

PRESQUE ISLE ELECTRIC & GAS CO-OP
REPORT ON CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2018 AND 2017

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**PRESQUE ISLE ELECTRIC & GAS CO-OP
BOARD OF DIRECTORS
DECEMBER 31, 2018**

John Brown	Chairperson
Allan Berg	Vice Chairperson
Sandra Borowicz	Secretary
Charles Arbour	Treasurer
Kurt Krajniak	Director
Raymond Wozniak	Director
Sally Knopf	Director
Daryl Peterson	Director
Brentt Lucas	Director

President & Chief Executive Officer

Tom Sobeck



Independent Auditor's Report

The Board of Directors
Presque Isle Electric & Gas Co-op
Onaway, Michigan

We have audited the accompanying consolidated financial statements of Presque Isle Electric & Gas Co-op (the Co-op) and subsidiary, as of December 31, 2018 and 2017, which comprises the balance sheet, related statements of income, retained earnings, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 risk 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Presque Isle Electric & Gas Co-op as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, in 2018 the Co-op acquired Presque Isle Aurora Gas Assets, Inc., a wholly-owned subsidiary.

Harris Group CPA's

Traverse City, Michigan
March 5, 2019

731 S. Garfield Ave., Traverse City, MI 49686 tel. 231-946-8930 fax. 231-946-1377
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**PRESQUE ISLE ELECTRIC & GAS CO-OP
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2018 AND 2017**

	2018	2017
ASSETS		
UTILITY PLANT:		
In-Service – at cost	\$ 158,392,302	\$ 140,239,665
Construction work in progress	1,014,201	32,344
SUBTOTAL	159,406,503	140,272,009
Less accumulated depreciation and amortization	70,648,602	63,737,119
NET UTILITY PLANT	88,757,901	76,534,890
OTHER ASSETS AND INVESTMENTS		
Investments in associated organizations	24,621,871	24,644,319
CURRENT ASSETS:		
Cash and temporary cash investments	2,964,539	2,971,080
Accounts Receivable, less allowance for possible losses of \$121,000 in 2018 and \$118,000 in 2017.	4,498,418	4,648,383
Materials and supplies (at average cost)	1,945,684	1,460,638
Other current assets	373,934	347,401
TOTAL CURRENT ASSETS	9,782,575	9,427,502
DEFERRED DEBITS	341,403	236,795
TOTAL ASSETS	\$ 123,503,750	\$ 110,843,506

The accompanying notes are an integral part of these statements.

	<u>2018</u>	<u>2017</u>
EQUITIES AND LIABILITIES		
EQUITIES:		
Memberships	\$ 285,265	\$ 276,930
Patronage capital	50,329,692	50,165,119
Other equities	<u>3,612,994</u>	<u>2,836,466</u>
TOTAL EQUITIES	<u>54,227,951</u>	<u>53,278,515</u>
LONG-TERM DEBT, NET OF CURRENT MATURITIES:		
Mortgage notes to National Rural Utilities Cooperative Finance Corporation (CFC)	58,272,209	48,874,610
Accrued post – retirement benefits	<u>1,216,061</u>	<u>1,274,093</u>
TOTAL LONG-TERM DEBT	<u>59,488,270</u>	<u>50,148,703</u>
CURRENT LIABILITIES:		
Current maturities of long-term debt	2,010,000	1,731,000
Line of credit	2,500,000	-
Accounts payable, purchased energy	2,298,895	2,471,023
Accounts payable, other	456,740	847,569
Patronage capital payable	26,784	20,661
Customer deposits	596,468	544,851
Accrued property taxes	550,280	521,015
Accrued interest	293,986	259,442
Accrued sick and vacation pay	564,781	575,134
Accrued other	<u>489,595</u>	<u>416,349</u>
TOTAL CURRENT LIABILITIES	<u>9,787,529</u>	<u>7,387,044</u>
DEFERRED CREDITS	<u>-</u>	<u>29,244</u>
TOTAL EQUITIES AND LIABILITIES	<u>\$ 123,503,750</u>	<u>\$ 110,843,506</u>

**PRESQUE ISLE ELECTRIC & GAS CO-OP
CONSOLIDATED STATEMENTS OF REVENUE
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017**

