138,258	180,176
Cash and Cash Equivalents – End of Year	$ 154,496	$ 117,664	$ 138,258
Supplemental Disclosures of Cash Flow Information – Noncash Transactions			
Increase in accounts payable related to capital expenditures	$ 5,689	$ 4,252	$ 7,524
Cash paid for interest	$ 39,732	$ 37,387	$ 36,843

Note 1: Summary of Significant Accounting Policies

Organization

Arkansas Electric Cooperative Corporation (AECC), an electric generation and transmission cooperative, follows the Uniform System of Accounts prescribed by the Rural Utilities Service (RUS) and the Federal Energy Regulatory Commission (FERC).

AECC was organized and exists under Arkansas law to provide wholesale electric power and associated energy to its 17 members (Members). AECC provides electric power to its Members under wholesale power contracts, which may be terminated only upon 60 months' prior written notice and, in any event, no earlier than January 1, 2042. The wholesale power contracts require Members to purchase, with the limited exception of one member 100% of their energy requirements from AECC. AECC's rate to its Members includes a demand charge, an energy charge and certain rate riders, the combination of which are designed to recover the operating costs of AECC, plus a margin as approved by AECC's board of directors (the Board) and the Arkansas Public Service Commission (APSC). APSC approval is required for any rate adjustments and RUS approval is required for all rate decreases.

AECC's power supply resources are primarily composed of purchase power agreements, owned and co-owned generating facilities, which are offered into two separate, day-ahead and real-time energy markets operated by FERC-designated Regional Transmission Organizations (RTO). AECC provides energy over its owned and contracted transmission facilities via participation in the same two regional, FERC-designated RTOs.

Carrying Value of Certain Assets and Liabilities

AECC's accounting policies and the accompanying financial statements conform to accounting principles generally accepted in the United States of America applicable to rate-regulated enterprises and reflect, for financial reporting purposes, the effects of the rate-making process in accordance with Financial Accounting Standards Board's Accounting Standards Codification (ASC) 980, *Regulated Operations*. In accordance with ASC 980, AECC has regulatory assets, primarily recorded in deferred charges, in the amount of approximately $37.3 million and $55.4 million as of October 31, 2019 and 2018, respectively.

As of October 31, 2019 and 2018, regulatory assets included $2.9 million and $3.6 million, respectively, attributable to premiums associated with debt refinancings and retirements (which are being amortized over the life of the related debt instruments); deferred past service pension cost of $0.2 million and $0.2 million, respectively; $2.5 million and $17.1 million, respectively, for the purchase of the lease residual and subsequent reclassification from an operating lease to a capital lease for the Independence Steam Electric Station Unit 2 (Independence 2) in June 2003; regulatory assets associated with the Clyde T. Ellis Hydroelectric Station (Ellis) lease and subsequent lease residual purchase of $19.4 million and $20.8 million, respectively (see *Note 9*); and $12.3 million and $13.7 million, respectively, related to the market value of congestion hedging that is included in monthly member billings through approved riders. In the event operations are no longer subject to the provisions of ASC 980, as a result of a change in regulation or the effects of competition, AECC would be required to recognize the effects of any regulatory change in assets currently in its statements of operations.

Utility Plant and Related Depreciation

All utility plant is recorded at original cost. The cost of additions to utility plant includes contracted work, direct labor, materials, allocable overhead, and an allowance for funds used during construction as allowed by the APSC. The major classes of utility plant as of October 31, 2019 and 2018, are listed below (in thousands):

	2019	2018
Generation plant	$ 2,335,467	$ 2,344,104
Transmission plant	202,926	198,406
General plant	51,215	46,086
Electric plant in service	2,589,608	2,588,596
Construction work in progress	105,731	69,597
Total	$ 2,695,339	$ 2,658,193

The cost of retirements, replacements or betterments are removed from utility plant and, in accordance with industry practice, the cost of the unit and its removal cost, less salvage, are charged to accumulated depreciation. Maintenance and repairs are charged to operating expenses as incurred.

Depreciation of utility plant is typically recorded using guidelines prescribed by the RUS. A provision has been made for depreciation of steam generation plant, gas turbine generation plant, hydroelectric generation plant and transmission plant at annual straight-line composite rates of 3.1%, 3%, 2% and 2.75%, respectively. Effective January 1, 2014, AECC received approval from the RUS to apply special rates to three existing coal plants. The special rates for these plants range from 0.73% to 1.08%.

General plant depreciation rates are applied on an annual straight-line composite basis as follows:

Structures and improvements	2%
Office furniture and equipment	4.8 and 9.6
Transportation equipment	20
Power-operated equipment	15
Tools, shop, and garage equipment	5
Communication equipment	8
Other general plant	5 and 6

When indicators of impairment are identified, AECC evaluates the recoverability of assets by comparing the carrying amount of the relevant asset group against the related, estimated undiscounted future cash flows expected over the remaining useful life of the asset group. When an evaluation indicates that the future undiscounted cash flows are not sufficient to recover the carrying value of the asset group, the carrying value of the asset group would be reduced to its estimated fair value. AECC did not identify any triggering events for the year ended October 31, 2019.

Asset Retirement Obligations

AECC has recognized a conditional Asset Retirement Obligation (ARO) related to the future removal and disposal of materials from three oil-/gas-fired plants and three coal-fired plants, and oil and gas plugging obligations. As of October 31, 2019, there are no assets legally restricted for the purpose of settling any AROs. These AROs are recorded as deferred credits on the balance sheets. A reconciliation of the aggregate carrying amount of the obligation as of October 31, 2019 and 2018, is as follows (in thousands):

Balance – November 1, 2017	$ 5,048
Accretion expense	393
Balance – October 31, 2018	5,441
Cashflow revision	4,110
Accretion expense	322
Balance – October 31, 2019	$ 9,873

Electric Revenues and Fuel

Revenues are recorded in the same month that power is generated and billed. AECC charges the cost of fuel to expense as fuel is consumed. Uncollectible accounts have historically been negligible, so AECC does not provide an allowance for doubtful accounts.

