# Southern Maryland Electric Cooperative, Inc.

Pre-Qualification Filing for Designated Entity Status
Submitted to PJM Interconnection, L.L.C.

May 2017

Prepared by:

Southern Maryland Electric Cooperative, Inc.
15035 Burnt Store Road
Hughesville, MD 20637
https://smeco.coop

**(i) Name and address of the entity including a point of contact.**

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Hughesville, MD 20637

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**(ii) Technical and engineering qualifications of the entity or its affiliate, partner, or parent company.**

Southern Maryland Electric Cooperative, Inc. (SMECO) has substantial internal expertise in the engineering, development, project management, construction, operation and maintenance of transmission facilities, as well as an agreement with industry-leading consulting firms and contractors to assist as needed.

In the past 10 years, SMECO has completed approximately $130 million of 230kV substation and transmission capital projects, including the Southern Maryland Reliability Project (SMRP), which included a new 230kV interconnect with PEPCO and 30 miles of new transmission line creating a 230kV loop in our service territory.

SMECO's 230kV system is managed by licensed professional engineers that oversee the construction, operations, and maintenance of the system.

SMECO has the talent and experience required to provide all of the necessary design, construction, maintenance, operations, and planning to competently maintain and operate the transmission system. SMECO is supported by the necessary consultants and contractors to augment the internal workforce to successfully manage and complete all capital projects, maintenance tasks and system restoration activities that are necessary.

**(iii) Demonstrated experience of the entity or its affiliate, partner, or parent company to develop, construct, maintain, and operate transmission facilities. Including a list or other evidence of transmission facilities previously developed regarding construction, maintenance, or operation of transmission facilities both inside and outside of the PJM Region.**

SMECO is an electric cooperative owned by the customers it serves and was created 80 years ago to provide electric service to the rural area of Southern Maryland. SMECO now provides electric service to 160,000 customers in four counties in Southern Maryland.

SMECO now has five 230kV switching stations and 45 miles of dual circuit and 12 miles of single circuit 1590 AAC overhead.

As mentioned in item ii above, SMECO recently completed the Southern Maryland Reliability Project (SMRP), which consisted of the following projects:

**Aquasco to Holland Cliff (2008-2009)**

**Aquasco** - New 230kV interconnect PEPCO source.

**Aquasco to Holland Cliff** - Upgrade 3.5 miles of existing dual circuit 230kV line 2350 and 2355.

**Holland Cliff** - New 230/69kV switching station.

**Hawkins Gate –** 230kV XFMR replacement to increase capacity at existing PEPCO source.

**Holland Cliff to Hewitt Road (2012 -2014)**

**Holland Cliff to Sollers Wharf –** New 18 miles of dual circuit 230kV line 2340 and 2345.

**Sollers Wharf –** New 230/69kV switching station.

**Sollers Wharf to Hewitt Road –** New 10 miles of dual circuit line 2330 and 2335.

**Patuxent River Crossing –** New 2 miles of underground XLPE 230kV line 2330.

**Hewitt Road -** 230kV XFMR replacement to increase capacity.

**Ryceville –** New Line Differential relaying on existing 230kV interconnect Pepco source.

The significance of the SMRP was that all project milestones were delivered ahead of schedule and under budget and at no time was any part of the project budget or schedule in jeopardy. In fact, the certificate of public convenience and necessity (CPCN) permit was obtained in less than one year. In addition, the Patuxent River crossing was the longest, at 4600 feet, 230kV solid dielectric installation of its time.

The SMRP demonstrates SMECO's capability to develop, construct, maintain, and operate a 230kV transmission system.

**(iv) Previous record of the entity or its affiliate, partner, or parent company to adhere to standardized construction, maintenance and operating practices.**

As demonstrated in the recent SMRP, SMECO has a successful history of substation and transmission project development, installation and operation. SMECO designs all transmission facilities in accordance with standardized construction, maintenance and operating practices, which incorporate the best practices of both internal and external resources. The resources are utilized effectively to build on best practices and to take advantage of the latest information and technologies.

Transmission lines and substations are designed, constructed, and operated in accordance with SMECO Engineering Practices and Construction Standards, which meet all applicable codes, standards, regulations, laws and guidelines including NERC, IEEE, NESC and PJM TSDS guidelines. In addition, all equipment is purchased from manufacturers that meet all industry standards.

SMECO has a primary local control center responsible for the safe and reliable operation of SMECO's 230kV transmission system and switching stations (and facilities at lower voltages) in compliance with applicable NERC, PJM and ReliabilityFirst requirements. This control center is staffed 24/7. All transmission system operators hold both NERC and PJM system operator certifications. SMECO also has a fully functional backup control center, which operates independently of the systems at the primary facility.

SMECO consistently meets and exceeds service quality and reliability standards established by the Maryland Public Service Commission. SMECO also has a Compliance Department that oversees the NERC compliance program to ensure SMECO is fully compliant with all applicable NERC Standards and requirements.

**(v) Capability of the entity or its affiliate, partner, or parent company to adhere to standardized construction, maintenance and operating practices.**

SMECO maintains an internal staff of engineering and maintenance personnel that are responsible for the construction and maintenance of the transmission system. These resources are responsible for successfully engineering all capital and maintenance projects. The projects vary in scope from routine equipment replacements to new facilities. The resources use the best of past practices as well as the latest information and technology to accomplish the projects.

SMECO strives to develop and maintain strategic relationships with a variety of contract resources to complete capital projects in a safe, reliable and cost-effective manner. The resources are identified and selected through a rigorous process that includes a formal bidding process, reference checks, safety record review, and other financial reviews. Through this process, SMECO has a proven record of identifying resources to successfully complete any capital projects or system maintenance.

SMECO's Substation and Transmission Operations Department is responsible for remediation of any items found during SMECO's yearly inspections of its transmission lines.

Inspections are performed by fixed wing and helicopter aerial inspection as well as foot patrol. Any repairs identified are documented and addressed as required.

SMECO's Operations department has implemented LiDAR technology to support a comprehensive transmission inspection and vegetation management plan. The data gathered is computer modeled and utilized to its fullest extent to assist in SMECO's line maintenance and vegetation management program.

**(vi) Financial statements of the entity or its affiliate, partner, or parent company. Please provide the most recent fiscal quarter, as well as the most recent three fiscal years, or the period of existence of the entity, if shorter, or such other evidence demonstrating an entity's current and expected financial capability acceptable to the Office of the Interconnection.**

Attached to this filing are the SMECO Financial Statements for 2013 through 2016 to demonstrate our financial capability. Below is a list of the financial statements being provided for this filing.

SMECO Financial Statements for 2013-2014
SMECO Financial Statements for 2014-2015
SMECO Financial Statements for 2015-2016

**(vii) Commitment by the entity to execute the Consolidated Transmission Owners Agreement, if the entity becomes a Designated Entity.**

SMECO is registered with NERC as a Transmission Owner (TO) and Distribution Provider (DP) and is signatory to the PJM Operating Agreement and Consolidated Transmission Owners Agreement (CTOA).

**(viii) Evidence demonstrating the ability of the entity to address and timely remedy failure of facilities.**

SMECO is prepared to address all emergencies and equipment failures on the transmission system utilizing a variety of solutions depending on the circumstances associated with any particular situation.

SMECO employees, contractors and suppliers are responsive on a 24-7-365 day a year basis and are ready to address all system emergencies that occur. SMECO has an Emergency Response Plan, and employees are expected to fill secondary roles during system emergencies with the goal of restoring the electric system to normal as soon as possible. Incident drills are held on a routine basis. Planning for potential large-scale storms and emergencies begins as soon as the weather forecast indicates the potential for an incident.

SMECO's internal work force will perform initial response, damage assessment, isolation of impacted facilities and development of corrective action plans in response to an emergency situation. SMECO will execute repairs in the field with a combination of its internal work force supported by external contract resources as necessary to respond to each emergency situation that arises.

SMECO also employs on a regular and ongoing basis a number of qualified construction contract companies that, while they are conducting scheduled construction and maintenance work, are fully prepared to respond immediately to small, medium and large scale emergencies on the system. Among those companies providing support are traditional line construction contractors and specialty services such as helicopter inspection and damage survey, specialty heavy construction equipment vendors, bridge/matting suppliers, rigging/hauling contractors, and cable and termination services. SMECO has immediate access to all of these services when they become necessary.

SMECO also maintains a sufficient stock of spare equipment and materials and vendor agreements are in place to be able to support emergency restoration requirements. SMECO utilizes existing stock and equipment to make permanent repairs and, as necessary, to make temporary repairs if circumstances require in order to accelerate restoration.

**(ix) Description of the experience of the entity in acquiring rights of way**

SMECO has an Environmental and Property Rights Department dedicated to permitting and real estate. Property rights specialists research, procure, and further manage company real property assets, to include fee-owned properties, transmission and distribution rights-of-way and other miscellaneous excess properties. The Environmental and Property Rights Department works very closely with Transmission Planning and Engineering, Environmental, Governmental Affairs and any needed external firms to either verify existing rights-of-way or acquire new rights-of-way and real property interests necessary to advance pending projects, as well as sustain, modify and improve existing facilities.

SMECO's Real Estate team manages transmission right-of-way assets to best preserve corridor integrity and maximize complementary uses, to include: leasing fee simple interests, licensing easement interests, and managing encroachments to ensure compliance with all applicable standards, safety codes and environmental and governmental regulations.

SMECO's Real Estate team is prepared to support the necessary requirements of the transmission, including the acquisition of new rights-of-way and property and the management and enhancement of existing rights-of-way and property.

# Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC

## Financial Statements

## December 31, 2014 and 2013

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### Financial Statements



### Supplementary Information

ADAMS, JENKINS AND CHEATHAM
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS CONSULTANTS

# Independent Auditor's Report

The Board of Directors
Southern Maryland Electric Cooperative, Inc.
and SMECO Solar LLC

**Report on the Financial Statements**

We have audited the accompanying consolidated financial statements of Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC ("SMECO") which comprise the balance sheets as of December 31, 2014 and 2013 and the related statements of revenues, expenses and patronage capital and comprehensive income and cash flows for the years then ended, and the related notes to the consolidated financial statements.

**Management's Responsibility for the Consolidated Financial Statements**

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

**Auditor's Responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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



231 Wylderose Drive | Midlothian, VA 23113 | 804.323.1313

**Opinion**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of SMECO as of December 31, 2014 and 2013, 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.

**Report on Other Regulatory Requirements**

In accordance with *Government Auditing Standards*, we have also issued our report dated March 10, 2015, on our consideration of SMECO'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, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering SMECO's internal control over financial reporting and compliance.

Adams, Jenkins & Cheatham

Richmond, Virginia
March 10, 2015

## Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
## Consolidated Balance Sheets
## December 31, 2014 and 2013

| | 2014 | 2013 |
|---|---|---|
| **Assets** | | |
| Utility Plant, at Original Cost (Notes 2 and 3) | $ 1,027,563,938 | $ 967,303,113 |
| Less: Accumulated Depreciation and Amortization | (324,260,523) | (310,109,692) |
| Net utility plant | 703,303,415 | 657,193,421 |
| Nonutility Property (net) | 2,024,867 | 1,228,443 |
| Investments (Note 2): | | |
| Investments in associated organizations, at cost (Note 4) | 12,273,378 | 13,375,698 |
| Investment in an unconsolidated entity (Note 5) | 1,183,868 | 1,180,555 |
| Other investments | 11,944,069 | 8,755,037 |
| Total investments | 25,401,315 | 23,311,290 |
| Current Assets (Note 2): | | |
| Cash and cash equivalents | 6,644,148 | 5,292,624 |
| Accounts receivable, net of allowance for doubtful accounts of $900,000 and $1,200,000 respectively | 54,689,447 | 59,973,942 |
| Materials and supplies inventory | 13,208,763 | 11,976,698 |
| Prepaid expenses | 10,088,632 | 5,496,995 |
| Current portion of direct financing lease (Note 6) | 4,504,717 | 4,276,896 |
| Other current assets | 7,731,019 | 13,116,670 |
| Total current assets | 96,866,726 | 100,133,825 |
| Noncurrent Portion of Direct Financing Lease (Note 6) | - | 4,887,563 |
| Regulatory Assets (Notes 2 and 7) | 77,186,544 | 87,154,753 |
| Deferred Charges and Other (Note 2) | 10,162,439 | 9,795,246 |
| Derivative Assets (Notes 2 and 15) | 5,591,119 | - |
| Total assets | $ 920,536,425 | $ 883,704,541 |
| **Equities and Liabilities** | | |
| Equities (Note 9): | | |
| Patronage capital | $ 204,255,833 | $ 197,113,366 |
| Other equities | 8,139,540 | 7,756,615 |
| Accumulated other comprehensive (loss) | (84,809,741) | (42,883,991) |
| Total equities | 127,585,632 | 161,985,990 |
| Long-Term Debt, Less Current Maturities (Notes 10 and 14) | 416,774,088 | 395,784,690 |
| Current Liabilities: | | |
| Accounts payable | 31,673,187 | 39,971,033 |
| Current maturities of long-term debt (Note 10) | 19,075,025 | 16,924,219 |
| Notes payable (Note 10) | 158,000,000 | 130,500,000 |
| Current portion of obligations under capital lease (Note 11) | 2,850,590 | 2,270,981 |
| Customer deposits | 6,258,136 | 5,938,626 |
| Other current liabilities | 13,773,338 | 13,308,699 |
| Total current liabilities | 231,630,276 | 208,913,558 |
| Accrued Pension and Postretirement Benefits (Note 8) | 79,673,204 | 42,228,015 |
| Noncurrent Portion of Obligations Under Capital Lease (Note 11) | 7,822,887 | 7,630,783 |
| Deferred Credits | 9,241,381 | 5,935,841 |
| Derivative Liabilities (Notes 2 and 15) | 47,808,957 | 61,225,664 |
| Commitments and Contingencies (Notes 12 and 13) | - | - |
| Total equities and liabilities | $ 920,536,425 | $ 883,704,541 |

The accompanying notes are an integral part of the above statements.

## Southern Maryland Electric Cooperative, Inc.
## and SMECO Solar LLC
## Consolidated Statements of Revenue, Expenses and Patronage Capital
## Years Ended December 31, 2014 and 2013

| | 2014 | 2013 |
|---|---|---|
| Operating Revenue: | | |
| Sales of electricity | $ 460,931,055 | $ 438,346,363 |
| Lease income (Note 6) | 621,144 | 1,538,359 |
| Other | 21,625,695 | 19,475,805 |
| Total operating revenue | 483,177,894 | 459,360,527 |
| Operating Expenses: | | |
| Purchased power (Note 12) | 321,683,773 | 297,747,235 |
| Power production | 216,386 | 177,683 |
| Transmission | 4,016,843 | 3,893,596 |
| Distribution - operations | 10,227,779 | 9,732,884 |
| Distribution - maintenance | 18,794,091 | 18,466,029 |
| Customer accounts | 10,970,143 | 10,140,122 |
| Customer service and information | 17,929,786 | 15,694,102 |
| Administrative and general | 33,219,602 | 32,859,833 |
| Depreciation and amortization | 29,450,913 | 26,134,423 |
| Taxes | 13,860,042 | 12,152,377 |
| Other | 361,564 | 382,440 |
| Total operating expenses | 460,730,922 | 427,380,724 |
| Operating margins | 22,446,972 | 31,979,803 |
| Interest Expense: | | |
| Interest on long-term debt | 17,535,136 | 16,039,006 |
| Other interest | 1,877,250 | 1,630,428 |
| Total interest expenses | 19,412,386 | 17,669,434 |
| Net Operating Margins | 3,034,586 | 14,310,369 |
| Other Patronage Allocations | 2,372,848 | 1,763,339 |
| Total operating margins | 5,407,434 | 16,073,708 |
| Nonoperating Margins | 3,020,993 | 1,926,791 |
| Net margins | $ 8,428,427 | $ 18,000,499 |
| Patronage Capital, Beginning of Year | $ 197,113,366 | $ 180,480,809 |
| Net Margins | 8,428,427 | 18,000,499 |
| Distribution of Capital Credits | (1,285,960) | (1,367,942) |
| Patronage capital, end of year | $ 204,255,833 | $ 197,113,366 |

## Consolidated Statements of Comprehensive Income
## Years Ended December 31, 2014 and 2013

| | 2014 | 2013 |
|---|---|---|
| Net Margins | $ 8,428,427 | $ 18,000,499 |
| Other Comprehensive (Loss) Income: | | |
| Net (loss) gain during period | (40,247,028) | 22,156,985 |
| Amortization of net (loss) gain | (1,678,722) | 2,391,627 |
| Other comprehensive (loss) income | (41,925,750) | 24,548,612 |
| Comprehensive (Loss) Income | $ (33,497,323) | $ 42,549,111 |

The accompanying notes are an integral part of the above statements.

**Southern Maryland Electric Cooperative, Inc.**
**and SMECO Solar LLC**
**Consolidated Statements of Cash Flows**
**Years Ended December 31, 2014 and 2013**

| | 2014 | 2013 |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Net margins | $ 8,428,427 | $ 18,000,499 |
| Adjustments to reconcile net margins to net cash provided by operating activities: | | |
| Depreciation and amortization | 29,450,913 | 26,134,423 |
| (Earnings) loss in unconsolidated entities | (3,313) | (27,608) |
| Other patronage allocations | (2,372,848) | (1,763,339) |
| Change in operating assets and liabilities: | | |
| Accounts receivable, net | 5,284,495 | (11,852,624) |
| Prepaid expenses | (4,591,637) | 702,092 |
| Derivative assets | (5,591,119) | - |
| Other current assets | 5,385,651 | (2,807,330) |
| Deferred charges and other | (367,193) | 8,939,143 |
| Regulatory assets | 9,968,209 | (18,954,136) |
| Accounts payable | (8,297,846) | (2,403,554) |
| Customer deposits | 319,510 | 356,798 |
| Other current liabilities | 464,639 | (290,058) |
| Deferred credits | 3,305,540 | (2,355,355) |
| Derivative liabilities | (13,416,707) | 12,551,079 |
| Accrued pension and postretirement benefits | (4,480,561) | (4,367,817) |
| Net cash provided by operating activities | 23,486,160 | 21,862,213 |
| Cash Flows From Investing Activities: | | |
| Construction of utility plant | (76,858,152) | (114,323,767) |
| Plant removal cost | (2,545,293) | (2,775,500) |
| Proceeds from the salvage of utility plant | 3,952,780 | 804,106 |
| Contributions in aid of construction | 2,240,406 | 3,801,862 |
| Capitalized interest | 1,133,983 | 781,587 |
| Grants receivable | - | 5,921,036 |
| Materials and supplies inventory | (1,232,065) | 959,471 |
| Disposition of nonutility property | (796,424) | 17,087 |
| Net change in other investments | (3,189,032) | (6,861,933) |
| Net redemption of capital term certificates | 837,099 | 51,937 |
| Net redemption of member capital securities | 1,000,000 | - |
| Net sale of associated investments | 1,638,069 | 1,263,391 |
| Net investment in direct financing lease | 4,659,742 | 3,742,527 |
| Net cash used in investing activities | (69,158,887) | (106,618,196) |
| Cash Flows From Financing Activities: | | |
| Advances on long-term debt | 40,288,000 | 66,372,000 |
| Payments of long-term debt | (17,147,796) | (16,005,873) |
| Advances under line of credit agreements | 254,285,000 | 271,839,098 |
| Payments under line of credit agreements | (226,785,000) | (233,390,411) |
| Obligations under capital lease | (2,712,918) | (930,526) |
| Distribution of capital credits | (903,035) | (1,263,761) |
| Net cash provided by financing activities | 47,024,251 | 86,620,527 |
| Net Increase in Cash and Cash Equivalents | 1,351,524 | 1,864,544 |
| Cash and Cash Equivalents, Beginning of Year | 5,292,624 | 3,428,080 |
| Cash and cash equivalents, end of year | $ 6,644,148 | $ 5,292,624 |
| Non-cash Investing Activity: | | |
| Capital lease | $ 3,484,631 | $ 3,746,337 |

The accompanying notes are an integral part of the above statements.

### Note 1: Description of Business

Southern Maryland Electric Cooperative, Inc. (SMECO) is an electric distribution cooperative that was initially formed as Southern Maryland Tri-County Cooperative Association on February 5, 1937. In 1942, the members voted to change the form of the organization from an association to a cooperative, nonprofit membership corporation under the Maryland Electric Cooperative Act and adopted the current name. SMECO serves about 160,000 customers in a 1,150 square-mile area in Southern Maryland comprised of Calvert, Charles, Prince George's and St. Mary's counties.

SMECO Solar LLC, a wholly-owned subsidiary that constructed and owns a solar project with a capacity of approximately 5.5 megawatts and can produce nearly 8,700 megawatt-hours of energy annually, was established by SMECO on June 21, 2011. Producing solar renewable energy helps SMECO fulfill its renewable portfolio obligation as required by the state (see Note 2).

### Note 2: Summary of Significant Accounting Policies

**A. System of Accounts and Regulation** - The accounting records are maintained in accordance with the Uniform System of Accounts for Electric Borrowers prescribed by the Rural Utilities Service (RUS). SMECO is subject to regulation by the Maryland Public Service Commission (PSC). The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The consolidated financial statements reflect the ratemaking policies of the PSC in conformity with guidance set forth by Accounting Standards Codification (ASC) Topic 980 as it relates to certain types of regulated industries. This standard allows SMECO to record certain regulatory assets and liabilities, which will be included in future rates and would not be recorded under GAAP for nonregulated entities in the United States (see Note 7).

If portions of SMECO's operations no longer become subject to the provisions as set forth by ASC 980, a write-off of any related regulatory assets or liabilities would be required unless some form of transition cost recovery continues through rates established and collected for the remaining regulated operations. In addition, a determination of any impairment to the carrying costs of deregulated plant and inventory assets would be required.

**B. Consolidation** - The consolidated financial statements include the accounts and results of operations of SMECO and its wholly-owned subsidiary. All significant intercompany transactions have been eliminated in consolidation.

**C. Estimates** - The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of revenues, expenses, assets, liabilities and disclosure of contingencies as of the date of the consolidated financial statements. Actual results could differ from those estimates and assumptions.

**D. Utility Plant** - Utility plant is stated at cost which includes the cost of labor, material and applicable indirect costs. When a retirement unit of property is replaced or removed, the cost of such property is deducted from utility plant and such cost, together with the cost of removal less salvage, is charged to accumulated depreciation. Expenditures for additions and replacements that are not considered units of property, as well as routine repairs and maintenance, are expensed as incurred.

SMECO periodically evaluates long-lived assets such as utility plant when events or changes in circumstances indicate that the carrying value of these assets may not be recoverable. The determination of whether impairment has occurred is based on an estimate of undiscounted cash flows attributable to these assets, as compared to the carrying value of the assets.

**E. Depreciation** - For financial reporting purposes, depreciation is computed on a straight-line composite basis using the estimated useful service lives of the depreciable property.

**F. Investments** - The investment in an unconsolidated entity is accounted for under the equity method. SMECO records its proportionate share of equity in earnings or loss of the unconsolidated entity in the Statements of Revenue, Expenses and Patronage Capital under Nonoperating Margins (see Note 5). Patronage capital certificates from associated organizations are recorded at cost plus the stated amount of the certificate (see Note 4).

**G. Cash and Cash Equivalents** - Cash and cash equivalents are considered to be highly liquid investments with an original maturity of three months or less.

**H. Accounts Receivable** - Credit is extended to customers for electric service received as customers are billed on a monthly basis after the service is rendered and the electric meter is read. These readings occur as nearly as practicable every 30 days. Bills are payable within 20 days of rendering. If not paid timely, late payment charges may be applied. In compliance with the rules and regulations of the PSC, SMECO may require both residential and nonresidential customers to make and maintain cash deposits to secure the payment of final bills. The allowance for doubtful accounts is calculated as a percentage of sales. Accounts are reviewed periodically to determine collectability. Bad debts are written off automatically throughout the year after one year of nonpayment.

**I. Materials and Supplies Inventory** - Materials and supplies inventory is generally used for construction or maintenance of operations. Inventory is recorded using the lower of market or average cost and issued items are charged to construction or operations at the recorded average cost.

**J. Derivative Instruments** - SMECO uses various methods, such as forward purchase contracts, option contracts, financial swaps and commodity swaps to manage the commodity and financial risks associated with meeting its power supply requirements. SMECO accounts for the aforementioned contracts in accordance with guidance as set forth by FASB as it relates to derivative instruments and hedging activities. This guidance requires all derivatives, subject to certain exceptions, to be accounted for at fair value. According to FASB guidance, the majority of SMECO's forward purchase contracts and option contracts qualify for the normal purchase and normal sales exception. As a result, these contracts are not recorded at fair value. Since all of SMECO's power supply related costs are subject to rate recovery, changes in the fair value of financial and commodity swaps are periodically reflected as derivative assets and regulatory liabilities or derivative liabilities and regulatory assets, respectively, under the provisions as set forth by FASB (see Note 2A). As of December 31, 2014, the fair value of SMECO's derivative instruments, excluding contracts accounted for as normal purchase/normal sale were as follows:

| Derivatives | Balance Sheet Location | Fair Value |
|---|---|---|
| Financial Gas | Regulatory assets and Derivative liabilities | $ (20,330,406) |
| Financial Energy | Regulatory assets and Derivative liabilities | (27,478,551) |
| Financial Transmission Rights | Derivative assets and Regulatory liabilities | 5,591,119 |
| Total | | $ (42,217,838) |

At December 31, 2014, total derivative contracts in a gross asset and gross liability position amounted to approximately $8.3 million and $50.5 million, respectively.

As of December 31, 2013, the fair value of SMECO's derivative instruments, excluding contracts accounted for as normal purchase/normal sale were as follows:

| Derivatives | Balance Sheet Location | Fair Value |
|---|---|---|
| Financial Gas | Regulatory assets and Derivative liabilities | $ (7,202,861) |
| Financial Energy | Regulatory assets and Derivative liabilities | (52,545,972) |
| Financial Transmission Rights | Regulatory assets and Derivative liabilities | (1,476,831) |
| Total | | $ (61,225,664) |

At December 31, 2013, total derivative contracts in a gross asset and gross liability position amounted to approximately $1.0 million and $62.2 million, respectively.