	2018	2017
OPERATING REVENUES	\$ 46,046,735	\$ 42,909,614
OPERATING EXPENSES:		
Cost of energy	25,020,082	24,003,855
Distribution – operation	2,096,353	1,678,316
Distribution – maintenance	4,368,302	3,841,955
Consumers accounts	2,180,561	1,781,925
Customer service and information expense	874,923	832,042
Administrative and general	2,087,233	1,871,995
Depreciation and amortization	4,445,463	3,748,845
Taxes – property	1,179,823	1,136,847
Taxes – other	1,064	1,052
	42,253,804	38,896,832
TOTAL OPERATING EXPENSES		
OPERATING MARGIN BEFORE FIXED CHARGES	3,792,931	4,012,782
FIXED CHARGES:		
Interest	2,717,103	2,464,041
Other deductions	1,000	1,000
	2,718,103	2,465,041
TOTAL FIXED CHARGES		
OPERATING MARGINS AFTER FIXED CHARGES	1,074,828	1,547,741
CAPITAL CREDITS:		
Generation and transmission capital credits	1,486,730	1,340,933
Other capital credits	273,028	271,253
	1,759,758	1,612,186
TOTAL CAPITAL CREDITS		
NET OPERATING MARGINS	2,834,586	3,159,927

The accompanying notes are an integral part of these statements.

PRESQUE ISLE ELECTRIC & GAS CO-OP
CONSOLIDATED STATEMENTS OF REVENUE
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017
(Continued)

	2018	2017
NET OPERATING MARGINS (from previous page)	\$ 2,834,586	\$ 3,159,927
NON-OPERATING MARGINS:		
Interest and dividend income	73,660	74,105
Other expenses	(341,236)	(88,479)
TOTAL NON-OPERATING MARGINS	(267,576)	(14,374)
NET MARGINS	\$ 2,567,010	\$ 3,145,553

The accompanying notes are an integral part of these statements.

PRESQUE ISLE ELECTRIC & GAS CO-OP
CONSOLIDATED STATEMENT OF CHANGES IN PATRONAGE CAPITAL
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

	<u>Memberships</u>	<u>Patronage Capital</u>	<u>Other Equities</u>	<u>Accumulated Other Comprehensive Loss</u>	<u>Total</u>
Balance, January 1, 2017	\$ 268,545	\$ 49,647,759	\$ 2,553,797	\$ (1,319,079)	\$ 51,151,022
Capital credits retired		(2,628,193)			(2,628,193)
Memberships retired	8,385				8,385
Other equity transactions			535,751	1,065,997	1,601,748
Net margin		<u>3,145,553</u>			<u>3,145,553</u>
Balance, December 31, 2017	276,930	50,165,119	3,089,548	(253,082)	53,278,515
Capital credits retired		(2,402,437)			(2,402,437)
Memberships issued (retired)	8,335				8,335
PIAGA acquisition equity			260,647		260,647
Other equity transactions			515,881		515,881
Net margin		<u>2,567,010</u>			<u>2,567,010</u>
Balance, December 31, 2018	<u>\$ 285,265</u>	<u>\$ 50,329,692</u>	<u>\$ 3,866,076</u>	<u>\$ (253,082)</u>	<u>\$ 54,227,951</u>

The accompanying notes are an integral part of these statements.

PRESQUE ISLE ELECTRIC & GAS CO-OP
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from consumers	\$ 46,385,280	\$ 42,955,756
Cash paid to suppliers and employees	(37,120,098)	(34,458,481)
Interest received	73,660	74,105
Interest paid	(2,683,559)	(2,467,575)
Taxes paid	(1,135,593)	(1,103,791)
	<u>5,519,690</u>	<u>5,000,014</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Construction and acquisition of plant & goodwill	(17,140,972)	(4,346,202)
(Increase) decrease in:		
Material inventory	(485,046)	48,257
Investments – associated organizations	1,779,036	1,700,876
	<u>(15,846,982)</u>	<u>(2,597,069)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payment of debt	(1,823,401)	(1,621,675)
Advances of long term debt	11,500,000	-
Advances on line of credit	2,500,000	-
Memberships issued	8,335	8,385
Patronage capital retired	(2,402,437)	(2,628,193)
Adjustment to pension benefit obligation	-	1,065,997
Increased (decrease) in:		
Consumer deposits	51,617	10,904
Deferred credits	(29,244)	(297,651)
Other equities	515,881	535,751
	<u>10,320,751</u>	<u>(2,926,482)</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	(6,541)	(523,537)
CASH AND CASH EQUIVALENTS, beginning of year	2,971,080	3,494,617
CASH AND CASH EQUIVALENTS, end of year	\$ 2,964,539	\$ 2,971,080

