SHELBY ENERGY COOPERATIVE, INC.
AND SUBSIDIARY
KENTUCKY 30

CONSOLIDATED FINANCIAL REPORT

December 31, 2019

C O N T E N T S

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Shelby Energy Cooperative, Inc. and Subsidiary
Shelbyville, Kentucky

We have audited the accompanying consolidated financial statements of Shelby Energy Cooperative, Inc. and Subsidiary, which comprise the consolidated balance sheet as of December 31, 2019, and the related consolidated statements of revenue and comprehensive income, changes in members' equities, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Shelby Energy Cooperative, Inc. and Subsidiary as of December 31, 2019, and the results of their operations and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of a Matter

As discussed in Note 2, Shelby Energy Cooperative, Inc. and Subsidiary have adopted Financial Accounting Standards Update 2014-09, *Revenue from Contracts with Customers.* Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued a report dated March 19, 2020, on our consideration of Shelby Energy Cooperative, Inc. and Subsidiary's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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 internal control over financial reporting and compliance.

Prior Period Financial Statements

The consolidated financial statements of Shelby Energy Cooperative, Inc. and Subsidiary, as of December 31, 2018, were audited by other auditors whose report dated February 9, 2019, expressed an unmodified opinion on those statements.

Jones, Nale & Mattingly PLC

Louisville, Kentucky
March 19, 2020

SHELBY ENERGY COOPERATIVE, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
December 31, 2019 and 2018

Assets	2019	2018
Utility Plant, at original cost:		
In service	$ 102,363,915	$ 98,517,316
Under construction	1,081,402	691,721
	103,445,317	99,209,037
Less accumulated depreciation	22,009,926	20,144,964
	81,435,391	79,064,073
Investments		
Associated organizations	28,403,499	26,505,310
Goodwill	368,414	368,414
	28,771,913	26,873,724
Current Assets:		
Cash and cash equivalents	1,849,316	2,505,305
Accounts receivable, less allowance for 2019 of $480,707 and 2018 of $489,116	4,403,216	4,416,440
Material and supplies, at average cost	726,526	672,999
Prepayments and other current assets	277,079	182,874
Total current assets	7,256,137	7,777,618
Total	$ 117,463,441	$ 113,715,415

Members' Equities and Liabilities	2019	2018
Members' Equities:		
Patronage capital and retained earnings	$ 44,931,212	$ 42,334,747
Other equities and minority interests	3,114,000	2,902,401
Accumulated other comprehensive income	324,752	342,794
	48,369,964	45,579,942
Long-Term Debt	58,899,853	58,058,726
Accumulated Postretirement Benefits	1,463,374	1,481,249
Current Liabilities:		
Current portion of long-term debt	2,213,099	2,235,000
Accounts payable	3,740,360	3,739,593
Consumer deposits	1,616,773	1,596,008
Accrued expenses	630,719	541,535
Total current liabilities	8,200,951	8,112,136
Consumer Advances for Construction	529,299	483,362
Total	$ 117,463,441	$ 113,715,415

The Notes to Consolidated Financial Statements are an integral part of these statements.

SHELBY ENERGY COOPERATIVE, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF REVENUE AND COMPREHENSIVE INCOME
Years Ended December 31, 2019 and 2018

	2019	2018
Operating Revenues	$ 48,432,816	$ 49,647,753
Operating Expenses:		
Cost of power and propane	34,081,124	35,089,064
Distribution - operations	2,230,710	2,369,777
Distribution - maintenance	2,936,837	3,273,442
Consumer accounts	629,929	608,189
Customer service and information	377,680	326,829
Sales	(1,631)	699
Administrative and general	1,058,357	1,162,572
Depreciation, excluding $209,622 in 2019 and $199,999 in 2018 charged to clearing accounts	3,583,688	3,454,237
Taxes	77,224	71,288
Interest on long-term debt	2,139,259	1,985,420
Other interest	47,486	42,983
Other deductions	86,457	20,339
Total cost of electric service	47,247,120	48,404,839
Operating Margins	1,185,696	1,242,914
Nonoperating Margins:		
Interest income	123,517	61,900
Non-operating taxes	(128,960)	- -
Gain (loss) on sale of equipment	(63,557)	77,497
	(69,000)	139,397
Patronage Capital assigned from:		
East Kentucky Power Cooperative, Inc.	1,802,479	1,633,909
Other organizations	96,017	105,585
	1,898,496	1,739,494
Net Margins	3,015,192	3,121,805
Other Comprehensive Income:		
Postretirement benefits (expense)	(18,042)	(18,042)
Total Comprehensive Income	$ 2,997,150	$ 3,103,763

The Notes to Consolidated Financial Statements are an integral part of these statements.

