

NUECES ELECTRIC COOPERATIVE, INC.

ROBSTOWN, TEXAS

FINANCIAL STATEMENTS WITH SUPPLEMENTARY INFORMATION

FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018

AND

REPORT OF CERTIFIED PUBLIC ACCOUNTANTS

**NUECES ELECTRIC COOPERATIVE, INC.
ROBSTOWN, TEXAS**

**FINANCIAL STATEMENTS WITH SUPPLEMENTARY INFORMATION
FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018**

TABLE OF CONTENTS

	<u>Statement Identification</u>	<u>Page No.</u>
Independent Auditor's Report		1
Financial Statements		
Balance Sheets	Exhibit A	3
Statements of Income and Patronage Capital	Exhibit B	4
Statements of Cash Flows	Exhibit C	5
Notes to Financial Statements		6
Supplementary Information		
Electric Plant	Schedule 1	19
Accumulated Provision for Depreciation	Schedule 2	20
Other Property and Investments	Schedule 3	21
Administrative and General Expenses	Schedule 4	22
Compliance and Internal Control Section		
Letter to Board of Directors Regarding Policies Concerning Audits of CFC Borrowers		23

BOLINGER, SEGARS, GILBERT & MOSS, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

PHONE: (806) 747-3806

FAX: (806) 747-3815

8215 NASHVILLE AVENUE

LUBBOCK, TEXAS 79423-1954

Independent Auditor's Report

Board of Directors
Nueces Electric Cooperative, Inc.
Robstown, Texas

We have audited the accompanying financial statements of Nueces Electric Cooperative, Inc., which comprise the balance sheets as of December 31, 2019 and 2018, and the related statements of income and patronage capital and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Nueces Electric Cooperative, Inc. as of December 31, 2019 and 2018, 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.

Other Matter

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The schedules of electric plant, accumulated provision for depreciation, other property and investments, and administrative and general expenses is presented for the purposes of additional analysis and is not a required part of the 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 financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Bolinger, Segars, Gilbert & Moss LLP

Certified Public Accountants

Lubbock, Texas

March 16, 2020

NUECES ELECTRIC COOPERATIVE, INC.

Exhibit A

BALANCE SHEETS
DECEMBER 31, 2019 AND 2018

ASSETS

	December 31,	
	2019	2018
UTILITY PLANT AT COST		
Electric Plant in Service	\$ 143,733,601	\$ 139,929,582
Construction Work in Progress	703,731	113,793
	\$ 144,437,332	\$ 140,043,375
Less: Accumulated Provision for Depreciation	27,175,723	25,016,522
	\$ 117,261,609	\$ 115,026,853
OTHER PROPERTY AND INVESTMENTS		
Investments in Associated Organizations	\$ 42,146,135	\$ 37,825,493
Held-to-Maturity Securities - At Amortized Cost	28,810,289	24,586,492
Other Investments - Restricted	1,673,749	1,479,525
	\$ 72,630,173	\$ 63,891,510
CURRENT ASSETS		
Cash - General	\$ 5,750,877	\$ 2,798,737
Accounts Receivable (Less allowance for uncollectibles of \$329,149 in 2019 and \$312,644 in 2018)	3,098,274	2,211,736
Accrued Unbilled Revenue	4,770,952	5,214,275
Materials and Supplies (At average cost)	1,932,816	1,989,330
Other Current and Accrued Assets	456,050	380,852
Total Current Assets	\$ 16,008,969	\$ 12,594,930
DEFERRED CHARGES	\$ 772,509	\$ 1,007,448
TOTAL ASSETS	\$ 206,673,260	\$ 192,520,741

EQUITIES AND LIABILITIES

EQUITIES		
Memberships	\$ 449,800	\$ 431,525
Patronage Capital	102,428,751	92,567,163
Other Equities	8,580,402	8,006,101
	\$ 111,458,953	\$ 101,004,789
LONG-TERM DEBT		
CoBank Mortgage Notes	\$ 64,104,417	\$ 62,922,236
CFC Mortgage Notes	11,273,021	7,927,539
Less: Current Maturities	(4,041,000)	(3,924,000)
	\$ 71,336,438	\$ 66,925,775
CURRENT LIABILITIES		
Current Maturities of Long-Term Debt	\$ 4,041,000	\$ 3,924,000
Line of Credit		500,000
Accounts Payable - Purchased Power	5,695,815	6,203,726
Accounts Payable - Other	554,323	1,050,850
Consumer Deposits	2,071,156	2,058,621
Accrued Taxes	270,954	270,358
Accrued Interest	297,579	241,457
Unclaimed Patronage Capital Payable	723,095	630,395
Accrued Employee Compensated Absences	726,040	648,730
Other Current and Accrued Liabilities	654,154	595,134
Total Current Liabilities	\$ 15,034,116	\$ 16,123,271
DEFERRED CREDITS	\$ 8,843,753	\$ 8,466,906
TOTAL EQUITIES AND LIABILITIES	\$ 206,673,260	\$ 192,520,741

See accompanying notes to financial statements.

-4-
NUECES ELECTRIC COOPERATIVE, INC.