The accompanying notes are an integral part of these statements.

PRESQUE ISLE ELECTRIC & GAS CO-OP
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017
(Continued)

	2018	2017
RECONCILIATION OF NET MARGINS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net Margins	\$ 2,567,010	\$ 3,145,553
Adjustments to reconcile net margins to net cash provided by		
Operating activities:		
Depreciation and amortization	4,674,583	3,931,664
(Gain) loss on disposition of assets	507,196	102,117
G&T and other capital credits	(1,759,758)	(1,612,186)
(Increase) decrease in:		
Customer and other accounts receivable	149,965	(2,925)
Other current assets	(26,533)	50,272
Deferred debits	(104,608)	(15,713)
Increase (decrease) in:		
Accounts payable	(545,663)	608,832
Accrued property taxes	18,094	6,678
Accrued interest payable	34,544	(2,534)
Current and accrued liabilities – other	62,892	(48,992)
Accrued post retirement benefits	(58,032)	(1,162,752)
 Total Adjustments	 2,952,680	 1,854,461
 NET CASH PROVIDED BY OPERATING ACTIVITIES	 \$ 5,519,690	 \$ 5,000,014
 NON-CASH ITEMS – INVESTING & FINANCING		
Capital credits from associated organizations	\$ 1,759,758	\$ 1,612,186

The accompanying notes are an integral part of these statements.

PRESQUE ISLE ELECTRIC & GAS CO-OP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of the accounting policies adopted by Presque Isle Electric & Gas Co-op which have a significant effect on the financial statements.

Nature of Operations

Presque Isle Electric & Gas Co-op (Presque Isle) is a member-owned, not-for-profit corporation whose purpose is to provide retail energy services to its members. As a cooperative, all monies in excess of cost of providing electric service are capital, at the moment of receipt, and are credited to each member's capital account.

Presque Isle Aurora Gas Assets (PIAGA) is a wholly-owned subsidiary of Presque Isle Electric & Gas Cooperative (PIE&G), acquired in 2018. PIE&G has a rental agreement with PIAGA for use of building, equipment, and transportation assets. In addition, there is an irrevocable right to use agreement that grants PIE&G access and use of PIAGA natural gas pipelines and related property. In consideration, PIE&G manages, operates and maintains the assets.

Use of Estimates

The process of preparing financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

Utility Plant

Additions, with a life expectancy of more than one year, are recorded at cost, less contributions in aid of construction received from customers. As items are retired or otherwise disposed of, the asset account is credited for the cost and the accumulated depreciation account is charged. The cost of removal, less salvage, is charged to the loss on disposition of utility plant account, and shown on the Statement of Revenue.

Investments

The carrying values of investments in associated organizations are stated at cost, adjusted for capital credits earned or retired. Short-term investments are stated at cost, which approximates market value.

Cash

For purposes of the statement of cash flows, Presque Isle considers all short-term debt securities purchased with a maturity of three months or less to be cash equivalents.

Member Energy Prepayments and Unbilled Revenues

Seasonal account billings are accounted for as deferred credits and recognized as income on a straight-line basis over a period of one year. There were no estimated net unbilled revenues for the year.

PRESQUE ISLE ELECTRIC & GAS CO-OP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Accounts receivable

Accounts receivable consist primarily of amounts due from members for electric and gas service. An allowance for doubtful accounts has been estimated based on collection history. When a member's account becomes past due and uncollectible, the member's service is terminated. The Board of Directors approve all accounts charged off.