SHELBY ENERGY COOPERATIVE, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITIES
Years ended December 31, 2019 and 2018

	Patronage Capital					Other	Accumulated Other Comprehensive	Total Members'
	Assigned	Assignable	Retirements	Unassigned	Total	Equity	Income (Loss)	Equities
Balance - December 31, 2017	$ 46,943,293	$ 960,341	$ (9,462,547)	$ 1,327,771	$ 39,768,858	$ 2,688,621	$ 360,836	$ 42,818,315
Comprehensive income:								
Net margins		3,121,805			3,121,805			3,121,805
Assigned margins	960,341	(960,341)			- -			- -
Amortization							(18,042)	
Adjustment							- -	(18,042)
Total comprehensive income								3,103,763
Refunds of capital credits			(555,916)		(555,916)			(555,916)
Other equities						213,780		213,780
Balance - December 31, 2018	47,903,634	3,121,805	(10,018,463)	1,327,771	42,334,747	2,902,401	342,794	45,579,942
Comprehensive income:								
Net margins		3,015,192			3,015,192			3,015,192
Assigned margins	3,121,805	(3,121,805)			- -			- -
Amortization							(18,042)	
Adjustment							- -	(18,042)
Total comprehensive income								2,997,150
Refunds of capital credits			(399,702)		(399,702)			(399,702)
Other equities			(320)	(18,705)	(19,025)	211,599		192,574
Balance - December 31, 2019	$ 51,025,439	$ 3,015,192	$ (10,418,485)	$ 1,309,066	$ 44,931,212	$ 3,114,000	$ 324,752	$ 48,369,964

The Notes to Consolidated Financial Statements are an integral part of these statements.

SHELBY ENERGY COOPERATIVE, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2019 and 2018

	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Net margins	$ 3,015,192	$ 3,121,805
Adjustments to reconcile net margins to net cash provided by operating activities:		
Depreciation		
Charged to expense	3,583,688	3,454,237
Charged to clearing accounts	209,622	199,999
Patronage capital credits	(1,898,496)	(1,739,494)
Accumulated postretirement benefits	(35,917)	(3,784)
Change in assets and liabilities:		
Receivables	13,224	603,202
Material and supplies	(53,527)	106,686
Prepayments	(94,205)	71,467
Payables	767	(79,696)
Consumer deposits	20,765	48,680
Accrued expenses and accumulated benefits	89,184	(108,709)
Consumer advances for construction	45,937	18,866
Net cash provided by operating activities	4,896,234	5,693,259
CASH FLOWS FROM INVESTING ACTIVITIES		
Plant additions	(5,533,129)	(4,882,993)
Salvage, net of removal costs	(631,499)	(691,887)
Receipts from investments, net	306	86,405
Net cash (used in) investing activities	(6,164,322)	(5,488,475)
CASH FLOWS FROM FINANCING ACTIVITIES		
Other equities and minority interests	211,599	213,780
Additional long term borrowings	3,200,000	8,000,000
Short term borrowings (repayments)	- -	(2,692,985)
Payments on long term debt	(4,892,157)	(2,202,757)
Retirement of patronage capital	(418,726)	(555,916)
Cushion of credit (advances) applied	2,511,384	(2,500,000)
Net cash provided by financing activities	612,099	262,122
Net increase (decrease) in cash and cash equivalents	(655,989)	466,906
Cash and cash equivalents, beginning of year	2,505,305	2,038,399
Cash and cash equivalents, end of year	$ 1,849,316	$ 2,505,305
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash payments for interest	$ 2,166,643	$ 1,982,574

The Notes to Consolidated Financial Statements are an integral part of these statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

Shelby Energy Cooperative, Inc. (Shelby Energy) maintains its records in accordance with the policies prescribed or permitted by the Kentucky Public Service Commission (PSC) and the United States Department of Agriculture, Rural Utilities Service (RUS), which conform in all material respects with accounting principles generally accepted in the United States of America. The significant accounting policies are as follows:

Principals of Consolidation The consolidated financial statements include the accounts of Shelby Energy and Shelby Propane Plus, LLC (Propane Plus). Shelby Energy owns 100% of the member units of Propane Plus. All significant intercompany accounts and transactions have been eliminated.

Business Activity Shelby Energy provides distribution electric service to residential, business, and commercial consumers in 10 counties in central Kentucky. Propane Plus sells propane and related accessories to residential and commercial customers in central Kentucky. Shelby Energy provides overall business direction to Propane Plus.

Cash and Cash Equivalents Shelby Energy considers all short-term, highly liquid investments with original maturities of three months or less to be cash equivalents. Shelby Energy maintains cash deposits in financial institutions in excess of the amounts insured by the Federal Deposit Insurance Corporation (FDIC). As of December 31, 2019 and 2018, the financial institutions reported deposits in excess of the $250,000 FDIC insured limit several times during the audit period. Deposits in excess of the FDIC limit are 100% secured with collateral at the financial institution.