Exhibit B

**STATEMENTS OF INCOME AND PATRONAGE CAPITAL
FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018**

	December 31,				
	2019		2018		Increase (Decrease)
	Amount	%	Amount	%	
OPERATING REVENUES					
Residential	\$ 56,175,245	51.8	\$ 56,571,468	52.0	\$ (396,223)
Small Commercial and Industrial	11,220,346	10.3	11,614,125	10.7	(393,779)
Large Commercial and Industrial	39,496,169	36.4	38,991,740	35.8	504,429
Public Street and Highway Lighting	981,806	0.9	998,101	0.9	(16,295)
Unbilled Revenue	(443,324)	(0.4)	(391,558)	(0.4)	(51,766)
Late Payment Penalties	722,482	0.7	639,334	0.6	83,148
Rent from Electric Property	47,342	0.0	92,014	0.1	(44,672)
Other Operating Revenues	331,549	0.3	354,300	0.3	(22,751)
Total Operating Revenues	<u>\$ 108,531,615</u>	<u>100.0</u>	<u>\$ 108,869,524</u>	<u>100.0</u>	<u>\$ (337,909)</u>
OPERATING EXPENSES					
Purchased Power	\$ 77,805,120	71.7	\$ 78,647,383	72.2	\$ (842,263)
Distribution - Operation	1,589,095	1.5	1,645,951	1.5	(56,856)
Distribution - Maintenance	3,561,460	3.3	3,532,627	3.2	28,833
Consumer Accounts	4,560,804	4.2	4,571,447	4.2	(10,643)
Customer Service and Information	302,256	0.3	276,461	0.3	25,795
Administrative and General	5,802,429	5.3	5,456,602	5.0	345,827
Depreciation	4,168,412	3.8	4,264,834	3.9	(96,422)
Taxes	1,291,270	1.2	1,309,962	1.2	(18,692)
Other Interest	41,038	0.0	104,447	0.1	(63,409)
Other Deductions	88,154	0.1	260,190	0.2	(172,036)
Total Operating Expenses	<u>\$ 99,210,038</u>	<u>91.4</u>	<u>\$ 100,069,904</u>	<u>91.8</u>	<u>\$ (859,866)</u>
OPERATING MARGINS - Before Fixed Charges	<u>\$ 9,321,577</u>	<u>8.6</u>	<u>\$ 8,799,620</u>	<u>8.2</u>	<u>\$ 521,957</u>
FIXED CHARGES					
Interest on Long-Term Debt	\$ 3,184,554	2.9	\$ 2,681,552	2.5	\$ 503,002
Amortization of Premium on Reacquired Debt	80,988	0.1	80,988	0.1	
	<u>\$ 3,265,542</u>	<u>3.0</u>	<u>\$ 2,762,540</u>	<u>2.6</u>	<u>\$ 503,002</u>
OPERATING MARGINS - After Fixed Charges	<u>\$ 6,056,035</u>	<u>5.6</u>	<u>\$ 6,037,080</u>	<u>5.6</u>	<u>\$ 18,955</u>
G&T Capital Credits	\$ 3,995,437	3.7	\$ 3,651,447	3.4	\$ 343,990
Other Capital Credits	769,569	0.7	1,044,778	1.0	(275,209)
	<u>\$ 4,765,006</u>	<u>4.4</u>	<u>\$ 4,696,225</u>	<u>4.4</u>	<u>\$ 68,781</u>
NET OPERATING MARGINS	<u>\$ 10,821,041</u>	<u>10.0</u>	<u>\$ 10,733,305</u>	<u>10.0</u>	<u>\$ 87,736</u>
NONOPERATING MARGINS					
Interest Income	\$ 1,046,407	1.0	\$ 844,075	0.8	\$ 202,332
Other Nonoperating Income	31,488	0.0	3,140	0.0	28,348
Naval Base Net Margin (Loss)	(164,104)	(0.2)	335,302	0.3	(499,406)
Gain on Disposition of Property	45,523	0.0	16,626	0.0	28,897
	<u>\$ 959,314</u>	<u>0.8</u>	<u>\$ 1,199,143</u>	<u>1.1</u>	<u>\$ (239,829)</u>
NET MARGINS	<u>\$ 11,780,355</u>	<u>10.8</u>	<u>\$ 11,932,448</u>	<u>11.1</u>	<u>\$ (152,093)</u>
PATRONAGE CAPITAL - BEGINNING OF YEAR	92,567,163		85,211,382		
Patronage Capital Retired	(1,527,209)		(3,641,926)		
Transferred to Other Equities	(391,558)		(934,741)		
PATRONAGE CAPITAL - END OF YEAR	<u>\$ 102,428,751</u>		<u>\$ 92,567,163</u>		

See accompanying notes to financial statements.

NUECES ELECTRIC COOPERATIVE, INC.