Net gains and losses on financial and commodity swaps and Financial Transmission Rights are reflected in cost of power at the time they are settled. For the year ended December 31, 2014, the realized gain (loss) on these transactions was as follows:

| Derivatives | Realized Gain (Loss) Recognized in Purchased Power |
|---|---|
| Financial Gas | $ 3,445,715 |
| Financial Energy | (2,288,442) |
| Financial Transmission Rights | 8,617,504 |
| Total | $ 9,774,777 |

For the year ended December 31, 2013, the realized loss on these transactions was as follows:

| Derivatives | Realized (Loss) Recognized in Purchased Power |
|---|---|
| Financial Gas | $ - |
| Financial Energy | (1,705,926) |
| Financial Transmission Rights | (2,331,110) |
| Total | $ (4,037,036) |

As of December 31, 2014 and 2013, SMECO had entered into commitments for options totaling $12.7 million and $900,000, respectively.

**K. Deferred Charges** - Costs of preliminary surveys and studies made for the purpose of determining the feasibility of proposed utility projects are recorded as deferred charges. If a project is constructed, such costs are capitalized as part of the cost of the facility. If the plans for a project are subsequently abandoned, the costs are expensed.

**L. Revenue Recognition** - Revenue is recognized as service is rendered to customers. Recorded revenue includes an estimate of unbilled revenue for utility service rendered but not billed to customers as of year-end. Estimated unbilled revenue was approximately $17.5 million and $18.7 million as of December 31, 2014 and 2013, respectively.

**M. Income Taxes** - As a not-for-profit, membership cooperative under Section 501(c)(12) of the Internal Revenue Code, SMECO is exempt from federal income taxes on income from operating activities. Pursuant to the Maryland Electric Cooperative Act, SMECO is also exempt from state income taxes. Accordingly, no provision for such taxes has been made in the accompanying financial statements.

Certain income earned from other unrelated products and services may require SMECO to pay federal and state income taxes. Should this situation arise, the necessary provisions for income tax liability will be recorded in the consolidated financial statements.

The tax years from 2011 to 2013 remain subject to examination by the taxing authorities.

SMECO Solar LLC is taxed as a corporation and is subject to federal and state income taxes. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences arising between the tax bases of assets and liabilities and their reported amounts in accordance with GAAP. At December 31, 2014 and 2013, there were no deferred tax assets and liabilities reported on the consolidated balance sheets.

**N. Accumulated Other Comprehensive Income** - This item consists of other gains and losses affecting equity that, under GAAP, are excluded from net income. During 2014 and 2013, such items relate to SMECO's unrecognized actuarial loss and amortization from the adoption of guidance issued by FASB as it relates to the accounting for defined benefit pension and other postretirement plans.

**O. Subsequent Events** - Subsequent events have been evaluated through March 10, 2015, which is the date the consolidated financial statements were available to be issued.

**P. Advertising Costs** - Advertising costs are expensed as incurred.

**Q. Renewable Portfolio Standard (RPS)** - SMECO is subject to Maryland's RPS, which requires retail suppliers of electricity to provide twenty percent of their retail sales using renewable resources by 2022. SMECO fulfills this obligation by purchasing renewable energy from various resources such as wind and solar, as well as by procuring Renewable Energy Credits (RECs) in the market.

### Note 3: Utility Plant

The major classes of utility plant in service as of December 31, 2014 and 2013 are as follows:

| | 2014 | 2013 |
|---|---|---|
| Distribution | $ 567,915,807 | $551,064,311 |
| Transmission | 250,030,735 | 209,581,880 |
| Generation | 14,681,335 | 14,676,905 |
| General | 148,303,053 | 145,241,190 |
| | 980,930,930 | 920,564,286 |
| Construction work in progress | 46,633,008 | 46,738,827 |
| | 1,027,563,938 | 967,303,113 |
| Less: Accumulated depreciation and amortization | (324,260,523) | (310,109,692) |
| Net utility plant | $ 703,303,415 | $657,193,421 |

The provision for depreciation, stated as a percentage of the average balance of related properties, approximated the following percentages during 2014 and 2013:

| | 2014 | 2013 |
|---|---|---|
| Distribution | 3.40% | 3.42% |
| Transmission | 3.11% | 2.93% |
| General | 2.46%-10.54% | 2.46%-10.54% |
| Composite rate | 3.35% | 3.29% |
| Generation | 5.00% | 5.00% |

SMECO follows the regulatory principle of intergenerational cost allocation by including net salvage (gross salvage less costs of removal) as a component of depreciation rates. Net salvage is a "non-legal asset retirement obligation," and as such is not subject to the accounting requirements issued by FASB as it relates to accounting for asset retirement obligations and Federal Energy Regulatory Commission (FERC) Order 631 (as adopted by RUS). SMECO has no legal asset retirement obligations as that term is defined by FASB guidance and FERC Order 631.

In accordance with the reporting requirements of FASB's guidance on asset retirement obligations and FERC Order 631, SMECO's accumulated provision for depreciation included a net salvage timing difference of approximately $7.7 million and $3.6 million for the years ended December 31, 2014 and 2013, respectively. This represents the differences in the timing of recognition of the period costs associated with net salvage.

SMECO capitalizes interest cost incurred on funds used to construct utility plant. The capitalized interest is recorded as part of the asset to which it relates and is amortized over the asset's estimated useful life.

### Note 4: Investments in Associated Organizations

Investments in associated organizations, which are recorded at cost (see Note 14), consisted of the following as of December 31, 2014 and 2013:

| | 2014 | 2013 |
|---|---|---|
| National Rural Utilities Cooperative Finance Corporation (CFC): | | |
| Capital Term Certificates | | |
| 3% | $1,000,650 | $1,000,650 |
| 5% | 3,164,783 | 3,164,783 |
| 8.55% | 720,411 | 1,516,525 |
| Noninterest bearing | 299,057 | 340,042 |
| Member capital securities | - | 1,000,000 |
| Patronage capital certificates | 1,662,285 | 1,568,856 |
| CFC membership | 1,000 | 1,000 |
| | 6,848,186 | 8,591,856 |
| Federated Rural Electric Insurance Corporation | 859,772 | 685,675 |
| CoBank, ACB (CoBank) | 4,344,956 | 3,872,903 |
| Other | 220,464 | 225,264 |
| | $12,273,378 | $13,375,698 |

### Note 5: Equity Method Investments

Effective August 1, 2003, SMECO invested $1,000,000 for a membership and equity investment in Alliance for Cooperative Energy Services Power Marketing, LLC (subsequently renamed ACES). SMECO's proportionate share of ACES earnings was $3,313 in 2014 and $27,608 in 2013. As of December 31, 2014 and 2013, the carrying value of the investment was $1,183,868 and $1,180,555, respectively.

### Note 6: Net Investment in Facility Capacity Credit Agreement

Pursuant to the Facility and Capacity Credit Agreement (FCC Agreement) entered into with Potomac Electric Power Company (Pepco) in March 1989, SMECO constructed a 77-megawatt combustion turbine generating unit at Pepco's then-owned Chalk Point Generating Station in Aquasco, Maryland. This facility was placed in commercial operation on December 1, 1990. As part of the FCC Agreement, in exchange for electric capacity and generated energy from the facility, Pepco is obligated to operate and maintain the facility for a period of 25 years, commencing December 1990.

In accordance with SMECO's concurrence under the Agreement and Consent executed in December 2000, Pepco assigned its rights and obligations under the FCC Agreement to Southern Energy, Inc. (subsequently renamed Mirant Corporation (Mirant)), a Delaware corporation. Mirant subsequently assigned the FCC Agreement to one of its subsidiaries, Mirant Peaker, LLC, which subsequently merged into another Mirant subsidiary, Mirant Chalk Point, LLC. In December 2010, Mirant merged with RRI Energy, creating GenOn Energy, Inc. (GenOn), in connection with which Mirant Chalk Point, LLC changed its name to GenOn Chalk Point, LLC. The agreement permits GenOn Chalk Point, LLC to operate, dispatch and receive all electricity generated from the facility. GenOn Chalk Point, LLC is now responsible for all costs associated with operating and maintaining the combustion turbine during the remaining term of the FCC Agreement. On December 14, 2012, NRG Energy, Inc. (NRG) acquired all of the ownership interests of GenOn and, accordingly, NRG is now the ultimate corporate parent of GenOn Chalk Point, LLC.

The FCC Agreement is accounted for as a direct financing lease. The current monthly payment is $437,510.

The following sets forth the components of the net investment in the FCC Agreement as of December 31, 2014 and 2013:

| | 2014 | 2013 |
|---|---|---|
| Total minimum FCC payments receivable | $ 4,812,610 | $10,062,730 |
| Estimated residual value of FCC property | - | - |
| Gross investment in FCC | 4,812,610 | 10,062,730 |
| Less: Unearned income | (307,893) | (898,271) |
| Net investment in FCC Agreement | $ 4,504,717 | $ 9,164,459 |

| | | |
|---|---|---|
| Current portion | $ 4,504,717 | $ 4,276,896 |
| Noncurrent portion | - | 4,887,563 |
| Net investment in FCC Agreement | $ 4,504,717 | $ 9,164,459 |

Future minimum FCC receivables due under this direct financing lease as of December 31, 2014 are as follows:

| | |
|---|---|
| 2015 | $ 4,812,610 |

**Note 7: Regulatory Assets**

Regulatory assets consisted of the following:

**A. Demand Response (DR) and EmPOWER Maryland Programs** - Conservation expenditures pertaining to DR and EmPOWER Maryland programs are recognized as regulatory assets and amortized over a one-year or five-year period in accordance with PSC requirements. Conservation costs are recovered through a rate surcharge approved by the PSC that reflects expenditures and an allowed rate of return. The related amounts of regulatory assets for the DR and EmPOWER Maryland programs were $24,311,600 and $21,311,620 as of December 31, 2014 and 2013, respectively.

**B. Advanced Metering Infrastructure (AMI) Implementation** - Pursuant to PSC approval, a regulatory asset was established for the costs associated with an AMI staged implementation to determine whether the deployment of AMI in SMECO's service territory would achieve the operational savings anticipated. In 2013, the PSC approved the system-wide deployment of AMI and a regulatory asset was established. As of December 31, 2014 and 2013, the regulatory assets for these projects totaled $5,065,987 and $4,617,469, respectively.

**C. Energy and Energy-Related Costs** - As of December 31, 2014 and 2013, the regulatory asset pertaining to energy and energy-related costs was $47,808,957 and $61,225,664, respectively (see Note 2).

**Note 8: Employee Benefit Plans**

**A. Pension Plan and Other Postretirement Benefits** - SMECO has a qualified, noncontributory, defined benefit pension plan which provides for retirement benefits based upon age, years of service and compensation. The Retirement Annuity Plan for Employees of SMECO was closed effective December 31, 2006, so that employees who were hired or re-hired on or after January 1, 2007, were not eligible to participate (or recommence participation) in the Pension Plan. SMECO continued to maintain the Pension Plan for current employees through December 31, 2010 at which time the Plan was frozen. The net effect was that a participant's benefits under the Pension Plan were calculated as if the participant terminated employment with SMECO on December 31, 2010. As a result of this curtailment, SMECO requested a deferral as available under FASB's regulatory accounting treatment to amortize the prior service costs (benefit cost) of $4.7 million, over an eight-year period. Annual provisions for accrued pension costs are based upon independent actuarial valuations dated as of December 31, 2014 and 2013. SMECO's policy is to fund accrued pension costs in accordance with provisions of the Employee Retirement Income Security Act of 1974 (ERISA). Effective with the 2013 fiscal year, the amortization period has changed from the average expected future working lifetime of active participants to the average life expectancy of all plan participants.

The Retirement Annuity Plan offered Terminated Vested Participants a limited period of time to elect a one-time lump sum distribution option in lieu of a deferred annuity effective September 15, 2014. The forms of payment available during this election period were a lump sum distribution or immediate annuity (as required by law). Qualified Terminated Vested Participants had from September 15 through October 30, 2014 to elect this voluntary lump sum distribution. Benefits were payable as of November 1, 2014 and paid in a single lump sum cash distribution or roll-over, if the lump sum option was elected. If an immediate annuity was elected, the monthly annuity payment was payable beginning November 1, 2014. All participants not making an election by October 30, 2014 remain in the plan as terminated vested participants until their normal retirement date.

SMECO provides additional retirement benefits to certain employees under a nonqualified plan established in accordance with Section 457 of the Internal Revenue Code. The periodic plan expenses are based on the present value of the retirement benefits earned during the year.

SMECO supplements health care insurance premiums for retirees and covered dependents through their inclusion in the same insurance coverage pool as active employees. The expected cost of these benefits under the unfunded plan is recognized during the years in which employees render service.

The following sets forth the obligations, funded status and periodic costs for the plans and the actuarial assumptions used:

| | Pension Benefits | |
|---|---|---|
| | 2014 | 2013 |
| Benefit obligation at year end | $154,805,530 | $124,768,526 |
| Fair value of plan assets at year end | 105,655,757 | 102,297,066 |
| Funded status | $(49,149,773) | $(22,471,460) |
| Amounts recognized in the Balance Sheets: | | |
| Accrued benefit cost | $(49,149,773) | $(22,471,460) |
| Accumulated other comprehensive loss | 68,994,677 | 35,916,433 |
| Deferred charges | 2,130,756 | 2,367,506 |
| Weighted-average assumptions used to determine benefit obligations as of year end: | | |
| Discount rate | 4.35% | 5.50% |
| Benefit cost | $ 533,585 | $ 1,627,171 |
| Employer contribution | 7,048,398 | 7,804,696 |
| Benefits paid | 9,458,292 | 6,582,233 |
| Weighted-average assumptions used to determine benefit costs: | | |
| Discount rate | 5.50% | 4.50% |
| Expected return on plan assets | 8.00% | 8.00% |
| Expected contributions for year ending December 31, 2015: | | |
| Employer | $5,723,878 | |
| Employees | - | |

Estimated future benefit payments reflecting expected future service for years ending December 31:

| | |
|---|---|
| 2015 | $ 6,909,893 |
| 2016 | 7,228,968 |
| 2017 | 7,418,737 |
| 2018 | 7,618,088 |
| 2019 | 7,992,727 |
| 2020-2024 | 43,262,493 |

| | |
|---|---|
| Estimated Loss Amortization for Next Fiscal Year | $ 1,927,594 |

| Plan Assets: | | |
|---|---|---|
| Equity Securities (a) (c) | 52% | 58% |
| Fixed Income Securities (b) (c) | 48% | 42% |

(a) The portfolio's target asset allocation range is 50% equity with an allowable range of 30% to 60%.
(b) The portfolio's target asset allocation range is 50% fixed income with an allowable range of 30% to 60%.
(c) The portfolio's target asset allocation also allows for up to 20% in cash.

SMECO's investment strategy with respect to pension assets is designed to achieve a moderate level of overall portfolio risk in keeping with its desired risk objective, which is established after careful consideration of plan liabilities, plan funded status and SMECO's overall financial condition. The portfolio's target asset allocation is 52% equity and 48% fixed income with specified allowable ranges around these targets. The equity segment is broadly diversified across growth/value and small-, mid- and large-cap equities. The fixed income segment is diversified by investing in preferred stocks, corporate debt securities and obligations of the U.S. Government and its agencies.

SMECO also sponsors a defined benefit postretirement medical insurance plan that covers substantially all collectively bargained and management employees and their dependents. Employees who reach the age of 55 with 10 years of service (provided active coverage was elected before retirement), become eligible to receive benefits. Participants under the age of 65 are eligible for the PPO Plan or HDHP/HSA Plan and participants of the age 65 and older are eligible for the Medicare Supplemental Plan. The following sets forth the funded status of the Plan reconciled with amounts reported in the balance sheets:

| | Other Postretirement Benefits | |
|---|---|---|
| | 2014 | 2013 |
| Benefit obligation at year end | $ 30,523,431 | $ 19,756,555 |
| Fair value of plan assets at year end | - | - |
| Funded status | $(30,523,431) | $(19,756,555) |
| Amounts recognized in the Balance Sheets: | | |
| Accrued benefit cost | $(30,523,431) | $(19,756,555) |
| Accumulated other comprehensive loss | 15,815,064 | 6,967,558 |
| Deferred charges | 75,261 | 312,238 |
| Weighted-average assumptions used to determine benefit obligations as of year end: | | |
| Discount rate | 4.35% | 5.50% |
| Benefit cost | $ 2,814,546 | $ 2,617,360 |
| Employer contribution | 658,199 | 254,994 |
| Benefits paid | 658,199 | 254,994 |
| Weighted-average assumptions used to determine benefit costs: | | |
| Discount rate | 5.50% | 4.50% |

Expected contributions for year ending December 31, 2015:

| | |
|---|---|
| Employer | $ 703,484 |
| Employees | - |

Estimated future benefit payments reflecting expected future service for years ending December 31:

| | |
|---|---|
| 2015 | $ 703,484 |
| 2016 | 830,818 |
| 2017 | 938,044 |
| 2018 | 1,063,442 |
| 2019 | 1,136,075 |
| 2020-2024 | 6,805,220 |

| | |
|---|---|
| Estimated Amortization for Next Fiscal Year | $ 934,763 |

For measurement purposes, a 6.5% annual rate of increase in per capita cost of covered health care benefits was assumed for 2015. The rate is assumed to decrease gradually to 4.5% to 2019 and remain at that level thereafter. A 6.5% annual rate of increase in employee premiums was assumed for 2015. This rate is assumed to gradually decrease to 4.5% to 2019 and remain at that level thereafter.

On December 8, 2003, the President signed into law the Medicare Prescription Drug Improvement and Modernization Act of 2003. This Act introduces a prescription drug benefit under Medicare Part D as well as a federal subsidy to sponsors of retiree healthcare benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. SMECO has not, and does not intend to, apply for this subsidy for the years ended December 31, 2014 and 2013.

**B. Health Insurance** - SMECO is self-insured for medical and dental claims of its current employees and retirees and their covered dependents. SMECO is liable for claims of up to $150,000 per occurrence for medical claims and $2,000 per year per participant for dental claims. Catastrophic coverage is maintained to pay claims in excess of these amounts. Claims paid under this plan approximated $7.0 million in 2014 and $6.2 million in 2013. Provisions for claims incurred but not reported have been made based on claim experience and approximated $245,000 and $462,000 as of December 31, 2014 and 2013, respectively.

**C. 401(k) Plans** - SMECO maintains 401(k) plans for its management and bargaining unit employees. All full-time employees are eligible to participate in the plans after meeting minimum service requirements. SMECO matches employee contributions to the management plan up to 6% of annual compensation. Effective with the freeze of the Pension Plan (see Note 8A), the amount of SMECO's non-elective employer contribution for compensation earned on or after January 1, 2011, varies based on length of service. For employees with 0 - 4 years of service, the contribution will be 3% of base pay; 5 - 20 years of service, 7% of base pay; and more than 20 years of service, 9% of base pay. During 2014 and 2013, SMECO recorded 401(k) plan-related expenses of approximately $3.9 million and $3.3 million, respectively.

**D. Workers' Compensation Trust** - SMECO is self-insured for workers' compensation insurance through a separate trust which was established to pay workers' compensation claims. Contributions to the trust are based upon an actuarial valuation and SMECO maintains excess liability insurance coverage of up to $2 million per incident for claims exceeding the net assets available for benefits in the trust. Transactions within the trust are not reflected in the accompanying consolidated financial statements. During 2014 and 2013, SMECO made aggregated contributions to the trust of $570,000 and $490,000, respectively. At December 31, 2014 and 2013, the trust had estimated net assets available for benefits of $200,208 and ($32,984), respectively.

**Note 9: Patronage Capital and Other Equities**

Assigned patronage capital consists of net margins that have been allocated to individual member patronage accounts. Patronage capital is applied against unpaid accounts receivable when customers leave SMECO. Patronage capital retirements to date represent amounts that have been paid to individual members. Patronage capital activity as of December 31, 2014 and 2013 consisted of the following:

| | 2014 | 2013 |
|---|---|---|
| Assignable | $ 8,417,636 | $ 18,002,711 |
| Assigned to date | 283,326,618 | 265,313,116 |
| | 291,744,254 | 283,315,827 |
| Less: Retirements to date | (87,488,421) | (86,202,461) |
| Patronage capital | $204,255,833 | $197,113,366 |

Other equities consist of donated capital from members and nonrefundable membership fees that were previously collected from new members upon joining SMECO.

**Note 10: Long-Term Debt**

SMECO has obtained long-term debt from RUS; CFC; CoBank; National Cooperative Services Corporation (NCSC), a wholly-owned subsidiary of CFC; and Federal Financing Bank (FFB). SMECO is subject to various loan covenants under its master mortgage and substantially all assets are pledged as collateral for the long-term debt. The covenants include maintaining certain minimum debt service and equity to assets ratio requirements. SMECO Solar LLC has obtained long-term debt from FFB, which has been guaranteed by SMECO. The following debt was outstanding as of December 31, 2014 and 2013:

| Lender | Interest Rates | Maturity (Year) | 2014 | 2013 |
|---|---|---|---|---|
| RUS | 3.44–5.19% | 2034-41 | $114,760,656 | $117,157,280 |
| CFC | 3.35–9.50% | 2015-30 | 16,771,782 | 19,289,738 |
| CoBank | 2.85–6.44% | 2017-40 | 68,417,813 | 74,187,106 |
| NCSC | 7.25% | 2015 | 3,345,964 | 6,459,950 |
| FFB | 2.34–8.07% | 2025-46 | 232,552,898 | 195,614,835 |
| Total debt outstanding | | | 435,849,113 | 412,708,909 |
| Less: Current maturities | | | 19,075,025 | 16,924,219 |
| Long-term debt | | | $416,774,088 | $395,784,690 |

At December 31, 2014, the required principal payments of the long-term debt are as follows:

| | |
|---|---|
| 2015 | $ 19,075,025 |
| 2016 | 14,790,994 |
| 2017 | 15,329,596 |
| 2018 | 14,842,256 |
| 2019 | 15,440,038 |
| Thereafter | 356,371,204 |
| Total | $435,849,113 |

Cash paid for interest totaled approximately $20.7 million and $18.4 million for the years ended December 31, 2014 and 2013, respectively. Unadvanced loan funds totaled $40.7 million as of December 31, 2013.

SMECO has received requisite approvals from RUS and the PSC to buy out of the RUS loan program and refinance approximately $330 million in long term debt, currently outstanding with RUS and FFB, with CoBank and CFC. Final settlement of the refinance is anticipated in early 2015. Future long term debt will be financed through CoBank, CFC and the private placement market.

SMECO maintains unsecured revolving line of credit agreements at variable interest rates with CoBank and CFC for its short-term borrowing needs. The CoBank agreement expires March 31, 2015. The CFC agreement automatically renews each March unless CFC or SMECO provides written notice not to renew at least 90 days in advance of the renewal date.

As of December 31, 2014, SMECO had authorized lines of credit of $175 million with CFC and $125 million with CoBank. Pursuant to limitations on total unsecured debt of $200 million, amounts borrowed from either CFC or CoBank may reduce the amounts available from the other party. SMECO received a temporary waiver on limitations of unsecured debt of $200 million until March 30, 2015.

As of December 31, 2014 and 2013, SMECO had outstanding letters of credit totaling $15.4 million and $17.7 million, respectively.

The outstanding balances for CoBank lines of credit and their respective interest rates as of December 31, 2014 were $75.0 million at 1.78% and $50.0 million at 2.72% and for 2013 were $45.0 million at 1.76% and $25.0 million at 2.73%. The outstanding balances for CFC lines of credit and their respective interest rates as of December 31, 2014 were $33.0 million at 2.9% and as of December 31, 2013 were $60.5 million at 2.9%.

**Note 11: Leases**

SMECO is obligated under long-term capital leases for utility equipment, office furniture and equipment and vehicles that expire at various dates through 2024. The future minimum lease payments required under the capital leases and the present value of the net minimum lease payments as of December 31, 2014, are as follows:

| | |
|---|---|
| 2015 | $ 3,165,677 |
| 2016 | 2,460,614 |
| 2017 | 2,097,163 |
| 2018 | 1,566,109 |
| 2019 | 1,056,317 |
| Thereafter | 2,338,819 |
| Total minimum lease payments | 12,684,699 |
| Less: Amount representing interest | (2,011,222) |
| Present value of minimum lease payments | 10,673,477 |
| Less: Current obligations | (2,850,590) |
| Long-term capital lease obligation | $ 7,822,887 |

The assets under capital leases are included in the consolidated balance sheets as part of net utility plant as follows:

| | 2014 | 2013 |
|---|---|---|
| Distribution | $ 9,852,280 | $7,551,930 |
| General | 6,513,246 | 5,009,407 |
| | 16,365,526 | 12,561,337 |
| Less: Accumulated depreciation | (1,464,815) | (1,038,390) |
| | $14,900,711 | $11,522,947 |

Interest paid on the capital lease obligations for the years ended December 31, 2014 and 2013 was $374,733 and $310,180, respectively. The capital leases are collateralized by the assets leased under the agreements, which are recorded in the accompanying consolidated balance sheet. Depreciation expense at December 31, 2014 and 2013 relating to these assets was $614,287 and $459,556, respectively.

SMECO leases many of its vehicles and power-operated equipment for various terms under long-term, operating lease agreements. The leases expire at various dates through 2019. At the expiration of the scheduled lease term, SMECO can either purchase the equipment at fair market value, have the lessor sell the equipment on its behalf or renew the lease for twelve or twenty-four months. Operating lease expense amounted to $2,027,659 and $1,882,175 in 2014 and 2013, respectively.

The future minimum rental payments required under the operating lease agreements as of December 31, 2014, are as follows:

| | |
|---|---|
| 2015 | $1,972,128 |
| 2016 | 1,500,122 |
| 2017 | 995,756 |
| 2018 | 489,249 |
| 2019 | 43,689 |
| Total | $5,000,944 |

Pursuant to a 50-year operating lease, SMECO is obligated to rent the parcel of land on which SMECO's combustion turbine is located at the Chalk Point Generating Station (see Note 6). SMECO makes annual rental payments of $5,000 under the lease agreement that expires in 2039.

**Note 12: Commitments and Contingencies**

SMECO contracts with various suppliers for energy and energy-related products to serve its native load requirements. As of December 31, 2014, SMECO had forward purchase commitments with multiple parties through May 2035 covering a significant portion of SMECO's power supply needs.

At December 31, 2014 and 2013, SMECO had made commitments for capital expenditures of approximately $13.6 million and $38.9 million, respectively.

SMECO is involved in legal proceedings in the normal course of business. Management is of the opinion that the final disposition of these proceedings will not have a material adverse effect on SMECO's financial position, results of operations or cash flows.