Accounts Receivable Accounts receivable consists of amounts due for sales of electric energy and propane, which were not collected at year-end. Accounts receivable are recorded at net realizable value consisting of the carrying amount less an allowance for uncollectible accounts. Shelby Energy and Propane Plus use the allowance method to account for uncollectible accounts receivable balances. Management charges off uncollectible receivables to the allowance when it is determined the amounts will not be realized.

Materials and Supplies Shelby Energy and Propane Plus value materials and supplies at the lower of average cost or net realizable value.

Propane Inventory Propane Plus purchases all of its propane requirements from unrelated parties through Kentucky Propane Plus, LLC. Propane is delivered to bulk tanks owned by Propane Plus, then delivered to customers on an as needed basis.

Cost of Power Shelby Energy is one of 16 members of East Kentucky Power Cooperative (East Kentucky). Under a wholesale power agreement, Shelby Energy is committed to purchase its electric power and energy requirements from East Kentucky until 2051. The rates charged by East Kentucky are subject to approval of the PSC. The cost of purchased power is recorded monthly, during the period in which the energy is consumed, based upon billings from East Kentucky. There are certain surcharges, clauses, and credits that East Kentucky includes to Shelby Energy that are passed on to consumers using a methodology prescribed by the PSC.

Utility Plant Electric plant is stated at original cost, which is the cost when first dedicated to public service. Such amount includes applicable supervisory and overhead cost including any construction period interest and taxes. There was no interest required to be capitalized during the year.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies (Continued)

Utility Plant (Continued) The cost of maintenance and repairs, including renewals of minor items of property, is charged to operating expense. The cost of replacement of depreciable property units, as distinguished from minor items, is charged to electric plant. The units of property replaced or retired, including cost of removal net of any salvage value, is charged to accumulated depreciation.

Propane Plus's fixed assets consist primarily of propane tanks located on customers' premises, bulk tanks, trucks used for delivery, and buildings and office equipment.

The major classifications of utility plant in service consist of the following as of December 31, 2019 and 2018:

	2019	2018
Distribution plant	$ 94,618,875	$ 91,114,517
General plant	4,717,363	4,548,847
Subtotal electric plant	$ 99,336,238	$ 95,663,364
Propane tanks on customer premises	$ 1,111,117	$ 1,077,219
Bulk tanks	387,195	387,195
Delivery and other trucks	951,352	820,451
Land and buildings	465,442	465,442
Office and other equipment	112,571	103,645
Subtotal propane plant	$ 3,027,677	$ 2,853,952
Utility Plant, at original cost	$ 102,363,915	$ 98,517,316

Depreciation Shelby Energy's provision has been made for depreciation, on the basis of the estimated lives of assets, using the straight-line method. Distribution plant depreciation is based on a composite rate of 3.48% per annum. General plant rates are as follows:

Structures and improvements	2.50%
Transportation equipment	10.50 - 20.00%
Other general plant	5.00 - 14.00%

Propane Plus's depreciation is computed using the straight-line method over the useful lives of its assets.

Management Services Propane Plus is one of 4 members of a group of propane companies that utilize the abilities of an individual who manages the day to day operations of each propane company and arranges for the purchase of bulk propane. Propane Plus shares the cost equally for the labor, benefits, and other costs of this manager.

Advertising Shelby Energy and Shelby Propane expense advertising costs as incurred. Shelby Propane advertising expense amounted to $11,819 and $4,506 for the years ended December 31, 2019 and 2018, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies (Continued)

Goodwill The goodwill has been recorded in connection with the purchase of one-half (1/2) of the interest from an unrelated party on June 30, 2000. The excess of the payment price over the value of assets acquired has been recorded as goodwill. Propane Plus tests goodwill for impairment when a triggering event occurs that indicates the fair value of the entity may be below its carrying value. As of December 31, 2019 and 2018, management does not believe an impairment exists.

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

Risk Management Shelby Energy is exposed to various forms of losses of assets associated with, but not limited to, fire, personal liability, theft, vehicular accidents, errors and omissions, fiduciary responsibility, workers compensation, etc. Each of these areas is covered through the purchase of commercial insurance.

Credit Risk Shelby Energy grants credit to residents of local counties. Concentrations of credit risk with respect to accounts receivables are limited due to its large number of customers.

Taxes The Companies are required to collect, on behalf of the Commonwealth of Kentucky, sales taxes based on 6 percent of gross sales from non-residential consumers, a 3 percent school tax from certain counties on most gross sales, and franchise fees in certain cities. Shelby Energy's policy is to exclude sales tax from revenue when collected and expenses when paid and instead, record collection and payment of sales taxes through a liability account.

Income Tax Status Shelby Energy is exempt from federal and state income taxes under provisions of Section 501(c)(12). Accordingly, the financial statements for Shelby Energy include no provision for income taxes. Propane Plus is a limited liability company treated as a partnership for federal income tax purposes.