Exhibit C

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018

	December 31,	
	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Margins	\$ 11,780,355	\$ 11,932,448
Adjustments to Reconcile Net Margins to Net Cash From Operating Activities		
Depreciation	5,014,932	5,049,154
Amortized Loss on Retirement of RUS Debt	80,988	80,988
Capital Credits - Non-Cash	(4,373,765)	(4,042,962)
(Increase) Decrease		
Accounts Receivable	(886,538)	2,178,969
Accrued Unbilled Revenue	443,323	391,558
Inventories and Other Current and Accrued Assets	(18,684)	188,753
Deferred Charges	153,951	251,023
Increase (Decrease)		
Payables and Accrued Expenses	(706,155)	(161,697)
Deferred Credits	376,847	350,984
Net Cash From Operating Activities	\$ 11,865,254	\$ 16,219,218
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to Utility Plant	\$ (6,687,471)	\$ (6,283,486)
Plant Removal Costs (in excess of) Salvage and Other Credits	(562,218)	(231,035)
Purchase of Held-to-Maturity Securities	(4,223,797)	(3,229,340)
Sale of Held-to-Maturity Securities		900,000
Other Property and Investments	(141,100)	(88,673)
Net Cash From Investing Activities	\$ (11,614,586)	\$ (8,932,534)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments on Long-Term Debt to CoBank	\$ (2,487,819)	\$ (2,971,783)
Payments on Long-Term Debt to CFC	(1,504,518)	(1,157,642)
Payments on Other Long Term Debt		(399,174)
Advances on CoBank Long-Term Debt	3,670,000	3,580,000
Advances on CFC Long-Term Debt	4,850,000	2,800,000
Advances (Repayments) on Line of Credit - Net	(500,000)	(4,900,000)
Other Equities	182,743	245,170
Retirement of Patronage Capital	(1,527,209)	(3,641,926)
Increase (Decrease) in Memberships - Net	18,275	7,075
Net Cash From Financing Activities	\$ 2,701,472	\$ (6,438,280)
CHANGE IN CASH AND CASH EQUIVALENTS	\$ 2,952,140	\$ 848,404
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	2,798,737	1,950,333
CASH AND CASH EQUIVALENTS - END OF YEAR	\$ 5,750,877	\$ 2,798,737
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash Paid During the Year for:		
Interest on Long-Term Debt	\$ 3,143,605	\$ 2,661,443
Income Taxes	\$ 0	\$ 0

See accompanying notes to financial statements.

-6-
NUECES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

1. Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Nueces Electric Cooperative, Inc. (the Cooperative) is a non-profit company organized to provide electric service at the retail level to primarily residential and commercial accounts in a historically defined service area. Power delivered at retail is purchased wholesale from South Texas Electric Cooperative. Any revenues earned in excess of costs incurred are allocated to members of the Cooperative and are reflected as patronage capital in the balance sheet.

System of Accounts

Although the Cooperative is no longer an Rural Utilities Service (RUS) borrower, its accounting records are maintained in accordance with the RUS Uniform System of Accounts (USOA) prescribed for RUS electric borrowers.

Electric Plant, Maintenance, and Depreciation

Electric plant is stated at the original cost of construction which includes the cost of contracted services, direct labor, materials, and overhead items. Contributions from others toward the construction of electric plant are credited to the applicable plant accounts.

When property which represents a retirement unit is replaced or removed, the average cost of such property as determined from the continuing property records is credited to electric plant and such cost, together with cost of removal less salvage, is charged to the accumulated provision for depreciation.

Maintenance and repairs, including the renewal of minor items of plant not comprising a retirement unit, are charged to the appropriate maintenance accounts, except that repairs of transportation and service equipment are charged to clearing accounts and redistributed to operating expense and other accounts.

Cash and Cash Equivalents

For purposes of the statement of cash flows, cash - general is considered cash and cash equivalents.

Accounts Receivable

In the normal course of business, the Cooperative recognizes accounts receivable for energy delivered and billed. The Cooperative allows 16 days from the date of the bill for payment to be received or the service is considered delinquent. Delinquent notices are sent after the due date giving the member an additional ten days to pay. The NEC wires division charges 7% for delinquent accounts while the NEC retail division (DBA - NEC Co-op Energy) charges 5%. If no payment is received within 26 days or a deferred payment agreement is not in place, the account is subject to disconnect.

The Cooperative provides an allowance for doubtful accounts to recognize the portion of receivables considered uncollectible. The Cooperative accrues amounts monthly to the allowance. The allowance is estimated based on historical trends, aging of receivables and review of potential bad debts. The Board of Directors reviews delinquent accounts quarterly and charges off accounts over one year old.

NUECES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

Inventories

Materials and supplies inventories are valued at average unit cost.

Electric Revenues from Contracts with Customers

Substantially all operating revenues and customer accounts receivables are derived from contracts with customers. Performance obligations related to the sale of energy are satisfied as energy is delivered to customers. The Cooperative recognizes revenue that corresponds to the price of the energy delivered to the customer. The measurement of energy sales to customers is generally based on the reading of their meters, which occurs on a systematic basis throughout the month. At the end of each month, amounts of energy delivered to customers since the date of the last meter reading are estimated, and the corresponding unbilled revenue is recognized. The Cooperative has calculated that its unbilled revenue for delivered power usage which has not been billed to customers at December 31, 2019 and 2018 amounted to \$4,770,952 and \$5,214,275, respectively.

The Cooperative does not recognize a separate financing component of its collections from customers as contract terms are short-term in nature.

In 2008, the Cooperative entered into a 50 year contract with Corpus Christi and Kingsville Naval bases as part of a privatization agreement by which the Cooperative agreed to maintain the distribution plant for the federal government. The contract provided for the Cooperative to perform operations and maintenance, renewals and replacements, and special projects. Revenue for operations and maintenance is recorded when billed. Revenue for renewals and replacements is deferred and recognized upon performing the renewal or replacement for the Corpus Christi or Kingsville Naval Base. (See Note 16) Revenue for special projects is recognized upon completion of the project with the profit or loss recorded to revenue.