Carrying Costs Capitalized During Construction

AECC capitalizes the carrying costs on certain significant construction and development projects while in progress. AECC is allowed, with approval of the APSC, to capitalize the interest costs for debt specifically borrowed to finance projects during construction and development. Additionally, for the portion of construction and development projects funded without specific borrowings, the APSC allows AECC to capitalize carrying costs based first on the incremental rate incurred in relation to its notes payable, and to the extent the construction and development project costs exceed the balance of the notes payable, AECC may capitalize carrying costs attributable to the remaining costs based on the weighted-average interest rate of AECC's long-term debt, excluding any amounts representing specific borrowings.

AECC records the interest costs capitalized related to debt specifically borrowed for construction and development projects as interest during construction, which is reflected as a credit to interest expense as part of operating expenses in the accompanying statements of operations. Additionally, AECC is allowed to record the carrying costs capitalized related to construction and development projects funded without specific borrowings as an allowance for funds used during construction, which is reflected below the margin from operations in the accompanying statements of operations.

There were no interest costs capitalized during the periods ended October 31, 2019, 2018 and 2017.

Statements of Cash Flows

For purposes of the statements of cash flows, cash and cash equivalents represent demand deposits in financial institutions and securities with original maturity dates of three months or less when purchased. From time to time, AECC will have funds in excess of FDIC limits. These balances are monitored daily. No amounts were paid for income taxes for the years ended October 31, 2019, 2018 and 2017.

Inventories

Fuel inventories and material and supply inventories are stated at the lower of average cost or net-realizable value.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect 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. Actual results could differ from those estimates and assumptions used in preparing the accompanying financial statements.

Changes in Accounting Standards

In May 2014, the Financial Accounting Standards Board (FASB) issued ASU No. 2014-09 (ASU 2014-09), *Revenue from Contracts with Customers*. ASU 2014-09 introduces new, increased requirements for disclosure of revenue in financial statements and is intended to eliminate inconsistencies in revenue recognition and thereby improve financial reporting comparability across entities, industries and capital markets. In August 2015, ASU 2015-14 was issued that deferred the effective date of ASU 2014-09. The revised effective date is for annual reporting periods beginning after December 15, 2018. FASB has since issued various updates clarifying ASU 2014-09 including ASU 2016-08 in March 2016, ASU 2016-10 in April 2016, and ASU 2016-12 in May 2016. All of these ASUs amend ASU 2014-09 and have the effective dates from the amendment ASU 2015-14. AECC is currently evaluating the potential impact of ASU 2014-09, however, currently the adoption of ASU 2014-09 is not expected to have a material effect on AECC's reported results of operations, financial condition or cash flows.

In February 2016, FASB issued ASU 2016-02, *Leases*. The standard introduces a new lessee model that brings substantially all leases onto the balance sheet. Additionally, the guidance retains most of the principles of the existing lessor model in principles generally accepted in the United States of America, and it aligns many of those principles with *Revenue from Contracts with Customers*. This standard will be effective for annual reporting periods beginning after December 15, 2020. AECC is still evaluating the impact that this standard will have on its financial statements.

Restricted Investment

AECC has a Cushion of Credit (COC) program administered by the RUS. Under the COC program, RUS borrowers could make voluntary irrevocable deposits into a special account. The President signed the 2019 Farm Bill on December 20, 2018. Provisions in that bill have modified the RUS COC Program. No additional deposits into the COC were allowed after December 20, 2018. Existing COC balances will continue to earn interest at a rate of 5% until October 1, 2020, at which time the interest rates drop to 4%. The new bill allows for COC balance holders to prepay their RUS/FFB debt without a prepayment penalty through September 30, 2020, after this date amounts (deposits and earned interest) can only be used to make scheduled payments on loans guaranteed by RUS. As of October 31, 2019 and 2018, AECC's balances in the COC program were $36.0 million and $48.0 million, respectively. Deposits of $55.0 million were made for the year ended October 31, 2019. There were no deposits made into the program for the years ended October 31, 2018 and 2017. During the years ended October 31, 2019, 2018 and 2017, AECC made scheduled and prepayments from the COC program in the amounts of $71.1 million, $20.6 million and $0.02 million, respectively. AECC earned interest income from the COC program in the amounts of $4.1 million, $3.1 million and $3.2 million for the years ending October 31, 2019, 2018 and 2017, respectively.

Fair Value Measurements

AECC applies ASC 820, *Fair Value Measurements and Disclosures*, which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The statement applies to reported balances that are required or permitted to be measured at fair value under existing accounting pronouncements.

ASC 820 emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, ASC 820 establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

Level 1 inputs utilize observable market data in active markets for identical assets or liabilities. Level 2 inputs consist of observable market data, other than that included in Level 1, that are either directly or indirectly observable. Level 3 inputs consist of unobservable market data, which are typically based on an entity's own assumptions of what a market participant would use in pricing an asset or liability if there is little, if any, related market activity. In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest-level input that is significant to the fair value measurement in its entirety. AECC's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

The following tables summarize AECC's assets and liabilities measured at fair value on a recurring basis as of October 31, 2019 and 2018, aggregated by the level in the fair value hierarchy within which those measurements fall (in thousands):

	Fair Value Measurements as of October 31, 2019			
	Level 1	Level 2	Level 3	Total
Assets – marketable securities	$ 5,392	$ -	$ -	$ 5,392

	Fair Value Measurements as of October 31, 2018			
	Level 1	Level 2	Level 3	Total
Assets – marketable securities	$ 5,558	$ -	$ -	$ 5,558

ASC 825, *Financial Instruments* permits entities to choose to measure many financial instruments and certain other items at fair value (Fair Value Option). Election of the Fair Value Option is made on an instrument-by-instrument basis and is irrevocable. At the adoption date, unrealized gains and losses on financial assets and liabilities for which the Fair Value Option has been elected would be reported as a cumulative adjustment to beginning accumulated margins. Following the election of the Fair Value Option for certain financial assets and liabilities, unrealized gains and losses would be reported due to changes in fair value in earnings at each subsequent reporting date.