Management evaluates its potential exposures from tax positions taken that have or could be challenged by taxing authorities. These potential exposures result because taxing authorities may take positions that differ from those taken by management in the interpretation and application of statutes, regulations, and rules. There are no tax positions for which the ultimate deductibility is highly uncertain included in the accompanying consolidated financial statements. Shelby Energy recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. Shelby Energy did not recognize any interest or penalties during the years ended December 31, 2019 or 2018. Shelby Energy's income tax return is subject to possible examination by taxing authorities until the expiration of related statues of limitations on the return, which is generally three years.

Comprehensive Income Comprehensive income includes both net margin and other comprehensive income. Other comprehensive income represents the change in funded status of the accumulated postretirement benefit obligation.

Reclassifications Certain amounts presented in the 2018 consolidated financial statements have been reclassified to conform to the 2019 presentation.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies (Continued)

Pension Accounting Pronouncement In May 2017, the Financial Accounting Standards Board (FASB) issued ASU 2017-07, *Improving the Presentation of Net periodic Pension Cost and Net Periodic Postretirement Benefit Cost.* The standard specifies how the amount of pension costs and costs for post-retirement benefits other than pensions (PBOP) should be presented on the income statement under accounting principles generally accepted in the United States of America, and what components of those costs are eligible for capitalization in assets. This standard is effective for years beginning after December 15, 2018. The Federal Energy Regulatory Commission (FERC) issued Docket No. AI18-1-000 that allowed jurisdictional public utilities to continue to record PBOP costs in their entirety, less amounts capitalized, without change. Pension and PBOP costs are made up of several components: service cost, interest cost, actual return on plan assets, gain or loss, amortization of prior service cost or credit, and amortization of ASC Subtopic 715-30. Though pension and PBOP costs are computed using the aggregate total of these various components, the PSC's longstanding policy is to consider the amount as a singular cost to the employer. This cost is calculated based on Statement of Financial Accounting Standards No. 106 and reported as an expense under net margins from continuing operations.

Recent Accounting Pronouncements In February 2016, the FASB issued ASU 2016-02, *Leases.* The standard requires all leases with lease terms over 12 months to be capitalized as a right-of-use asset and lease liability on the balance sheet at the date of lease commencement. Leases will be classified as either finance or operating. This distinction will be relevant for the pattern of expense recognition in the statement of revenue and comprehensive income. This standard will be effective for the year ending December 31, 2021.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments-Credit Losses.* The standard requires a financial asset (including trade receivables) measured at amortized cost basis to be presented at the net amount expected to be collected. Thus, the statement of revenue and comprehensive income will reflect the measurement of credit losses for newly recognized financial assets as well as the expected increases or decreases of expected credit losses that have taken place during the period. This standard will be effective for the year ending December 31, 2023.

Shelby Energy is currently in the process of evaluating the impact of the adoption of these ASUs on the consolidated financial statements.

Subsequent Events Management has evaluated subsequent events through March 19, 2020, the date the consolidated financial statements were available to be issued.

Note 2. Revenue Recognition

Adoption of accounting pronouncement

Shelby Energy and Propane Plus adopted ASU 2014-09, *Revenue from Contracts with Customers,* as of January 1, 2019. The new standard replaces existing revenue recognition rules with a single comprehensive model to use in accounting for revenue arising from contracts with customers. The standard was adopted using the modified retrospective method and had no effect on the consolidated financial position or results of operations.

Under ASU 2014-09, the timing of recognition of revenue for each performance obligation may differ from the timing of the customer billing, creating a contract asset or contract liability. Short-term contract liabilities are classified as consumer deposits. Shelby Energy and Propane Plus have no contract assets or long-term contract liabilities.

Note 2. Revenue Recognition (Continued)

Revenue from contracts

Shelby Energy is engaged in the distribution and sale of electricity to residential and commercial customers in 10 counties in central Kentucky. Revenue from these activities is generated from tariffs approved by the PSC. Shelby Energy satisfies their performance obligation upon the delivery of electricity to customers. Revenue is recognized over-time as the customer simultaneously receives and consumes the benefits provided by Shelby Energy. The amount of revenue recognized is the billed volume of electricity multiplied by a tariff rate per-unit of energy, plus any applicable fixed or additional regulatory charges. Customers are billed monthly and outstanding amounts are typically due within 15 days of the date of the bill.

Propane Plus is primarily engaged in the sale of propane to residential and commercial customers in central Kentucky. Propane Plus has standard prices for regular customers but also enters into contracts with some customers for an agreed-upon fixed price per gallon. Customers request propane as needed, and Propane Plus recognizes revenue at the point in time when the propane is delivered. The amount of revenue recognized is the volume of propane delivered multiplied by the price per gallon. Customers are billed at the point of sale and outstanding amounts are typically due within 30 days of the date of the bill.