In 2019, the Cooperative implemented new rates. The rates were designed to increase wires revenues by 10.88% based on a 2017 test year.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers, Topic 606*, which provides a new framework for the recognition of revenue. The Cooperative implemented the guidance on January 1, 2019. Results and disclosures for reporting periods beginning after December 31, 2018 are presented in accordance with Topic 606, while prior period results have not been adjusted and continue to be reported in accordance with prior accounting guidance. The implementation did not have a material impact on the Cooperative's financial statements, other than increased disclosures regarding revenues related to contracts with customers.

Income Tax Status

The Cooperative is an exempt organization for federal income tax purposes under Section 501(c)(12) of the Internal Revenue Code.

-8-
NUECES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

The Cooperative has adopted the "uncertain tax positions" provisions of accounting principles generally accepted in the United States of America. The primary tax position of the Cooperative is its filing status as a tax exempt entity. The Cooperative determined that it is more likely than not that its tax positions will be sustained upon examination by the Internal Revenue Service (IRS), or other State taxing authority and that all tax benefits are likely to be realized upon settlement with taxing authorities.

The Cooperative files income tax returns in the U.S. federal jurisdiction. The Cooperative is no longer subject to U.S. federal and state income tax examinations by federal taxing authorities for years before 2016.

The Cooperative recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. There were no penalties or interest recognized during the years ended December 31, 2019 and 2018.

Group Concentration of Credit Risk

The Cooperative's headquarters facility is located in Robstown, Texas. The service area includes members located in all or parts of an eight county area surrounding the City of Robstown. In addition, the Cooperative provides "energy only" services to members outside their traditional service territory. The Cooperative records a receivable for electric revenues as billed on a monthly basis. The Cooperative may require a deposit from new members upon connection which is applied to unpaid bills and fees in the event of default. The deposit accrues interest annually and is returned along with accrued interest after one year of prompt payments. The accrued interest on all retained deposits is returned annually. As of December 31, 2019 and 2018, deposits on hand totaled \$2,071,156 and \$2,058,621, respectively.

Although the financial institutions in which the Cooperative has deposits are insured by agencies of the federal government, deposits at times exceeded insured amounts.

Patronage Capital Certificates

Patronage capital from associated organizations is recorded at the stated amount of the certificate. At the end of each year, the Cooperative receives an estimated allocation from its G&T power supply cooperative. In accordance with the USOA, the Cooperative records this estimated amount as income. Any difference between the estimated amount and the actual final allocation is recorded in the following year.

The G&T patronage income recognized for the 2019 and 2018 years are as follows:

	December 31,	
	2019	2018
Estimated Allocation for 2019	\$ 4,007,173	\$
True Up to Actual for 2018	(11,736)	
Estimated Allocation for 2018		3,682,303
True Up to Actual for 2017		(30,856)
	<u>\$ 3,995,437</u>	<u>\$ 3,651,447</u>

NUECES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

Advertising

It is the Cooperative's policy to expense advertising as incurred. Advertising expense was \$1,487,718 and \$1,491,940 for 2019 and 2018, respectively.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Fair Value Hierarchy

The Fair Value Measurements Topic of the FASB Accounting Standards Codification establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1 - Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Cooperative has the ability to access at the measurement date.

Level 2 - Inputs are other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 - Inputs are unobservable inputs for the asset or liability.

2. Assets Pledged

All assets are pledged as security for the long-term debt due the National Rural Utilities Cooperative Finance Corporation (CFC) and CoBank.

3. Electric Plant

The major classes of electric plant are as follows:

	December 31,	
	2019	2018
Distribution Plant	\$ 110,445,655	\$ 107,425,886
General Plant	33,287,946	32,503,696
Total Electric Plant in Service	\$ 143,733,601	\$ 139,929,582
Construction Work in Progress	703,731	113,793
Total Electric Plant	\$ 144,437,332	\$ 140,043,375

-10-
NUECES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

Provision for depreciation of electric plant is computed using straight-line rates as follows:

Distribution Plant	3.00%
Distribution Plant - Meters	14.20%
General Plant	
Structures and Improvements	2.00%
Office Furniture and Fixtures	14.29%-33.33%
Transportation Equipment	14.29%-21.62%
Power Operated Equipment	20.00%
Communications Equipment	26.67%-33.33%
Miscellaneous Equipment	3.96%-10.00%
Tools, Shop, and Garage Equipment	6.00%
Laboratory Equipment	16.67%

Depreciation for the years ended December 31, 2019 and 2018 was \$5,014,932 and \$5,049,154, respectively, of which \$4,168,412 and \$4,264,834, was charged to depreciation expense and \$846,520 and \$784,320, was allocated to other accounts.