Regional Transmission Organization Accounting

Starting on December 19, 2013, AECC began participating in both the day-ahead and real-time energy markets operated by the Midcontinent Independent System Operator Inc. (MISO) RTO, and, with APSC approval, joined MISO as a transmission-owning member on June 1, 2014. Additionally, on March 1, 2014, AECC began participating in the Integrated Marketplace, which also includes day-ahead and real-time energy markets, launched by the Southwest Power Pool (SPP) RTO and effective July 1, 2016, again with APSC approval, AECC joined SPP as a transmission-owner member. MISO covers, among other areas, approximately the eastern two-thirds of Arkansas. SPP covers, among other areas, the western one-third of Arkansas. Both RTOs operate wholesale energy markets, in day-ahead and real-time, and are responsible for moving electricity over large interstate areas. They also coordinate, control and monitor the electricity transmission grid within their respective areas.

As a result, AECC offers its plant generation into the respective RTO markets and simultaneously purchases the energy to serve its load from the same, respective RTO markets. Transactions within each individual hour are netted to a single purchase or sale, within each individual market (MISO and SPP) based on the actual load and net megawatt hour generation.

Reclassifications

Certain reclassifications have been made to the 2018 and 2017 statements of operations to conform to the 2019 financial statement presentation. These reclassifications had no effect on net margins.

Note 2: Power Plants

AECC has an ownership interest in and is responsible for providing its share of the costs for wholly owned or jointly owned facilities in Arkansas, with the corresponding direct expenses included in the statements of operations as operating expenses. AECC also has long term purchase power/capacity agreements with other utilities. AECC's generation mix based on installed capacity reported in megawatts (MW) as of October 31, 2019, is as follows:

Generating Resources	Current Installed Capacity (MW) (Unaudited)
Fossil Steam	1,740
Hydroelectric	167
Combined Cycle	1,373
Simple Cycle	213
Purchase Power Agreements	733
Other	60
Total	4,286

Under a power purchase agreement with Southwestern Power Administration (SWPA), which expires June 30, 2020, AECC has the right to purchase, except in certain circumstances, up to 189 MW of power and associated energy from SWPA. AECC can draw power and energy under this contract for up to 200 hours a month, but not more than 600 hours in any four consecutive months and not more than 1,200 hours over a contract year (July 1–June 30).

In March 2012, AECC entered into a power purchase agreement with BP Wind Energy North America, Inc., to purchase the net output from a wind-powered generating facility for a fixed price. Effective June 13, 2012, this agreement was assigned to Flat Ridge 2 Wind Energy, LLC. The facility has 51 MW of installed capacity and became operational on December 26, 2012. The agreement is for a 20-year term.

AECC entered into a power purchase agreement on July 17, 2013, with Origin Wind Energy, LLC, to purchase the net output from a wind-powered generating facility for a fixed price. The facility has 150 MW of installed capacity and began commercial operation on November 24, 2014. The agreement is for a 20-year term.

AECC entered into a power purchase agreement with Drift Sand Project, LLC, on May 15, 2015, to purchase the net output from a wind-powered generating facility for a fixed price. The facility has 108 MW of installed capacity and began commercial operation on December 14, 2016. The agreement is for a 20-year term.

AECC entered into a power purchase agreement on November 9, 2015, with Enel Kansas, LLC, to purchase the net output from a wind-powered generating facility for a fixed price. Effective September 28, 2016, this agreement was assigned to Chisholm View Wind Project II, LLC. The facility has 64.8 MW of installed capacity and began commercial operation on December 21, 2016. The agreement is for a 25-year term.

On April 18, 2016, AECC extended an existing agreement originally dated September 9, 2011, with Eastman Cogeneration, L.P., for the purchase of 170 MW of unit capacity and associated energy from a gas-fired plant in Texas. The amendment extended the delivery period by five years with a new ending date of May 31, 2025.

AECC entered into a power purchase agreement on January 27, 2017, with Wildhorse Wind Energy, LLC, to purchase the net output from a wind-powered generating facility for a fixed price. The facility has 100 MW of installed capacity and began commercial operation on December 26, 2019. The agreement is for a 20-year term.

AECC entered into a power purchase agreement on January 16, 2018, with Crossett Solar Energy, LLC, to purchase the net output from a solar-powered generating facility for a fixed price. The facility is expected to have 100 MW of installed capacity and to begin commercial operation by December 2022. The agreement is for a 17-year term.

The above power purchase agreements have been determined to be derivatives under ASC 815, and qualify for the normal purchase, normal sales exception under the same guidance.

Note 3: Investments

Subordinated term certificates were purchased in connection with the issuance of the National Rural Utilities Cooperative Finance Corporation (CFC) Guaranteed Pollution Control Revenue Bonds. These amounts are recorded in the accompanying balance sheets as part of long-term investments—other, and totaled $6.7 million at October 31, 2019 and 2018. In accordance with ASC 320, *Investments: Debt and Equity Securities*, these investments have been classified as held to maturity and, accordingly, are recorded at amortized cost. These investments have maturity dates which extend through 2080.

AECC has a leasehold interest in the revenue stream of certain gas wells. AECC is accounting for its mineral interests using the successful efforts method of accounting and the mineral interests are being depleted on a field-by-field basis using the unit-of-production method based on estimated proven reserves. As of October 31, 2019 and 2018, AECC's leasehold interests in the gas reserves totaled approximately $11.1 million and $11.6 million, respectively. The net interest received less the depletion of the gas reserves resulted in losses of $0.8 million, $0.6 million and $0.6 million for the years ended October 31, 2019, 2018 and 2017, respectively.