**Note 13: Concentration of Risk**

The electric utility industry continues to be subject to increasing competitive pressures, consolidation and restructuring. Federal and state legislatures and regulators, including the United States Congress, Maryland General Assembly and PSC, and large industrial electricity consumers are working to reshape the industry through legislative and regulatory initiatives that increase electric competition at the generation, transmission and distribution levels.

Under Maryland's Electric Customer Choice and Competition Act and the Electric and Gas Utility Tax Reform Act, electric customers residing in Maryland are entitled to select or choose their electric energy supplier. As of December 31, 2014, SMECO had 2,081 customers served by an alternative electricity supplier. SMECO continues to provide distribution service to all of its customers.

The outcome of these initiatives and their impact on SMECO is uncertain. Customer choice and the resulting retail competition will likely continue to affect the entire industry.

With the assistance of ACES (see Notes 5 and 12), SMECO has developed a more diversified market strategy to meet future power supply needs, including reduced dependence on a single supplier and varied contract termination dates. This approach represents a significant departure from the traditional cooperative model of multiple year contracts with a sole supplier. Given the changes in the wholesale power market in recent years, SMECO has concluded that it is no longer operationally or economically prudent to engage in the traditional full-requirements contract with one supplier.

In order to meet its power supply requirements for its standard offer service customers, SMECO has executed numerous Master Power Purchase and Sale Agreements with a number of counterparties. Such agreements stipulate credit limits and other information pertaining to the establishment of trading relationships. Accordingly, SMECO is subject to the normal market, credit and performance risks inherent in these arrangements. To monitor and mitigate such risk exposure, SMECO continues to work closely with ACES personnel, has created and implemented related trading and credit policies and has established Board and internal risk oversight committees that meet frequently to address pertinent matters.

Financial instruments that subject SMECO to concentration of credit risks include customer accounts receivable and the RUS loan programs. SMECO places its cash on deposit with financial institutions located in the United States of America, which are insured by the Federal Deposit Insurance Corporation (FDIC). The FDIC provides insurance coverage for up to $250,000 of cash held by SMECO in each separate FDIC insured bank and savings institution. From time to time, SMECO may have amounts on deposit in excess of the insured limits. As of December 31, 2014, SMECO had approximately $4.8 million of deposits that exceeded the insured limits. SMECO grants credit to customers, substantially all of whom are local residents of SMECO's four-county service area. In 2014, SMECO obtained 100% of its new debt under the RUS loan program. The RUS loan program is subject to federal legislative changes which could affect the interest rates and availability of future loans under the program.

SMECO expects to buy out of the RUS loan program in 2015 and refinance its existing RUS and FFB debt with CoBank and CFC. Current expectations are that future long-term debt will be financed using various sources such as CoBank, CFC and the private placement market.

**Note 14: Fair Value of Financial Instruments**

SMECO has accounted for all financial instruments, classified as derivatives, at fair market value. SMECO has accounted for all other financial instruments based on the carrying amount (book value) in the financial statements in accordance with GAAP. According to guidance set forth by FASB, SMECO is required to disclose the fair value of those financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using discounted cash flow analysis. This technique involves subjective judgment and is significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. As a result, the derived fair value estimates cannot be substantiated by comparison to independent markets, and in many cases, could not be realized in immediate settlement of the instrument.

Accordingly, the following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it was practicable to estimate that value.

Cash and Cash Equivalents

The carrying amount of cash and cash equivalents approximates fair value due to the short maturity of these instruments.

Accounts Receivable

The carrying amount of accounts receivable approximates fair value due to the short period of time amounts are outstanding.

Investments in Associated Organizations

Fair value of capital term certificates was determined by computing the present value of estimated future cash flows, discounted at the long-term treasury rate of 2.75% and 3.96% as of December 31, 2014 and 2013, respectively. The fair value of patronage capital is not determinable since no legal obligation exists to retire capital credits. The fair value of the equity method investment is not estimated since there are no identified events or changes in circumstances that may have a significant adverse effect on the fair value and it is not practicable to estimate fair value. The carrying value of memberships approximates fair value.

Accounts Payable

The carrying amount of accounts payable approximates fair value due to the short period of time amounts are outstanding.

Long-Term Debt

The carrying amount of SMECO's fixed long-term debt includes certain interest rates that are below quoted market prices for the same or similar issues. Therefore, the fair value of fixed long-term debt is estimated based on current market prices for the same or similar issues offered for debt of the same and remaining maturities which was 5.40% and 6.50% as of December 31, 2014 and 2013, respectively.

The carrying amount of lines of credit approximates fair value due to the short maturity of these instruments.

Consumer Deposits

The carrying amount approximates fair value due to the relatively short maturity of the deposits.

The estimated fair value of SMECO's financial instruments, reported at cost, is as follows:

| | Carrying Value | | Fair Value | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| | (000 Omitted) | | (000 Omitted) | |
| Assets: | | | | |
| Capital Term Certificates | $ 5,185 | $ 7,022 | $ 7,470 | $ 8,605 |
| Liabilities: | | | | |
| Long-term Debt | (435,849) | (412,709) | (406,263) | (343,846) |

**Note 15: Fair Value Measurements**

SMECO follows the guidance issued by FASB as it relates to the accounting and disclosure requirements for financial instruments reported as assets and liabilities at fair value. This guidance also establishes a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability. Inputs may be observable or unobservable and refer broadly to the assumptions that market participants would use in pricing the asset or liability. Observable inputs reflect the assumptions market participants would use in pricing the asset or liability based on market data obtained from sources independent of the reporting entity. Unobservable inputs reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

The three levels of the fair value hierarchy are described as follows:

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 - Other significant observable inputs, including quoted prices for similar assets or liabilities in markets that are not active.

Level 3 - Significant unobservable inputs, which are generally based on SMECO's own assumptions.

The following table summarizes the financial liabilities measured at fair value:

| | December 31, 2014 (000 Omitted) | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Derivative Assets, net | $ 5,591 | $ - | $ 5,591 | $ - |
| Liabilities: | | | | |
| Derivative Liabilities, net | ($47,809) | $ - | ($47,809) | $ - |

| | December 31, 2013 (000 Omitted) | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| Derivative Liabilities, net | ($61,266) | $ - | ($61,226) | $ - |

The fair value of derivative liabilities is comprised of forward trades, power and gas positions and Financial Transmission Rights (FTRs). The fair value of all forward trades is calculated by a third party, ACES, using market prices when possible and modeled forward prices including constant heat rate projections, supply-demand simulation generated values, inflation escalated market prices, or a blend of these sources when market prices are not available. The power positions are valued at AEP Dayton - Dominion Zone, Brandywine, PJM East or PJM West and the gas positions are valued using NYMEX Henry Hub or TRANSCO Zone 6 Non-NY pricing. FTRs are marked-to-market based on data from the most recent FTR auction.

### Note 16: Related Party Transactions

SMECO is a member of CFC, NCSC and CoBank. Pursuant to the member relationships, SMECO has invested in CFC and CoBank, entered into various loan agreements with the three organizations and maintains unsecured lines of credit with CFC and CoBank (see Notes 4 and 10). SMECO earned interest income of about $283,100 and $392,600 in 2014 and 2013, respectively, on investments with CFC. During years 2014 and 2013, SMECO paid interest expense of approximately $7.5 million and $7.4 million, respectively, on aggregated loans from CFC, NCSC and CoBank.

As a customer, NRG is a member of SMECO. SMECO has entered into a direct financing lease with NRG (see Note 6).

SMECO invested in and became a member of ACES during 2003 to engage ACES' professional assistance in meeting future power supply needs (see Note 5). In addition to the membership fee, SMECO paid ACES approximately $1.0 million and $978,000 for such services during 2014 and 2013, respectively.

SMECO invested in and became a member of National Renewables Cooperative Organization (NRCO) during 2008 to utilize NRCO's services in the analysis of renewable projects in which SMECO may choose to participate in order to fulfill the Maryland Renewable Portfolio Standard obligations (see Note 4). SMECO paid NRCO approximately $97,000 and $29,000 for such services in 2014 and 2013, respectively. Additionally, SMECO paid NRCO approximately $65,000 in 2013 for their consulting services relating to the establishment of SMECO Solar LLC.

SMECO is a member of Electric Research and Manufacturing Cooperative (ERMCO) and purchases materials and supplies from them (see Note 4). During 2014 and 2013, SMECO purchased approximately $704,000 and $227,000, respectively, of materials and supplies from ERMCO.

SMECO is a member of Federated Rural Electric Insurance Corporation (Federated) and purchases general liability and property insurance from them (see Note 4). During 2014 and 2013, SMECO purchased insurance from Federated totaling about $809,000 and $838,000, respectively.

ADAMS, JENKINS AND CHEATHAM
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS CONSULTANTS

**Independent Auditor's Report on Supplementary Information**

To the Board of Directors of
Southern Maryland Electric Cooperative, Inc.
and SMECO Solar LLC

We have audited the consolidated financial statements of Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC ("SMECO") for the years ended December 31, 2014 and 2013, and our report thereon dated March 10, 2015, which expressed an unmodified opinion on those consolidated financial statements appears on pages 1 and 2. Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating financial information and comparative summary of operations is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual entities, and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

We also have previously audited, in accordance with auditing standards generally accepted in the United States of America, the balance sheets of SMECO as of December 31, 2012, 2011, and 2010, and the related statements of revenue, expenses and patronage capital and comprehensive income, and cash flows for each of the three years then ended (none of which is presented herein), and we expressed unmodified opinions on those financial statements. In our opinion, the comparative summary of operations is fairly stated in all material respects in relation to the basic consolidated financial statements from which it has been derived.

Adams, Jenkins & Cheatham

Richmond, Virginia
March 10, 2015



231 Wylderose Drive | Midlothian, VA 23113 | 804.323.1313

**Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC**
**Consolidating Balance Sheets**
**December 31, 2014**

| | SMECO | SMECO Solar LLC | Eliminations | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| Utility Plant, at Original Cost (Notes 2 and 3) | $ 1,013,345,778 | $ 14,218,160 | $ - | $ 1,027,563,938 |
| Less: Accumulated Depreciation and Amortization | (322,783,965) | (1,476,558) | - | (324,260,523) |
| Net utility plant | 690,561,813 | 12,741,602 | - | 703,303,415 |
| Nonutility Property (net) | 2,024,867 | - | - | 2,024,867 |
| Investments (Note 2): | | | | |
| Investments in associated organizations, at cost (Note 4) | 12,273,378 | - | - | 12,273,378 |
| Investment in an unconsolidated entity (Note 5) | 1,183,868 | - | - | 1,183,868 |
| Investment in SMECO Solar LLC (Note 2) | 148,549 | - | (148,549) | - |
| Other investments | 11,944,069 | - | - | 11,944,069 |
| Total investments | 25,549,864 | - | (148,549) | 25,401,315 |
| Current Assets (Note 2): | | | | |
| Cash and cash equivalents | 5,024,218 | 1,619,930 | - | 6,644,148 |
| Accounts receivable, net of allowance for doubtful accounts of $900,000 and $1,200,000 respectively | 54,689,447 | - | - | 54,689,447 |
| Materials and supplies inventory | 13,186,594 | 22,169 | - | 13,208,763 |
| Prepaid expenses | 10,025,401 | 63,231 | - | 10,088,632 |
| Current portion of direct financing lease (Note 6) | 4,504,717 | - | - | 4,504,717 |
| Intercompany receivables | 196,566 | 62,183 | (258,749) | - |
| Other current assets | 7,731,019 | - | - | 7,731,019 |
| Total current assets | 95,357,962 | 1,767,513 | (258,749) | 96,866,726 |
| Regulatory Assets (Notes 2 and 7) | 77,186,544 | - | - | 77,186,544 |
| Deferred Charges and Other (Note 2) | 10,162,439 | - | - | 10,162,439 |
| Derivative Assets (Notes 2 and 15) | 5,591,119 | - | - | 5,591,119 |
| Total assets | $ 906,434,608 | $ 14,509,115 | $ (407,298) | $ 920,536,425 |
| **Equities and Liabilities** | | | | |
| Equities (Note 9): | | | | |
| Patronage capital | $ 204,255,833 | $ - | $ - | $ 204,255,833 |
| Other equities | 8,139,540 | 148,549 | (148,549) | 8,139,540 |
| Accumulated other comprehensive (loss) | (84,809,741) | - | - | (84,809,741) |
| Total equities | 127,585,632 | 148,549 | (148,549) | 127,585,632 |
| Long-Term Debt, Less Current Maturities (Notes 10 and 14) | 403,168,494 | 13,605,594 | - | 416,774,088 |
| Current Liabilities: | | | | |
| Accounts payable | 31,673,187 | - | - | 31,673,187 |
| Current maturities of long-term debt (Note 10) | 18,516,619 | 558,406 | - | 19,075,025 |
| Notes payable (Note 10) | 158,000,000 | - | - | 158,000,000 |
| Current portion of obligations under capital lease (Note 11) | 2,850,590 | - | - | 2,850,590 |
| Customer deposits | 6,258,136 | - | - | 6,258,136 |
| Intercompany payables | 62,183 | 196,566 | (258,749) | - |
| Other current liabilities | 13,773,338 | - | - | 13,773,338 |
| Total current liabilities | 231,134,053 | 754,972 | (258,749) | 231,630,276 |
| Accrued Pension and Postretirement Benefits (Note 8) | 79,673,204 | - | - | 79,673,204 |
| Noncurrent Portion of Obligations Under Capital Lease (Note 11) | 7,822,887 | - | - | 7,822,887 |
| Deferred Credits | 9,241,381 | - | - | 9,241,381 |
| Derivative Liabilities (Notes 2 and 15) | 47,808,957 | - | - | 47,808,957 |
| Commitments and Contingencies (Notes 12 and 13) | - | - | - | - |
| Total equities and liabilities | $ 906,434,608 | $ 14,509,115 | $ (407,298) | $ 920,536,425 |

See Independent Auditor's Report on Supplementary Information.

## Southern Maryland Electric Cooperative, Inc.
## and SMECO Solar LLC
## Consolidating Statements of Revenue, Expenses and Patronage Capital
## Year Ended December 31, 2014

| | SMECO | SMECO Solar LLC | Eliminations | Total |
|---|---|---|---|---|
| Operating Revenue: | | | | |
| Sales of electricity | $ 460,931,055 | $ 1,435,427 | $ (1,435,427) | $ 460,931,055 |
| Lease income (Note 6) | 692,591 | - | (71,447) | 621,144 |
| Other | 21,625,695 | - | - | 21,625,695 |
| Total operating revenue | 483,249,341 | 1,435,427 | (1,506,874) | 483,177,894 |
| Operating Expenses: | | | | |
| Purchased power (Note 12) | 323,119,200 | - | (1,435,427) | 321,683,773 |
| Power production | 5,000 | 282,833 | (71,447) | 216,386 |
| Transmission | 4,016,843 | - | - | 4,016,843 |
| Distribution - operations | 10,227,779 | - | - | 10,227,779 |
| Distribution - maintenance | 18,794,091 | - | - | 18,794,091 |
| Customer accounts | 10,970,143 | - | - | 10,970,143 |
| Customer service and information | 17,929,786 | - | - | 17,929,786 |
| Administrative and general | 33,167,400 | 52,202 | - | 33,219,602 |
| Depreciation and amortization | 28,740,398 | 710,515 | - | 29,450,913 |
| Taxes | 13,751,458 | 108,584 | - | 13,860,042 |
| Other | 361,564 | - | - | 361,564 |
| Total operating expenses | 461,083,662 | 1,154,134 | (1,506,874) | 460,730,922 |
| Operating margins | 22,165,679 | 281,293 | - | 22,446,972 |
| Interest Expense: | | | | |
| Interest on long-term debt | 17,082,879 | 452,257 | - | 17,535,136 |
| Other interest | 1,877,250 | - | - | 1,877,250 |
| Total interest expenses | 18,960,129 | 452,257 | - | 19,412,386 |
| Net Operating Margins (Loss) | 3,205,550 | (170,964) | - | 3,034,586 |
| Other Patronage Allocations | 2,372,848 | - | - | 2,372,848 |
| Total operating margins (loss) | 5,578,398 | (170,964) | - | 5,407,434 |
| Nonoperating Margins | 2,850,029 | 73,950 | 97,014 | 3,020,993 |
| Net margins (loss) | $ 8,428,427 | $ (97,014) | $ 97,014 | $ 8,428,427 |
| Patronage Capital & Other Equities, Beginning of Year | $ 197,113,366 | $ 245,563 | $ (245,563) | $ 197,113,366 |
| Net Margins (Loss) | 8,428,427 | (97,014) | 97,014 | 8,428,427 |
| Distribution of Capital Credits | (1,285,960) | - | - | (1,285,960) |
| Patronage capital & other equities, end of year | $ 204,255,833 | $ 148,549 | $ (148,549) | $ 204,255,833 |

## Consolidating Statements of Comprehensive Income
## Year Ended December 31, 2014

| | SMECO | SMECO Solar LLC | Eliminations | Total |
|---|---|---|---|---|
| Net Margins (Loss) | $ 8,428,427 | $ (97,014) | $ 97,014 | $ 8,428,427 |
| Other Comprehensive (Loss): | | | | |
| Net (loss) during period | (40,247,028) | - | - | (40,247,028) |
| Amortization of net (loss) | (1,678,722) | - | - | (1,678,722) |
| Other comprehensive (loss) | (41,925,750) | - | - | (41,925,750) |
| Comprehensive (Loss) Income | $ (33,497,323) | $ (97,014) | $ 97,014 | $ (33,497,323) |

See Independent Auditor's Report on Supplementary Information.

# Southern Maryland Electric Cooperative, Inc.
## and SMECO Solar LLC
## Comparative Summary of Operations
## Years Ended December 31, 2014 - 2010

| | 2014 | 2013 | 2012 | 2011 | 2010 |
|---|---|---|---|---|---|
| Operating Revenue: | | | | | |
| Sales of electricity | $ 460,931,055 | $ 438,346,363 | $ 403,170,680 | $ 435,200,226 | $ 482,248,410 |
| Lease income | 621,144 | 1,538,359 | 2,005,961 | 2,415,140 | 2,773,195 |
| Other | 21,625,695 | 19,475,805 | 13,316,654 | 11,854,049 | 7,646,339 |
| Total operating revenue | 483,177,894 | 459,360,527 | 418,493,295 | 449,469,415 | 492,667,944 |
| Operating Expenses: | | | | | |
| Purchased power | 321,683,773 | 297,747,235 | 275,256,422 | 312,274,549 | 354,885,238 |
| Power production | 216,386 | 177,683 | 2,167 | - | - |
| Transmission | 4,016,843 | 3,893,596 | 3,684,194 | 3,184,075 | 3,246,566 |
| Distribution - operations | 10,227,779 | 9,732,884 | 8,315,945 | 8,110,012 | 7,264,686 |
| Distribution - maintenance | 18,794,091 | 18,466,029 | 16,829,638 | 16,209,398 | 16,521,451 |
| Customer accounts | 10,970,143 | 10,140,122 | 9,253,741 | 8,579,949 | 8,202,811 |
| Customer service and information | 17,929,786 | 15,694,102 | 11,007,022 | 7,894,534 | 4,557,947 |
| Administrative and general | 33,219,602 | 32,859,833 | 30,078,841 | 27,868,433 | 28,422,330 |
| Depreciation and amortization | 29,450,913 | 26,134,423 | 26,487,914 | 24,982,801 | 27,174,659 |
| Taxes | 13,860,042 | 12,152,377 | 12,589,731 | 9,787,305 | 10,253,691 |
| Other | 361,564 | 382,440 | 317,770 | 340,144 | 340,448 |
| Total operating expenses | 460,730,922 | 427,380,724 | 393,823,385 | 419,231,200 | 460,869,827 |
| Operating margins | 22,446,972 | 31,979,803 | 24,669,910 | 30,238,215 | 31,798,117 |
| Interest Expense: | | | | | |
| Interest on long-term debt | 17,535,136 | 16,039,006 | 16,098,719 | 16,099,488 | 15,295,576 |
| Other interest | 1,877,250 | 1,630,428 | 865,966 | 937,993 | 2,414,624 |
| Total interest expense | 19,412,386 | 17,669,434 | 16,964,685 | 17,037,481 | 17,710,200 |
| Net Operating Margins | 3,034,586 | 14,310,369 | 7,705,225 | 13,200,734 | 14,087,917 |
| Other Patronage Allocations | 2,372,848 | 1,763,339 | 1,398,309 | 1,226,017 | 1,369,027 |
| Total operating margins | 5,407,434 | 16,073,708 | 9,103,534 | 14,426,751 | 15,456,944 |
| Nonoperating Margins | 3,020,993 | 1,926,791 | 3,755,426 | 686,035 | 1,596,952 |
| Net margins | $ 8,428,427 | $ 18,000,499 | $ 12,858,960 | $ 15,112,786 | $ 17,053,896 |
| Patronage Capital, Beginning of Year | $ 197,113,366 | $ 180,480,809 | $ 170,117,158 | $ 158,811,239 | $ 142,658,535 |
| Net Margins | 8,428,427 | 18,000,499 | 12,858,960 | 15,112,786 | 17,053,896 |
| Distribution of Capital Credits | (1,285,960) | (1,367,942) | (2,495,309) | (3,806,867) | (901,192) |
| Patronage capital, end of year | $ 204,255,833 | $ 197,113,366 | $ 180,480,809 | $ 170,117,158 | $ 158,811,239 |
| Electric Revenue: | | | | | |
| Residential | $ 302,538,996 | $ 293,263,234 | $ 268,659,885 | $ 279,647,444 | $ 308,894,513 |
| General service | 134,650,211 | 122,594,208 | 112,813,667 | 120,531,733 | 124,854,802 |
| Large power | 17,543,851 | 16,954,218 | 16,813,427 | 18,599,089 | 22,663,254 |
| Street lights | 2,414,335 | 2,324,151 | 2,215,760 | 2,047,584 | 1,841,175 |
| Transmission | 3,762,725 | 3,207,636 | 2,667,941 | 14,374,376 | 23,994,666 |
| Solar facility services | 20,937 | 2,916 | - | - | - |
| Total | $ 460,931,055 | $ 438,346,363 | $ 403,170,680 | $ 435,200,226 | $ 482,248,410 |
| Megawatt-Hour Sales: | | | | | |
| Residential | 2,159,553 | 2,135,838 | 2,043,774 | 2,113,645 | 2,216,406 |
| General service | 1,127,834 | 1,106,967 | 1,111,438 | 1,017,715 | 956,418 |
| Large power | 151,599 | 165,767 | 184,385 | 176,605 | 179,828 |
| Street lights | 6,986 | 6,947 | 6,703 | 6,241 | 5,897 |
| Transmission | 41,329 | 33,137 | 29,763 | 123,363 | 204,230 |
| Solar facility services | 60 | 12 | - | - | - |
| Total | 3,487,361 | 3,448,668 | 3,376,063 | 3,437,569 | 3,562,779 |
| Customers at Year End (Billings) | 160,213 | 156,533 | 154,346 | 152,730 | 150,152 |

See Independent Auditor's Report on Supplementary Information.

**Independent Auditor's 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***

The Board of Directors
Southern Maryland Electric Cooperative, Inc.
and SMECO Solar LLC

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC ("SMECO"), which comprise the consolidated balance sheets as of December 31, 2014 and the related consolidated statements of revenue, expenses, and patronage capital and comprehensive income and the consolidated statements of cash flows as of and for the year ended December 31, 2014, and the related notes to the financial statements, and have issued our report thereon dated March 10, 2015.

**Internal Control Over Financial Reporting**

In planning and performing our audits of the consolidated financial statements, we considered SMECO's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of SMECO's internal control. Accordingly, we do not express an opinion on the effectiveness of SMECO'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 combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's consolidated financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or 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 over financial reporting that might be material weaknesses or significant deficiencies. Given these limitations, during our audits 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 SMECO's consolidated financial statements are free of 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 consolidated 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*.

We noted certain matters that we reported to management of SMECO in a separate letter dated March 10, 2015.



231 Wylderose Drive | Midlothian, VA 23113 | 804.323.1313

**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 SMECO's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering SMECO's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Adams, Jenkins & Cheatham

Richmond, Virginia
March 10, 2015

ADAMS, JENKINS AND CHEATHAM
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS CONSULTANTS

**Independent Auditor's Report on Compliance With Aspects of Contractual Agreements and Regulatory Requirements for Electric Borrowers**

The Board of Directors
Southern Maryland Electric Cooperative, Inc.
and SMECO Solar LLC

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 Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC ("SMECO"), which comprise the balance sheet as of December 31, 2014, and the related statements of revenue, expenses, patronage capital and comprehensive income and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated March 10, 2015. In accordance with *Government Auditing Standards*, we have also issued a report dated March 10, 2015 on our consideration of SMECO's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. No reports other than the reports referred to above and our schedule of findings and recommendations related to our audit have been furnished to management.

In connection with our audit, nothing came to our attention that caused us to believe that SMECO failed to comply with the terms, covenants, provisions, or conditions of their loan, grant, and security instruments as set forth in 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers*, §1773.33 and clarified in the RUS policy memorandum dated February 7, 2014, insofar as they relate to accounting matters as enumerated below. However, our audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding SMECO's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they related to accounting matters. In connection with our audit, we noted no matters regarding SMECO's accounting and records to indicate that SMECO did not:

- Maintain adequate and effective accounting procedures;
- Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts;
- Reconcile continuing property records to the controlling general ledger plant accounts;
- Clear construction accounts and accrue depreciation on completed construction;
- Record and properly price the retirement of plant;
- Seek approval of the sale, lease or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap;
- Maintain adequate control over materials and supplies;
- Prepare accurate and timely Financial and Operating Reports;



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- Obtain written RUS approval to enter into any contract for the management, operations, or maintenance of the borrower's system if the contract covers all or substantially all of the electric system;

- Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles;

- Record depreciation in accordance with RUS requirements (See RUS Bulletin 183-1, Depreciation Rates and Procedures);

- Comply with the requirements for the detailed schedule of deferred debits and deferred credits; and

- Comply with the requirements for the detailed schedule of investments.