Significant judgements

Shelby Energy recognizes unbilled electric revenue as a result of customers' bills being generated throughout the month rather than at the end of the month. Unbilled revenues for the month are calculated by taking the difference between the billing register and the estimated sales based on the kilowatt hours of electricity purchased less an estimated amount of line loss based on the prior 12 months. Any difference between estimated and actual revenues is adjusted the following month when the previous unbilled estimate is reversed and actual billings are generated. This method of revenue recognition presents fairly, the Shelby Energy's transfer of electricity to customers as the amount recognized is based on actual and estimated volumes delivered and the tariff rate per-unit of energy and any applicable fixed charges as set by the PSC. Propane Plus recognizes revenue at the point when customer orders are delivered, therefore, there are no unbilled or overbilled amounts to recognize.

Performance obligations

Shelby Energy and Propane Plus customers generally have no minimum purchase commitments. Shelby Energy and Propane Plus recognize revenue as each performance obligation is satisfied. Performance obligations are limited to the service requested and received to date. Accordingly, there are no unsatisfied performance obligations to recognize as of December 31, 2019 and 2018.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2. Revenue Recognition (Continued)

Disaggregation of revenue

The following table shows Shelby Energy's revenues from contracts with customers disaggregated by customer class, for the years ended December 31, 2019 and 2018:

	2019	2018
Residential	$ 26,648,209	$ 27,217,690
Large Industrial	10,742,617	11,021,586
Commercial	7,845,985	7,958,530
Public Lights	56,061	56,664
Other	825,037	909,198
Propane	2,314,907	2,484,085
Total	$ 48,432,816	$ 49,647,753

Contract cost liabilities

Contract cost liabilities include consumer deposits. The balance in contract liabilities was $1,616,773 and $1,596,008 as of December 31, 2019 and 2018, respectively.

Note 3. Investments in Associated Organizations

Investments in associated organizations consist of the following as of December 31, 2019 and 2018:

	2019	2018
East Kentucky, patronage capital	$ 26,460,048	$ 24,742,645
CFC, CTC's	628,197	630,912
CFC, patronage capital	342,776	327,050
CFC, Member capital security	25,000	25,000
Other associated organizations	814,151	760,473
Economic development loans	133,327	19,230
Total	$ 28,403,499	$ 26,505,310

Shelby Energy records patronage capital assigned by associated organizations in the year in which such assignments are received. The Capital Term Certificates (CTCs) of CFC are recorded at cost. The CTCs were purchased from CFC as a condition of obtaining long-term financing. The CTCs bear interest at 3.00% and 5.00% and are scheduled to mature at varying times from 2020 to 2080.

Note 4. Patronage Capital

Under provisions of the long-term debt agreement, return to patrons of capital contributed by them is limited to amounts which would not allow the total equities and margins to be less than 30.00% of total assets, except that distributions may be made to estates of deceased patrons. The debt agreement provides, however, that should such distributions to estates not exceed 25.00% of the net margins for the next preceding year, Shelby Energy may distribute the difference between 25.00% and the payments made to such estates. Shelby Energy's equity at December 31, 2019 and 2018 was 41.00% and 40.00% of total assets, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5. Long-Term Debt

All assets of Shelby Energy, except vehicles, are pledged as collateral on the long-term debt to RUS, Federal Financing Bank (FFB), and CFC under a joint mortgage agreement. The long-term debt is due in quarterly and monthly installments of varying amounts through 2052. Long-term debt consists of the following as of December 31, 2019 and 2018:

	2019	2018
Shelby Energy Cooperative		
RUS, 2.00% to 4.50%	$ 1,467,770	$ 1,959,771
Cushion of credit, earns 5.00% interest	- -	(2,511,383)
FFB, 2.30% to 4.79%	42,666,131	42,677,549
CFC:		
3.65% to 6.65% notes	1,894,760	2,063,628
Refinance RUS loans 3.20% to 5.05%	15,084,291	15,823,347
	61,112,952	60,012,912
Less current portion	2,213,099	2,190,000
	$ 58,899,853	$ 57,822,912
Shelby Propane		
East Kentucky Power Cooperative 3.00%	$ - -	$ 280,814
Less current portion	- -	45,000
	- -	235,814
Total long-term portion	$ 58,899,853	$ 58,058,726

The interest rates on the notes to CFC are subject to repricing at various dates for each individual note. RUS assesses 12.5 basis points to administer the FFB loans. As of December 31, 2019 and 2018, there was $15,919,000 and $19,119,000 of FFB loan funds unadvanced, respectively. These funds will be used for future plant additions.

As of December 31, 2019, the annual principal portion of long-term debt outstanding for the next five years are as follows: 2020 - $2,213,099; 2021 - $2,291,950; 2022 - $2,390,130; 2023 - $2,497,075; 2024 - $2,544,300.