AECC evaluates the recoverability of assets by comparing the carrying amount of the relevant asset group against the related, estimated undiscounted future cash flows expected over the remaining useful life of the asset group. When an evaluation indicates that the future undiscounted cash flows are not sufficient to recover the carrying value of the asset group, the carrying value of the asset group would be reduced to its estimated fair value. AECC completed an impairment review as of October 31, 2019, related to its leasehold interest in the gas reserves and concluded that the gas reserves were not impaired.

Note 4: Patronage Capital

Patronage allocations are based on an amount not less than the fiscal year's taxable income for federal income tax purposes. Patronage allocations are assigned to patrons' accounts as credits on a patronage basis. Using this allocation method, $10.5 million and $18.7 million of patronage capital was allocated for the years ended October 31, 2019 and 2018, respectively.

Patronage retirements are restricted by the *Indenture of Mortgage, Security and Financing Statement* dated as of June 1, 2009, as amended, made by AECC, as grantor, to Regions Bank, as trustee, as supplemented (the Indenture). The Indenture prohibits AECC from making any distribution of patronage capital to its members if, at the time of the distribution or immediately following the distribution, (i) an event of default exists or (ii) AECC's aggregate margins and equities at the end of the most recent fiscal quarter would be less than 20% of its total long-term debt and equities. AECC may, however, distribute up to the lesser of 5% of its aggregate margins and equities as of the end of the immediate preceding fiscal year, or 25% of its prior year's margins.

During the years ended October 31, 2019, 2018, and 2017, the Board authorized patronage retirements of approximately $20.0 million, $20.0 million, and $20.1 million, respectively.

Note 5: Other Equities

Other equities include proceeds of approximately $43.2 million from the sale of tax benefits in 1982 under the *Economic Recovery Tax Act of 1981*—net of applicable expenses. The tax benefits sold were the depreciation and tax credits applicable to the Independence Steam Electric Station Unit No. 1 (Independence 1) boiler and turbine, coal handling equipment, and certain common and related items having a cost of approximately $113.6 million.

The other equities balance also includes $75.6 million of income related to the amortization of the deferred gain resulting from the Independence 2 sale and leaseback transaction. In accordance with ASC 980, due to rate-making treatment, the gain from this sale was recognized for financial reporting purposes over the lease term until June 27, 2003, when AECC purchased the Independence 2 lease residual resulting in the operating lease being reclassified as a capital lease. On December 16, 2009, AECC entered into a purchase and sale agreement to buy out the Independence 2 leased assets. On December 30, 2009, closing of the transaction, the Independence 2 lease was terminated and now AECC owns a 35.0% undivided interest in Independence 2 (see *Note 9*).

Note 6: Long-Term Debt

Long-term debt as of October 31, 2019 and 2018, consisted of the following (in thousands):

	2019	2018
Mortgage notes payable to Federal Financing Bank (FFB) at varying interest rates from 2.111% to 5.868%, due in quarterly installments through December 2041	$ 646,861	$ 601,056
Series 2011A First Mortgage Obligation Senior Notes payable at an annual interest rate of 4.71%, due in semiannual installments through December 2030	62,000	65,000
Series 2011B First Mortgage Obligation Senior Notes payable at an annual interest rate of 5.62%, due in semiannual installments beginning December 2031 through December 2041	120,000	120,000
CoBank ACB (CoBank) notes payable at an annual interest rate of 3.59%, due in quarterly installments through October 2036	46,439	49,170
CoBank unsecured notes payable at an annual interest rate of 2.62%, due in quarterly installments through March 2023	5,550	7,052
Total debt	880,850	842,278
Current maturities of long-term debt	31,422	29,123
Total long-term debt less current maturities	$ 849,428	$ 813,155

The estimated maturities of long-term debt for each of the next five years ending October 31, and in the aggregate thereafter are as follows (in thousands):

	2020	2021	2022	2023	2024	Thereafter	Total
FFB	$ 23,648	$ 24,406	$ 25,145	$ 25,835	26,804	$ 521,023	$ 646,861
CoBank	2,732	2,732	2,732	2,732	2,732	32,779	46,439
CoBank – unsecured	1,542	1,584	1,626	798	-	-	5,550
Series 2011A	3,500	4,000	4,000	4,500	5,000	41,000	62,000
Series 2011B	-	-	-	-	-	120,000	120,000
Total	$ 31,422	$ 32,722	$ 33,503	$ 33,865	$ 34,536	$ 714,802	$ 880,850

All long-term debt, with the exception of the above disclosed CoBank unsecured debt, is secured equally and ratably by a first priority lien on substantially all of the owned tangible and certain of the intangible assets of AECC, subject to certain exceptions and limitations. Under the terms of AECC's Indenture, substantially all of the after-acquired assets of AECC become subject to the lien of the Indenture. Also, under the terms of the Indenture, the RUS loan contract and other loan agreements, AECC must maintain certain financial covenants. AECC was in compliance with these financial covenants at October 31, 2019.

AECC entered into a long-term loan agreement with CoBank on December 9, 2009, in the amount of $122.0 million for the purpose of funding the lease buyout and purchase of Independence 2. The original loan had a maturity date of January 20, 2020; however, it was refinanced on July 14, 2016, at a lower interest rate with a new maturity date of October 20, 2036. AECC incurred a refinance premium in the amount of $2.5 million as a result of the refinancing. As of October 31, 2019 and 2018, $46.4 million and $49.2 million, respectively, was outstanding to CoBank. On April 23, 2013, AECC entered into an unsecured long-term loan agreement with CoBank in the amount of $14.7 million for the purpose of funding certain pension plan prepayments (see *Note 11*). The loan has a maturity date of March 30, 2023. As of October 31, 2019 and 2018, $5.5 million and $7.1 million, respectively, was outstanding to CoBank – Unsecured.

AECC entered into a long-term loan agreement on December 8, 2010, with RUS on the FFB S-8 loan. AECC received $140.7 million in loan funds on November 27, 2018, as the final advance from this loan which brought the total amount borrowed against this loan to $414.5 million. The final advance on this loan has an interest rate of 3.129% and a maturity date of December 31, 2040.