This report is intended solely for the information and use of the board of directors, management, and the RUS and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Adams, Jenkins & Cheatham

Richmond, Virginia
March 10, 2015

# Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC

## Financial Statements

## December 31, 2015 and 2014

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### Financial Statements



### Supplementary Information

ADAMS, JENKINS AND CHEATHAM
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS CONSULTANTS

## Independent Auditor's Report

The Board of Directors
Southern Maryland Electric Cooperative, Inc.
and SMECO Solar LLC

**Report on the Financial Statements**

We have audited the accompanying consolidated financial statements of Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC ("SMECO") which comprise the balance sheets as of December 31, 2015 and 2014 and the related statements of revenue, expenses and comprehensive income, changes in equities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

**Management's Responsibility for the Consolidated Financial Statements**

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

**Auditor's Responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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



231 Wylderose Drive | Midlothian, VA 23113 | 804.323.1313

**Opinion**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of SMECO as of December 31, 2015 and 2014, 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.

Adams, Jenkins & Cheatham

Richmond, Virginia
March 8, 2016

## Southern Maryland Electric Cooperative, Inc.
## and SMECO Solar LLC
## Consolidated Balance Sheets
## December 31, 2015 and 2014

| | 2015 | 2014 |
|---|---|---|
| **Assets** | | |
| Utility Plant, at Original Cost (Notes 2 and 3) | $ 1,086,799,102 | $ 1,027,563,938 |
| Less: Accumulated Depreciation and Amortization | (344,788,178) | (324,260,523) |
| Net utility plant | 742,010,924 | 703,303,415 |
| Nonutility Property (net) | 1,958,546 | 2,024,867 |
| Investments (Note 2): | | |
| Investments in associated organizations, at cost (Note 4) | 13,383,618 | 12,273,378 |
| Investment in an unconsolidated entity (Note 5) | 1,201,111 | 1,183,868 |
| Other investments | 23,069,821 | 11,944,069 |
| Total investments | 37,654,550 | 25,401,315 |
| Current Assets (Note 2): | | |
| Cash and cash equivalents | 6,436,020 | 6,644,148 |
| Accounts receivable, net of allowance for doubtful accounts of $900,000 | 38,476,695 | 54,689,447 |
| Materials and supplies inventory | 12,901,423 | 13,208,763 |
| Prepaid expenses | 7,667,984 | 10,088,632 |
| Current portion of direct financing lease (Note 6) | - | 4,504,717 |
| Other current assets | 11,761,660 | 7,731,019 |
| Total current assets | 77,243,782 | 96,866,726 |
| Regulatory Assets (Notes 2 and 7) | 86,876,566 | 77,186,544 |
| Deferred Charges and Other (Note 2) | 34,750,509 | 10,162,439 |
| Derivative Assets (Notes 2 and 15) | 4,822,133 | 5,591,119 |
| Total assets | $ 985,317,010 | $ 920,536,425 |
| **Equities and Liabilities** | | |
| Equities (Note 9): | | |
| Patronage capital | $ 193,597,616 | $ 204,255,833 |
| Other equities | 26,355,732 | 8,139,540 |
| Accumulated other comprehensive (loss) | (87,503,582) | (84,809,741) |
| Total equities | 132,449,766 | 127,585,632 |
| Long-Term Debt, Less Current Maturities (Notes 10 and 14) | 413,388,051 | 416,774,088 |
| Current Liabilities: | | |
| Accounts payable | 28,560,636 | 31,673,187 |
| Current maturities of long-term debt (Note 10) | 19,537,261 | 19,075,025 |
| Notes payable (Note 10) | 194,800,000 | 158,000,000 |
| Current portion of obligations under capital lease (Note 11) | 2,164,203 | 2,850,590 |
| Customer deposits | 6,834,934 | 6,258,136 |
| Other current liabilities | 39,451,053 | 13,773,338 |
| Total current liabilities | 291,348,087 | 231,630,276 |
| Accrued Pension and Postretirement Benefits (Note 8) | 81,074,155 | 79,673,204 |
| Noncurrent Portion of Obligations Under Capital Lease (Note 11) | 6,241,911 | 7,822,887 |
| Deferred Credits | 6,817,946 | 9,241,381 |
| Derivative Liabilities (Notes 2 and 15) | 53,997,094 | 47,808,957 |
| Commitments and Contingencies (Notes 12 and 13) | - | - |
| Total equities and liabilities | $ 985,317,010 | $ 920,536,425 |

The accompanying notes are an integral part of the above statements.

## Southern Maryland Electric Cooperative, Inc.
## and SMECO Solar LLC
## Consolidated Statements of Revenue and Expenses
## Years Ended December 31, 2015 and 2014

| | 2015 | 2014 |
|---|---|---|
| Operating Revenue: | | |
| Sales of electricity | $ 405,399,569 | $ 460,931,055 |
| Lease income (Note 6) | - | 621,144 |
| Other | 22,959,601 | 21,625,695 |
| Total operating revenue | 428,359,170 | 483,177,894 |
| Operating Expenses: | | |
| Purchased power (Note 12) | 268,004,220 | 321,683,773 |
| Power production | 241,473 | 216,386 |
| Transmission | 3,294,460 | 4,016,843 |
| Distribution - operations | 10,335,018 | 10,227,779 |
| Distribution - maintenance | 19,678,200 | 18,794,091 |
| Customer accounts | 11,657,223 | 10,970,143 |
| Customer service and information | 19,337,758 | 17,929,786 |
| Administrative and general | 38,048,920 | 33,219,602 |
| Depreciation and amortization | 32,506,510 | 29,450,913 |
| Taxes | 15,991,502 | 13,860,042 |
| Other | 1,350,253 | 361,564 |
| Total operating expenses | 420,445,537 | 460,730,922 |
| Operating margins | 7,913,633 | 22,446,972 |
| Interest Expense: | | |
| Interest on long-term debt | 15,491,096 | 17,535,136 |
| Other interest | 3,850,643 | 1,877,250 |
| Total interest expenses | 19,341,739 | 19,412,386 |
| Net Operating (Loss) Margins | (11,428,106) | 3,034,586 |
| Other Patronage Allocations | 3,802,958 | 2,372,848 |
| Total operating (loss) margins | (7,625,148) | 5,407,434 |
| Nonoperating Margins (Notes 6 and 17) | 17,226,561 | 3,020,993 |
| Net margins | $ 9,601,413 | $ 8,428,427 |

## Consolidated Statements of Comprehensive Income
## Years Ended December 31, 2015 and 2014

| | 2015 | 2014 |
|---|---|---|
| Net Margins | $ 9,601,413 | $ 8,428,427 |
| Other Comprehensive (Loss): | | |
| Net gain (loss) during period | 405,157 | (40,247,028) |
| Amortization of net (loss) | (3,098,998) | (1,678,722) |
| Other comprehensive (loss) | (2,693,841) | (41,925,750) |
| Comprehensive Income (Loss) | $ 6,907,572 | $ (33,497,323) |

The accompanying notes are an integral part of the above statements.

**Southern Maryland Electric Cooperative, Inc.
and SMECO Solar LLC
Condolidated Statements of Changes in Equities
Years Ended December 31, 2015 and 2014**

| | Patronage Capital | Other Equities | Accumulated Other Comprehensive Loss | Total |
|---|---|---|---|---|
| Balance, December 31, 2013 | $ 197,113,366 | $ 7,756,615 | $ (42,883,991) | $ 161,985,990 |
| Net margins | 8,428,427 | - | - | 8,428,427 |
| Retirement of capital credits | (1,285,960) | 382,925 | - | (903,035) |
| Other comprehensive loss | - | - | (41,925,750) | (41,925,750) |
| Balance, December 31, 2014 | 204,255,833 | 8,139,540 | (84,809,741) | 127,585,632 |
| Net (loss) margins | (7,399,796) | 17,001,209 | - | 9,601,413 |
| Retirement of capital credits | (3,258,421) | 1,214,983 | - | (2,043,438) |
| Other comprehensive loss | - | - | (2,693,841) | (2,693,841) |
| Balance, December 31, 2015 | $ 193,597,616 | $ 26,355,732 | $ (87,503,582) | $ 132,449,766 |

The accompanying notes are an integral part of the above statements.

# Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
# Consolidated Statements of Cash Flows
# Years Ended December 31, 2015 and 2014

| | 2015 | 2014 |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Net margins | $ 9,601,413 | $ 8,428,427 |
| Adjustments to reconcile net margins to net cash provided by operating activities: | | |
| Depreciation and amortization | 32,506,510 | 29,450,913 |
| Earnings in unconsolidated entities | (17,243) | (3,313) |
| Other patronage allocations | (3,802,958) | (2,372,848) |
| Gain on sale of assets | (14,551,872) | - |
| Non-cash refinancing costs | 2,879,147 | - |
| Change in operating assets and liabilities: | | |
| Accounts receivable, net | 16,212,752 | 5,284,495 |
| Prepaid expenses | 2,420,648 | (4,591,637) |
| Derivative assets | 768,986 | (5,591,119) |
| Other current assets | (4,030,641) | 5,385,651 |
| Deferred charges and other | 3,454,962 | (367,193) |
| Regulatory assets | (9,690,022) | 9,968,209 |
| Accounts payable | (3,112,551) | (8,297,846) |
| Customer deposits | 576,798 | 319,510 |
| Other current liabilities | 25,677,715 | 464,639 |
| Deferred credits | (2,551,574) | 3,305,540 |
| Derivative liabilities | 6,188,137 | (13,416,707) |
| Accrued pension and postretirement benefits | (1,292,890) | (4,480,561) |
| Net cash provided by operating activities | 61,237,317 | 23,486,160 |
| Cash Flows From Investing Activities: | | |
| Construction of utility plant | (72,382,014) | (76,858,152) |
| Plant removal cost | (2,572,111) | (2,545,293) |
| Proceeds from the salvage of utility plant | - | 3,952,780 |
| Contributions in aid of construction | 3,443,922 | 2,240,406 |
| Capitalized interest | 614,376 | 1,133,983 |
| Materials and supplies inventory | 307,340 | (1,232,065) |
| Disposition of nonutility property | 66,321 | (796,424) |
| Net change in other investments | (11,085,894) | (3,189,032) |
| Proceeds from the sale of fixed assets | 14,951,994 | - |
| Net redemption of capital term certificates | 48,198 | 837,099 |
| Net redemption of member capital securities | - | 1,000,000 |
| Net sale of associated investments | 2,644,520 | 1,638,069 |
| Net investment in direct financing lease | 4,504,717 | 4,659,742 |
| Net cash used in investing activities | (59,458,631) | (69,158,887) |
| Cash Flows From Financing Activities: | | |
| Advances on long-term debt | - | 40,288,000 |
| Payments of long-term debt | (20,210,479) | (17,147,796) |
| Advances under line of credit agreements | 219,800,000 | 254,285,000 |
| Payments under line of credit agreements | (196,635,501) | (226,785,000) |
| Payments on capital lease obligations | (3,025,535) | (2,712,918) |
| Distribution of capital credits | (1,915,299) | (903,035) |
| Net cash (used in) provided by financing activities | (1,986,814) | 47,024,251 |
| Net (Decrease) Increase in Cash and Cash Equivalents | (208,128) | 1,351,524 |
| Cash and Cash Equivalents, Beginning of Year | 6,644,148 | 5,292,624 |
| Cash and cash equivalents, end of year | $ 6,436,020 | $ 6,644,148 |
| Non-cash Investing Activity: | | |
| Capital lease | $ 712,895 | $ 3,484,631 |

The accompanying notes are an integral part of the above statements.

# Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
# Notes to Consolidated Financial Statements
# Years Ended December 31, 2015 and 2014

**Note 1: Description of Business**

Southern Maryland Electric Cooperative, Inc. (SMECO) is an electric distribution cooperative that was initially formed as Southern Maryland Tri-County Cooperative Association on February 5, 1937. In 1942, the members voted to change the form of the organization from an association to a cooperative, nonprofit membership corporation under the Maryland Electric Cooperative Act and adopted the current name. SMECO serves about 163,000 customers in a 1,150 square-mile area in Southern Maryland comprised of Calvert, Charles, Prince George's and St. Mary's counties.

SMECO Solar LLC, a wholly-owned subsidiary that constructed and owns a solar project with a capacity of approximately 5.5 megawatts and can produce nearly 8,700 megawatt-hours of energy annually, was established by SMECO on June 21, 2011. Producing solar renewable energy helps SMECO fulfill its renewable portfolio obligation as required by the state (see Note 2).

**Note 2: Summary of Significant Accounting Policies**

**A. System of Accounts and Regulation** - The accounting records are maintained in accordance with the Uniform System of Accounts for Electric Borrowers prescribed by the Federal Energy Regulatory Commission (FERC). SMECO is subject to regulation by the Maryland Public Service Commission (PSC). The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The consolidated financial statements reflect the ratemaking policies of the PSC in conformity with guidance set forth by the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 980 as it relates to certain types of regulated industries. This standard allows SMECO to record certain regulatory assets and liabilities, which will be included in future rates and would not be recorded under GAAP for nonregulated entities in the United States (see Note 7).

If portions of SMECO's operations no longer become subject to the provisions as set forth by ASC Topic 980, a write-off of any related regulatory assets or liabilities would be required unless some form of transition cost recovery continues through rates established and collected for the remaining regulated operations. In addition, a determination of any impairment to the carrying costs of deregulated plant and inventory assets would be required.

**B. Consolidation** - The consolidated financial statements include the accounts and results of operations of SMECO and its wholly-owned subsidiary. All significant intercompany transactions have been eliminated in consolidation.

**C. Estimates** - The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of revenues, expenses, assets, liabilities and disclosure of contingencies as of the date of the consolidated financial statements. Actual results could differ from those estimates and assumptions.

**D. Utility Plant** - Utility plant is stated at cost which includes the cost of labor, material and applicable indirect costs. When a retirement unit of property is replaced or removed, the cost of such property is deducted from utility plant and such cost, together with the cost of removal less salvage, is charged to accumulated depreciation. Expenditures for additions and replacements that are not considered units of property, as well as routine repairs and maintenance, are expensed as incurred.

SMECO periodically evaluates long-lived assets such as utility plant when events or changes in circumstances indicate that the carrying value of these assets may not be recoverable. The determination of whether impairment has occurred is based on an estimate of undiscounted cash flows attributable to these assets, as compared to the carrying value of the assets.

**E. Depreciation** - For financial reporting purposes, depreciation is computed on a straight-line composite basis using the estimated useful service lives of the depreciable property.

**F. Investments** - The investment in unconsolidated entity is accounted for under the equity method. SMECO records its proportionate share of equity in earnings or loss of the unconsolidated entity in the Consolidated Statement of Revenue and Expenses under Nonoperating Margins (see Note 5). Patronage capital certificates from associated organizations are recorded at cost plus the stated amount of the certificate (see Note 4).

**G. Cash and Cash Equivalents** - Cash and cash equivalents are considered to be highly liquid investments with an original maturity of three months or less.

**H. Accounts Receivable** - Credit is extended to customers for electric service received as customers are billed on a monthly basis after the service is rendered and the electric meter is read. These readings occur as nearly as practicable every 30 days. Bills are payable within 20 days of rendering. If not paid timely, late payment charges may be applied. In compliance with the rules and regulations of the PSC, SMECO may require both residential and nonresidential customers to make and maintain cash deposits to secure the payment of final bills. The allowance for doubtful accounts is calculated as a percentage of sales. Accounts are reviewed periodically to determine collectability. Bad debts are written off automatically throughout the year after one year of nonpayment.

**I. Materials and Supplies Inventory** - Materials and supplies inventory is generally used for construction or maintenance of operations. Inventory is recorded using the lower of market or average cost and issued items are charged to construction or operations at the recorded average cost.

**J. Derivative Instruments** - SMECO uses various methods, such as forward purchase contracts, option contracts, financial swaps and commodity swaps to manage the commodity and financial risks associated with meeting its power supply requirements. SMECO accounts for the aforementioned contracts in accordance with guidance as set forth by FASB as it relates to derivative instruments and hedging activities. This guidance requires all derivatives, subject to certain exceptions, to be accounted for at fair value. According to FASB guidance, the majority of SMECO's forward purchase contracts and option contracts qualify for the normal purchase and normal sales exception. As a result, these contracts are not recorded at fair value. Since all of SMECO's power supply related costs are subject to rate recovery, changes in the fair value of financial and commodity swaps are periodically reflected as derivative assets and regulatory liabilities or derivative liabilities and regulatory assets, respectively, under the provisions as set forth by FASB (see Note 2A). As of December 31, 2015, the fair value of SMECO's derivative instruments, excluding contracts accounted for as normal purchase/normal sale were as follows:

| Derivatives | Balance Sheet Location | Fair Value |
|---|---|---|
| Financial Gas | Regulatory assets and Derivative liabilities | $ (36,023,289) |
| Financial Energy | Regulatory assets and Derivative liabilities | (17,973,805) |
| Financial Transmission Rights | Derivative assets and Regulatory liabilities | 4,822,133 |
| Total | | $ (49,174,961) |

At December 31, 2015, total derivative contracts in a gross asset and gross liability position amounted to approximately $5.0 million and $54.2 million, respectively.

As of December 31, 2014, the fair value of SMECO's derivative instruments, excluding contracts accounted for as normal purchase/normal sale were as follows:

| Derivatives | Balance Sheet Location | Fair Value |
|---|---|---|
| Financial Gas | Regulatory assets and Derivative liabilities | $ (20,330,406) |
| Financial Energy | Regulatory assets and Derivative liabilities | (27,478,551) |
| Financial Transmission Rights | Derivative assets and Regulatory liabilities | 5,591,119 |
| Total | | $ (42,217,838) |

At December 31, 2014, total derivative contracts in a gross asset and gross liability position amounted to approximately $8.3 million and $50.5 million, respectively.

Net gains and losses on financial and commodity swaps and Financial Transmission Rights are reflected in cost of power at the time they are settled. For the year ended December 31, 2015, the realized gain (loss) on these transactions was as follows:

| Derivatives | Realized Gain (Loss) Recognized in Purchased Power |
|---|---|
| Financial Gas | $ (4,727,173) |
| Financial Energy | (11,251,460) |
| Financial Transmission Rights | 3,376,203 |
| Total | $(12,602,430) |

For the year ended December 31, 2014, the realized gain (loss) on these transactions was as follows:

| Derivatives | Realized Gain (Loss) Recognized in Purchased Power |
|---|---|
| Financial Gas | $ 3,445,715 |
| Financial Energy | (2,288,442) |
| Financial Transmission Rights | 8,617,504 |
| Total | $ 9,774,777 |

As of December 31, 2015 and 2014, SMECO had entered into commitments for options totaling $14.8 million and $12.7 million, respectively.

**K. Deferred Charges** - Costs of preliminary surveys and studies made for the purpose of determining the feasibility of proposed utility projects are recorded as deferred charges. If a project is constructed, such costs are capitalized as part of the cost of the facility. If the plans for a project are subsequently abandoned, the costs are expensed.

SMECO exited out of the Rural Utilities Service (RUS) loan program and refinanced all of its outstanding long-term debt with RUS and the Federal Financing Bank (FFB) during 2015, and as such, was required to pay a prepayment premium to FFB of almost $29 million (see Note 10). This amount will be amortized over the remaining life of the old debt issue.

**L. Revenue Recognition** - Revenue is recognized as service is rendered to customers. Recorded revenue includes an estimate of unbilled revenue for utility service rendered but not billed to customers as of year-end. Estimated unbilled revenue was approximately $10.4 million and $17.5 million as of December 31, 2015 and 2014, respectively.

**M. Income Taxes** - As a not-for-profit, membership cooperative under Section 501(c)(12) of the Internal Revenue Code, SMECO is exempt from federal income taxes on income from operating activities. Pursuant to the Maryland Electric Cooperative Act, SMECO is also exempt from state income taxes. Accordingly, no provision for such taxes has been made in the accompanying financial statements.

Certain income earned from other unrelated products and services may require SMECO to pay federal and state income taxes. Should this situation arise, the necessary provisions for income tax liability will be recorded in the consolidated financial statements.

The tax years from 2012 to 2014 remain subject to examination by the taxing authorities.

SMECO Solar LLC is taxed as a corporation and is subject to federal and state income taxes. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences arising between the tax bases of assets and liabilities and their reported amounts in accordance with GAAP. At December 31, 2015 and 2014, there were no material deferred tax assets and liabilities reported on the consolidated balance sheets.

**N. Accumulated Other Comprehensive Income** - This item consists of other gains and losses affecting equity that, under GAAP, are excluded from net income. During 2015 and 2014, such items relate to SMECO's unrecognized actuarial loss and amortization from the adoption of guidance issued by FASB as it relates to the accounting for defined benefit pension and other postretirement plans.

**O. Subsequent Events** - Subsequent events have been evaluated through March 8, 2016, which is the date the consolidated financial statements were available to be issued.

**P. Advertising Costs** - Advertising costs are expensed as incurred.

**Q. Renewable Portfolio Standard (RPS)** - SMECO is subject to Maryland's RPS, which requires retail suppliers of electricity to provide twenty percent of their retail sales using renewable resources by 2022. SMECO fulfills this obligation by purchasing renewable energy from various resources such as wind and solar, as well as by procuring Renewable Energy Credits (RECs) in the market.

**Note 3: Utility Plant**

The major classes of utility plant in service as of December 31, 2015 and 2014 are as follows:

| | 2015 | 2014 |
|---|---|---|
| Distribution | $ 596,722,061 | $ 567,915,807 |
| Transmission | 286,983,546 | 250,030,735 |
| Generation | 14,218,160 | 14,681,335 |
| Other Production Plant | 463,175 | - |
| General | 152,039,458 | 148,303,053 |
| | 1,050,426,400 | 980,930,930 |
| Construction work in progress | 36,372,702 | 46,633,008 |
| Utility plant | $ 1,086,799,102 | $ 1,027,563,938 |

The annual composite rates used in calculating depreciation are as follows:

| | |
|---|---|
| Distribution | 3.51% |
| Transmission | 2.60% |
| Generation | 5.00% |
| General | 7.14% |

SMECO follows the regulatory principle of intergenerational cost allocation by including net salvage (gross salvage less costs of removal) as a component of depreciation rates. Net salvage is a "non-legal asset retirement obligation," and as such is not subject to the accounting requirements issued by ASC Topic 410 Asset Retirement and Environmental Obligations and FERC Order 631. SMECO has no legal asset retirement obligations as that term is defined by FASB guidance and FERC Order 631.

In accordance with the reporting requirements of FASB's guidance on asset retirement obligations and FERC Order 631, SMECO's accumulated provision for depreciation included a net salvage timing difference of approximately $8.6 million and $7.7 million for the years ended December 31, 2015 and 2014, respectively. This represents the differences in the timing of recognition of the period costs associated with net salvage.

SMECO capitalizes interest cost incurred on funds used to construct utility plant. The capitalized interest is recorded as part of the asset to which it relates and is amortized over the asset's estimated useful life.

**Note 4: Investments in Associated Organizations**

Investments in associated organizations, which are recorded at cost (see Note 14), consisted of the following as of December 31, 2015 and 2014:

| | 2015 | 2014 |
|---|---|---|
| National Rural Utilities Cooperative Finance Corporation (CFC): | | |
| Capital Term Certificates | | |
| 3% | $1,000,650 | $1,000,650 |
| 5% | 3,164,783 | 3,164,783 |
| 8.55% | 720,411 | 720,411 |
| Noninterest bearing | 250,858 | 299,057 |
| Patronage capital certificates | 1,772,149 | 1,662,285 |
| CFC membership | 1,000 | 1,000 |
| | 6,909,851 | 6,848,186 |
| Federated Rural Electric Insurance Corporation | 974,871 | 859,772 |
| CoBank, ACB (CoBank) | 5,244,956 | 4,344,956 |
| Other | 253,940 | 220,464 |
| | $13,383,618 | $12,273,378 |

**Note 5: Equity Method Investments**

Effective August 1, 2003, SMECO invested $1,000,000 for a membership and equity investment in Alliance for Cooperative Energy Services Power Marketing, LLC (subsequently renamed ACES). SMECO's proportionate share of ACES earnings was $17,243 in 2015 and $3,313 in 2014. As of December 31, 2015 and 2014, the carrying value of the investment was $1,201,111 and $1,183,868, respectively.

**Note 6: Net Investment in Facility Capacity Credit Agreement**

Pursuant to the Facility and Capacity Credit Agreement (FCC Agreement) entered into with Potomac Electric Power Company (Pepco) in March 1989, SMECO constructed a 77-megawatt combustion turbine generating unit at Pepco's then-owned Chalk Point Generating Station in Aquasco, Maryland. This facility was placed in commercial operation on December 1, 1990. As part of the FCC Agreement, in exchange for electric capacity and generated energy from the facility, Pepco is obligated to operate and maintain the facility for a period of 25 years, commencing December 1990.

In accordance with SMECO's concurrence under the Agreement and Consent executed in December 2000, Pepco assigned its rights and obligations under the FCC Agreement to Southern Energy, Inc. (subsequently renamed Mirant Corporation (Mirant)), a Delaware corporation. Mirant subsequently assigned the FCC Agreement to one of its subsidiaries, Mirant Peaker, LLC, which subsequently merged into another Mirant subsidiary, Mirant Chalk Point, LLC. In December 2010, Mirant merged with RRI Energy, creating GenOn Energy, Inc. (GenOn), in connection with which Mirant Chalk Point, LLC changed its name to GenOn Chalk Point, LLC. The agreement permits GenOn Chalk Point, LLC to operate, dispatch and receive all electricity generated from the facility. GenOn Chalk Point, LLC is now responsible for all costs associated with operating and maintaining the combustion turbine during the remaining term of the FCC Agreement. On December 14, 2012, NRG Energy, Inc. (NRG) acquired all of the ownership interests of GenOn and, accordingly, NRG is now the ultimate corporate parent of GenOn Chalk Point, LLC.

The FCC Agreement is accounted for as a direct financing lease. The current monthly payment is $437,510.

The following sets forth the components of the net investment in the FCC Agreement as of December 31, 2015 and 2014:

| | 2015 | 2014 |
|---|---|---|
| Total minimum FCC payments receivable | $ - | $ 4,812,610 |
| Estimated residual value of FCC property | - | - |
| Gross investment in FCC | - | 4,812,610 |
| Less: Unearned income | - | (307,893) |
| Net investment in FCC Agreement | $ - | $ 4,504,717 |
| Current portion | $ - | $ 4,504,717 |
| Noncurrent portion | - | - |
| Net investment in FCC Agreement | $ - | $ 4,504,717 |

On December 1, 2015 at the expiration of the FCC Agreement, the combustion turbine was sold to NRG Chalk Point CT LLC for $12,350,000. As the combustion turbine had been accounted for as a direct financing lease, there was no book value at the time of sale and therefore, the entire amount was recorded as a gain and is included in Nonoperating Margins on the Consolidated Statement of Revenue and Expenses for the year ended December 31, 2015.