4. Investments in Associated Organizations

Investments in associated organizations consisted of:

	December 31,	
	2019	2018
CFC		
Capital Term Certificates	\$ 738,569	\$ 738,569
Patronage Capital	248,575	241,089
Membership	1,000	1,000
South Texas Electric Cooperative		
Patronage Capital	37,653,318	33,657,883
Texas Electric Cooperatives, Inc.		
Patronage Capital	822,016	752,495
CoBank		
Patronage Capital	1,909,450	1,708,581
Other	773,207	725,876
Total	<u>\$ 42,146,135</u>	<u>\$ 37,825,493</u>

-11-
NUECES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

5. Other Investments – Held-to-Maturity Securities

In connection with the retirement of capital credits in future years the Cooperative has purchased U.S. Treasury Strips. These investments are designed to mature at the time the retirements are made. These investments were purchased at significant discounts. Securities classified as held-to-maturity with maturity dates between 2020 and 2038 consist of the following:

	December 31,	
	2019	2018
U.S. Treasury Strips		
Maturity Amount	\$ 38,133,000	\$ 37,233,000
Less: Unaccreted Discount	<u>(9,322,711)</u>	<u>(12,646,508)</u>
Total	<u>\$ 28,810,289</u>	<u>\$ 24,586,492</u>

The market value of the held-to-maturity securities was \$32,023,156 and \$25,829,695 as of December 31, 2019 and 2018, respectively.

Held-to-maturity valuations are considered Level 1.

6. Other Investments – Restricted

Restricted investments consisted of the following:

	December 31,	
	2019	2018
Transitional Charges Special Deposit	\$ 1,329,515	\$ 1,122,733
Scholarship Fund	<u>344,234</u>	<u>356,792</u>
Total	<u>\$ 1,673,749</u>	<u>\$ 1,479,525</u>

As part of the retail competitive market, the retail division of the Cooperative ensures the energy delivery provider's payment of their energy delivery charges through a special deposit held by an indenture trustee.

7. Materials and Supplies

Materials and supplies inventories consisted of:

	December 31,	
	2019	2018
Construction Materials and Supplies	<u>\$ 1,932,816</u>	<u>\$ 1,989,330</u>

-12-
NUECES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

8. Deferred Charges

Deferred charges included the following:

	December 31,	
	2019	2018
Premium - Refinancing RUS Debt	\$ 296,956	\$ 377,944
NRECA Pension Prepayment	465,641	620,855
Other	9,912	8,649
Total	<u>\$ 772,509</u>	<u>\$ 1,007,448</u>

In 2013, the Cooperative elected to participate in the NRECA RS Plan Prepayment Program. The Cooperative's original contribution was \$1,552,137 and is being amortized over 10 years. Amortization expense for the years ended December 31, 2019 and 2018 was \$155,213.

In 2010, the Cooperative bought out RUS with loan draws from CFC. In the process the Cooperative had to pay a premium to RUS which is being amortized over the life of the new debt. The premium is being amortized over a period of 13 years starting November 2010.

Original RUS Refinancing Premium	\$ 1,039,346
Less: Accumulated Amortization	<u>742,390</u>
Balance	<u>\$ 296,956</u>

9. Return of Capital

The mortgage agreements contain provisions that must be met for the Cooperative to make patronage capital retirements. These provisions include minimum equity, debt service, and earnings ratios. The Cooperative is in compliance with these provisions at December 31, 2019 and 2018. The equities and margins of the Cooperative represent 53.93% and 52.46% of the total assets at December 31, 2019 and 2018, respectively. Patronage capital totaling \$1,527,209 and \$3,641,926 was retired during 2019 and 2018, respectively.

10. Patronage Capital

	December 31,	
	2019	2018
Beginning Patronage Capital	\$ 92,567,163	\$ 85,211,382
Transferred to Other Equities	(391,558)	(934,741)
Assignable	<u>11,780,355</u>	<u>11,932,448</u>
	\$ 103,955,960	\$ 96,209,089
Less: Current Year Retirements	<u>1,527,209</u>	<u>3,641,926</u>
Total	<u>\$ 102,428,751</u>	<u>\$ 92,567,163</u>

NUECES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

11. Other Equities

	December 31,	
	2019	2018
Retired Capital Credits - Gains	\$ 3,166,148	\$ 2,983,358
Unassignable Margins - Unbilled Revenue	5,414,254	5,022,743
	<u>\$ 8,580,402</u>	<u>\$ 8,006,101</u>

12. Mortgage Notes – CoBank

Following is a summary of long-term debt due CoBank and maturing at various times from 2020 to 2050:

	December 31,	
	2019	2018
Fixed Rate Notes - 2.40% - 4.99%	\$ 62,604,417	\$ 57,342,478
Variable Rate Note - 3.89% in 2019 and 4.96% in 2018	1,500,000	5,579,758
Less: Current Maturities	<u>2,412,000</u>	<u>2,474,600</u>
Total	<u>\$ 61,692,417</u>	<u>\$ 60,447,636</u>

Principal and interest installments on the above notes are due on a monthly and quarterly basis. Annual maturities of long-term debt due CoBank for the next five years are as follows:

2020	\$ 2,412,000
2021	2,510,000
2022	2,530,000
2023	2,620,000
2024	2,710,000

13. Mortgage Notes – CFC

Following is a summary of long-term debt due CFC and maturing at various times from 2020 to 2044:

	December 31,	
	2019	2018
Fixed Rate Notes - 3.83% - 4.55%	\$ 11,273,021	\$ 7,927,539
Less: Current Maturities	<u>1,629,000</u>	<u>1,449,400</u>
Total	<u>\$ 9,644,021</u>	<u>\$ 6,478,139</u>

NUECES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

Principal and interest installments on the above notes are due quarterly. Annual maturities of long-term debt due CFC for the next five years are as follows:

2020	\$ 1,629,000
2021	1,701,600
2022	1,615,500
2023	1,273,200
2024	588,800

14. Short-Term Borrowing

As of December 31, 2019 and 2018, the Cooperative had a \$4,000,000 line of credit with CFC to be drawn upon as needed. The interest rate on this line of credit was 3.25% and 3.75% as of December 31, 2019 and 2018, respectively. As of December 31, 2019 and 2018 the Cooperative had drawn \$0 and \$500,000, respectively against this line of credit.