AECC completed a private placement debt issuance on February 22, 2011, by issuing $200.0 million in First Mortgage Obligation Senior Notes. The debt issuance involved two tranches, with outstanding amounts of $62.0 million and $65.0 million at October 31, 2019 and 2018, respectively, in Series 2011A Notes, due December 30, 2030, at a coupon rate of 4.71% and $120.0 million in Series 2011B Notes, due December 30, 2041, at a coupon rate of 5.62%.

Note 7: Notes Payable

AECC maintains a $75.0 million perpetual line of credit with CFC, which bears interest at a rate of 1.0% above the prime rate or such lesser total rate per annum as may be fixed by CFC. During each 12-month period, the balance on this line of credit shall be reduced to zero for at least five consecutive business days, and AECC shall make the first balance reduction within 360 days of the first advance. AECC also has a $10.0 million committed line of credit with CoBank through September 6, 2020, which bears interest at 1.20% over the 30-day London InterBank Offered Rate (LIBOR). AECC has a $10.0 million uncommitted line of credit with Regions Bank through November 2, 2020, which bears interest at 0.85% over the 30-day LIBOR. No amounts were outstanding under these lines of credits during the fiscal years 2019 and 2018.

AECC has signed related-party master promissory notes with all of its Members. These notes allow Members to advance AECC funds with such advances payable upon demand. When needed, AECC may use such advances for its own operating requirements and, when it does, AECC recognizes interest as a component of interest expense in the statements of operations.

However, when AECC is in a financial position such that it does not require these advances for operations, Members may continue to advance funds to AECC for investment purposes, in which case, AECC recognizes the interest expense in interest income—net, in the statements of operations. AECC collectively invests such funds, along with AECC's general funds, and pays its Members an interest rate comparable to the monthly average rate earned on the combined investments. AECC invests these funds in U.S. Treasury notes, bills and bonds, other U.S. government agency securities, and various other debt securities, such as corporate notes, bonds, and commercial paper.

As of October 31, 2019 and 2018, Members' advances to AECC totaled approximately $133.3 million and $116.5 million, respectively. As of October 31, 2019 and 2018, the variable interest rate on the notes payable was 2.14% and 2.54%, respectively.

Total interest expense related to the Members' advances for the years ended October 31, 2019, 2018 and 2017, was as follows (in thousands):

	2019	2018	2017
Operating interest, included in interest expense	$ 668	$ 1,587	$ 908
Nonoperating interest, included in interest income – net	2,352	1,085	778
Total interest expense	$ 3,020	$ 2,672	$ 1,686

With its Board and APSC approval, AECC entered into a five-year $250.0 million senior unsecured revolving credit agreement on December 21, 2015, with a syndication of financial institutions. This agreement has a maturity date of December 21, 2020. This $250.0 million credit facility is used to support AECC's commercial paper program, for general purposes and for the issuance of letters of credit. There was no outstanding balance on this credit agreement as of October 31, 2019 and 2018.

AECC has agreements with Goldman Sachs and Wells Fargo Securities, LLC to act as dealers for commercial paper notes issued by AECC. As of October 31, 2019, $30.0 million of commercial paper notes were outstanding at rate of 1.90% and with a maturity of 2 days. As of October 31, 2018, $77.7 million of commercial paper notes were outstanding at rates varying from 2.25% to 2.50% and with maturities varying from 2 to 91 days.

AECC has a 3.57% promissory note with Arkansas Electric Cooperatives, Inc. (AECI) for $30.0 million with a maturity date of December 31, 2019. A new promissory note with AECI was executed to replace this expiring promissory note (see *Note 15*).

Note 8: Fuel Supply and Transmission Agreements

AECC pays Entergy Arkansas, LLC (Entergy), in accordance with provisions of joint operating agreements, for its 35% interest in the coal stockpiles at the White Bluff Steam Electric Station (White Bluff) and Independence generating plants. Entergy retains all ownership rights to the coal. AECC makes monthly payments to Entergy to maintain the stockpiles. These payments are classified as prepaid fuel supply in the accompanying balance sheets.

AECC also has a joint operating agreement with American Electric Power's Southwestern Electric Power Company (SWEPCO), in connection with its 50% interest of the Flint Creek generating station and 11.667% interest in the John W. Turk, Jr. Power Plant, whereby AECC pays for its share of the fuel consumed at those stations.

AECC owns approximately 360 miles of transmission lines, but relies primarily on the transmission facilities of Entergy, SWEPCO, Oklahoma Gas & Electric, and SWPA to deliver electricity to the members pursuant to FERC approved tariffs.

Note 9: Rental and Lease Commitments

Independence 2

Pursuant to the terms of a sale-leaseback agreement dated December 4, 1984, AECC sold and leased back for 35 years its 35% undivided interest in Independence 2. On June 27, 2003, AECC repurchased its future ownership interest in the leased Independence 2 assets effective December 31, 2019.

As a result of this transaction, the operating lease was reclassified as a capital lease and an associated regulatory asset was created. The balance of this regulatory-created asset was $2.5 million and $17.1 million as of October 31, 2019 and 2018, respectively.

AECC executed a purchase and sale agreement on November 23, 2009, with General Electric Capital Corporation (GECC) to purchase the entire beneficial interest that GECC retained in the Independence 2 leased assets (the Transaction). On December 16, 2009, the APSC entered an order that the Transaction was in the public interest and approved the Transaction. The Transaction closed on December 30, 2009, with a purchase price of $122.2 million (see *Note 6*).

AECC negotiated with a lender for a 10-year term loan for approximately $122.0 million in order to fund the lease buyout and purchase of Independence 2 (see *Note 6*). As a result of this buyout transaction, the Independence 2 finance obligation of approximately $115.4 million was effectively refinanced with the new $122.0 million loan with CoBank. Upon the closing of the Transaction, the Independence 2 lease terminated and AECC now owns a 35.0% undivided interest in Independence 2.