**Note 7: Regulatory Assets**

Regulatory assets consisted of the following:

**A. Demand Response (DR) and EmPOWER Maryland Programs -** Conservation expenditures pertaining to DR and EmPOWER Maryland programs are recognized as regulatory assets and amortized over a one-year or five-year period in accordance with PSC requirements. Conservation costs are recovered through a rate surcharge approved by the PSC that reflects expenditures and an allowed rate of return. The related amounts of regulatory assets for the DR and EmPOWER Maryland programs were $27,454,337 and $24,311,600 as of December 31, 2015 and 2014, respectively.

**B. Advanced Metering Infrastructure (AMI) Implementation** – Pursuant to PSC approval, a regulatory asset was established for the costs associated with an AMI staged implementation to determine whether the deployment of AMI in SMECO's service territory would achieve the operational savings anticipated. In 2013, the PSC approved the system-wide deployment of AMI and a regulatory asset was established. As of December 31, 2015 and 2014, the regulatory assets for these projects totaled $5,425,135 and $5,065,987, respectively.

**C. Energy and Energy-Related Costs** - As of December 31, 2015 and 2014, the regulatory asset pertaining to energy and energy-related costs was $53,997,094 and $47,808,957, respectively (see Note 2).

**Note 8: Employee Benefit Plans**

**A. Pension Plan and Other Postretirement Benefits** - SMECO has a qualified, noncontributory, defined benefit pension plan which provides for retirement benefits based upon age, years of service and compensation. The Retirement Annuity Plan for Employees of SMECO was closed effective December 31, 2006, so that employees who were hired or re-hired on or after January 1, 2007, were not eligible to participate (or recommence participation) in the Pension Plan. SMECO continued to maintain the Pension Plan for current employees through December 31, 2010 at which time the Plan was frozen. The net effect was that a participant's benefits under the Pension Plan were calculated as if the participant terminated employment with SMECO on December 31, 2010. As a result of this curtailment, SMECO requested a deferral as available under ASC Topic 980 to amortize the prior service costs (benefit cost) of $4.7 million, over an eight-year period. Annual provisions for accrued pension costs are based upon independent actuarial valuations dated as of December 31, 2015 and 2014. SMECO's policy is to fund accrued pension costs in accordance with provisions of the Employee Retirement Income Security Act of 1974 (ERISA).

SMECO provides additional retirement benefits to certain employees under a nonqualified plan established in accordance with Section 457 of the Internal Revenue Code. The periodic plan expenses are based on the present value of the retirement benefits earned during the year.

SMECO supplements health care insurance premiums for retirees and covered dependents through their inclusion in the same insurance coverage pool as active employees. The expected cost of these benefits under the unfunded plan is recognized during the years in which employees render service.

The following sets forth the obligations, funded status and periodic costs for the plans and the actuarial assumptions used in accordance with ASC Topic 715:

| | Pension Benefits | |
|---|---|---|
| | 2015 | 2014 |
| Benefit obligation at year end | $146,977,989 | $154,805,530 |
| Fair value of plan assets at year end | 104,213,907 | 105,655,757 |
| Funded status | $(42,764,082) | $(49,149,773) |
| Amounts recognized in the Balance Sheets: | | |
| Accrued benefit cost | $(42,764,082) | $(49,149,773) |
| Accumulated other comprehensive loss | 67,552,908 | 68,994,677 |
| Deferred charges | 1,894,005 | 2,130,756 |
| Weighted-average assumptions used to determine benefit obligations as of year end: | | |
| Discount rate | 4.60% | 4.35% |
| Benefit cost | $1,723,295 | $ 533,585 |
| Employer contribution | 6,367,146 | 7,048,398 |
| Benefits paid | 7,188,000 | 9,458,292 |
| Weighted-average assumptions used to determine benefit costs: | | |
| Discount rate | 4.35% | 5.50% |
| Expected return on plan assets | 7.00% | 8.00% |
| Expected contributions for year ending December 31, 2016: | | |
| Employer | $4,123,818 | |
| Employees | - | |

Estimated future benefit payments reflecting expected future service for years ending December 31:

| | |
|---|---|
| 2016 | $ 7,212,691 |
| 2017 | 7,393,575 |
| 2018 | 7,572,274 |
| 2019 | 7,980,888 |
| 2020 | 8,193,901 |
| 2021-2025 | 43,512,644 |

| | |
|---|---|
| Estimated Loss Amortization for Next Fiscal Year | $ 1,754,495 |

| | | |
|---|---|---|
| Plan Assets: | | |
| Equity Securities (a) (c) | 56% | 52% |
| Fixed Income Securities (b) (c) | 44% | 48% |

(a) The portfolio's target asset allocation range is 55% equity with an allowable range of 30% to 60%.
(b) The portfolio's target asset allocation range is 45% fixed income with an allowable range of 30% to 60%.
(c) The portfolio's target asset allocation also allows for up to 20% in cash.

Plan assets are considered Level 1 inputs on the fair value measurement hierarchy as described in Note 15. During the year, there were no significant changes in the valuation techniques or inputs.

SMECO's investment strategy with respect to pension assets is designed to achieve a moderate level of overall portfolio risk in keeping with its desired risk objective, which is established after careful consideration of plan liabilities, plan funded status and SMECO's overall financial condition. The portfolio's target asset allocation is 55% equity and 45% fixed income with specified allowable ranges around these targets. The equity segment is broadly diversified across growth/value and small-, mid- and large-cap equities. The fixed income segment is diversified by investing in preferred stocks, corporate debt securities and obligations of the U.S. Government and its agencies.

SMECO also sponsors a defined benefit postretirement medical insurance plan that covers substantially all collectively bargained and management employees and their dependents. Employees who reach the age of 55 with 10 years of service (provided active coverage was elected before retirement), become eligible to receive benefits. Participants under the age of 65 are eligible for the PPO Plan or HDHP/HSA Plan and participants of the age 65 and older are eligible for the Medicare Supplemental Plan. The following sets forth the funded status of the Plan reconciled with amounts reported in the balance sheets in accordance with ASC Topic 715:

| | Other Postretirement Benefits | |
|---|---|---|
| | 2015 | 2014 |
| Benefit obligation at year end | $ 38,310,073 | $ 30,523,431 |
| Fair value of plan assets at year end | - | - |
| Funded status | $(38,310,073) | $(30,523,431) |
| Amounts recognized in the Balance Sheets: | | |
| Accrued benefit cost | $(38,310,073) | $(30,523,431) |
| Accumulated other comprehensive loss | 19,950,674 | 15,815,064 |
| Deferred charges | 14,059 | 75,261 |
| Weighted-average assumptions used to determine benefit obligations as of year end: | | |
| Discount rate | 4.60% | 4.35% |
| Benefit cost | $ 4,123,920 | $ 2,814,546 |
| Employer contribution | 411,686 | 658,199 |
| Benefits paid | 411,686 | 658,199 |
| Weighted-average assumptions used to determine benefit costs: | | |
| Discount rate | 4.35% | 5.50% |

Expected contributions for year ending December 31, 2016:

| | |
|---|---|
| Employer | $ 811,599 |
| Employees | - |

Estimated future benefit payments reflecting expected future service for years ending December 31:

| | |
|---|---|
| 2016 | $ 811,559 |
| 2017 | 941,708 |
| 2018 | 1,082,639 |
| 2019 | 1,196,357 |
| 2020 | 1,302,342 |
| 2021-2025 | 7,732,446 |

| | |
|---|---|
| Estimated Amortization for Next Fiscal Year | $ 1,116,890 |

For measurement purposes, a 7.25% medical trend rate was assumed for health care benefits and premiums for 2016. It is further assumed that this rate will decrease to 4.5% through 2027 and remain at that level thereafter.

On December 8, 2003, the President signed into law the Medicare Prescription Drug Improvement and Modernization Act of 2003. This Act introduces a prescription drug benefit under Medicare Part D as well as a federal subsidy to sponsors of retiree healthcare benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. SMECO has not, and does not intend to, apply for this subsidy for the years ended December 31, 2015 and 2014.

**B. Health Insurance** - SMECO is self-insured for medical and dental claims of its current employees and retirees and their covered dependents. SMECO is liable for claims of up to $150,000 per occurrence for medical claims and $2,000 per year per participant for dental claims. Catastrophic coverage is maintained to pay claims in excess of these amounts. Claims paid under this plan approximated $6.3 million in 2015 and $7.0 million in 2014.

Provisions for claims incurred but not reported have been made based on claim experience and approximated $393,000 and $245,000 as of December 31, 2015 and 2014, respectively.

**C. 401(k) Plans** - SMECO maintains 401(k) plans for its management and bargaining unit employees. All full-time employees are eligible to participate in the plans after meeting minimum service requirements. SMECO matches employee contributions to the management plan up to 6% of annual compensation. Effective with the freeze of the Pension Plan (see Note 8A), SMECO provides a non-elective employer contribution which varies based on length of service. For employees with 0 - 4 years of service, the contribution is 3% of base pay; 5 - 20 years of service, 7% of base pay; and more than 20 years of service, 9% of base pay. Effective December 1, 2015 for bargaining unit employees and January 1, 2016 for management employees, these contributions increased to 3%, 8%, and 10%, respectively. During 2015 and 2014, SMECO recorded 401(k) plan-related expenses of approximately $4.0 million and $3.9 million, respectively.

**D. Workers' Compensation Trust** - SMECO is self-insured for workers' compensation insurance through a separate trust which was established to pay workers' compensation claims. Contributions to the trust are based upon an actuarial valuation and SMECO maintains excess liability insurance coverage of up to $2 million per incident for claims exceeding the net assets available for benefits in the trust. Transactions within the trust are not reflected in the accompanying consolidated financial statements. During 2015 and 2014, SMECO made aggregated contributions to the trust of approximately $782,000 and $570,000, respectively. At December 31, 2015 and 2014, the trust had estimated net assets available for benefits of $460,575 and $200,208, respectively.

### Note 9: Patronage Capital and Other Equities

Assigned patronage capital consists of net operating margins that have been allocated to individual member patronage accounts. Patronage capital is applied against unpaid accounts receivable when customers leave SMECO. Patronage capital retirements to date represent amounts that have been paid to individual members. Patronage capital activity as of December 31, 2015 and 2014 consisted of the following:

| | 2015 | 2014 |
|---|---|---|
| Assignable | $ (7,398,791) | $ 8,417,636 |
| Assigned to date | 291,743,249 | 283,326,618 |
| | 284,344,458 | 291,744,254 |
| Less: Retirements to date | (90,746,842) | (87,488,421) |
| Patronage capital | $193,597,616 | $204,255,833 |

Other equities consist of donated capital from members and nonrefundable membership fees that were previously collected from new members upon joining SMECO. Beginning December 31, 2015, nonoperating margins were included as part of other equities.

### Note 10: Long-Term Debt

SMECO has obtained long-term debt from CFC; CoBank; and National Cooperative Services Corporation (NCSC), a wholly-owned subsidiary of CFC. SMECO is subject to various loan covenants under its master mortgage and substantially all assets are pledged as collateral for the long-term debt. The covenants include maintaining certain minimum debt service and equity ratio requirements. SMECO Solar LLC has obtained long-term debt from FFB, which has been guaranteed by SMECO.

In early 2015, with the approvals of RUS and the PSC, SMECO decided to exit the RUS loan program and refinanced all of its outstanding RUS and FFB loans totaling approximately $333.1 million at interest rates ranging between 3.44% to 5.19% with CoBank and CFC at interest rates between 1.64% to 3.65%. This debt was refinanced in the form of a mortgage indenture which will provide ease of access to the capital markets for privately placed debt in the future. As a result of the refinance, SMECO was required to pay a prepayment premium to FFB of almost $29.0 million, of which $16.9 million was financed with CoBank and CFC for total long-term debt of $350 million. The remainder of the premium was paid using funds from the unsecured line of credit. SMECO will realize significant savings in interest costs over the life of the loans, net of the prepayment penalty. In addition to interest savings, SMECO will also benefit from patronage capital from CoBank and CFC. All future long-term debt will be financed through CoBank, CFC and the private placement market.

The following debt was outstanding as of December 31, 2015 and 2014:

| Lender | Interest Rates | Maturity (Year) | 2015 | 2014 |
|---|---|---|---|---|
| RUS | 3.44-5.19% | 2034-41 | $ - | $114,760,656 |
| CFC | 2.90-9.50% | 2015-45 | 180,777,052 | 16,771,782 |
| CoBank | 1.64-6.44% | 2017-45 | 238,542,665 | 68,417,813 |
| NCSC | 7.25% | 2015 | - | 3,345,964 |
| FFB | 2.34-8.07% | 2015-34 | 13,605,595 | 232,552,898 |
| Total debt outstanding | | | 432,925,312 | 435,849,113 |
| Less: Current maturities | | | 19,537,261 | 19,075,025 |
| Long-term debt | | | $413,388,051 | $416,774,088 |

At December 31, 2015, the required principal payments of the long-term debt are as follows:

| | |
|---|---|
| 2016 | $ 19,537,261 |
| 2017 | 20,026,467 |
| 2018 | 19,573,324 |
| 2019 | 20,254,854 |
| 2020 | 19,078,901 |
| Thereafter | 334,454,505 |
| Total | $432,925,312 |

Cash paid for interest totaled approximately $18.3 million and $20.7 million for the years ended December 31, 2015 and 2014, respectively. Unadvanced loan funds totaled $401,000 as of December 31, 2015.

Effective October 2015, SMECO authorized the repricing with CFC for two loans with an outstanding balance of about $637,000 at variable rates and two loans with an outstanding balance of $9.1 million at rates of 2.9% - 3.9%.

SMECO maintains unsecured revolving line of credit agreements at variable interest rates with CoBank and CFC for its short-term borrowing needs. The CoBank agreement expires February 29, 2016. The CFC agreement automatically renews each March unless CFC or SMECO provides written notice not to renew at least 90 days in advance of the renewal date.

As of December 31, 2015, SMECO had authorized lines of credit of $175 million with CFC and $125 million with CoBank. As of December 31, 2015, SMECO had outstanding letters of credit totaling $8.2 million and $15.4 million, respectively.

The outstanding balances for CoBank lines of credit and their respective interest rates as of December 31, 2015, were $125 million at 2.53% and as of December 31, 2014, were $75 million at 1.78% and $50 million at 2.72%. The outstanding balances for CFC lines of credit and their respective interest rates as of December 31, 2015 were $69.8 million at 2.9% and as of December 31, 2014, were $33 million at 2.9%.

**Note 11: Leases**

SMECO is obligated under long-term capital leases for utility equipment, office furniture and equipment and vehicles that expire at various dates through 2024. The future minimum lease payments required under the capital leases and the present value of the net minimum lease payments as of December 31, 2015, are as follows:

| | |
|---|---|
| 2016 | $2,462,053 |
| 2017 | 1,877,522 |
| 2018 | 1,541,850 |
| 2019 | 1,132,342 |
| 2020 | 774,196 |
| Thereafter | 1,643,930 |
| Total minimum lease payments | 9,431,893 |
| Less: Amount representing interest | (1,025,779) |
| Present value of minimum lease payments | 8,406,114 |
| Less: Current obligations | (2,164,203) |
| Long-term capital lease obligation | $6,241,911 |

The assets under capital leases are included in the consolidated balance sheets as part of net utility plant as follows:

| | 2015 | 2014 |
|---|---|---|
| Transmission | $ 9,688,830 | $ 9,688,830 |
| General | 6,698,989 | 6,513,246 |
| | 16,387,819 | 16,202,076 |
| Less: Accumulated depreciation | (2,574,973) | (1,464,815) |
| | $13,812,846 | $14,737,261 |

Interest paid on the capital lease obligations for the years ended December 31, 2015 and 2014 was $384,494 and $374,733, respectively. The capital leases are collateralized by the assets leased under the agreements, which are recorded in the accompanying consolidated balance sheet. Depreciation expense at December 31, 2015 and 2014 relating to these assets was $625,648 and $614,287, respectively.

SMECO leases many of its vehicles and power-operated equipment for various terms under long-term, operating lease agreements. The leases expire at various dates through 2019. At the expiration of the scheduled lease term, SMECO can either purchase the equipment at fair market value, have the lessor sell the equipment on its behalf or renew the lease for twelve or twenty-four months. Operating lease expense amounted to $2,186,788 and $2,027,659 in 2015 and 2014, respectively.

The future minimum rental payments required under the operating lease agreements as of December 31, 2015, are as follows:

| | |
|---|---|
| 2016 | $1,728,861 |
| 2017 | 1,223,260 |
| 2018 | 513,117 |
| 2019 | 57,010 |
| Total | $3,522,248 |

SMECO was obligated under a 50-year operating lease to rent the parcel of land on which SMECO's combustion turbine was located at the Chalk Point Generating Station. SMECO made annual rental payments of $5,000. The combustion turbine was sold on December 1, 2015, and consequently, the lease agreement has now been transferred to the buyer (see Note 6).

**Note 12: Commitments and Contingencies**

SMECO contracts with various suppliers for energy and energy-related products to serve its native load requirements. As of December 31, 2015, SMECO had forward purchase commitments with multiple parties through May 2035 covering a significant portion of SMECO's power supply needs.

At December 31, 2015 and 2014, SMECO had made commitments for capital expenditures of approximately $1.9 million and $13.6 million, respectively.

SMECO is involved in legal proceedings in the normal course of business. Management is of the opinion that the final disposition of these proceedings will not have a material adverse effect on SMECO's financial position, results of operations or cash flows.

**Note 13: Concentration of Risk**

The electric utility industry continues to be subject to increasing competitive pressures, consolidation and restructuring. Federal and state legislatures and regulators, including the United States Congress, Maryland General Assembly and PSC, and large industrial electricity consumers are working to reshape the industry through legislative and regulatory initiatives that increase electric competition at the generation, transmission and distribution levels.

Under Maryland's Electric Customer Choice and Competition Act and the Electric and Gas Utility Tax Reform Act, electric customers residing in Maryland are entitled to select or choose their electric energy supplier. As of December 31, 2015, SMECO had 2,317 customers served by an alternative electricity supplier. SMECO continues to provide distribution service to all of its customers.

The outcome of these initiatives and their impact on SMECO is uncertain. Customer choice and the resulting retail competition will likely continue to affect the entire industry.

With the assistance of ACES (see Notes 5 and 12), SMECO has developed a more diversified market strategy to meet future power supply needs, including reduced dependence on a single supplier and varied contract termination dates. This approach represents a significant departure from the traditional cooperative model of multiple year contracts with a sole supplier. Given the changes in the wholesale power market in recent years, SMECO has concluded that it is no longer operationally or economically prudent to engage in the traditional full-requirements contract with one supplier.

In order to meet its power supply requirements for its standard offer service customers, SMECO has executed numerous Master Power Purchase and Sale Agreements with a number of counterparties. Such agreements stipulate credit limits and other information pertaining to the establishment of trading relationships. Accordingly, SMECO is subject to the normal market, credit and performance risks inherent in these arrangements. To monitor and mitigate such risk exposure, SMECO continues to work closely with ACES personnel, has created and implemented related trading and credit policies and has established a Board Risk Oversight Committee and an internal Power Supply Committee that meet frequently to address relevant matters.

Financial instruments that subject SMECO to concentration of credit risks include customer accounts receivable. SMECO places its cash on deposit with financial institutions located in the United States of America, which are insured by the Federal Deposit Insurance Corporation (FDIC). The FDIC provides insurance coverage for up to $250,000 of cash held by SMECO in each separate FDIC insured bank and savings institution. From time to time, SMECO may have amounts on deposit in excess of the insured limits. As of December 31, 2015, SMECO had approximately $4.5 million of deposits that exceeded the insured limits. SMECO grants credit to customers, substantially all of whom are local residents of SMECO's four-county service area. In 2014, SMECO obtained 100% of its new debt under the RUS loan program. The RUS loan program is subject to federal legislative changes which could affect the interest rates and availability of future loans under the program. In 2015, SMECO refinanced all of its existing RUS and FFB debt with CoBank and CFC. Future long-term debt will be financed using various sources such as CoBank, CFC and the private placement market (see Note 10).

**Note 14: Fair Value of Financial Instruments**

SMECO has accounted for all financial instruments, classified as derivatives, at fair market value. SMECO has accounted for all other financial instruments based on the carrying amount (book value) in the financial statements in accordance with GAAP. According to guidance set forth by FASB, SMECO is required to disclose the fair value of those financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using discounted cash flow analysis. This technique involves subjective judgment and is significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. As a result, the derived fair value estimates cannot be substantiated by comparison to independent markets, and in many cases, could not be realized in immediate settlement of the instrument.

Accordingly, the following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it was practicable to estimate that value.

Cash and Cash Equivalents

The carrying amount of cash and cash equivalents approximates fair value due to the short maturity of these instruments.

Accounts Receivable

The carrying amount of accounts receivable approximates fair value due to the short period of time amounts are outstanding.

Investments in Associated Organizations

Fair value of capital term certificates was determined by computing the present value of estimated future cash flows, discounted at the long-term treasury rate of 3.01% and 2.75% as of December 31, 2015 and 2014, respectively. The fair value of patronage capital is not determinable since no legal obligation exists to retire capital credits. The fair value of the equity method investment is not estimated since there are no identified events or changes in circumstances that may have a significant adverse effect on the fair value and it is not practicable to estimate fair value. The carrying value of memberships approximates fair value.

Accounts Payable

The carrying amount of accounts payable approximates fair value due to the short period of time amounts are outstanding.

Long-Term Debt

The carrying amount of SMECO's fixed long-term debt includes certain interest rates that are below quoted market prices for the same or similar issues. Therefore, the fair value of fixed long-term debt is estimated based on current market prices for the same or similar issues offered for debt of the same and remaining maturities which was 5.85% and 5.40% as of December 31, 2015 and 2014, respectively.

The carrying amount of lines of credit approximates fair value due to the short maturity of these instruments.

Consumer Deposits

The carrying amount approximates fair value due to the relatively short maturity of the deposits.

The estimated fair value of SMECO's financial instruments, reported at cost, is as follows:

| | Carrying Value | | Fair Value | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| | (000 Omitted) | | (000 Omitted) | |
| Assets: | | | | |
| Capital Term Certificates | $ 5,137 | $ 5,185 | $ 7,006 | $ 7,470 |
| Liabilities: | | | | |
| Long-term Debt | (432,925) | (435,849) | (375,453) | (406,263) |

**Note 15: Fair Value Measurements**

SMECO follows the guidance issued by FASB as it relates to the accounting and disclosure requirements for financial instruments reported as assets and liabilities at fair value. This guidance also establishes a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability. Inputs may be observable or unobservable and refer broadly to the assumptions that market participants would use in pricing the asset or liability. Observable inputs reflect the assumptions market participants would use in pricing the asset or liability based on market data obtained from sources independent of the reporting entity. Unobservable inputs reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

The three levels of the fair value hierarchy are described as follows:

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 - Other significant observable inputs, including quoted prices for similar assets or liabilities in markets that are not active

Level 3 - Significant unobservable inputs, which are generally based on SMECO's own assumptions.

The following table summarizes the financial liabilities measured at fair value:

| | December 31, 2015 (000 Omitted) | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Derivative Assets, net | $ 4,822 | $ - | $ 4,822 | $ - |
| Liabilities: | | | | |
| Derivative Liabilities, net | $(53,997) | $ - | $(53,997) | $ - |

| | December 31, 2014 (000 Omitted) | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Derivative Assets, net | $ 5,591 | $ - | $ 5,591 | $ - |
| Liabilities: | | | | |
| Derivative Liabilities, net | $(47,809) | $ - | $(47,809) | $ - |

The fair value of derivative liabilities is comprised of forward trades, power and gas positions and Financial Transmission Rights (FTRs). The fair value of all forward trades is calculated by a third party, ACES, using market prices when possible and modeled forward prices including constant heat rate projections, supply-demand simulation generated values, inflation escalated market prices, or a blend of these sources when market prices are not available. The power positions are valued at AEP Dayton - Dominion Zone, Brandywine, PJM East or PJM West and the gas positions are valued using NYMEX Henry Hub or TRANSCO Zone 6 Non-NY pricing. FTRs are marked-to-market based on data from the most recent FTR auction.

**Note 16: Related Party Transactions**

SMECO is a member of CFC, NCSC and CoBank. Pursuant to the member relationships, SMECO has invested in CFC and CoBank, entered into various loan agreements with the three organizations and maintains unsecured lines of credit with CFC and CoBank (see Notes 4 and 10). SMECO earned interest income of approximately $250,000 and $283,000 in 2015 and 2014, respectively, on investments with CFC. During years 2015 and 2014, SMECO paid interest expense of approximately $15.1 million and $7.5 million, respectively, on aggregated loans from CFC, NCSC and CoBank.

As a customer, NRG is a member of SMECO. SMECO had entered into a direct financing lease with NRG (see Note 6).

SMECO invested in and became a member of ACES during 2003 to engage ACES' professional assistance in meeting future power supply needs (see Note 5). In addition to the membership fee, SMECO paid ACES approximately $1.1 million and $1.0 million for such services during 2015 and 2014, respectively.

SMECO invested in and became a member of National Renewables Cooperative Organization (NRCO) during 2008 to utilize NRCO's services in the analysis of renewable projects in which SMECO may choose to participate in order to fulfill the Maryland RPS obligations (see Note 4). SMECO paid NRCO approximately $53,000 and $97,000 for such services in 2015 and 2014, respectively.

SMECO is a member of Electric Research and Manufacturing Cooperative (ERMCO) and purchases materials and supplies from them (see Note 4). SMECO paid ERMCO approximately $637,000 and $704,000 for such purchases in 2015 and 2014, respectively.

SMECO is a member of Federated Rural Electric Insurance Corporation (Federated) and purchases general liability and property insurance from them (see Note 4). SMECO paid Federated approximately $853,000 and $809,000 for such insurance in 2015 and 2014, respectively.

**Note 17: Sale of Utility Property**

In 2015, SMECO sold an office building located on a 20.05 acre parcel of land. The purchase price of the land was $127,092 and the office building was constructed at a cost of $1,269,691. The book value at the time of sale was $383,931. The property sold for $2,600,000, a gain of $2,216,069. This gain is included in Nonoperating Margins on the Consolidated Statement of Revenue and Expenses for the year ended December 31, 2015.