As of December 31, 2019 and 2018, the Cooperative had a \$4,000,000 line of credit, with CoBank to be drawn upon as needed. The interest rate on this line of credit was 3.34% and 4.06% as of December 31, 2019 and 2018, respectively. As of December 31, 2019 and 2018 the Cooperative had drawn \$0 and \$0, respectively against this line of credit.

15. Operating Leases

The Cooperative leases office space for the Nueces Electric Cooperative, Inc. retail division. Minimum lease payments as of December 31, 2019 are as follows:

2020	\$ 77,760
2021	77,760
2022	79,488
2023	81,216
2024	40,608

Lease expense for 2019 was \$58,320.

In February 2016, the FASB issued Accounting Standards Update (ASU) 2016-02, *Leases* (Topic 842), effective for annual reporting periods beginning after December 15, 2020. Under the new guidance, a lessee will be required to recognize assets and liabilities for leases with lease terms of more than 12 months. Consistent with current GAAP, the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. However, unlike current GAAP, which requires only capital leases to be recognized on the statement of financial condition, the new ASU will require both types of leases to be recognized on the statement of financial condition. The ASU will also require disclosures to help financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. These disclosures include qualitative and quantitative requirements providing additional information about the amounts recorded in the financial statements. The Cooperative is currently assessing the impact on its financial statements.

NUECES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

16. Deferred Credits

Deferred credits include the following:

	December 31,	
	2019	2018
Consumer Advances for Construction	\$ 2,191,695	\$ 2,139,423
Corpus Christi Naval Base - Deferred Revenue	4,867,640	4,685,114
Kingsville Naval Base - Deferred Revenue	1,439,134	1,284,176
Scholarship Fund	344,234	356,792
Other	1,050	1,401
Total	\$ 8,843,753	\$ 8,466,906

Consumer Advances for Construction represents refundable aid to construction on line extensions and subdivision construction contracts. Any amounts remaining anywhere from five to ten years, depending on the agreement, are forfeited to the Cooperative and charged against construction work in progress.

Corpus Christi Naval Base and Kingsville Naval Base – Deferred Revenue represents the amount billed per the contract with Corpus Christi Naval Base and Kingsville Naval Base for renewals and replacements and construction work in progress. These amounts will be recognized as qualifying renewals and replacements and construction work in progress costs as incurred.

17. Litigation and Commitments

The Cooperative is involved in various legal actions arising in the normal course of business. Currently, there is one pending case against the Cooperative that is in the discovery stage and ongoing. It is the opinion of management and legal counsel that the resolution of such litigation will not have a material adverse effect on the financial position of the Cooperative, its results of operations, or cash flows.

18. Pension Benefits

Narrative Description

The Retirement and Security Plan (the RS Plan), sponsored by the NRECA is a defined benefit pension plan qualified under Section 401 and tax-exempt under Section 501(a) of the Internal Revenue Code. It is a multiemployer plan under the accounting standards. The RS Plan sponsor's Employer Identification Number is 53-0116145 and the RS Plan Number is 333.

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

NUECES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

Plan Information

The Cooperative's contributions to the RS Plan in 2019 and in 2018 represented less than five percent of the total contributions made to the RS Plan by all participating employers. The Cooperative made contributions to the RS Plan of \$681,999 in 2019 and \$632,193 in 2018. Pension expense for the years ended December 31, 2019 and 2018, including amortization of the RS Plan prepayment, was \$837,213 and \$787,406, respectively. There have been no significant changes that affect the comparability of 2019 and 2018 contributions.

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

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

In addition, the Cooperative provides retirement benefits through a 401(k) plan that is administered by NRECA SelectRe Pension plan. The Cooperative provides matching funds up to 3.20% of an employee's salary. The cost of this plan for 2019 and 2018 was \$189,037 and \$152,194, respectively.

19. Related Party Transactions

Nueces Electric Cooperative, Inc. is committed to purchase its electric power from South Texas Electric Cooperative, Inc. (STEC), a cooperative of which it is a member and is represented on its Board of Directors.

During the years ended December 31, 2019 and 2018, the Cooperative purchased \$77,805,120 and \$78,647,383, respectively, from STEC. At December 31, 2019 and 2018 amounts due to STEC were \$5,797,086 and \$6,478,828, respectively.

During the years ended December 31, 2019 and 2018, the Cooperative held a patronage capital investment with STEC in the amount of \$37,653,318 and \$33,657,883, respectively. The Cooperative was allocated patronage capital from STEC for the years ended December 31, 2019 and 2018 in the amount of \$3,995,437 and \$3,651,447, respectively.

NUECES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

20. Major Consumer

The Cooperative has one consumer who accounted for the following:

	December 31,	
	2019	2018
Electric Energy Revenue	\$ 35,109,149	\$ 35,070,437
kWh Sales	631,680,010	612,653,440
Purchase Power Expense	\$ 33,409,101	\$ 33,409,628

21. Disclosures About Fair Value of Financial Statements

Many of the Cooperative's financial instruments lack an available market with similar terms, conditions, and maturities as those reflected in the carrying amount recorded. Accordingly, significant assumptions, estimations, and present value calculations were used for purposes of this disclosure.