Related expenses were $15.3 million for each of the years ended October 31, 2019, 2018 and 2017. These expenses include depreciation expense of approximately $0.1 million, $0.1 million, and $3.7 million for each of the years ended October 31, 2019, 2018 and 2017, respectively. In addition, interest expense was approximately $0.5 million, $1.2 million, and $2.0 million for the years ended October 31, 2019, 2018 and 2017, respectively. Amortization expense on the regulatory-created asset was approximately $14.7 million, $14.0 million and $9.6 million for the years ended October 31, 2019, 2018 and 2017, respectively.

Ellis

AECC sold and leased back its interest in Ellis on December 19, 1988. As a result of the sale and leaseback, under the provisions of ASC 840, *Leases*, this transaction was accounted for as a long-term finance obligation. This lease was treated as an operating lease for rate-making purposes. In accordance with ASC 980, the timing of expense recognition was modified during the lease term to conform to rate treatment.

AECC executed an agreement of sale and purchase on November 30, 2011, with The Bank of New York Mellon as owner trustee, to purchase the Ellis leased assets and the entire beneficial interest that the owner trustee retained in the leased assets for $35.6 million (the Lease Buyout). On December 20, 2011, the purchase closed with the purchase price being funded by AECC's use of general funds in the amount of $25.6 million and $10.0 million of trust funds. Upon closing, the Ellis lease and trust agreement terminated.

As a result of the Lease Buyout, $25.9 million was accounted for as a deferred regulatory asset and is being amortized straight line over the remaining FERC license life for Ellis through 2033. As of October 31, 2019 and 2018, this regulatory asset had a balance of $16.7 million and $17.8 million, respectively. Upon the lease buyout the remaining unamortized regulatory and other deferred costs were $5.5 million which are also being amortized straight line through 2033. As of October 31, 2019 and 2018, the remaining unamortized costs related to the sales and leaseback transaction and the Lease Buyout transaction were $3.5 million and $3.8 million, respectively. The ASPC and RUS approved the Lease Buyout transaction.

Related expenses, including the effect of the Lease Buyout and legal defeasance, were $2.9 million, for each of the years ended October 31, 2019, 2018 and 2017. These expenses include depreciation expense of approximately $1.5 million for each of the years ended October 31, 2019, 2018 and 2017. Amortization of regulatory and other deferred costs was approximately $1.4 million for each of the years ended October 31, 2019, 2018 and 2017.

Note 10: Income Taxes

In December 1982, AECC elected to revoke its tax-exempt status for federal income tax purposes. For state income tax purposes, AECC operates as a tax-exempt Cooperative under Arkansas statute. No amounts were expensed for income taxes for the years ended October 31, 2019, 2018 and 2017.

The differences between the statutory federal income tax rate on income before income taxes and AECC's effective tax rate are summarized as follows (in thousands):

	2019	Percent	2018	Percent	2017	Percent
Statutory federal income	$ 5,185	21.0 %	$ 8,176	21.0 %	$ 13,296	35.0 %
Nontaxable member income	(5,185)	(21.0)	(8,176)	(21.0)	(13,296)	(35.0)
Tax credit carryforwards not benefited	-	0%	-	0%	-	0%
Effective income tax rate	$ -	0%	$ -	0%	$ -	0%

The components of the net deferred tax asset as of October 31, 2019 and 2018, were as follows (in thousands):

	2019	2018
Deferred tax assets:		
Patronage exclusions available	$ 73,468	$ 72,723
Alternative minimum tax (AMT) credit carryforwards	2,527	2,533
Other	4,308	3,975
	80,303	79,231
Valuation allowance	-	(2,533)
	80,303	76,698
Deferred tax liabilities:		
Utility plant	(58,847)	(57,984)
Safe harbor lease	(18,172)	(18,172)
Other	(757)	(542)
	(77,776)	(76,698)
Net deferred tax asset	$ 2,527	$ -

As of October 31, 2019, AECC had an AMT credit carryforward of approximately $2.5 million. Based on AECC's historical transactions resulting in nonmember losses and the patronage provisions of its bylaws, AECC does not anticipate any future taxable income sufficient to realize the benefit of the tax credits existing as of October 31, 2019. As of October 31, 2018, AECC had a valuation allowance for these credits. During 2019, AECC reduced the valuation allowance to zero. AECC has net operating loss carryforwards of approximately $140.5 million, which expire in 2020, and thereafter.

On December 22, 2017, the United States enacted tax reform legislation through the Tax Cuts and Jobs Act (TCJA), which significantly changed the existing U.S. tax laws, including a reduction in the corporate tax rate from 35% to 21%. As a result of this tax act, AECC does not expect to see any change in its income tax expense. Due to the TCJA, AECC will be able to start realizing the AMT credits in cash and will no longer have a valuation allowance for the AMT credits. AECC will be able to claim 50% of the refundable AMT credit carryforward on the 2019 tax return with the remainder being allowed in future years. The AMT refund is classified on the balance sheet in Other Current Assets and Deferred Charges.

Note 11: Employee Benefits

The National Rural Electric Cooperative Association (NRECA) Retirement Security Plan (RS Plan) is a defined benefit pension plan qualified under Section 401 and is tax-exempt under Section 501(a) of the Internal Revenue Code.

It is considered a master multiple employer plan under the accounting standards. The RS Plan sponsor's Employer Identification Number is 53-0116145 and the RS Plan Number is 333.

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

AECC's contributions to the RS Plan in 2019, 2018 and 2017, represented less than 5% of the total contributions made to the RS Plan by all participating employers. AECC made contributions to the RS Plan of $6.6 million, $6.4 million and $5.8 million for the years ended October 31, 2019, 2018 and 2017, respectively.

For the RS Plan, a "zone status" determination is not required, and therefore not determined, under the *Pension Protection Act of 2006* (PPA). In addition, the accumulated benefit obligations and plan assets are not determined or allocated separately by individual employer. In total, the RS Plan was over 80% funded on January 1, 2019 and 2018, based on the PPA funding target and PPA actuarial value of assets on those dates.