**Independent Auditor's Report on Supplementary Information**

To the Board of Directors of
Southern Maryland Electric Cooperative, Inc.
and SMECO Solar LLC

We have audited the consolidated financial statements of Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC ("SMECO") for the years ended December 31, 2015 and 2014, and our report thereon dated March 8, 2016, which expressed an unmodified opinion on those consolidated financial statements appears on pages 1 and 2. Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating financial information and comparative summary of operations is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual entities, and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

We also have previously audited, in accordance with auditing standards generally accepted in the United States of America, the balance sheets of SMECO as of December 31, 2013, 2012, and 2011, and the related statements of revenue, expenses and patronage capital and comprehensive income, and cash flows for each of the three years then ended (none of which is presented herein), and we expressed unmodified opinions on those financial statements. In our opinion, the comparative summary of operations is fairly stated in all material respects in relation to the basic consolidated financial statements from which it has been derived.

Adams, Jenkins & Cheatham

Richmond, Virginia
March 8, 2016

# Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
# Consolidating Balance Sheets
# December 31, 2015

| | SMECO | SMECO Solar LLC | Eliminations | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| Utility Plant, at Original Cost (Notes 2 and 3) | $ 1,072,579,109 | $ 14,219,993 | $ - | $ 1,086,799,102 |
| Less: Accumulated Depreciation and Amortization | (342,600,713) | (2,187,465) | - | (344,788,178) |
| Net utility plant | 729,978,396 | 12,032,528 | - | 742,010,924 |
| Nonutility Property (net) | 1,958,546 | - | - | 1,958,546 |
| Investments (Note 2): | | | | |
| Investments in associated organizations, at cost (Note 4) | 13,383,618 | - | - | 13,383,618 |
| Investment in an unconsolidated entity (Note 5) | 1,201,111 | - | - | 1,201,111 |
| Investment in SMECO Solar LLC (Note 2) | 5,823 | - | (5,823) | - |
| Other investments | 23,069,821 | - | - | 23,069,821 |
| Total investments | 37,660,373 | - | (5,823) | 37,654,550 |
| Current Assets (Note 2): | | | | |
| Cash and cash equivalents | 4,607,197 | 1,828,823 | - | 6,436,020 |
| Accounts receivable, net of allowance for doubtful accounts of $900,000 | 38,476,695 | - | - | 38,476,695 |
| Materials and supplies inventory | 12,880,492 | 20,931 | - | 12,901,423 |
| Prepaid expenses | 7,524,576 | 143,408 | - | 7,667,984 |
| Intercompany receivables | 51,230 | 193,579 | (244,809) | - |
| Other current assets | 11,761,660 | - | - | 11,761,660 |
| Total current assets | 75,301,850 | 2,186,741 | (244,809) | 77,243,782 |
| Regulatory Assets (Notes 2 and 7) | 86,876,566 | - | - | 86,876,566 |
| Deferred Charges and Other (Note 2) | 34,750,509 | - | - | 34,750,509 |
| Derivative Assets (Notes 2 and 15) | 4,822,133 | - | - | 4,822,133 |
| Total assets | $ 971,348,373 | $ 14,219,269 | $ (250,632) | $ 985,317,010 |
| **Equities and Liabilities** | | | | |
| Equities (Note 9): | | | | |
| Patronage capital | $ 193,597,616 | $ - | $ - | $ 193,597,616 |
| Other equities | 26,355,732 | 5,823 | (5,823) | 26,355,732 |
| Accumulated other comprehensive (loss) | (87,503,582) | - | - | (87,503,582) |
| Total equities | 132,449,766 | 5,823 | (5,823) | 132,449,766 |
| Long-Term Debt, Less Current Maturities (Notes 10 and 14) | 400,354,838 | 13,033,213 | - | 413,388,051 |
| Current Liabilities: | | | | |
| Accounts payable | 28,004,015 | 556,621 | - | 28,560,636 |
| Current maturities of long-term debt (Note 10) | 18,964,879 | 572,382 | - | 19,537,261 |
| Notes payable (Note 10) | 194,800,000 | - | - | 194,800,000 |
| Current portion of obligations under capital lease (Note 11) | 2,164,203 | - | - | 2,164,203 |
| Customer deposits | 6,834,934 | - | - | 6,834,934 |
| Intercompany payables | 193,579 | 51,230 | (244,809) | - |
| Other current liabilities | 39,451,053 | - | - | 39,451,053 |
| Total current liabilities | 290,412,663 | 1,180,233 | (244,809) | 291,348,087 |
| Accrued Pension and Postretirement Benefits (Note 8) | 81,074,155 | - | - | 81,074,155 |
| Noncurrent Portion of Obligations Under Capital Lease (Note 11) | 6,241,911 | - | - | 6,241,911 |
| Deferred Credits | 6,817,946 | - | - | 6,817,946 |
| Derivative Liabilities (Notes 2 and 15) | 53,997,094 | - | - | 53,997,094 |
| Commitments and Contingencies (Notes 12 and 13) | - | - | - | - |
| Total equities and liabilities | $ 971,348,373 | $ 14,219,269 | $ (250,632) | $ 985,317,010 |

See Independent Auditor's Report on Supplementary Information.

## Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
## Consolidating Statements of Revenue and Expenses
## Year Ended December 31, 2015

| | SMECO | SMECO Solar LLC | Eliminations | Total |
|---|---|---|---|---|
| Operating Revenue: | | | | |
| Sales of electricity | $ 405,399,569 | $ 1,659,601 | $ (1,659,601) | $ 405,399,569 |
| Lease income (Note 6) | 72,560 | - | (72,560) | - |
| Other | 22,959,601 | - | - | 22,959,601 |
| Total operating revenue | 428,431,730 | 1,659,601 | (1,732,161) | 428,359,170 |
| Operating Expenses: | | | | |
| Purchased power (Note 12) | 269,663,821 | - | (1,659,601) | 268,004,220 |
| Power production | 4,583 | 309,450 | (72,560) | 241,473 |
| Transmission | 3,294,460 | - | - | 3,294,460 |
| Distribution - operations | 10,335,018 | - | - | 10,335,018 |
| Distribution - maintenance | 19,678,200 | - | - | 19,678,200 |
| Customer accounts | 11,657,223 | - | - | 11,657,223 |
| Customer service and information | 19,337,758 | - | - | 19,337,758 |
| Administrative and general | 37,994,135 | 54,785 | - | 38,048,920 |
| Depreciation and amortization | 31,795,602 | 710,908 | - | 32,506,510 |
| Taxes | 15,627,230 | 364,272 | - | 15,991,502 |
| Other | 1,350,253 | - | - | 1,350,253 |
| Total operating expenses | 420,738,283 | 1,439,415 | (1,732,161) | 420,445,537 |
| Operating margins | 7,693,447 | 220,186 | - | 7,913,633 |
| Interest Expense: | | | | |
| Interest on long-term debt | 15,045,558 | 445,538 | - | 15,491,096 |
| Other interest | 3,850,643 | - | - | 3,850,643 |
| Total interest expenses | 18,896,201 | 445,538 | - | 19,341,739 |
| Net Operating (Loss) | (11,202,754) | (225,352) | - | (11,428,106) |
| Other Patronage Allocations | 3,802,958 | - | - | 3,802,958 |
| Total operating (loss) | (7,399,796) | (225,352) | - | (7,625,148) |
| Nonoperating Margins (Notes 6 and 17) | 17,001,209 | 72,626 | 152,726 | 17,226,561 |
| Net margins (loss) | $ 9,601,413 | $ (152,726) | $ 152,726 | $ 9,601,413 |

## Consolidating Statements of Comprehensive Income
## Year Ended December 31, 2015

| | SMECO | SMECO Solar LLC | Eliminations | Total |
|---|---|---|---|---|
| Net Margins (Loss) | $ 9,601,413 | $ (152,726) | $ 152,726 | $ 9,601,413 |
| Other Comprehensive (Loss): | | | | |
| Net gain during period | 405,157 | - | - | 405,157 |
| Amortization of net (loss) | (3,098,998) | - | - | (3,098,998) |
| Other comprehensive (loss) | (2,693,841) | - | - | (2,693,841) |
| Comprehensive Income (Loss) | $ 6,907,572 | $ (152,726) | $ 152,726 | $ 6,907,572 |

See Independent Auditor's Report on Supplementary Information.

## Southern Maryland Electric Cooperative, Inc.
## and SMECO Solar LLC
## Comparative Summary of Operations
## Years Ended December 31, 2015 - 2011

| | 2015 | 2014 | 2013 | 2012 | 2011 |
|---|---|---|---|---|---|
| Operating Revenue: | | | | | |
| Sales of electricity | $ 405,399,569 | $ 460,931,055 | $ 438,346,363 | $ 403,170,680 | $ 435,200,226 |
| Lease income | - | 621,144 | 1,538,359 | 2,005,961 | 2,415,140 |
| Other | 22,959,601 | 21,625,695 | 19,475,805 | 13,316,654 | 11,854,049 |
| Total operating revenue | 428,359,170 | 483,177,894 | 459,360,527 | 418,493,295 | 449,469,415 |
| Operating Expenses: | | | | | |
| Purchased power | 268,004,220 | 321,683,773 | 297,747,235 | 275,256,422 | 312,274,549 |
| Power production | 241,473 | 216,386 | 177,683 | 2,167 | - |
| Transmission | 3,294,460 | 4,016,843 | 3,893,596 | 3,684,194 | 3,184,075 |
| Distribution - operations | 10,335,018 | 10,227,779 | 9,732,884 | 8,315,945 | 8,110,012 |
| Distribution - maintenance | 19,678,200 | 18,794,091 | 18,466,029 | 16,829,638 | 16,209,398 |
| Customer accounts | 11,657,223 | 10,970,143 | 10,140,122 | 9,253,741 | 8,579,949 |
| Customer service and information | 19,337,758 | 17,929,786 | 15,694,102 | 11,007,022 | 7,894,534 |
| Administrative and general | 38,048,920 | 33,219,602 | 32,859,833 | 30,078,841 | 27,868,433 |
| Depreciation and amortization | 32,506,510 | 29,450,913 | 26,134,423 | 26,487,914 | 24,982,801 |
| Taxes | 15,991,502 | 13,860,042 | 12,152,377 | 12,589,731 | 9,787,305 |
| Other | 1,350,253 | 361,564 | 382,440 | 317,770 | 340,144 |
| Total operating expenses | 420,445,537 | 460,730,922 | 427,380,724 | 393,823,385 | 419,231,200 |
| Operating margins | 7,913,633 | 22,446,972 | 31,979,803 | 24,669,910 | 30,238,215 |
| Interest Expense: | | | | | |
| Interest on long-term debt | 15,491,096 | 17,535,136 | 16,039,006 | 16,098,719 | 16,099,488 |
| Other interest | 3,850,643 | 1,877,250 | 1,630,428 | 865,966 | 937,993 |
| Total interest expense | 19,341,739 | 19,412,386 | 17,669,434 | 16,964,685 | 17,037,481 |
| Net Operating (Loss) Margins | (11,428,106) | 3,034,586 | 14,310,369 | 7,705,225 | 13,200,734 |
| Other Patronage Allocations | 3,802,958 | 2,372,848 | 1,763,339 | 1,398,309 | 1,226,017 |
| Total operating (loss) margins | (7,625,148) | 5,407,434 | 16,073,708 | 9,103,534 | 14,426,751 |
| Nonoperating Margins | 17,226,561 | 3,020,993 | 1,926,791 | 3,755,426 | 686,035 |
| Net margins | $ 9,601,413 | $ 8,428,427 | $ 18,000,499 | $ 12,858,960 | $ 15,112,786 |
| Electric Revenue: | | | | | |
| Residential | $ 265,841,379 | $ 302,538,996 | $ 293,263,234 | $ 268,659,885 | $ 279,647,444 |
| General service | 117,095,551 | 134,650,211 | 122,594,208 | 112,813,667 | 120,531,733 |
| Large power | 16,856,334 | 17,543,851 | 16,954,218 | 16,813,427 | 18,599,089 |
| Street lights | 2,425,368 | 2,414,335 | 2,324,151 | 2,215,760 | 2,047,584 |
| Transmission | 3,146,893 | 3,762,725 | 3,207,636 | 2,667,941 | 14,374,376 |
| Solar facility services | 34,044 | 20,937 | 2,916 | - | - |
| Total | $ 405,399,569 | $ 460,931,055 | $ 438,346,363 | $ 403,170,680 | $ 435,200,226 |
| Megawatt-Hour Sales: | | | | | |
| Residential | 2,172,605 | 2,159,553 | 2,135,838 | 2,043,774 | 2,113,645 |
| General service | 1,134,242 | 1,127,834 | 1,106,967 | 1,111,438 | 1,017,715 |
| Large power | 153,589 | 151,599 | 165,767 | 184,385 | 176,605 |
| Street lights | 7,303 | 6,986 | 6,947 | 6,703 | 6,241 |
| Transmission | 38,562 | 41,329 | 33,137 | 29,763 | 123,363 |
| Solar facility services | 147 | 60 | 12 | - | - |
| Total | 3,506,448 | 3,487,361 | 3,448,668 | 3,376,063 | 3,437,569 |
| Customers at Year End (Billings) | 163,303 | 160,213 | 156,533 | 154,346 | 152,730 |

See Independent Auditor's Report on Supplementary Information.

# Southern Maryland Electric Cooperative, Inc.
# and SMECO Solar LLC
## Financial Statements
## December 31, 2016 and 2015

## CONTENTS

### Financial Statements



### Supplementary Information

ADAMS, JENKINS AND CHEATHAM
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS CONSULTANTS

## Independent Auditor's Report

The Board of Directors
Southern Maryland Electric Cooperative, Inc.
and SMECO Solar LLC

**Report on the Consolidated Financial Statements**

We have audited the accompanying consolidated financial statements of Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC ("SMECO") which comprise the consolidated balance sheets as of December 31, 2016 and 2015 and the related consolidated statements of revenue, expenses and comprehensive income, changes in equities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

**Management's Responsibility for the Consolidated Financial Statements**

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

**Auditor's Responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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



231 Wylderose Drive | Midlothian, VA 23113 | 804.323.1313

**Opinion**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of SMECO as of December 31, 2016 and 2015, 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.

Adams, Jenkins & Cheatham

Richmond, Virginia
March 20, 2017

**Southern Maryland Electric Cooperative, Inc.
and SMECO Solar LLC
Consolidated Balance Sheets
December 31, 2016 and 2015**

| | 2016 | 2015 |
|---|---|---|
| **Assets** | | |
| Utility Plant, at Original Cost (Notes 2 and 3) | $ 1,128,032,463 | $ 1,086,799,102 |
| Less: Accumulated Depreciation and Amortization | (366,938,275) | (344,788,178) |
| Net utility plant | 761,094,188 | 742,010,924 |
| Nonutility Property (net) | 3,131,461 | 1,958,546 |
| Investments (Note 2): | | |
| Investments in associated organizations, at cost (Note 4 and 14) | 13,986,287 | 13,383,618 |
| Investment in an unconsolidated entity (Note 5) | 1,205,323 | 1,201,111 |
| Other investments | 20,587,215 | 23,069,821 |
| Total investments | 35,778,825 | 37,654,550 |
| Current Assets (Note 2): | | |
| Cash and cash equivalents | 4,644,003 | 6,436,020 |
| Accounts receivable, net of allowance for doubtful accounts of $1,200,000 and $900,000, respectively | 48,807,020 | 38,476,695 |
| Materials and supplies inventory | 17,513,344 | 12,901,423 |
| Prepaid expenses | 9,718,595 | 7,667,984 |
| Other current assets | 10,831,496 | 11,761,660 |
| Total current assets | 91,514,458 | 77,243,782 |
| Regulatory Assets (Notes 2 and 7) | 66,689,797 | 86,876,566 |
| Deferred Charges and Other (Note 2) | 34,648,444 | 34,750,509 |
| Derivative Assets (Notes 2 and 15) | 1,191,378 | 4,822,133 |
| Total assets | $ 994,048,551 | $ 985,317,010 |
| **Equities and Liabilities** | | |
| Equities (Note 9): | | |
| Patronage capital | $ 204,647,393 | $ 195,244,095 |
| Other equities | 27,410,365 | 24,709,253 |
| Accumulated other comprehensive (loss) | (81,245,079) | (87,503,582) |
| Total equities | 150,812,679 | 132,449,766 |
| Long-Term Debt, Less Current Maturities (Notes 10 and 14) | 586,015,898 | 413,388,051 |
| Current Liabilities: | | |
| Accounts payable | 27,304,218 | 28,560,636 |
| Current maturities of long-term debt (Note 10) | 24,081,505 | 19,537,261 |
| Notes payable (Note 10) | 72,100,000 | 194,800,000 |
| Current portion of obligations under capital lease (Note 11) | 1,661,219 | 2,164,203 |
| Customer deposits | 6,807,983 | 6,834,934 |
| Other current liabilities | 15,383,606 | 39,451,053 |
| Total current liabilities | 147,338,531 | 291,348,087 |
| Accrued Pension and Postretirement Benefits (Note 8) | 75,276,566 | 81,074,155 |
| Noncurrent Portion of Obligations Under Capital Lease (Note 11) | 4,588,809 | 6,241,911 |
| Deferred Credits | 2,390,629 | 6,817,946 |
| Derivative Liabilities (Notes 2 and 15) | 27,625,439 | 53,997,094 |
| Commitments and Contingencies (Notes 12 and 13) | - | - |
| Total equities and liabilities | $ 994,048,551 | $ 985,317,010 |

The accompanying notes are an interal part of the above statements.

## Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
## Consolidated Statements of Revenue and Expenses
## Years Ended December 31, 2016 and 2015

| | 2016 | 2015 |
|---|---|---|
| Operating Revenue: | | |
| Sales of electricity | $ 412,091,512 | $ 405,399,569 |
| Other | 24,996,383 | 22,959,601 |
| Total operating revenue | 437,087,895 | 428,359,170 |
| Operating Expenses: | | |
| Purchased power (Note 12) | 250,313,710 | 268,004,220 |
| Power production | 251,502 | 241,473 |
| Transmission | 3,640,137 | 3,294,460 |
| Distribution - operations | 10,614,462 | 10,335,018 |
| Distribution - maintenance | 20,203,136 | 19,678,200 |
| Customer accounts | 12,108,719 | 11,657,223 |
| Customer service and information | 21,942,948 | 19,337,758 |
| Administrative and general | 38,655,415 | 38,048,920 |
| Depreciation and amortization | 35,221,311 | 32,506,510 |
| Taxes | 15,104,610 | 15,991,502 |
| Other | 1,592,419 | 1,350,253 |
| Total operating expenses | 409,648,369 | 420,445,537 |
| Operating margins | 27,439,526 | 7,913,633 |
| Interest Expense: | | |
| Interest on long-term debt | 21,875,522 | 15,491,096 |
| Other interest | 911,570 | 3,850,643 |
| Total interest expenses | 22,787,092 | 19,341,739 |
| Net Operating Margins (Loss) | 4,652,434 | (11,428,106) |
| Other Patronage Allocations | 4,618,308 | 3,802,958 |
| Total operating margins (loss) | 9,270,742 | (7,625,148) |
| Nonoperating Margins (Notes 6 and 17) | 2,532,617 | 17,226,561 |
| Net margins | $ 11,803,359 | $ 9,601,413 |

## Consolidated Statements of Comprehensive Income
## Years Ended December 31, 2016 and 2015

| | 2016 | 2015 |
|---|---|---|
| Net Margins | $ 11,803,359 | $ 9,601,413 |
| Other Comprehensive Income (Loss): | | |
| Postretirement benefit plans actuarial gain (loss), net | 1,047,830 | (5,792,839) |
| Prior service credit | 2,283,094 | - |
| Amortization of actuarial loss | 2,927,579 | 3,098,998 |
| Other comprehensive income (loss) | 6,258,503 | (2,693,841) |
| Comprehensive Income | $ 18,061,862 | $ 6,907,572 |

The accompanying notes are an integral part of the above statements.

**Southern Maryland Electric Cooperative, Inc.**
**and SMECO Solar LLC**
**Consolidated Statements of Changes in Equities**
**Years Ended Dcember 31, 2016 and 2015**

| | Patronage Capital | Other Equities | Accumulated Other Comprehensive (Loss) Income | Total |
|---|---|---|---|---|
| Balance, December 31, 2014 | $ 204,255,833 | $ 8,139,540 | $ (84,809,741) | $ 127,585,632 |
| Net (loss) margins | (5,753,317) | 15,354,730 | - | 9,601,413 |
| Retirement of capital credits | (3,258,421) | 1,214,983 | - | (2,043,438) |
| Other comprehensive (loss) | - | - | (2,693,841) | (2,693,841) |
| Balance, December 31, 2015 | 195,244,095 | 24,709,253 | (87,503,582) | 132,449,766 |
| Net margins | 10,835,201 | 968,158 | - | 11,803,359 |
| Retirement of capital credits | (1,431,903) | 820,922 | - | (610,981) |
| Prior year unclaimed capital credits | - | 912,032 | - | 912,032 |
| Other comprehensive income | - | - | 6,258,503 | 6,258,503 |
| Balance, December 31, 2016 | $ 204,647,393 | $ 27,410,365 | $ (81,245,079) | $ 150,812,679 |

The accompanying notes are an integral part of the above statements.

# Southern Maryland Electric Cooperative, Inc.
# and SMECO Solar LLC
# Consolidated Statements of Cash Flows
# Years Ended December 31, 2016 and 2015

| | 2016 | 2015 |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Net margins | $ 11,803,359 | $ 9,601,413 |
| Adjustments to reconcile net margins to net cash provided by operating activities: | | |
| Depreciation and amortization | 35,221,311 | 32,506,510 |
| Earnings in unconsolidated entities | (4,212) | (17,243) |
| Other patronage allocations | (4,618,308) | (3,802,958) |
| Gain on sale of assets | - | (14,551,872) |
| Non-cash refinancing costs | - | 2,879,147 |
| Change in operating assets and liabilities: | | |
| Accounts receivable, net | (10,330,325) | 16,212,752 |
| Prepaid expenses | (2,050,611) | 2,420,648 |
| Derivative assets | 3,630,755 | 768,986 |
| Other current assets | 930,164 | (4,030,641) |
| Deferred charges and other | 102,065 | 3,454,962 |
| Regulatory assets | 20,186,769 | (9,690,022) |
| Accounts payable | (1,256,418) | (3,112,551) |
| Customer deposits | (26,951) | 576,798 |
| Other current liabilities | (24,067,447) | 25,677,715 |
| Deferred credits | (3,515,285) | (2,551,574) |
| Derivative liabilities | (26,371,655) | 6,188,137 |
| Accrued pension and postretirement benefits | 460,914 | (1,292,890) |
| Net cash provided by operating activities | 94,125 | 61,237,317 |
| Cash Flows From Investing Activities: | | |
| Construction of utility plant | (55,372,748) | (71,153,262) |
| Plant removal cost | (3,556,736) | (2,572,111) |
| Proceeds from the salvage of utility plant | 348,398 | - |
| Contributions in aid of construction | 4,619,425 | 3,443,922 |
| Capitalized interest | (342,914) | (614,376) |
| Materials and supplies inventory | (4,611,921) | 307,340 |
| Disposition of nonutility property | (1,172,915) | 66,321 |
| Net change in other investments | 2,482,606 | (11,085,894) |
| Proceeds from the sale of fixed assets | - | 14,951,994 |
| Net redemption of capital term certificates | 741,324 | 48,198 |
| Net sale of associated investments | 3,274,315 | 2,644,520 |
| Net investment in direct financing lease | - | 4,504,717 |
| Net cash used in investing activities | (53,591,166) | (59,458,631) |
| Cash Flows From Financing Activities: | | |
| Advances on long-term debt | 200,000,000 | - |
| Payments of long-term debt | (22,827,909) | (20,210,479) |
| Advances under line of credit agreements | 225,100,000 | 219,800,000 |
| Payments under line of credit agreements | (347,800,000) | (196,635,501) |
| Payments on capital lease obligations | (2,156,086) | (3,025,535) |
| Distribution of capital credits | (610,981) | (1,915,299) |
| Net cash provided by (used in) financing activities | 51,705,024 | (1,986,814) |
| Net Decrease in Cash and Cash Equivalents | (1,792,017) | (208,128) |
| Cash and Cash Equivalents, Beginning of Year | 6,436,020 | 6,644,148 |
| Cash and cash equivalents, end of year | $ 4,644,003 | $ 6,436,020 |
| Non-cash Investing Activity: | | |
| Capital lease | $ - | $ 712,895 |

The accompanying notes are an integral part of the above statements.

**Note 1: Description of Business**

Southern Maryland Electric Cooperative, Inc. (SMECO) is an electric transmission and distribution cooperative that was initially formed as Southern Maryland Tri-County Cooperative Association on February 5, 1937. In 1942, the members voted to change the form of the organization from an association to a cooperative, nonprofit membership corporation under the Maryland Electric Cooperative Act and adopted the current name. SMECO serves about 163,000 customers in a 1,150 square-mile area in Southern Maryland comprised of Calvert, Charles, Prince George's and St. Mary's counties.

SMECO Solar LLC, a wholly-owned subsidiary that constructed and owns a solar project with a capacity of approximately 5.5 megawatts and can produce nearly 8,700 megawatt-hours of energy annually, was established by SMECO on June 21, 2011. Producing solar renewable energy helps SMECO fulfill its renewable portfolio obligation as required by the state (see Note 2).

**Note 2: Summary of Significant Accounting Policies**

**A. System of Accounts and Regulation** - The accounting records are maintained in accordance with the Uniform System of Accounts for Electric Borrowers prescribed by the Federal Energy Regulatory Commission (FERC). SMECO is subject to regulation by the Maryland Public Service Commission (PSC). The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The consolidated financial statements reflect the ratemaking policies of the PSC in conformity with guidance set forth by the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 980 as it relates to certain types of regulated industries. This standard allows SMECO to record certain regulatory assets and liabilities, which will be included in future rates and would not be recorded under GAAP for nonregulated entities in the United States (see Note 7).

If portions of SMECO's operations no longer become subject to the provisions as set forth by ASC Topic 980, a write-off of any related regulatory assets or liabilities would be required unless some form of transition cost recovery continues through rates established and collected for the remaining regulated operations. In addition, a determination of any impairment to the carrying costs of deregulated plant and inventory assets would be required.

**B. Consolidation -** The consolidated financial statements include the accounts and results of operations of SMECO and its wholly-owned subsidiary. All significant intercompany transactions have been eliminated in consolidation.

**C. Estimates -** The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of revenues, expenses, assets, liabilities and disclosure of contingencies as of the date of the consolidated financial statements. Actual results could differ from those estimates and assumptions.