Regulation

Electric accounting and rate matters are subject to the Board of Directors and membership approval. Natural gas accounting and rate matters are either subject to Home Rule approval pursuant to the Michigan Home Rule Statute or subject to the approval of the Michigan Public Service Commission.

Materials and Supplies

Electrical and natural gas materials and supplies are valued at average cost. Merchandise held for resale is valued at average cost.

Retirement Plan

Presque Isle has a retirement savings plan for substantially all employees. Under the terms of the plan, Presque Isle is required to contribute 10 to 16 percent of the employee's total base earnings to the retirement plan.

Contributions in Aid of Construction

Contributions in aid of construction are received from members on electrical and gas service requests and re-applied against the construction costs.

Income Taxes

The Cooperative is exempt from federal and state income taxes under Section 501(c)(12) of the Internal Revenue Code which provides, in part that the Cooperative derive at least 85 percent of its annual gross income from members to retain the exemption. The Cooperative expects to meet the requirements for the tax year ended December 31, 2018. Accordingly, no provision for income taxes has been made in the financial statements. The Cooperative's federal information returns for Calendar year 2012 and after are subject to examination by the Internal Revenue Service.

NOTE 2: ASSETS PLEDGED

Substantially all assets are pledged as collateral on long-term debt payable to the National Rural Utilities Cooperative Finance Corporation (CFC).

PRESQUE ISLE ELECTRIC & GAS CO-OP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3: ELECTRIC AND GAS PLANT AND DEPRECIATION RATES AND PROCEDURES

Major classes of electric and gas plant as of December 31, 2018 and 2017 consisted of:

	<u>2018</u>	<u>2017</u>
Intangible plant & goodwill	\$ 10,400,753	\$ 1,021,015
Distribution plant	135,479,874	129,447,361
General plant	11,676,778	9,771,289
Transmission plant	<u>834,897</u>	<u>-</u>
	158,392,302	140,239,665
Construction work in progress	<u>1,014,201</u>	<u>32,344</u>
TOTAL	<u><u>\$ 159,406,503</u></u>	<u><u>\$ 140,272,009</u></u>

NOTE 4: ELECTRIC AND GAS PLANT AND DEPRECIATION RATES AND PROCEDURES

Provision has been made for depreciation of the distribution plant at a straight-line rate of 10 to 50 years for all distribution plant additions.

General plant depreciation rates have been applied on a straight-line basis as follows for the year ended December 31, 2018:

	<u>Years</u>
Structures and improvements	10-50
Office furniture equipment	1.5-7
Transportation equipment	4-7
Power operated equipment	3-16
Other	4-5

Depreciation and amortization of electric and gas plant in service was charged as follows for the years ended December 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Charged to:		
Classified as depreciation and amortization	\$ 4,445,463	\$ 3,748,845
Classified in other operating expenses	<u>229,120</u>	<u>182,819</u>
	4,674,583	3,931,664
Capitalized to construction	<u>299,228</u>	<u>246,716</u>
TOTAL DEPRECIATION AND AMORTIZATION	<u><u>\$ 4,973,811</u></u>	<u><u>\$ 4,178,380</u></u>

PRESQUE ISLE ELECTRIC & GAS CO-OP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5: INVESTMENTS IN ASSOCIATED ORGANIZATIONS

Investments in associated organizations consisted of the following at December 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Wolverine Power Supply Coop. Inc. - capital credits	\$ 20,379,590	\$ 20,486,928
National Rural Utilities Cooperative Finance Corp.:		
Capital term certificates maturing October 1, 2020 through October 1, 2080 at interest rates between 3% and 5.0%	1,500,225	1,521,664
Patronage capital certificates	2,094,040	1,989,899
Other	<u>648,016</u>	<u>645,828</u>
 TOTAL	 <u>\$ 24,621,871</u>	 <u>\$ 24,644,319</u>

NOTE 6: CASH AND INVESTMENTS

Statements of Financial Accounting Standards (SFAS) No. 105 require disclosure of significant concentrations of credit risk arising from cash deposits in excess of federally insured limits.