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

At the December 2012 meeting of the Insurance and Financial Services Committee of the NRECA Board of Directors (Committee), the Committee approved an option to allow participating cooperatives in the RS Plan to make a contribution prepayment and reduce future required contributions. The prepayment amount is AECC's share, as of January 1, 2013, of future contributions required to fund the RS Plan's unfunded value of benefits earned to date using RS Plan actuarial valuation assumptions.

The prepayment amount will typically equal approximately 2.5 times a cooperative's annual RS Plan required contribution as of January 1, 2013. After making the prepayment, 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 3, 2013, the Board approved a prepayment of $14.7 million to the RS Plan. AECC is amortizing this amount over ten years as approved by the RUS. As of October 31, 2019 and 2018, the balance of the prepayment was $4.6 million and $6.1 million, respectively.

AECC also has a defined contribution plan for eligible employees, for which contributions are determined annually. Additionally, AECC contributes a portion of the premiums related to medical insurance for eligible employees.

AECC has deferred compensation agreements with certain employees that provide benefits upon death, disability, at age 65 and retired, or retirement. The present value of total estimated deferred compensation is being accrued over the remaining years to the full eligibility date. Contributions to the plans were $0.1 million for the year ended October 31, 2019 and $0.2 million for the years ended October 31, 2018 and 2017.

AECC has acquired certain assets, principally life insurance policies and mutual fund shares, to provide benefits under the deferred compensation agreements. As of October 31, 2019 and 2018, AECC had accrued deferred compensation liabilities of $9.7 million, which are reflected in deferred credits in the accompanying balance sheets.

In addition, as of October 31, 2019 and 2018, AECC had $13.5 million and $13.4 million, respectively, related to life insurance policies and mutual fund shares to fund the deferred compensation plans, which are reflected in other long-term investments in the accompanying balance sheets. Total benefit costs were approximately $12.4 million, $12.0 million, and $11.2 million for the years ended October 31, 2019, 2018 and 2017, respectively.

In accordance with ASC 715, *Compensation—Retirement Benefits*, AECC is required to record the funded status of the postretirement health care plans. On December 31, 2016, AECC froze its plan to new retirees. The current retirees active in the plan were allowed to remain in the plan until December 31, 2017, at which time, the plan terminated.

Note 12: Related-Party Transactions

AECC and AECI have limited staff who provide shared services to one another and certain members of the Board also serve on each board. AECI, among other things, is engaged, via subsidiaries, in the construction and maintenance of electrical substations and transmission facilities, the marketing of new pole-mount and pad-mount transformers and pole-line hardware as well as the construction and maintenance of utility-scale solar projects. Under a contractual agreement, AECC and AECI allocate the costs between them for certain facilities and shared services. Separate accounting records and related information are maintained for each cooperative. AECC had patronage allocations outstanding from AECI in the amount of $1.1 million and $1.0 million at October 31, 2019 and 2018, respectively.

AECI pays AECC monthly rent for use of the general office facilities and other expenses. The total amounts paid to AECC for the years ended October 31, 2019, 2018 and 2017, were approximately $6.2 million, $6.0 million and $4.4 million, respectively. AECI owed AECC approximately $0.5 million and $0.6 million at October 31, 2019 and 2018, respectively, related to the reimbursement of these expenses.

AECC has a $30.0 million promissory note with AECI, with an interest rate of 3.57%, as of October 31, 2019 and 2018, and is reflected as notes payable – related party (*see Note 7*). Interest expense paid to AECI for each of the years ended October 31, 2019, 2018 and 2017 was $1.1 million. Interest payable to AECI at October 31, 2019 and 2018 was $0.1 million.

AECI personnel provide various services for AECC. The amounts incurred by AECC for its allocable share of certain AECI personnel's salaries and reimbursement of expenses were approximately $0.9 million, $1.1 million and $1.2 million for the years ended October 31, 2019, 2018 and 2017, respectively. The amounts incurred by AECC for purchases of supplies and services, and right-of-way clearing and construction were approximately $11.0 million, $5.8 million and $6.6 million for the years ended October 31, 2019, 2018 and 2017, respectively. As of October 31, 2019 and 2018, AECC owed AECI approximately $1.1 million and $0.7 million, respectively, for materials and services.

Note 13: Commitments and Contingencies

AECC is not a party to any pending legal proceedings that management believes are material to its financial condition, results of its operations, or cash flows. AECC maintains liability insurance against risks, subject to certain self-insurance limits, arising out of the normal course of its business.

AECC purchased a leasehold interest in Magnet Cove on September 10, 2012. At that time, AECC also purchased the Hot Spring Power Company, LLC interest in a long-term warranty agreement with Siemens and executed a new agreement (the Agreement) between AECC and Siemens. The Agreement calls for quarterly payments to Siemens based on, among other items, the number of hours that Magnet Cove runs during a quarter.

The Agreement covers, among other items, regularly scheduled maintenance and replacement costs related to the 501G Combustion Turbine replacements at regularly scheduled intervals during the life of the Agreement. At October 31, 2019 and 2018, a balance of $5.1 million and $5.2 million, respectively, was included in deferred charges on AECC's balance sheets.

As of October 31, 2019, contractual commitments have been entered into for construction totaling approximately $57.6 million related to capital improvements estimated for 2020 at AECC's jointly owned coal-fired power plants.

Projects to install flue gas desulfurization equipment (scrubber) with a baghouse and activated carbon injection (ACI) equipment at Flint Creek are complete. This equipment became operational on June 12, 2016 and has been operating as designed and in compliance with its permit. ACI equipment has been installed and is currently in operation on the four units at White Bluff and Independence. This equipment allows each plant to achieve compliance with the Utility Mercury and Air Toxics Standard (MATS), and in the case of Flint Creek, compliance with the current Regional Haze Rule (RHR)[1] requirements[2].

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[1] The RHR is a federal rule that protects visibility in Class I areas.
[2] The scrubber at Flint Creek is required by the RHR State Implementation Plan.