**D. Utility Plant** - Utility plant is stated at cost which includes the cost of labor, material and applicable indirect costs. When a retirement unit of property is replaced or removed, the cost of such property is deducted from utility plant and such cost, together with the cost of removal less salvage, is charged to accumulated depreciation. Expenditures for additions and replacements that are not considered units of property, as well as routine repairs and maintenance, are expensed as incurred.

SMECO periodically evaluates long-lived assets such as utility plant when events or changes in circumstances indicate that the carrying value of these assets may not be recoverable. The determination of whether impairment has occurred is based on an estimate of undiscounted cash flows attributable to these assets, as compared to the carrying value of the assets.

**E. Depreciation** - For financial reporting purposes, depreciation is computed on a straight-line composite basis using the estimated useful service lives of the depreciable property.

**F. Investments** - The investment in unconsolidated entity is accounted for under the equity method. SMECO records its proportionate share of equity in earnings or loss of the unconsolidated entity in the Consolidated Statements of Revenue and Expenses under Nonoperating Margins (see Note 5). Patronage capital certificates from associated organizations are recorded at cost plus the stated amount of the certificate (see Note 4).

**G. Cash and Cash Equivalents** - The Cooperative considers all highly liquid investments with a maturity of three months or less to be cash equivalents.

**H. Accounts Receivable** - Credit is extended to customers for electric service received as customers are billed on a monthly basis after the service is rendered and the electric meter is read. These readings occur as nearly as practicable every 30 days. Bills are payable within 20 days of rendering. If not paid timely, late payment charges may be applied. In compliance with the rules and regulations of the PSC, SMECO may require both residential and nonresidential customers to make and maintain cash deposits to secure the payment of final bills. The allowance for doubtful accounts is calculated as a percentage of sales. Accounts are reviewed periodically to determine collectability. Bad debts are written off automatically throughout the year after one year of nonpayment.

**I. Materials and Supplies Inventory** - Materials and supplies inventory is generally used for construction or maintenance of operations. Inventory is recorded using the lower of market or average cost and issued items are charged to construction or operations at the recorded average cost.

**J. Derivative Instruments** - SMECO uses various methods, such as forward purchase contracts, option contracts, financial swaps and commodity swaps to manage the commodity and financial risks associated with meeting its power supply requirements. SMECO accounts for the aforementioned contracts in accordance with guidance as set forth by FASB as it relates to derivative instruments and hedging activities. This guidance requires all derivatives, subject to certain exceptions, to be accounted for at fair value. According to FASB guidance, the majority of SMECO's forward purchase contracts and option contracts qualify for the normal purchase and normal sales exception. As a result, these contracts are not recorded at fair value. Since all of SMECO's power supply related costs are subject to rate recovery, changes in the fair value of financial and commodity swaps are periodically reflected as derivative assets and regulatory liabilities or derivative liabilities and regulatory assets, respectively, under the provisions as set forth by FASB (see Note 2A). As of December 31, 2016, the change in fair value of SMECO's derivative instruments, excluding contracts accounted for as normal purchase/normal sale were as follows:

| Derivatives | Balance Sheet Location | Change in Fair Value |
|---|---|---|
| Financial Gas | Regulatory assets and Derivative liabilities | $ (26,686,698) |
| Financial Energy | Regulatory assets and Derivative liabilities | (938,741) |
| Financial Transmission Rights | Derivative assets and Regulatory liabilities | 1,191,378 |
| Total | | $ (26,434,061) |

At December 31, 2016, total derivative contracts in a gross asset and gross liability position amounted to approximately $3.0 million and $29.4 million, respectively.

As of December 31, 2015, the change in fair value of SMECO's derivative instruments, excluding contracts accounted for as normal purchase/normal sale were as follows:

| Derivatives | Balance Sheet Location | Change in Fair Value |
|---|---|---|
| Financial Gas | Regulatory assets and Derivative liabilities | $ (36,023,289) |
| Financial Energy | Regulatory assets and Derivative liabilities | (17,973,805) |
| Financial Transmission Rights | Derivative assets and Regulatory liabilities | 4,822,133 |
| Total | | $ (49,174,961) |

At December 31, 2015, total derivative contracts in a gross asset and gross liability position amounted to approximately $5.0 million and $54.2 million, respectively.

Net gains and losses on financial and commodity swaps and Financial Transmission Rights are reflected in cost of power at the time they are settled. For the year ended December 31, 2016, the realized gain (loss) on these transactions was as follows:

| Derivatives | Realized Gain (Loss) Recognized in Purchased Power |
|---|---|
| Financial Gas | $ (7,986,119) |
| Financial Energy | (23,079,980) |
| Financial Transmission Rights | 1,900,890 |
| Total | $(29,165,209) |

For the year ended December 31, 2015, the realized gain (loss) on these transactions was as follows:

| Derivatives | Realized Gain (Loss) Recognized in Purchased Power |
|---|---|
| Financial Gas | $ (4,727,173) |
| Financial Energy | (11,251,460) |
| Financial Transmission Rights | 3,376,203 |
| Total | $(12,602,430) |

As of December 31, 2016 and 2015, SMECO had entered into commitments for options totaling $11.9 million and $14.8 million, respectively.

**K. Deferred Charges** - Costs of preliminary surveys and studies made for the purpose of determining the feasibility of proposed utility projects are recorded as deferred charges. If a project is constructed, such costs are capitalized as part of the cost of the facility. If the plans for a project are subsequently abandoned, the costs are expensed.

SMECO exited out of the Rural Utilities Service (RUS) loan program and refinanced all of its outstanding long-term debt with RUS and the Federal Financing Bank (FFB) during 2015, and as such, was required to pay a prepayment premium to FFB of almost $29 million (see Note 10). This amount will be amortized over the remaining life of the old debt issue.

**L. Revenue Recognition** - Revenue is recognized as service is rendered to customers. Recorded revenue includes an estimate of unbilled revenue for utility service rendered but not billed to customers as of year-end. Estimated unbilled revenue was approximately $13.2 million and $10.4 million as of December 31, 2016 and 2015, respectively.

**M. Income Taxes** - As a not-for-profit, membership cooperative under Section 501(c)(12) of the Internal Revenue Code, SMECO is exempt from federal income taxes on income from operating activities. Pursuant to the Maryland Electric Cooperative Act, SMECO is also exempt from state income taxes. Accordingly, no provision for such taxes has been made in the accompanying financial statements.

Certain income earned from other unrelated products and services may require SMECO to pay federal and state income taxes. Should this situation arise, the necessary provisions for income tax liability will be recorded in the consolidated financial statements.

The tax years from 2013 to 2015 remain subject to examination by the taxing authorities for both SMECO and SMECO Solar LLC.

SMECO Solar LLC is taxed as a corporation and is subject to federal and state income taxes. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences arising between the tax bases of assets and liabilities and their reported amounts in accordance with GAAP. At December 31, 2016 and 2015, there were no material deferred tax assets and liabilities reported on the consolidated balance sheets. SMECO Solar LLC had no significant uncertain tax positions or tax liability for tax benefits, interest or penalties accrued at December 31, 2016 and 2015.

**N. Accumulated Other Comprehensive Income** - This item consists of other gains and losses affecting equity that, under GAAP, are excluded from net income. During 2016 and 2015, such items relate to SMECO's unrecognized actuarial loss and amortization from the adoption of guidance issued by FASB as it relates to the accounting for defined benefit pension and other postretirement plans.

**O. Subsequent Events** - Subsequent events have been evaluated through March 20, 2017, which is the date the consolidated financial statements were available to be issued.

**P. Advertising Costs** - Advertising costs are expensed as incurred.

**Q. Renewable Portfolio Standard (RPS)** - SMECO is subject to Maryland's RPS, which requires retail suppliers of electricity to provide twenty percent of their retail sales using renewable resources by 2022. SMECO fulfills this obligation by purchasing renewable energy from various resources such as wind and solar, as well as by procuring Renewable Energy Credits (RECs) in the market.

**R. Reclassifications -** Certain reclassifications have been made to the December 31, 2015 financial statements to conform to the December 31, 2016 presentation.

**Note 3: Utility Plant**

The major classes of utility plant in service as of December 31, 2016 and 2015 are as follows:

| | 2016 | 2015 |
|---|---|---|
| Distribution | $ 639,792,616 | $ 596,722,061 |
| Transmission | 307,753,733 | 286,983,546 |
| Generation | 14,217,507 | 14,218,160 |
| Other Production Plant | 463,175 | 463,175 |
| General | 154,607,645 | 152,039,458 |
| | 1,116,834,676 | 1,050,426,400 |
| Construction work in progress | 11,197,787 | 36,372,702 |
| Utility Plant | $1,128,032,463 | $1,086,799,102 |

The annual composite rates used in calculating depreciation are as follows:

| | |
|---|---|
| Distribution | 3.51% |
| Transmission | 2.60% |
| Generation | 5.00% |
| General | 7.14% |

SMECO follows the regulatory principle of intergenerational cost allocation by including net salvage (gross salvage less costs of removal) as a component of depreciation rates. Net salvage is a "non-legal asset retirement obligation," and as such is not subject to the accounting requirements issued by ASC Topic 410 Asset Retirement and Environmental Obligations and FERC Order 631. SMECO has no legal asset retirement obligations as that term is defined by FASB guidance and FERC Order 631.

In accordance with the reporting requirements of FASB's guidance on asset retirement obligations and FERC Order 631, SMECO's accumulated provision for depreciation included a net salvage timing difference of approximately $8.7 million and $8.6 million for the years ended December 31, 2016 and 2015, respectively. This represents the differences in the timing of recognition of the period costs associated with net salvage.

SMECO capitalizes interest cost incurred on funds used to construct utility plant. The capitalized interest is recorded as part of the asset to which it relates and is amortized over the asset's estimated useful life.

**Note 4: Investments in Associated Organizations**

Investments in associated organizations consisted of the following as of December 31, 2016 and 2015:

| | 2016 | 2015 |
|---|---|---|
| National Rural Utilities Cooperative Finance Corporation (CFC): | | |
| Capital Term Certificates | | |
| 3% | $ 1,000,650 | $ 1,000,650 |
| 5% | 3,164,783 | 3,164,783 |
| 8.55% | - | 720,411 |
| Noninterest bearing | 229,945 | 250,858 |
| Patronage capital certificates | 2,160,195 | 1,772,149 |
| CFC membership | 1,000 | 1,000 |
| | 6,556,573 | 6,909,851 |
| Federated Rural Electric Insurance Corporation | 1,049,011 | 974,871 |
| CoBank, ACB (CoBank) | 6,059,928 | 5,244,956 |
| Other | 320,775 | 253,940 |
| | $13,986,287 | $13,383,618 |

**Note 5: Equity Method Investments**

Effective August 1, 2003, SMECO invested $1,000,000 for a membership and equity investment in Alliance for Cooperative Energy Services Power Marketing, LLC (subsequently renamed ACES). SMECO's proportionate share of ACES earnings was $4,212 in 2016 and $17,243 in 2015. As of December 31, 2016 and 2015, the carrying value of the investment was $1,205,323 and $1,201,111, respectively.

**Note 6: Net Investment in Facility Capacity Credit Agreement**

Pursuant to the Facility and Capacity Credit Agreement (FCC Agreement) entered into with Potomac Electric Power Company (Pepco) in March 1989, SMECO constructed a 77-megawatt combustion turbine generating unit at Pepco's then-owned Chalk Point Generating Station in Aquasco, Maryland. This facility was placed in commercial operation on December 1, 1990. As part of the FCC Agreement, in exchange for electric capacity and generated energy from the facility, Pepco was obligated to operate and maintain the facility for a period of 25 years, commencing December 1990.

In accordance with SMECO's concurrence under the Agreement and Consent executed in December 2000, Pepco assigned its rights and obligations under the FCC Agreement to Southern Energy, Inc. (subsequently renamed Mirant Corporation (Mirant)), a Delaware corporation. Mirant subsequently assigned the FCC Agreement to one of its subsidiaries, Mirant Peaker, LLC, which subsequently merged into another Mirant subsidiary, Mirant Chalk Point, LLC. In December 2010, Mirant merged with RRI Energy, creating GenOn Energy, Inc. (GenOn), in connection with which Mirant Chalk Point, LLC changed its name to GenOn Chalk Point, LLC. The agreement permitted GenOn Chalk Point, LLC to operate, dispatch and receive all electricity generated from the facility. GenOn Chalk Point, LLC was responsible for all costs associated with operating and maintaining the combustion turbine during the remaining term of the FCC Agreement. On December 14, 2012, NRG Energy, Inc. (NRG) acquired all of the ownership interests of GenOn and, accordingly, NRG is now the ultimate corporate parent of GenOn Chalk Point, LLC.

The FCC Agreement was accounted for as a direct financing lease. The monthly payment was $437,510.

On December 1, 2015 at the expiration of the FCC Agreement, the combustion turbine was sold to NRG Chalk Point CT LLC for $12,350,000. As the combustion turbine had been accounted for as a direct financing lease, there was no book value at the time of sale and therefore, the entire amount was recorded as a gain and is included in Nonoperating Margins on the Consolidated Statement of Revenue and Expenses for the year ended December 31, 2015.

### Note 7: Regulatory Assets

Regulatory assets consisted of the following:

**A. Demand Response (DR) and EmPOWER Maryland Programs -** Conservation expenditures pertaining to DR and EmPOWER Maryland programs are recognized as regulatory assets and amortized over a one-year or five-year period in accordance with PSC requirements. Conservation costs are recovered through a rate surcharge approved by the PSC that reflects expenditures and an allowed rate of return. The related amounts of regulatory assets for the DR and EmPOWER Maryland programs were $28,667,974 and $27,454,337 as of December 31, 2016 and 2015, respectively.

**B. Advanced Metering Infrastructure (AMI) Implementation -** Pursuant to PSC approval, a regulatory asset was established for the costs associated with an AMI staged implementation to determine whether the deployment of AMI in SMECO's service territory would achieve the operational savings anticipated. In 2013, the PSC approved the system-wide deployment of AMI and a regulatory asset was established. As of December 31, 2016 and 2015, the regulatory assets for these projects totaled $10,396,384 and $5,425,135, respectively.

**C. Energy and Energy-Related Costs** - As of December 31, 2016 and 2015, the regulatory asset pertaining to energy and energy-related costs was $27,625,439 and $53,997,094, respectively (see Note 2).

### Note 8: Employee Benefit Plans

**A. Pension Plan and Other Postretirement Benefits** - SMECO has a qualified, noncontributory, defined benefit pension plan which provides for retirement benefits based upon age, years of service and compensation. The Retirement Annuity Plan for Employees of SMECO was closed effective December 31, 2006, so that employees who were hired or re-hired on or after January 1, 2007, were not eligible to participate (or recommence participation) in the Pension Plan. SMECO continued to maintain the Pension Plan for current employees through December 31, 2010 at which time the Plan was frozen. The net effect was that a participant's benefits under the Pension Plan were calculated as if the participant terminated employment with SMECO on December 31, 2010. As a result of this curtailment, SMECO requested a deferral as available under ASC Topic 980 to amortize the prior service costs (benefit cost) of $4.7 million, over an eight-year period. Annual provisions for accrued pension costs are based upon independent actuarial valuations dated as of December 31, 2016 and 2015. SMECO's policy is to fund accrued pension costs in accordance with provisions of the Employee Retirement Income Security Act of 1974 (ERISA).

SMECO provides additional retirement benefits to certain employees under a nonqualified plan established in accordance with Section 457 of the Internal Revenue Code. The periodic plan expenses are based on the present value of the retirement benefits earned during the year.

SMECO supplements health care insurance premiums for retirees and covered dependents through their inclusion in the same insurance coverage pool as active employees. The expected cost of these benefits under the unfunded plan is recognized during the years in which employees render service.

The following sets forth the obligations, funded status and periodic costs for the plans and the actuarial assumptions used in accordance with ASC Topic 715:

| | Pension Benefits | |
|---|---|---|
| | 2016 | 2015 |
| Benefit obligation at year end | $145,861,231 | $146,977,989 |
| Fair value of plan assets at year end | 108,257,891 | 104,213,907 |
| Funded status | $ (37,603,340) | $ (42,764,082) |
| Amounts recognized in the Balance Sheets: | | |
| Accrued benefit cost | $ (37,603,340) | $ (42,764,082) |
| Deferred charges not included in equity | 1,657,254 | 1,894,005 |
| Amounts recognized as reduction in equity not yet recognized as periodic benefit cost: | | |
| Net actuarial loss | 66,073,811 | 67,552,908 |
| Expected amortization for the next fiscal year | 1,742,623 | 1,754,495 |
| Weighted-average assumptions used to determine benefit obligations as of year end: | | |
| Discount rate | 4.60% | 4.60% |
| Benefit cost | $ 1,362,366 | $ 1,723,295 |
| Employer contribution | 4,301,294 | 6,367,146 |
| Benefits paid | 7,493,524 | 7,188,000 |
| Weighted-average assumptions used to determine benefit costs: | | |
| Discount rate | 4.60% | 4.35% |
| Expected return on plan assets | 7.00% | 7.00% |

Expected contributions for year ending December 31, 2017:

| | |
|---|---|
| Employer | $ 3,323,756 |
| Employees | - |

Estimated future benefit payments reflecting expected future service for years ending December 31:

| | |
|---|---|
| 2017 | $ 7,418,407 |
| 2018 | 7,628,914 |
| 2019 | 8,020,826 |
| 2020 | 8,245,090 |

| | | |
|---|---|---|
| 2021 | 8,452,214 | |
| 2022-2026 | 44,218,711 | |
| | | |
| Plan Assets: | | |
| Equity Securities (a) (c) | 61% | 56% |
| Fixed Income Securities (b) (c) | 39% | 44% |

(a) The portfolio's target asset allocation range is 60% equity with an allowable range of 30% to 60%.
(b) The portfolio's target asset allocation range is 40% fixed income with an allowable range of 30% to 60%.
(c) The portfolio's target asset allocation also allows for up to 20% in cash.

Plan assets are considered Level 1 inputs on the fair value measurement hierarchy as described in Note 15. During the year, there were no significant changes in the valuation techniques or inputs.

SMECO's investment strategy with respect to pension assets is designed to achieve a moderate level of overall portfolio risk in keeping with its desired risk objective, which is established after careful consideration of plan liabilities, plan funded status and SMECO's overall financial condition. The portfolio's target asset allocation is 60% equity and 40% fixed income with specified allowable ranges around these targets. The equity segment is broadly diversified across growth/value and small-, mid- and large-cap equities. The fixed income segment is diversified by investing in preferred stocks, corporate debt securities and obligations of the U.S. Government and its agencies.

SMECO also sponsors a defined benefit postretirement medical insurance plan that covers substantially all collectively bargained and management employees and their dependents. Provided active coverage was elected before retirement, bargaining unit employees who reach the age of 55 with 10 years of service and management employees who reach the age of 60 with 15 years of service or age 55 with 33 years of service for participants in the Retirement Annuity Plan become eligible to receive benefits. Participants under the age of 65 are eligible for the PPO Plan or HDHP/HSA Plan and participants of the age 65 and older are eligible for the Medicare Supplemental Plan. The following sets forth the funded status of the Plan reconciled with amounts reported in the balance sheets in accordance with ASC Topic 715:

| | Other Postretirement Benefits | |
|---|---|---|
| | 2016 | 2015 |
| Benefit obligation at year end | $ 37,673,226 | $ 38,310,073 |
| Fair value of plan assets at year end | - | - |
| Funded status | $(37,673,226) | $(38,310,073) |
| Amounts recognized in the Balance Sheets: | | |
| Accrued benefit cost | $(37,673,226) | $(38,310,073) |
| Deferred charges not included in equity | - | 14,059 |
| Amounts recognized as reduction in equity not yet recognized as periodic benefit cost: | | |
| Net actuarial loss | 17,454,362 | 19,950,674 |
| Net prior service (credit) costs | (2,283,094) | |
| | 15,171,268 | 19,950,674 |
| Expected amortization for the next fiscal year | 771,877 | 1,116,890 |
| Weighted-average assumptions used to determine benefit obligations as of year end: | | |
| Discount rate | 4.60% | 4.60% |
| Benefit cost | $ 4,444,253 | $ 4,123,920 |
| Employer contribution | 287,635 | 411,686 |
| Benefits paid | 287,635 | 411,686 |
| Weighted-average assumptions used to determine benefit costs: | | |
| Discount rate | 4.60% | 4.35% |

Expected contributions for year ending December 31, 2017 are $862,534.

Estimated future benefit payments reflecting expected future service for years ending December 31:

| | |
|---|---|
| 2017 | $ 862,534 |
| 2018 | 1,018,401 |
| 2019 | 1,118,191 |
| 2020 | 1,229,918 |
| 2021 | 1,236,351 |
| 2022-2026 | 7,710,894 |

For measurement purposes, a 7.0% medical trend rate was assumed for health care benefits and premiums for 2017. It is further assumed that this rate will decrease to 4.5% through 2027 and remain at that level thereafter.

On December 8, 2003, the President signed into law the Medicare Prescription Drug Improvement and Modernization Act of 2003. This Act introduces a prescription drug benefit under Medicare Part D as well as a federal subsidy to sponsors of retiree healthcare benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. SMECO has not, and does not intend to, apply for this subsidy for the years ended December 31, 2016 and 2015.

**B. Health Insurance** - SMECO is self-insured for medical and dental claims of its current employees and retirees and their covered dependents. SMECO is liable for claims of up to $150,000 per occurrence for medical claims and $2,000 per year per participant for dental claims. Catastrophic coverage is maintained to pay claims in excess of these amounts. Claims paid under this plan approximated $7.1 million in 2016 and $6.3 million in 2015. Provisions for claims incurred but not reported have been made based on claim experience and approximated $296,000 and $393,000 as of December 31, 2016 and 2015, respectively.

**C. 401(k) Plans** - SMECO maintains 401(k) plans for its management and bargaining unit employees. All full-time employees are eligible to participate in the plans after meeting minimum service requirements. SMECO matches employee contributions to the management plan up to 6% of annual compensation and as of May 1, 2016 for the bargaining plan, matches $.50 on the dollar up to 1% of annual straight time earnings. Effective with the freeze of the Pension Plan (see Note 8A), SMECO provides a non-elective employer contribution which varies based on length of service. For employees with 0 - 4 years of service, the contribution is 3% of base pay; 5 - 19 years of service, 8% of base pay; and 20 or more years of service, 10% of base pay. During 2016 and 2015, SMECO recorded 401(k) plan-related expenses of approximately $4.6 million and $4.0 million, respectively.

**D. Workers' Compensation Trust** - SMECO is self-insured for workers' compensation insurance through a separate trust which was established to pay workers' compensation claims. Contributions to the trust are based upon an actuarial valuation and SMECO maintains excess liability insurance coverage for claims exceeding $750,000. Part One of the policy covers the employer's statutory liabilities under state law up to $25 million. Part Two covers liability arising out of employee work-related injuries that do not fall under the workers' compensation statute up to $1 million. Transactions within the trust are not reflected in the accompanying consolidated financial statements. During 2016 and 2015, SMECO made aggregated contributions to the trust of approximately $793,000 and $782,000, respectively. At December 31, 2016 and 2015, the trust had estimated net assets available for benefits of $1,187,590 and $460,575, respectively.

### Note 9: Patronage Capital and Other Equities

Assigned patronage capital consists of net operating margins that have been allocated to individual member patronage accounts. Patronage capital is applied against unpaid accounts receivable when customers leave SMECO. Patronage capital retirements to date represent amounts that have been paid to individual members. Patronage capital activity as of December 31, 2016 and 2015 consisted of the following:

| | 2016 | 2015 |
|---|---|---|
| Assignable | $ 5,081,884 | $ (5,753,317) |
| Assigned to date | 291,744,254 | 291,744,254 |
| | 296,826,138 | 285,990,937 |
| Less: Retirements to date | (92,178,745) | (90,746,842) |
| Patronage capital | $204,647,393 | $195,244,095 |

Other equities consist of donated capital from members and nonrefundable membership fees that were previously collected from new members upon joining SMECO. Beginning December 31, 2015, certain nonoperating margins were included as part of other equities.

### Note 10: Long-Term Debt

SMECO has obtained long-term debt from CFC and CoBank. SMECO is subject to various loan covenants under its master mortgage and substantially all assets are pledged as collateral for the long-term debt. The covenants include maintaining certain minimum debt service and equity ratio requirements. SMECO Solar LLC has obtained long-term debt from FFB, which has been guaranteed by SMECO.

In early 2015, with the approvals of RUS and the PSC, SMECO exited the RUS loan program and refinanced all of its outstanding RUS and FFB loans totaling approximately $333.1 million at interest rates ranging between 3.44% to 5.19% with CoBank and CFC at interest rates between 1.64% to 3.65%. This debt was refinanced in the form of a mortgage indenture which will provide ease of access to the capital markets for privately placed debt in the future. As a result of the refinance, SMECO was required to pay a prepayment premium to FFB of almost $29.0 million, of which $16.9 million was financed with CoBank and CFC for total long-term debt of $350 million. The remainder of the premium was paid using funds from the unsecured line of credit. SMECO will realize significant savings in interest costs over the life of the loans, net of the prepayment penalty. In addition to interest savings, SMECO will also benefit from patronage capital from CoBank and CFC. All future long-term debt will be financed through CoBank, CFC and the private placement market.

The following debt was outstanding as of December 31, 2016 and 2015:

| Lender | Interest Rates | Maturity (Year) | 2016 | 2015 |
|---|---|---|---|---|
| CFC | 2.90-4.15% | 2023-45 | $254,264,852 | $180,777,052 |
| CoBank | 2.04-6.44% | 2017-46 | 342,799,338 | 238,542,665 |
| FFB | 3.07% | 2034 | 13,033,213 | 13,605,595 |
| Total debt outstanding | | | 610,097,403 | 432,925,312 |
| Less: Current maturities | | | 24,081,505 | 19,537,261 |
| Long-term debt | | | $586,015,898 | $413,388,051 |

At December 31, 2016, the required principal payments of the long-term debt are as follows:

| | |
|---|---|
| 2017 | $ 24,081,505 |
| 2018 | 23,774,853 |
| 2019 | 24,619,028 |
| 2020 | 23,599,902 |
| 2021 | 22,531,830 |
| Thereafter | 491,490,285 |
| Total | $610,097,403 |

Cash paid for interest totaled approximately $22.5 million and $18.3 million for the years ended December 31, 2016 and 2015, respectively.