Note 6. Short-Term Borrowings

Shelby Energy has a short-term line of credit of $6,000,000 available from CFC. There were no advances against the line of credit as of December 31, 2019 and 2018.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7. Pension Plans

All eligible employees of Shelby Energy participate in the NRECA Retirement and Security Plan (R&S Plan), 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 Plan sponsor's identification number is 53-0116145 and the Plan Number is 333. Eligible employees include employees hired prior to September 2, 2009. Non-eligible employees are those hired after September 2, 2009. 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.

Shelby Energy's contributions to the R&S Plan in 2019 and 2018 represent less than 5.00% of the total contributions made to the plan by all participating employers. Shelby Energy made contributions to the plan of $173,818 in 2019 and $219,130 in 2018. There have been no significant changes that affect the comparability of 2019 and 2018. Employees hired after September 2, 2009 can only participate in the NRECA 401(k) plan. Employer contributions to the 401(k) plan amounted to $148,498 for 2019 and $145,715 for 2018.

In the R&S 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 R&S Plan was over 80.00% funded at January 1, 2018 and 2017 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 R&S Plan, funding improvement plans and surcharges are not applicable. Future contribution requirements are determined each year as part of the actuarial valuation of the plan and may change as a result of plan experience.

At the December 2012 meeting of the I&FS Committee of the NRECA Board of Directors, the Committee approved an option to allow participating cooperatives in the Retirement Security (R&S) Plan (a defined benefit multiemployer pension plan) to make a prepayment and reduce future required contributions. The prepayment amount is a cooperative share, as of January 1, 2013, of future contributions required to fund the R&S Plan's unfunded value of benefits earned to date using Plan actuarial valuation assumptions. The prepayment amount will typically equal approximately 2.5 times a cooperative's annual R&S Plan required contribution as of January 1, 2013. After making the prepayment, for most cooperatives the billing rate is reduced by approximately 25.00%, retroactive to January 1, 2013. The 25.00% differential in billing rates is expected to continue for approximately 15 years. However, changes in interest rates, asset returns and other plan experience different from that expected, plan assumptions changes, and other factors may have an impact on the differential in billing rates and the 15 year period. During the year ended December 31, 2013 Shelby Energy made the prepayment contribution.

Propane Plus has a profit-sharing plan of 12.50% of net profits before the pension amount, where managers receive 5.00%, employees receive 5.00%, and the chief operating officer receives the remaining 2.50%. The pension contribution for 2019 was $10,887 and 2018 was $7,800.

Note 8. Postretirement Benefits

Shelby Energy sponsors a noncontributory defined benefit plan that provides medical insurance coverage to retired employees hired prior to July 1, 1996. Employees hired after July 1, 1996 are not eligible to participate. The plan calls for benefits to be paid at retirement based primarily upon years of service with Shelby Energy. There have been no significant changes that affect the comparability of 2019 and 2018.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 8. Postretirement Benefits (Continued)

The funded status of the plan was as follows as of December 31, 2019 and 2018:

	2019	2018
Projected benefit obligation	$ (1,463,374)	$ (1,481,249)
Plan assets at fair value	- -	- -
Funded status (deficit)	$ (1,463,374)	$ (1,481,249)

The components of net periodic postretirement benefit cost are as follows as of and for the year ended December 31, 2019 and 2018:

	2019	2018
Benefit obligation at beginning of year	$ 1,481,249	$ 1,466,991
Components of net periodic benefit cost:		
Service cost	61,103	61,022
Interest cost	66,254	66,335
Net periodic benefit cost	127,357	127,357
Benefits paid	(145,232)	(113,099)
Benefit obligation at end of year	$ 1,463,374	$ 1,481,249
Amounts recognized in the balance sheet consists of:		
Accumulated Postretirement Benefits	$ 1,463,374	$ 1,481,249
Amounts included in other comprehensive income:		
Unrecognized actuarial gain	$ 324,752	$ 342,794
Effect of 1% increase in the health care trend:		
Postemployment benefit obligation	$ 1,560,000	
Net periodic benefit cost	$ 136,000	

For measurement purposes, an annual rate of increase of 7.00% in 2019, then decreasing by .25% per year until 4.00% per year, in the per capita cost of covered healthcare benefit was assumed. The discount rate used in determining the accumulated postretirement benefit obligation was 4.50% in 2019 and 2018.

Projected retiree benefit payments for the next five years are expected to be as follows: 2020 - $115,000; 2021 - $113,000; 2022 - $113,000; 2023 - $115,000; 2024 - $122,000.

Note 9. Commitments

Shelby Energy has various other agreements outstanding with local contractors. Under these agreements, the contractors will perform certain construction, maintenance, and other work at specified hourly rates or unit cost, or on an as needed basis. The duration of these contracts are one to three years.