In 2017 and 2018, Low-NOx burners with separated overfire air (LNB/SOFA) were installed on both White Bluff units, both Independence units, and the Flint Creek unit for compliance with RHR requirements. LNB/SOFA also helps to comply with the Cross-State Air Pollution Rule Update (CSAPRU). In 2015, the federal Environmental Protection Agency (EPA) finalized the Clean Power Plan (CPP) – a rule focused on reducing CO2 emissions from the electric power industry. The CPP was replaced by the Affordable Clean Energy (ACE) Rule in 2019. ACE focuses on CO2 emission reductions from coal-fired units by implementing heat rate improvements (HRIs). Entergy and SWEPCO are currently determining if HRIs can be implemented at White Bluff, Independence, Flint Creek, and Turk in order to comply with the ACE Rule.

The National Ambient Air Quality Standard (NAAQS) for ozone were updated in 2015. There are no areas in Arkansas that are in non-attainment with the new NAAQS ozone standards, and AECC expects Arkansas will remain in compliance as Arkansas' air quality continues to improve.

The Coal Combustion Residuals (CCR) rule and the updated effluent limitation guidelines (ELG) for steam electric generating stations were issued in 2015. These two rules are expected to have the largest financial impacts to the AECC co-owned coal units over the next few years. Below are details regarding what changes will be made at each co-owned facility in order to comply with these two rules.

- White Bluff and Independence: For ELG compliance, dry bottom ash conversion and conveyance system will be implemented at both plants. These new systems are expected to be operational by the fall of 2020. For CCR rule compliance, two recycling ponds at each plant will no longer be used. It is anticipated that all ponds no longer in use at White Bluff and ISES will meet closure requirements specified by CCR.

- Flint Creek: A similar bottom ash system will be installed at Flint Creek for ELG compliance. The system is not expected to be commissioned until 2023. Flint Creek has a bottom ash pond, which will no longer be used as an ash pond upon completion of the new dry bottom ash conversion and conveyances system, as per the CCR Rule.

- Turk: Turk was constructed with future CCR and ELG Rule compliance in mind. No changes are needed at Turk to comply with these rules.

In October 2016, the EPA finalized the CSAPRU which addresses interstate transport of nitrogen oxide and sulfur dioxide. CSAPRU requires AECC to procure allowances to cover its emissions of nitrogen oxides (NOx) during the ozone season (May 1 to September 30). The final CSAPRU reduced Arkansas' current emission allowance allocation by 20% beginning in 2017 and another 19% in 2018 and beyond.

LNB/SOFA have been installed at Flint Creek, White Bluff Units 1 and 2, and Independence Units 1 and 2. Both technologies lower NOx emissions. AECC does not anticipate issues with complying with CSAPRU going forward due to the reduction in NOx emissions from the LNB/SOFA installations.

In September 2019, EPA approved Arkansas Department of Environmental Quality's (ADEQ) final Regional Haze Phase II State Implementation Plan (SIP). The SIP requires that an SO2 scrubber be installed at Flint Creek (which is already in service) and that Entergy does not have to install scrubbers on Units 1 and 2 at White Bluff if Entergy agrees to cease burning coal at White Bluff by December 31, 2028. There are no capital improvement requirements for other AECC owned units in the SIP.

AECC's current estimate, based on certain plans and cost estimates provided by Entergy and SWEPCO, for its total ownership share of environmental compliance upgrades is approximately $33.9 million.

Note 14: Significant Customers

Sales to members amounted to 91% of operating revenues for the year ended October 31, 2019 and 92% for each of the years ended October 31, 2018 and 2017. For the years ended October 31, 2019, 2018 and 2017, AECC had the following members that accounted for more than 10% of operating revenues (in thousands):

	2019		2018		2017	
Customer	Amount	%	Amount	%	Amount	%
Mississippi County Electric Cooperative, Inc.	$ 149,431	18.9 %	$ 158,639	19.2 %	$ 150,990	19.0 %
Carroll Electric Cooperative Corporation	112,860	14.3	115,233	13.9	111,080	14.0
First Electric Cooperative Corporation	109,299	13.8	114,154	13.9	110,716	13.9

Note 15: Subsequent Events

AECC has evaluated events or transactions through February 4, 2020, in conjunction with the preparation of these financial statements.

AECC's Board authorized a patronage retirement on November 6, 2019, to be paid on December 13, 2019, in the amount of $20.0 million.

Effective December 31, 2019, AECC executed a new 3.57% promissory note in the amount of $30.0 million with AECI with a maturity date of March 31, 2020.

Supplemental Schedules

Arkansas Electric Cooperative Corporation

Schedule of Deferred Debits and Deferred Credits

October 31, 2019

(In Thousands)

Deferred Charges		
Deferred pension costs	$	3,344
Miscellaneous deferred debits		11,095
Purchase of residual and ISES 2 lease		2,462
Unamortized loss on debt issuance		23,359
Total Deferred Charges	$	40,260
Deferred Credits		
Accumulated provision for pension and benefits	$	15,028
Asset retirement obligations		9,873
Miscellaneous deferred credits		1,196
Total Deferred Credits	$	26,097

Arkansas Electric Cooperative Corporation
Schedule of Investments
October 31, 2019
(In Thousands)

Related Party Investments – Investment in AECI	$	1,056
Total	$	1,056

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Report 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*

Independent Auditor's Report

Board of Directors
Arkansas Electric Cooperative Corporation
Little Rock, Arkansas

We have audited, 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, the financial statements of Arkansas Electric Cooperative Corporation (AECC), which comprise the balance sheet as of October 31, 2019, and the related statements of operations, members' equities and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated February 4, 2020.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered AECC'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 financial statements, but not for the purpose of expressing an opinion on the effectiveness of AECC's internal control. Accordingly, we do not express an opinion on the effectiveness of AECC'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 AECC's 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 AECC's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering AECC's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

BKD, LLP

Little Rock, Arkansas
February 4, 2020