	<u>Per Institution</u>	<u>Per Book</u>
Insured	\$ 1,189,410	\$ 1,189,410
Uninsured	<u>1,860,219</u>	<u>1,773,629</u>
 Cash in banks and credit union	 <u>\$ 3,049,629</u>	 2,963,039
 Working funds		 <u>1,500</u>
 Total per books		 <u>\$ 2,964,539</u>

PRESQUE ISLE ELECTRIC & GAS CO-OP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7: DEFERRED DEBITS

The Cooperative has recorded deferred debits in the following amounts:

	2018	2017
Prepaid tap fees	\$ 53,390	\$ 55,386
Prepaid years of service	48,466	75,113
Other deferred debits	59,655	59,655
Consumer prepayments	58,917	46,641
Over (Under) collection of WPSC costs	120,975	-
TOTAL	\$ 341,403	\$ 236,795

NOTE 8: MEMBERSHIPS

The following is a summary of changes in memberships for the years ended December 31, 2018 and 2017:

	2018	2017
Balance, beginning	\$ 276,930	\$ 268,545
Membership and subscriptions issued	8,335	8,385
Balance, ending	\$ 285,265	\$ 276,930

Memberships have been adjusted to reflect the number of members currently receiving service. In accordance with the Co-op by-laws, memberships are not refunded when a member leaves the service area. The membership fee is transferred to donated capital when the member terminates service.

NOTE 9: PATRONAGE CAPITAL

Patronage capital balances as of December 31, 2018 and 2017 consisted of:

	2018	2017
Assignable	\$ 2,567,010	\$ 3,145,553
Assigned to date	65,006,257	61,860,704
	67,573,267	65,006,257
Less retirements to date	17,243,575	14,841,138
Balance	\$ 50,329,692	\$ 50,165,119

PRESQUE ISLE ELECTRIC & GAS CO-OP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 9: PATRONAGE CAPITAL - continued

Under the provisions of the Mortgage Agreement, until the equities and margins equal or exceed twenty percent of the total assets of the Cooperative, the return to patrons of capital contributed by them is limited generally to twenty-five percent of the patronage capital or margins received by the Cooperative in the next preceding year. The equities and margins of Presque Isle represent 43.6% and 48.0% of the total assets for the years 2018 and 2017, respectively. There were capital credits retired of \$2,402,437 and \$2,628,193 during 2018 and 2017, respectively.

NOTE 10: MORTGAGE NOTES

Long-term debt is composed of 3.65% to 6.30% mortgage notes payable to the National Rural Utilities Cooperative Finance Corporation (CFC). All mortgage notes to CFC will be re-priced and the interest rate adjusted accordingly during the next 10 years in accordance with the policy and procedure governing such re-pricing. The notes are for 35 year periods each, with principal and interest installments due either quarterly or semiannually. The notes are scheduled to be fully repaid at various times from December, 2020 through April 2048.

There were unadvanced loan funds available at December 31, 2018 in the amount of \$9,900,000.

Detail of the long-term debt is as follows:

	<u>2018</u>	<u>2017</u>
National Rural Utilities Cooperative Finance Corporation mortgage notes bearing interest at 3.65% to 6.30% per annum for 2018 and 2017	\$ 60,282,209	\$ 50,605,610
	60,282,209	50,605,610
Less current maturities	<u>2,010,000</u>	<u>1,731,000</u>
TOTAL LONG-TERM DEBT	<u>\$ 58,272,209</u>	<u>\$ 48,874,610</u>

Maturities of long-term debt for each of the next five years are as follows:

2019	\$	2,010,000
2020	\$	2,105,389
2021	\$	2,116,808
2022	\$	2,217,202
2023	\$	2,322,747

**PRESQUE ISLE ELECTRIC & GAS CO-OP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

NOTE 11: LINE OF CREDIT

Presque Isle had available a short-term line of credit from CFC for 2018 and 2017 of \$8,000,000, with a revolving credit and term of sixty months. The agreement requires that within 360 days of the first advance, the cooperative will reduce to zero for a period of at least five consecutive business days amounts outstanding. The Cooperative was in compliance with this provision during 2018 and 2017. Balance available at December 31, 2018 and 2017 was \$8,000,000. The outstanding balance at December 31, 2018 and 2017 was \$-0-.