Effective February 2016, SMECO refinanced $200 million of CoBank and CFC short term debt to long term debt at interest rates ranging between 2.65% to 4.74%.

SMECO maintains unsecured revolving line of credit agreements at variable interest rates with CoBank and CFC for its short-term borrowing needs. The CoBank agreement expires March 31, 2017. The CFC agreement automatically renews each March unless CFC or SMECO provides written notice not to renew at least 90 days in advance of the renewal date.

As of December 31, 2016, SMECO had authorized lines of credit of $175 million with CFC and $125 million with CoBank. The outstanding balances for CFC lines of credit and their respective interest rates as of December 31, 2016 were $72.1 million at 2.5% and as of December 31, 2015, were $69.8 million at 2.9%.

The outstanding balance for the CoBank line of credit and the respective interest rate as of December 31, 2015, was $125 million at 2.53%. There was no outstanding balance as of December 31, 2016.

As of December 31, 2016 and 2015, SMECO had outstanding letters of credit totaling $5.5 million and $8.2 million, respectively.

**Note 11: Leases**

SMECO is obligated under long-term capital leases for utility equipment, office furniture and equipment and vehicles that expire at various dates through 2024. The future minimum lease payments required under the capital leases and the present value of the net minimum lease payments as of December 31, 2016, are as follows:

| | |
|---|---|
| 2017 | $1,860,989 |
| 2018 | 1,541,850 |
| 2019 | 1,132,342 |
| 2020 | 774,196 |
| 2021 | 558,999 |
| Thereafter | 1,084,931 |
| Total minimum lease payments | 6,953,307 |
| Less: Amount representing interest | ( 703,279) |
| Present value of minimum lease payments | 6,250,028 |
| Less: Current obligations | (1,661,219) |
| Long-term capital lease obligation | $4,588,809 |

The assets under capital leases are included in the consolidated balance sheets as part of net utility plant as follows:

| | 2016 | 2015 |
|---|---|---|
| Transmission | $ 9,852,280 | $ 9,852,280 |
| General | 3,571,307 | 6,698,989 |
| | 13,423,587 | 16,551,269 |
| Less: Accumulated depreciation | (2,335,053) | (2,574,973) |
| | $11,088,534 | $13,976,296 |

Interest paid on the capital lease obligations for the years ended December 31, 2016 and 2015 was $312,789 and $384,494, respectively. The capital leases are collateralized by the assets leased under the agreements, which are recorded in the accompanying consolidated balance sheet. Depreciation expense at December 31, 2016 and 2015 relating to these assets was $518,333 and $625,648, respectively.

SMECO leases many of its vehicles and power-operated equipment for various terms under long-term, operating lease agreements. The leases expire at various dates through 2021. At the expiration of the scheduled lease term, SMECO can either purchase the equipment at fair market value, have the lessor sell the equipment on its behalf or renew the lease for twelve or twenty-four months. Operating lease expense amounted to $1,841,559 and $2,186,788 in 2016 and 2015, respectively.

The future minimum rental payments required under the operating lease agreements as of December 31, 2016, are as follows:

| | |
|---|---|
| 2017 | $1,392,322 |
| 2018 | 682,810 |
| 2019 | 157,735 |
| 2020 | 60,569 |
| 2021 | 28,050 |
| Total | $2,321,486 |

**Note 12: Commitments and Contingencies**

SMECO contracts with various suppliers for energy and energy-related products to serve its native load requirements. As of December 31, 2016, SMECO had forward purchase commitments with multiple parties through May 2035 covering a significant portion of SMECO's power supply needs.

At December 31, 2016 and 2015, SMECO had made commitments for capital expenditures of approximately $5.2 million and $1.9 million, respectively.

SMECO is involved in legal proceedings in the normal course of business. Management is of the opinion that the final disposition of these proceedings will not have a material adverse effect on SMECO's financial position, results of operations or cash flows.

**Note 13: Concentration of Risk**

The electric utility industry continues to be subject to increasing competitive pressures, consolidation and restructuring. Federal and state legislatures and regulators, including the United States Congress, Maryland General Assembly and PSC, and large industrial electricity consumers are working to reshape the industry through legislative and regulatory initiatives that increase electric competition at the generation, transmission and distribution levels.

Under Maryland's Electric Customer Choice and Competition Act and the Electric and Gas Utility Tax Reform Act, electric customers residing in Maryland are entitled to select or choose their electric energy supplier. As of December 31, 2016, SMECO had approximately 4,600 customers served by an alternative electricity supplier. SMECO continues to provide distribution service to all of its customers.

Residential rooftop solar systems are becoming increasingly popular in SMECO's service territory. Solar developers have installed over 4,000 residential rooftop solar systems through 2016, over two percent of the residential class. The output of these systems offset sales of energy from SMECO. Distribution sales revenue from these customers is reduced resulting in additional revenue recovery from all other residential customers. SMECO is pursuing legislative and regulatory actions to reduce or eliminate this cost shifting within the residential class before it reaches a significant level as more customers have rooftop solar systems installed.

The outcome of these initiatives and their impact on SMECO is uncertain. Customer choice and the resulting retail competition will likely continue to affect the entire industry.

With the assistance of ACES (see Notes 5 and 12), SMECO has developed a more diversified market strategy to meet future power supply needs, including reduced dependence on a single supplier and varied contract termination dates. This approach represents a significant departure from the traditional cooperative model of multiple year contracts with a sole supplier. Given the changes in the wholesale power market in recent years, SMECO has concluded that it is no longer operationally or economically prudent to engage in the traditional full-requirements contract with one supplier.

In order to meet its power supply requirements for its standard offer service customers, SMECO has executed numerous Master Power Purchase and Sale Agreements with a number of counterparties. Such agreements stipulate credit limits and other information pertaining to the establishment of trading relationships. Accordingly, SMECO is subject to the normal market, credit and performance risks inherent in these arrangements. To monitor and mitigate such risk exposure, SMECO continues to work closely with ACES personnel, has created and implemented related trading and credit policies and has established a Board Risk Oversight Committee and an internal Power Supply Committee that meet frequently to address relevant matters.

Financial instruments that subject SMECO to concentration of credit risks include customer accounts receivable. SMECO grants credit to customers, substantially all of whom are local residents of SMECO's four-county service area. SMECO places its cash on deposit with financial institutions located in the United States of America, which are insured by the Federal Deposit Insurance Corporation (FDIC). The FDIC provides insurance coverage for up to $250,000 of cash held by SMECO in each separate FDIC insured bank and savings institution. From time to time, SMECO may have amounts on deposit in excess of the insured limits. As of December 31, 2016, SMECO had approximately $5.6 million of deposits that exceeded the insured limits.

**Note 14: Fair Value of Financial Instruments**

SMECO has accounted for all financial instruments, classified as derivatives, at fair market value. SMECO has accounted for all other financial instruments based on the carrying amount (book value) in the financial statements in accordance with GAAP. According to guidance set forth by FASB, SMECO is required to disclose the fair value of those financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using discounted cash flow analysis. This technique involves subjective judgment and is significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. As a result, the derived fair value estimates cannot be substantiated by comparison to independent markets, and in many cases, could not be realized in immediate settlement of the instrument.

Accordingly, the following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it was practicable to estimate that value.

Cash and Cash Equivalents

The carrying amount of cash and cash equivalents approximates fair value due to the short maturity of these instruments.

Accounts Receivable

The carrying amount of accounts receivable approximates fair value due to the short period of time amounts are outstanding.

Investments in Associated Organizations

Fair value of capital term certificates was determined by computing the present value of estimated future cash flows, discounted at the long-term treasury rate of 3.06% and 3.01% as of December 31, 2016 and 2015, respectively. The fair value of patronage capital is not determinable since no legal obligation exists to retire capital credits. The fair value of the equity method investment is not estimated since there are no identified events or changes in circumstances that may have a significant adverse effect on the fair value and it is not practicable to estimate fair value. The carrying value of memberships approximates fair value.

Accounts Payable

The carrying amount of accounts payable approximates fair value due to the short period of time amounts are outstanding.

Long-Term Debt

The carrying amount of SMECO's fixed long-term debt includes certain interest rates that are below quoted market prices for the same or similar issues. Therefore, the fair value of fixed long-term debt is estimated based on current market prices for the same or similar issues offered for debt of the same and remaining maturities which was 5.85% as of December 31, 2016 and 2015.

The carrying amount of lines of credit approximates fair value due to the short maturity of these instruments.

Customer Deposits

The carrying amount approximates fair value due to the relatively short maturity of the deposits.

Fair Value

The estimated fair value of SMECO's financial instruments, reported at cost, is as follows:

| | Carrying Value | | Fair Value | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| | (000 Omitted) | | (000 Omitted) | |
| Assets: | | | | |
| Capital Term Certificates | $ 4,395 | $ 5,137 | $ 6,188 | $ 7,006 |
| Liabilities: | | | | |
| Long-term Debt | (610,097) | (432,925) | (539,542) | (375,453) |

**Note 15: Fair Value Measurements**

SMECO follows the guidance issued by FASB as it relates to the accounting and disclosure requirements for financial instruments reported as assets and liabilities at fair value. This guidance also establishes a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability. Inputs may be observable or unobservable and refer broadly to the assumptions that market participants would use in pricing the asset or liability. Observable inputs reflect the assumptions market participants would use in pricing the asset or liability based on market data obtained from sources independent of the reporting entity. Unobservable inputs reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

The three levels of the fair value hierarchy are described as follows:

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 - Other significant observable inputs, including quoted prices for similar assets or liabilities in markets that are not active.

Level 3 - Significant unobservable inputs, which are generally based on SMECO's own assumptions.

The following table summarizes the financial instruments measured at fair value:

| | December 31, 2016 (000 Omitted) | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Derivative Assets, net | $ 1,191 | $ - | $ 1,191 | $ - |
| Plan Assets for Pension and Other Benefits | 108,258 | 108,258 | - | - |
| Liabilities: | | | | |
| Derivative Liabilities, net | $ (27,625) | $ - | $(27,625) | $ - |

| | December 31, 2015 (000 Omitted) | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Derivative Assets, net | $ 4,822 | $ - | $ 4,822 | $ - |
| Plan Assets for Pension and Other Benefits | 104,214 | 104,214 | - | - |
| Liabilities: | | | | |
| Derivative Liabilities, net | $(53,997) | $ - | $(53,997) | $ - |

The fair value of derivative liabilities is comprised of forward trades, power and gas positions and Financial Transmission Rights (FTRs). The fair value of all forward trades is calculated by a third party, ACES, using market prices when possible and modeled forward prices including constant heat rate projections, supply-demand simulation generated values, inflation escalated market prices, or a blend of these sources when market prices are not available. The power positions are valued at AEP Dayton – Dominion Zone, Brandywine, PJM East or PJM West and the gas positions are valued using NYMEX Henry Hub, TRANSCO Zone 5 or TRANSCO Zone 6 Non-NY pricing. FTRs are marked-to-market based on data from the most recent FTR auction.

**Note 16: Related Party Transactions**

SMECO is a member of CFC and CoBank. Pursuant to the member relationships, SMECO has invested in, entered into various loan agreements with, and maintains unsecured lines of credit with these organizations (see Notes 4 and 10). SMECO earned interest income of approximately $198,000 and $250,000 in 2016 and 2015, respectively, on investments with CFC. During years 2016 and 2015, SMECO paid interest expense of approximately $22.1 million and $15.1 million, respectively, on aggregated loans from CFC and CoBank.

As a customer, NRG is a member of SMECO. SMECO had entered into a direct financing lease with NRG (see Note 6).

SMECO invested in and became a member of ACES during 2003 to engage ACES' professional assistance in meeting future power supply needs (see Note 5). In addition to the membership fee, SMECO paid ACES approximately $1.1 million for such services during 2016 and 2015.

SMECO invested in and became a member of National Renewables Cooperative Organization (NRCO) during 2008 to utilize NRCO's services in the analysis of renewable projects in which SMECO may choose to participate in order to fulfill the Maryland RPS obligations (see Note 4). SMECO paid NRCO approximately $40,000 and $53,000 for such services in 2016 and 2015, respectively.

SMECO is a member of Electric Research and Manufacturing Cooperative (ERMCO) and The Tarheel Electric Membership Association, Inc. (TEMA) and purchases materials and supplies from them (see Note 4). During years 2016 and 2015, SMECO made aggregated purchases of approximately $1.3 million to these organizations.

SMECO is a member of Federated Rural Electric Insurance Corporation (Federated) and purchases general liability and property insurance from them (see Note 4). SMECO paid Federated approximately $794,000 and $853,000 for such insurance in 2016 and 2015, respectively.

**Note 17: Sale of Utility Property**

In 2015, SMECO sold an office building located on a 20.05 acre parcel of land. The purchase price of the land was $127,092 and the office building was constructed at a cost of $1,269,691. The book value at the time of sale was $383,931. The property sold for $2,600,000, a gain of $2,216,069. This gain is included in Nonoperating Margins on the Consolidated Statement of Revenue and Expenses for the year ended December 31, 2015.

ADAMS, JENKINS AND CHEATHAM
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS CONSULTANTS

**Independent Auditor's Report on Supplementary Information**

To the Board of Directors of
Southern Maryland Electric Cooperative, Inc.
and SMECO Solar LLC

We have audited the consolidated financial statements of Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC ("SMECO") for the years ended December 31, 2016 and 2015, and our report thereon dated March 20, 2017, which expressed an unmodified opinion on those consolidated financial statements appears on pages 1 and 2. Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating financial information and consolidated comparative summary of operations is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual entities, and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

We also have previously audited, in accordance with auditing standards generally accepted in the United States of America, the balance sheets of SMECO as of December 31, 2014, 2013, and 2012, and the related statements of revenue, expenses and patronage capital and comprehensive income, and cash flows for each of the three years then ended (none of which is presented herein), and we expressed unmodified opinions on those financial statements. In our opinion, the comparative summary of operations is fairly stated in all material respects in relation to the basic consolidated financial statements from which it has been derived.

Adams, Jenkins & Cheatham

Richmond, Virginia
March 20, 2017



231 Wylderose Drive | Midlothian, VA 23113 | 804.323.1313

## Southern Maryland Electric Cooperative, Inc.
## and SMECO Solar LLC
## Consolidating Balance Sheets
## December 31, 2016

| | SMECO | SMECO Solar LLC | Eliminations | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| Utility Plant, at Original Cost (Notes 2 and 3) | $ 1,113,814,956 | $ 14,217,507 | $ - | $ 1,128,032,463 |
| Less: Accumulated Depreciation and Amortization | (364,039,904) | (2,898,371) | - | (366,938,275) |
| Net utility plant | 749,775,052 | 11,319,136 | - | 761,094,188 |
| Nonutility Property (net) | 3,131,461 | - | - | 3,131,461 |
| Investments (Note 2): | | | | |
| Investments in associated organizations, at cost (Notes 4 and 14) | 13,986,287 | - | - | 13,986,287 |
| Investment in an unconsolidated entity (Note 5) | 1,205,323 | - | - | 1,205,323 |
| Investment in SMECO Solar LLC (Note 2) | 277,460 | - | (277,460) | - |
| Other investments | 20,587,215 | - | - | 20,587,215 |
| Total investments | 36,056,285 | - | (277,460) | 35,778,825 |
| Current Assets (Note 2): | | | | |
| Cash and cash equivalents | 2,334,845 | 2,309,158 | - | 4,644,003 |
| Accounts receivable, net of allowance for doubtful accounts of $1,200,000 | 48,807,020 | - | - | 48,807,020 |
| Materials and supplies inventory | 17,489,926 | 23,418 | - | 17,513,344 |
| Prepaid expenses | 9,711,859 | 6,736 | - | 9,718,595 |
| Intercompany receivables | 63,209 | 103,002 | (166,211) | - |
| Other current assets | 10,831,496 | - | - | 10,831,496 |
| Total current assets | 89,238,355 | 2,442,314 | (166,211) | 91,514,458 |
| Regulatory Assets (Notes 2 and 7) | 66,689,797 | - | - | 66,689,797 |
| Deferred Charges and Other (Note 2) | 34,648,444 | - | - | 34,648,444 |
| Derivative Assets (Notes 2 and 15) | 1,191,378 | - | - | 1,191,378 |
| Total assets | $ 980,730,772 | $ 13,761,450 | $ (443,671) | $ 994,048,551 |
| **Equities and Liabilities** | | | | |
| Equities (Note 9): | | | | |
| Patronage capital | $ 204,647,393 | $ - | $ - | $ 204,647,393 |
| Other equities | 27,410,365 | 277,460 | (277,460) | 27,410,365 |
| Accumulated other comprehensive (loss) | (81,245,079) | - | - | (81,245,079) |
| Total equities | 150,812,679 | 277,460 | (277,460) | 150,812,679 |
| Long-Term Debt, Less Current Maturities (Notes 10 and 14) | 573,577,390 | 12,438,508 | - | 586,015,898 |
| Current Liabilities: | | | | |
| Accounts payable | 27,053,318 | 250,900 | - | 27,304,218 |
| Current maturities of long-term debt (Note 10) | 23,486,800 | 594,705 | - | 24,081,505 |
| Notes payable (Note 10) | 72,100,000 | - | - | 72,100,000 |
| Current portion of obligations under capital lease (Note 11) | 1,661,219 | - | - | 1,661,219 |
| Customer deposits | 6,807,983 | - | - | 6,807,983 |
| Intercompany payables | 103,002 | 63,209 | (166,211) | - |
| Other current liabilities | 15,246,938 | 136,668 | - | 15,383,606 |
| Total current liabilities | 146,459,260 | 1,045,482 | (166,211) | 147,338,531 |
| Accrued Pension and Postretirement Benefits (Note 8) | 75,276,566 | - | - | 75,276,566 |
| Noncurrent Portion of Obligations Under Capital Lease (Note 11) | 4,588,809 | - | - | 4,588,809 |
| Deferred Credits | 2,390,629 | - | - | 2,390,629 |
| Derivative Liabilities (Notes 2 and 15) | 27,625,439 | - | - | 27,625,439 |
| Commitments and Contingencies (Notes 12 and 13) | - | - | - | - |
| Total equities and liabilities | $ 980,730,772 | $ 13,761,450 | $ (443,671) | $ 994,048,551 |

See Independent Auditor's Report on Supplementary Information.

## Southern Maryland Electric Cooperative, Inc.
## and SMECO Solar LLC
## Consolidating Statements of Revenue and Expenses
## Year Ended December 31, 2016

| | SMECO | SMECO Solar LLC | Eliminations | Total |
|---|---|---|---|---|
| Operating Revenue: | | | | |
| Sales of electricity | $ 412,091,512 | $ 2,001,831 | $ (2,001,831) | $ 412,091,512 |
| Lease income | 72,670 | - | (72,670) | - |
| Other | 24,996,383 | - | - | 24,996,383 |
| Total operating revenue | 437,160,565 | 2,001,831 | (2,074,501) | 437,087,895 |
| Operating Expenses: | | | | |
| Purchased power (Note 12) | 252,315,541 | - | (2,001,831) | 250,313,710 |
| Power production | - | 324,172 | (72,670) | 251,502 |
| Transmission | 3,640,137 | - | - | 3,640,137 |
| Distribution - operations | 10,614,462 | - | - | 10,614,462 |
| Distribution - maintenance | 20,203,136 | - | - | 20,203,136 |
| Customer accounts | 12,108,719 | - | - | 12,108,719 |
| Customer service and information | 21,942,948 | - | - | 21,942,948 |
| Administrative and general | 38,592,955 | 62,460 | - | 38,655,415 |
| Depreciation and amortization | 34,510,406 | 710,905 | - | 35,221,311 |
| Taxes | 14,830,973 | 273,637 | - | 15,104,610 |
| Other | 1,592,419 | - | - | 1,592,419 |
| Total operating expenses | 410,351,696 | 1,371,174 | (2,074,501) | 409,648,369 |
| Operating margins | 26,808,869 | 630,657 | - | 27,439,526 |
| Interest Expense: | | | | |
| Interest on long-term debt | 21,444,530 | 430,992 | - | 21,875,522 |
| Other interest | 911,570 | - | - | 911,570 |
| Total interest expenses | 22,356,100 | 430,992 | - | 22,787,092 |
| Net Operating Margins | 4,452,769 | 199,665 | - | 4,652,434 |
| Other Patronage Allocations | 4,618,308 | - | - | 4,618,308 |
| Total operating margins | 9,071,077 | 199,665 | - | 9,270,742 |
| Nonoperating Margins (Loss) | 2,732,282 | 71,972 | (271,637) | 2,532,617 |
| Net margins (loss) | $ 11,803,359 | $ 271,637 | $ (271,637) | $ 11,803,359 |

## Consolidating Statements of Comprehensive Income
## Year Ended December 31, 2016

| | SMECO | SMECO Solar LLC | Eliminations | Total |
|---|---|---|---|---|
| Net Margins (Loss) | $ 11,803,359 | $ 271,637 | $ (271,637) | $ 11,803,359 |
| Other Comprehensive Income: | | | | |
| Postretirement benefit plans actuarial gain (loss), net | 1,047,830 | | | 1,047,830 |
| Prior service credit | 2,283,094 | - | - | 2,283,094 |
| Amortization of actuarial loss | 2,927,579 | - | - | 2,927,579 |
| Other comprehensive income | 6,258,503 | - | - | 6,258,503 |
| Comprehensive Income (Loss) | $ 18,061,862 | $ 271,637 | $ (271,637) | $ 18,061,862 |

See Independent Auditor's Report on Supplementary Information.

## Southern Maryland Electric Cooperative, Inc.
## and SMECO Solar LLC
## Consolidated Comparative Summary of Operations
## Years Ended December 31, 2016 - 2012

| | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|
| Operating Revenue: | | | | | |
| Sales of electricity | $ 412,091,512 | $ 405,399,569 | $ 460,931,055 | $ 438,346,363 | $ 403,170,680 |
| Lease income | - | - | 621,144 | 1,538,359 | 2,005,961 |
| Other | 24,996,383 | 22,959,601 | 21,625,695 | 19,475,805 | 13,316,654 |
| Total operating revenue | 437,087,895 | 428,359,170 | 483,177,894 | 459,360,527 | 418,493,295 |
| Operating Expenses: | | | | | |
| Purchased power | 250,313,710 | 268,004,220 | 321,683,773 | 297,747,235 | 275,256,422 |
| Power production | 251,502 | 241,473 | 216,386 | 177,683 | 2,167 |
| Transmission | 3,640,137 | 3,294,460 | 4,016,843 | 3,893,596 | 3,684,194 |
| Distribution - operations | 10,614,462 | 10,335,018 | 10,227,779 | 9,732,884 | 8,315,945 |
| Distribution - maintenance | 20,203,136 | 19,678,200 | 18,794,091 | 18,466,029 | 16,829,638 |
| Customer accounts | 12,108,719 | 11,657,223 | 10,970,143 | 10,140,122 | 9,253,741 |
| Customer service and information | 21,942,948 | 19,337,758 | 17,929,786 | 15,694,102 | 11,007,022 |
| Administrative and general | 38,655,415 | 38,048,920 | 33,219,602 | 32,859,833 | 30,078,841 |
| Depreciation and amortization | 35,221,311 | 32,506,510 | 29,450,913 | 26,134,423 | 26,487,914 |
| Taxes | 15,104,610 | 15,991,502 | 13,860,042 | 12,152,377 | 12,589,731 |
| Other | 1,592,419 | 1,350,253 | 361,564 | 382,440 | 317,770 |
| Total operating expenses | 409,648,369 | 420,445,537 | 460,730,922 | 427,380,724 | 393,823,385 |
| Operating margins | 27,439,526 | 7,913,633 | 22,446,972 | 31,979,803 | 24,669,910 |
| Interest Expense: | | | | | |
| Interest on long-term debt | 21,875,522 | 15,491,096 | 17,535,136 | 16,039,006 | 16,098,719 |
| Other interest | 911,570 | 3,850,643 | 1,877,250 | 1,630,428 | 865,966 |
| Total interest expense | 22,787,092 | 19,341,739 | 19,412,386 | 17,669,434 | 16,964,685 |
| Net Operating Margins (Loss) | 4,652,434 | (11,428,106) | 3,034,586 | 14,310,369 | 7,705,225 |
| Other Patronage Allocations | 4,618,308 | 3,802,958 | 2,372,848 | 1,763,339 | 1,398,309 |
| Total operating margins (loss) | 9,270,742 | (7,625,148) | 5,407,434 | 16,073,708 | 9,103,534 |
| Nonoperating Margins | 2,532,617 | 17,226,561 | 3,020,993 | 1,926,791 | 3,755,426 |
| Net margins | $ 11,803,359 | $ 9,601,413 | $ 8,428,427 | $ 18,000,499 | $ 12,858,960 |
| Electric Revenue: | | | | | |
| Residential | $ 272,862,159 | $ 265,841,379 | $ 302,538,996 | $ 293,263,234 | $ 268,659,885 |
| General service | 117,276,689 | 117,095,551 | 134,650,211 | 122,594,208 | 112,813,667 |
| Large power | 16,397,550 | 16,856,334 | 17,543,851 | 16,954,218 | 16,813,427 |
| Street lights | 2,509,594 | 2,425,368 | 2,414,335 | 2,324,151 | 2,215,760 |
| Transmission | 2,896,767 | 3,146,893 | 3,762,725 | 3,207,636 | 2,667,941 |
| Solar facility/station power services | 148,753 | 34,044 | 20,937 | 2,916 | - |
| Total | $ 412,091,512 | $ 405,399,569 | $ 460,931,055 | $ 438,346,363 | $ 403,170,680 |
| Megawatt-Hour Sales: | | | | | |
| Residential | 2,112,651 | 2,172,605 | 2,159,553 | 2,135,838 | 2,043,774 |
| General service | 1,123,191 | 1,134,242 | 1,127,834 | 1,106,967 | 1,111,438 |
| Large power | 166,623 | 153,589 | 151,599 | 165,767 | 184,385 |
| Street lights | 7,856 | 7,303 | 6,986 | 6,947 | 6,703 |
| Transmission | 28,444 | 38,562 | 41,329 | 33,137 | 29,763 |
| Solar facility/station power services | 2,933 | 147 | 60 | 12 | - |
| Total | 3,441,698 | 3,506,448 | 3,487,361 | 3,448,668 | 3,376,063 |
| Customers at Year End (Billings) | 162,823 | 163,303 | 160,213 | 156,533 | 154,346 |

See Independent Auditor's Report on Supplementary Information.