Note 10. Related Party Transactions

Several of the Directors of Shelby Energy, its President and CEO, and another employee are on the boards of directors of various associated organizations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 11. Labor Force

Approximately 35.00% of Shelby Energy's labor force is subject to a collective bargaining agreement. A three (3) year agreement was negotiated and approved for the period starting September 2018 through September 2021 between Shelby Energy and the International Brotherhood of Electric Workers (IBEW).

Note 12. Environmental Contingency

Shelby Energy from time to time is required to work with and handle PCBs, herbicides, automotive fluids, lubricants, and other hazardous materials in the normal course of business. As a result, there is the possibility that environmental conditions may arise which would require Shelby Energy to incur cleanup costs. The likelihood of such an event, or the amount of such costs, if any, cannot be determined at this time. However, management does not believe such costs, if any, would materially affect Shelby Energy's financial position or its future cash flows.

Note 13. Contingencies

Shelby Energy, on occasion, is involved in litigation arising in the normal course of business. While the results of such litigation cannot be predicted with certainty, management, based upon advice of counsel, believes that the final outcome will not have a material adverse effect on the financial consolidated statements.

Note 14. Uncertainties

Subsequent to December 31, 2019, local, U.S., and world governments have encouraged self-isolation to curtail the spread of the global pandemic, coronavirus disease (COVID-19), by mandating temporary work stoppage in many sectors and imposing limitations on travel and size and duration of group meetings. Most industries are experiencing disruption to business operations and the impact of reduced consumer spending. There is unprecedented uncertainty surrounding the duration of the pandemic, its potential economic ramifications, and any government actions to mitigate them. Accordingly, while management cannot quantify the financial and other impact to Shelby Energy and Propane Plus as of March 19, 2020, management believes that a material impact on Shelby Energy and Propane Plus's financial position and results of future operations is reasonably possible.

INDEPENDENT AUDITOR'S REPORT ON SUPPLEMENTARY INFORMATION

To the Board of Directors
Shelby Energy Cooperative, Inc. and Subsidiary
Shelbyville, Kentucky

We have audited the consolidated financial statements of Shelby Energy Cooperative, Inc. and Subsidiary as of and for the years ended December 31, 2019 and 2018, and our report thereon dated March 19, 2020, which expressed an unmodified opinion on those consolidated financial statements, appears on pages 1 and 2. Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating supplementary information shown on pages 18 and 19 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating 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 information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Jones, Nale & Mattingly PLC

Louisville, Kentucky
March 19, 2020

SHELBY ENERGY COOPERATIVE, INC. AND SUBSIDIARY
CONSOLIDATING BALANCE SHEET
December 31, 2019

Assets	Shelby Energy	Propane Plus	Eliminations	Consolidated
Utility Plant, at original cost:				
In service	$ 99,336,238	$ 3,027,677	$ - -	$ 102,363,915
Under construction	1,081,402	- -	- -	1,081,402
	100,417,640	3,027,677	- -	103,445,317
Less accumulated depreciation	20,307,643	1,702,283	- -	22,009,926
	80,109,997	1,325,394	- -	81,435,391
Investments and Other Assets:				
Associated organizations	28,403,499	- -	- -	28,403,499
Goodwill, net of amortization	- -	368,414	- -	368,414
Investment in Subsidiary	2,525,921	- -	(2,525,921)	- -
	30,929,420	368,414	(2,525,921)	28,771,913
Current Assets:				
Cash and cash equivalents	1,307,415	541,901	- -	1,849,316
Accounts receivable, less allowance for Energy of $480,707 and Propane of $16,000	4,205,392	197,824	- -	4,403,216
Material and supplies, at average cost	601,750	124,776	- -	726,526
Prepayments	233,106	43,973	- -	277,079
	6,347,663	908,474	- -	7,256,137
Total	$ 117,387,080	$ 2,602,282	$ (2,525,921)	$ 117,463,441
Members' Equities and Liabilities				
Members' and Stockholder's Equities:				
Capital investment	$ - -	$ 487,677	$ (487,677)	$ - -
Patronage capital and retained earnings	44,931,212	2,038,244	($2,038,244)	44,931,212
Other equities	3,114,000	- -	- -	3,114,000
Other comprehensive income	324,752	- -	- -	324,752
	48,369,964	2,525,921	(2,525,921)	48,369,964
Long Term Debt	58,899,853	- -	- -	58,899,853
Accumulated Postretirement Benefits	1,463,374	- -	- -	1,463,374
Current Liabilities:				
Accounts payable	3,740,360	- -	- -	3,740,360
Short term borrowings	- -	- -	- -	- -
Current portion of long term debt	2,213,099	- -	- -	2,213,099
Consumer deposits	1,610,915	5,858	- -	1,616,773
Accrued expenses	560,216	70,503	- -	630,719
	8,124,590	76,361	- -	8,200,951
Consumer Advances for Construction	529,299	- -	- -	529,299
Total	$ 117,387,080	$ 2,602,282	$ (2,525,921)	$ 117,463,441