Additionally, Presque Isle has a \$5,000,000 unsecured revolving line-of-credit agreement with CoBank. Interest on outstanding borrowings is payable monthly and is computed at 4.61% at December 31, 2018. Presque Isle had an outstanding balance of \$2,500,000 at December 31, 2018 and \$0 at December 31, 2017.

NOTE 12: DEFERRED CREDITS

Following is a summary of the amounts recorded as deferred credits as of December 31, 2018 and 2017:

	2018	2017
Under-collection of 2017 WPSC PSCR Costs	\$ -	\$ 29,244
Customer energy prepayments	-	-
TOTAL	\$ -	\$ 29,244

NOTE 13: RETIREMENT PLAN

Retirement plan benefits for substantially all employees are provided through participation in a defined contribution SelectRE pension plan with 401k option with cash and deferred arrangement of the National Rural Electric Cooperative Association (NRECA) and its member systems. The income earned by funds while held under the plan is tax-exempt under Code Sections 401 and 501 of the Internal Revenue Code. Contributions to the savings program, which are based on a percentage of the employees' compensation, were \$530,687 in 2018 and \$515,800 in 2017.

NOTE 14: POWER SUPPLY COST RECOVERY CLAUSE

On October 12, 1982, the Governor of the State of Michigan signed PA 304 of 1982 into law creating the Power Supply Cost Recovery Clause (PSCR), a power cost recovery mechanism.

Wolverine Power Supply Cooperative, Inc. (Wolverine) and the member-distribution Cooperatives including Presque Isle, obtained authority to implement and apply PSCR clauses and monthly factors. Presque Isle's monthly factor may not exceed +0.8785 mills per KWH for the current period.

PRESQUE ISLE ELECTRIC & GAS CO-OP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 14: POWER SUPPLY COST RECOVERY CLAUSE - continued

Due to fluctuations in market conditions, over-collections or under-collections could result between the generation cooperative and distribution cooperative as well as between the distribution cooperatives and their member-consumers.

The PSCR clause includes provisions whereby power cost recovery over-collections must be remedied by refunds and power cost recovery under-collections must be remedied by additional collections.

Presque Isle's balance sheets reflect an amount (due to)/from member-consumers for under/(over) collections in the amounts of \$(888,464) and \$(191,698) at December 31, 2018 and 2017, respectively. These amounts are included in the accounts receivable balance.

The GCR mechanism includes provisions whereby gas cost recovery over-collections must be remedied by refunds and gas cost recovery under-collections must be remedied by additional collections. Presque Isle's balance sheet reflects an amount due (to)/from member-consumers for under collections in the amounts of \$103,112 and \$80,306 for the years ended December 31, 2018 and 2017, respectively. This amount is recorded in accounts receivable.

NOTE 15: POST-RETIREMENT BENEFITS OTHER THAN PENSIONS

The cooperative has chosen to recognize the accounting method required by the Statement of Financial Accounting Standards No. 106 for Employer's Accounting for Post-retirement Benefits Other Than Pensions. The statement requires a transition from accounting, for these benefits, on a pay-as-you go (cash basis) to recognizing the benefit cost as they are earned (accrual basis). The change in accounting method requires the accounting for costs incurred to date but unpaid, which is called the Transition amount. This amount may be either expensed in the year of transition or it may be amortized over either the benefit period or twenty-years.

The plan sponsored by the company is a defined benefit post-retirement plan that covers all employees who retire from the cooperative before April 1, 1997 after (i) attainment of age 55 and completion of 30 years of service, or (ii) attainment of age 62. Spouses of pensioners are also insured until the pensioner's death.