Estimated Fair Value has been determined by calculating the present value of financial instruments using the best data available.

Fair Value for some amounts carried on the financial statements has not been calculated for the following reasons:

Patronage Capital from Associated Organizations – The right to receive cash is an inherent component of a financial instrument. The Cooperative holds no right to receive cash since any payments are at the discretion of the governing body for the associated organizations. As such, Patronage Capital from Associated Organizations is not considered financial instruments.

CFC Capital Term Certificates – It is not practicable to estimate fair value for these financial instruments given the lack of a market and their long holding period. Relevant information with respect to these are as follows:

Amount	Interest Rate	Maturity
\$ 131,408	5.00%	2070
137,474	5.00%	2075
267,287	5.00%	2080
42,750	3.00%	2025
159,650	3.00%	2030
<u>\$ 738,569</u>		

Cash and Temporary Cash Investments – The recorded book value approximates fair value given the short period to maturity.

NUECES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

Long-Term Debt valuations are considered Level 2 as described in Note 1.

The estimated fair value of the Cooperative's financial instruments is as follows:

CoBank, CFC, and Other Fixed Rate Long-Term Debt – The fair value of the Cooperative's CFC, CoBank, and other long term fixed rate long-term debt is calculated by computing the present value of the individual notes to maturity. The discount rate used is the currently available CFC fixed interest rate available for long-term debt repricing at the same maturity as the current debt.

	Carrying Value	Fair Value
As of December 31, 2019	\$ <u>73,877,438</u>	\$ <u>76,266,799</u>

22. Subsequent Events

Subsequent to December 31, 2019, the Cooperative approved loans with CFC and CoBank totaling \$12,000,000 and \$2,000,000, respectively.

The Cooperative has evaluated subsequent events through March 16, 2020, the date which the financial statements were available to be issued.

SUPPLEMENTARY INFORMATION

NUECES ELECTRIC COOPERATIVE, INC.

Schedule 1

ELECTRIC PLANT
FOR THE YEAR ENDED DECEMBER 31, 2019

	Balance 1/1/2019	Additions	Retirements	Balance 12/31/2019
CLASSIFIED ELECTRIC PLANT IN SERVICE				
Distribution Plant				
Station Equipment	\$ 1,053,218	\$	\$	\$ 1,053,218
Poles, Towers, and Fixtures	32,296,012	1,634,754	516,067	33,414,699
Overhead Conductors and Devices	25,410,628	1,136,628	505,736	26,041,520
Underground Conductors and Devices	6,548,844	270,499	36,065	6,783,278
Line Transformers	19,858,951	1,623,764	823,237	20,659,478
Services	8,160,850	225,759	32,088	8,354,521
Meters	4,923,292	27,909	9,319	4,941,882
Installations on Consumer Premises	1,935,954	214,890	128,623	2,022,221
Corpus Christi Naval Base Plant	5,533,378	(28,739)	21,595	5,483,044
Kingsville Naval Base Plant	1,704,759	(9,343)	3,622	1,691,794
Total	<u>\$ 107,425,886</u>	<u>\$ 5,096,121</u>	<u>\$ 2,076,352</u>	<u>\$ 110,445,655</u>
General Plant				
Land and Land Rights	\$ 1,264,178	\$	\$	\$ 1,264,178
Structures and Improvements	26,566,486	116,762		26,683,248
Office Furniture and Computer Equipment	640,658			640,658
Transportation Equipment	929,038	180,471	22,575	1,086,934
Laboratory Equipment	164,422			164,422
Power Operated Equipment	2,743,206	704,179	194,587	3,252,798
Communications Equipment	41,558			41,558
Miscellaneous Equipment	154,150			154,150
Total	<u>\$ 32,503,696</u>	<u>\$ 1,001,412</u>	<u>\$ 217,162</u>	<u>\$ 33,287,946</u>
Total Classified Electric Plant in Service	\$ 139,929,582	\$ 6,097,533	\$ 2,293,514	\$ 143,733,601
Construction Work in Progress	<u>113,793</u>	<u>589,938</u>		<u>703,731</u>
Total Utility Plant	<u>\$ 140,043,375</u>	<u>\$ 6,687,471</u>	<u>\$ 2,293,514</u>	<u>\$ 144,437,332</u>

NUECES ELECTRIC COOPERATIVE, INC.