SHELBY ENERGY COOPERATIVE, INC. AND SUBSIDIARY
CONSOLIDATING STATEMENT OF REVENUE AND COMPREHENSIVE INCOME
Year ended December 31, 2019

	Shelby Energy	Propane Plus	Eliminations	Consolidated
Operating Revenues	$ 46,117,909	$ 2,314,907	$ - -	$ 48,432,816
Operating Expenses:				
Cost of purchases	33,130,833	950,291	- -	34,081,124
Distribution - operations	1,728,961	501,749	- -	2,230,710
Distribution - maintenance	2,936,837	- -	- -	2,936,837
Consumer accounts	501,441	128,488	- -	629,929
Customer service and information	377,680	- -	- -	377,680
Sales	(1,631)	- -	- -	(1,631)
Administrative and general	911,291	147,066	- -	1,058,357
Depreciation, excluding $209,622 charged to clearing accounts	3,408,008	175,680	- -	3,583,688
Taxes	59,049	18,175	- -	77,224
Interest on long term debt	2,135,613	3,646	- -	2,139,259
Other interest	47,486	- -	- -	47,486
Other	86,457	- -	- -	86,457
Total cost of electric service	45,322,025	1,925,095	- -	47,247,120
Operating Margins	795,884	389,812	- -	1,185,696
Nonoperating Margins:				
Interest income	121,044	2,473	- -	123,517
Non-operating taxes	(128,960)	- -	- -	(128,960)
(Loss) on sale of equipment	(63,557)	- -	- -	(63,557)
Investment in subsidiary	392,285	- -	(392,285)	- -
	320,812	2,473	(392,285)	(69,000)
Patronage Capital assigned from:				
East Kentucky Power Cooperative	1,802,479	- -	- -	1,802,479
Other organizations	96,017	- -	- -	96,017
	1,898,496	- -	- -	1,898,496
Net Margins	3,015,192	392,285	(392,285)	3,015,192
Other comprehensive Income:				
Postretirement benefits (expense)	(18,042)	- -	- -	(18,042)
Total Comprehensive Income	$ 2,997,150	$ 392,285	$ (392,285)	$ 2,997,150

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*

To the Board of Directors
Shelby Energy Cooperative, Inc. and Subsidiary
Shelbyville, Kentucky

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 Shelby Energy Cooperative, Inc. and Subsidiary (the Corporation), which comprise the consolidated balance sheet as of December 31, 2019 and the related consolidated statements of revenue and comprehensive income, changes in members' equities and cash flows for the year then ended, and related notes to the consolidated financial statements, and have issued our report thereon dated March 19, 2020.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Corporation'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 financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

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

Jones, Nale & Mattingly PLC

Louisville, Kentucky
March 19, 2020

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH ASPECTS OF CONTRACTUAL AGREEMENTS AND REGULATORY REQUIREMENTS FOR ELECTRIC BORROWERS

To the Board of Directors
Shelby Energy Cooperative, Inc. and Subsidiary
Shelbyville, Kentucky

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 consolidated financial statements of Shelby Energy Cooperative, Inc. and Subsidiary (the Corporation), which comprise the consolidated balance sheet as of December 31, 2019, and the related consolidated statements of revenue and comprehensive income, changes in members' equities, and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated March 19, 2020. In accordance with *Government Auditing Standards*, we have also issued our report dated March 19, 2020, on our consideration of the Corporation'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 the Corporation 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 and Grantees*, §1773.33, 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 the Corporation's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters. In connection with our audit, we noted no matters regarding the Corporation's accounting and records to indicate that the Corporation 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 material and supplies;
- Prepare accurate and timely Financial and Operating Reports;
- Obtain written RUS approval to enter into any contract for the management, operation, 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 consolidated 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, which are listed below; and
- Comply with the requirements for the detailed schedule of investments, which are listed below.

The deferred credits are as follows:

Consumer advances for construction	$ 529,299

Shelby Energy is a 100% owner of a subsidiary, Shelby Propane Plus, LLC, which is engaged in the distribution sales of propane gas in and around the areas in which Shelby Energy provides electric service. The activity of the subsidiary is as follows for the year ended December 31, 2019:

	Investment
Beginning balance	$ 2,252,596
Net income	392,285
Returns of income/others	(118,960)
Ending balance	$ 2,525,921

The purpose of this report is solely to communicate, in connection with the audit of the consolidated financial statements, on compliance with aspects of contractual agreements and the regulatory requirements for electric borrowers based on the requirements of 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers and Grantees*. Accordingly, this report is not suitable for any other purpose.

Jones, Nale & Mattingly PLC

Louisville, Kentucky
March 19, 2020