At the end of 2018 there were no active participants and the accounting rules of the Financial Accounting Standards Board Statement No. 88 regarding curtailment must be recognized. The reconciliation of the funded status at December 31, 2018 is as follows:

PRESQUE ISLE ELECTRIC & GAS CO-OP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15: POST-RETIREMENT BENEFITS OTHER THAN PENSIONS - continued

	2018	2017
(Accrued) post-retirement benefit costs, beginning	\$ (1,274,093)	\$ (2,436,845)
Net periodic post-retirement benefit (costs)	(5,708)	(47,967)
Contributions made	63,740	118,914
Valuation adjustment	-	1,091,805
(Accrued) post-retirement benefit cost, end of year	\$ (1,216,061)	\$ (1,274,093)

Net periodic post-retirement benefit cost includes the following components:

	2018	2017
Interest cost	\$ (5,708)	\$ (37,692)
Net actuarial gain (loss)	-	(10,275)
Net periodic post-retirement benefit cost	\$ (5,708)	\$ (47,967)

For measurement purposes a 8.0% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2018; the rate was assumed to decrease gradually to an ultimate rate of 5.0% per annum. The health care cost trend rate assumption has a significant effect on the amounts reported. To illustrate, increasing the assumed health care cost trend rates by 1 percentage point in each year would increase the accumulated post-retirement benefit obligation \$89,913. Decreasing the assumed health care cost trend rates by 1 percentage point in each year would decrease the accumulated post-retirement benefit obligation \$72,499.

The weighted-average discount rate used in determining the accumulated post-retirement benefit obligation was 3.08 percent.

NOTE 16: FLEX BENEFIT PLAN - under Section 125 of the Internal Revenue Code

The Flexible Benefit Plan is for the benefit of substantially all employees who have been employed for at least 30 days. The Cooperative has elected to offer to eligible employees the following Benefit Plans and Policies subject to the terms and conditions of the plan: (1) Disability Income - Short-Term (A&S); (2) Cancer Insurance; (3) Intensive Care Insurance; (4) Accident Insurance; and (5) Medical Care Expense Reimbursement, not to exceed \$1,200 per plan year. The maximum Pre-Tax Premiums a participant can contribute via the Salary Redirection Agreement is the aggregate cost of the applicable Benefit Plans or Policies selected minus any Nonelective Contributions made by the employer. It is intended that such Pre-Tax Premium accounts shall, for tax purposes, constitute an employer contribution.

PRESQUE ISLE ELECTRIC & GAS CO-OP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 17: LETTERS OF CREDIT

The Co-op has a letter of credit outstanding to CFC for \$1,500,000 at December 31, 2018. This letter of credit is required in order to mitigate counter party risk in natural gas purchase transactions. This also is a risk management tool for the Co-op with respect to mark to market issues.

NOTE 18: RECLASSIFICATION OF AMOUNTS

Certain amounts previously reported have been reclassified to conform to the 2018 presentation.

NOTE 19: SUBSEQUENT EVENTS

In preparing these financial statements, management has evaluated, for potential recognition or disclosure, significant events or transactions that occurred during the period subsequent to December 31, 2018, the most recent statement of financial position presented herein, through March 5, 2019, the issuance date of the accompanying financial statements. No significant such events or transactions were identified.

ADDITIONAL INFORMATION

**PRESQUE ISLE ELECTRIC & GAS COOPERATIVE
CONSOLIDATING BALANCE SHEET
DECEMBER 31, 2018**

	Presque Isle Electric & Gas Cooperative	Presque Isle Aurora Gas Assets	Eliminations	Consolidated Total
ASSETS				
UTILITY PLANT:				
In service – at cost	\$ 152,192,312	\$ 6,199,990	\$	\$ 158,392,302
Construction work in progress	1,014,201			1,014,201
	153,206,513	6,199,990		159,406,503
Less accumulated depreciation	(67,146,894)	(3,501,708)		(70,648,602)
NET UTILITY PLANT	86,059,619	2,698,282		88,757,901
OTHER ASSETS AND INVESTMENTS:				
Investments and memberships	24,621,871			24,621,871
Investment in subsidiary	2,571,910		(2,571,910)	
TOTAL OTHER ASSETS AND INVESTMENTS	27,193,781		(2,571,910)	24,621,871
CURRENT ASSETS:				
Cash and temporary cash investments	2,819,385	145,154		2,964,539
Accounts receivable, less allowance for doubtful accounts of approximately \$121,000	4,498,418			4,498,418
Intercompany		292	(292)	
Materials and supplies	1,945,684			1,945,684
Prepaid expenses and other current assets	373,934			373,934
TOTAL CURRENT ASSETS	9,637,421	145,446	(292)	9,782,575
DEFERRED DEBITS	341,403			341,403
TOTAL ASSETS	\$ 123,232,224	\$ 2,843,728	\$ (2,572,202)	\$ 123,503,750