Schedule 2

ACCUMULATED PROVISION FOR DEPRECIATION
FOR THE YEAR ENDED DECEMBER 31, 2019

	Balance 1/1/2019	Accruals	Retirements	Balance 12/31/2019
Distribution Plant				
NEC Distribution Plant	\$ 14,937,101	\$ 3,454,105	\$ 2,593,335	\$ 15,797,871
Corpus Christi Naval Base	2,736,603	269,255	16,937	2,988,921
Kingsville Naval Base	813,715	83,273	6,128	890,860
Total Distribution Plant	<u>\$ 18,487,419</u>	<u>\$ 3,806,633</u>	<u>\$ 2,616,400</u>	<u>\$ 19,677,652</u>
General Plant				
Structures and Improvements	\$ 3,583,118	\$ 668,946	\$	\$ 4,252,064
Office Furniture and Computer Equipment	431,877	44,212		476,089
Transportation Equipment	634,015	124,205	22,575	735,645
Laboratory Equipment	164,425			164,425
Power Operated Equipment	1,605,171	369,787	193,820	1,781,138
Communication Equipment	41,557			41,557
Miscellaneous Equipment	131,938	1,149		133,087
Total General Plant	<u>\$ 6,592,101</u>	<u>\$ 1,208,299</u>	<u>\$ 216,395</u>	<u>\$ 7,584,005</u>
Total Classified Electric Plant in Service	\$ 25,079,520	\$ 5,014,932	\$ 2,832,795	\$ 27,261,657
Retirement Work in Progress	<u>(62,997)</u>		<u>22,937</u>	<u>(85,934)</u>
Total	<u>\$ 25,016,523</u>	<u>\$ 5,014,932</u>	<u>\$ 2,855,732</u>	<u>\$ 27,175,723</u>
		(1)	(2)	

- (1) Depreciation
 Charged to Depreciation Expense
 Charged to Clearing and Other Accounts

\$ 4,168,412
846,520
\$ 5,014,932

- (2) Net Loss on Retirement
 Original Cost
 Cost of Removal
 Less: Salvage and Other Credits

\$ 2,293,514
901,288
339,070
\$ 2,855,732

-21-
NUECES ELECTRIC COOPERATIVE, INC.

Schedule 3

OTHER PROPERTY AND INVESTMENTS
AS OF DECEMBER 31, 2019 AND 2018

	December 31,	
	<u>2019</u>	<u>2018</u>
INVESTMENTS IN ASSOCIATED ORGANIZATIONS		
Memberships	\$ 2,135	\$ 2,135
Patronage Capital		
South Texas Electric Cooperative	37,653,318	33,657,883
Texas Electric Cooperatives, Inc.	822,016	752,495
National Information Solutions Cooperative	167,266	158,366
National Rural Utilities Cooperative Finance Corporation	248,575	241,089
CoBank	1,909,450	1,708,581
Federated Insurance	467,167	431,645
Cooperative Response Center	27,846	26,283
National Rural Telecommunications Cooperative	108,448	108,447
Other	1,345	
Capital Term Certificates		
National Rural Utilities Cooperative Finance Corporation	738,569	738,569
Total	<u>\$ 42,146,135</u>	<u>\$ 37,825,493</u>
HELD-TO-MATURITY SECURITIES		
Treasury Strips	<u>\$ 28,810,289</u>	<u>\$ 24,586,492</u>
OTHER INVESTMENTS - RESTRICTED		
Scholarship Funds	\$ 344,234	\$ 356,792
Transitional Charges Special Deposit	<u>1,329,515</u>	<u>1,122,733</u>
Total	<u>\$ 1,673,749</u>	<u>\$ 1,479,525</u>

NUECES ELECTRIC COOPERATIVE, INC.

Schedule 4

ADMINISTRATIVE AND GENERAL EXPENSES
FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018

	December 31,		Increase (Decrease)
	2019	2018	
Administrative and General Salaries	\$ 1,374,209	\$ 1,166,391	\$ 207,818
Office Supplies and Expenses	686,885	667,484	19,401
Outside Services Employed	202,140	189,535	12,605
Workmen's Compensation, General Liability, and Other Insurance	348,208	381,952	(33,744)
Regulatory Commission Expense	366,477	353,142	13,335
Directors' Fees and Expenses	275,987	226,664	49,323
Dues to Associated Organizations	72,746	117,373	(44,627)
Annual Meeting Expense	190,048	169,209	20,839
Advertising Expenses	1,487,718	1,491,940	(4,222)
Miscellaneous General Expenses	417,360	320,556	96,804
Maintenance of General Plant	380,651	372,356	8,295
Total	<u>\$ 5,802,429</u>	<u>\$ 5,456,602</u>	<u>\$ 345,827</u>

COMPLIANCE AND INTERNAL CONTROL SECTION

BOLINGER, SEGARS, GILBERT & MOSS, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

PHONE: (806) 747-3806

FAX: (806) 747-3815

8215 NASHVILLE AVENUE

LUBBOCK, TEXAS 79423-1954

**LETTER TO BOARD OF DIRECTORS REGARDING POLICIES
CONCERNING AUDITS OF CFC BORROWERS**

Board of Directors
Nueces Electric Cooperative, Inc.
Robstown, Texas

We have audited, in accordance with auditing standards generally accepted in the United States of America, the balance sheet of Nueces Electric Cooperative, Inc. as of December 31, 2019, and the related statements of income and patronage capital, and cash flows for the year then ended, and have issued our report thereon dated March 16, 2020.

In connection with our audit, nothing came to our attention that caused us to believe that the Cooperative failed to comply with the terms of Article V of the National Rural Utilities Cooperative Finance Corporation Loan Agreement insofar as they relate to accounting matters. However, our audits were not directed primarily toward obtaining knowledge of such noncompliance.

This report is intended solely for the information and use of the Board of Directors and management of Nueces Electric Cooperative, Inc. and the National Rural Utilities Cooperative Finance Corporation and is not intended to be and should not be used by anyone other than these specified parties.

Bolinger, Segars, Gilbert & Moss LLP

Certified Public Accountants

Lubbock, Texas

March 16, 2020