	Presque Isle Electric & Gas Cooperative	Presque Isle Aurora Gas Assets	Eliminations	Consolidated Total
EQUITIES:				
Memberships	\$ 285,265	\$	\$	\$ 285,265
Patronage capital	50,329,692			50,329,692
Other equities	3,352,347	2,832,557	(2,571,910)	3,612,994
TOTAL EQUITIES	53,967,304	2,832,557	(2,571,910)	54,227,951
LONG-TERM DEBT, NET OF CURRENT MATURITIES:				
Mortgage notes to National Rural Utilities Cooperative Finance Corporation	58,272,209			58,272,209
Accrued post-retirement benefits	1,216,061			1,216,061
TOTAL LONG-TERM DEBT	59,488,270			59,488,270
CURRENT LIABILITIES:				
Current maturities of long-term debt	2,010,000			2,010,000
Line of credit	2,500,000			2,500,000
Accounts payable:				
Purchased power	2,298,895			2,298,895
Other	456,740			456,740
Intercompany	292		(292)	
Patronage capital payable	26,784			26,784
Customer deposits and prepayments	596,468			596,468
Accrued property taxes	539,109	11,171		550,280
Accrued interest	293,986			293,986
Accrued vacation and sick pay	564,781			564,781
Other current liabilities	489,595			489,595
TOTAL CURRENT LIABILITIES	9,776,650	11,171	(292)	9,787,529
TOTAL EQUITIES AND LIABILITIES	\$ 123,232,224	\$ 2,843,728	\$ (2,572,202)	\$ 123,503,750

**PRESQUE ISLE ELECTRIC & GAS COOPERATIVE
CONSOLIDATING STATEMENT OF REVENUE
FOR THE YEAR ENDED DECEMBER 31, 2018**

	Presque Isle Electric & Gas Cooperative	Presque Isle Aurora Gas Assets	Eliminations	Consolidated Total
OPERATING REVENUES	\$ 46,046,735	\$	\$	\$ 46,046,735
OPERATING EXPENSES:				
Cost of energy	25,020,082			25,020,082
Distribution – operation	2,096,353			2,096,353
Distribution – maintenance	4,368,302			4,368,302
Consumers accounts	2,180,561			2,180,561
Customer service and information expense	874,923			874,923
Administrative and general	2,087,233			2,087,233
Depreciation and amortization	4,311,187	134,276		4,445,463
Taxes – property	1,167,528	12,295		1,179,823
Taxes – other	1,064			1,064
TOTAL OPERATING EXPENSES	42,107,233	146,571		42,253,804
OPERATING MARGINS BEFORE FIXED CHARGES	3,939,502	(146,571)		3,792,931
FIXED CHARGES:				
Interest on long-term debt	2,717,103			2,717,103
Other deductions	1,000			1,000
TOTAL FIXED CHARGES	2,718,103			2,718,103
OPERATING MARGINS AFTER FIXED CHARGES	1,221,399	(146,571)		1,074,828
CAPITAL CREDITS	1,759,758			1,759,758
NET OPERATING MARGINS	2,981,157	(146,571)		2,834,586
NON-OPERATING MARGINS:				
Interest Income	73,657	3		73,660
Other	(487,804)	146,568		(341,236)
TOTAL NON-OPERATING MARGINS	(414,147)	146,571		(267,576)
NET MARGINS	\$ 2,567,010	\$ -	\$	\$ 2,567,010



AUDITORS' CERTIFICATION REGARDING LOAN FUND EXPENDITURES

During the period of this audit, Presque Isle Electric & Gas Co-op received \$11,500,000 in long-term loan fund advances from CFC on loans controlled by the 100% CFC Mortgage and Loan Agreement. Based on our review of construction work orders and other plant accounting records created during the audit period, it is our opinion that these CFC loan funds were expended for purposes contemplated in the Loan Agreements on such loans.

Harris Group CPA's

Certified Public Accountants
March 5, 2019