ARIZONA CORPORATION COMMISSION
UTILITIES DIVISION

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ARIZONA CORPORATION
COMMISSION

ANNUAL REPORT MAILING LABEL – MAKE CHANGES AS NECESSARY

E-01773A

Arizona Electric Power Cooperative, Inc.
PO Box 670
Benson, AZ 85602

☐ **Please click here if pre-printed Company name on this form is not your current Company name or dba name is not included.**

Please list current Company name including dba here:

____

ANNUAL REPORT
Electric

FOR YEAR ENDING

12	31	2018

FOR COMMISSION USE

ANN 01	18

4-16-19

COMPANY INFORMATION

Company Name (Business Name) Arizona Electric Power Cooperative, Inc

Mailing Address P.O. Box 670
(Street)

Benson | AZ | 85602-0670
(City) | (State) | (Zip)

520-586-3631 | 520-586-5343 |
Telephone No. (Include Area Code) | Fax No. (Include Area Code) | Cell No. (Include Area Code)

Email Address www.azgt.coop

Local Office Mailing Address 1000 South Highway 80
(Street)

Benson | AZ | 85602
(City) | (State) | (Zip)

Same as above
Local Customer Service Phone No. (Include Area Code) | (1-800 or other long distance Customer Service Phone No.)

Email Address ______ Website address www.azgt.coop

MANAGEMENT INFORMATION

☒ **Regulatory Contact:**

☐ **Management Contact:** Erin Peters | Financial Analyst II - Rates Administration
(Name) | (Title)

1000 S Hwy 80 | Benson | AZ | 85602
(Street) | (City) | (State) | (Zip)

520-586-5336 | 520-586-5199 |
Telephone No. (Include Area Code) | Fax No. (Include Area Code) | Cell No. (Include Area Code)

Email Address epeters@azgt.coop

On Site Manager: Patrick Ledger, CEO
(Name)

Same as above
(Street) | (City) | (State) | (Zip)

520-586-5008
Telephone No. (Include Area Code) | Fax No. (Include Area Code) | Cell No. (Include Area Code)

Email Address pledger@azgt.coop

Statutory Agent: Rusing and Lopez, PLLC
(Name)

6262 N Swan Rd. Suite 200	Tucson	AZ	85718
(Street)	(City)	(State)	(Zip)

520-792-4800	520-529-4262	
Telephone No. (Include Area Code)	Fax No. (Include Area Code	Cell No. (Include Area Code)

Attorney: Pat Lopez
(Name)

Same as above			
(Street)	(City)	(State)	(Zip)

Telephone No. (Include Area Code)	Fax No. (Include Area Code)	Cell No. (Include Area Code)

Email Address plopez@rusingandlopez.com

OWNERSHIP INFORMATION

Check the following box that applies to your company:

- ☐ **Sole Proprietor (S)**
- ☐ **Partnership (P)**
- ☐ **Bankruptcy (B)**
- ☐ **Receivership (R)**
- ☐ **C Corporation (C) (Other than Association/Co-op)**
- ☐ **Subchapter S Corporation (Z)**
- ☒ **Association/Co-op (A)**
- ☐ **Limited Liability Company**
- ☐ **Other (Describe)**__________

COUNTIES SERVED

Check the box below for the county/ies in which you are certificated to provide service:

☐ **APACHE**	☐ **COCHISE**	☐ **COCONINO**
☐ **GILA**	☐ **GRAHAM**	☐ **GREENLEE**
☐ **LA PAZ**	☐ **MARICOPA**	☐ **MOHAVE**
☐ **NAVAJO**	☐ **PIMA**	☐ **PINAL**
☐ **SANTA CRUZ**	☐ **YAVAPAI**	☐ **YUMA**
☒ **STATEWIDE**		

SERVICES AUTHORIZED TO PROVIDE

Check the following box/es for the services that you are authorized to provide:

- [X] **Electric**
  - [ ] Investor Owned Electric
  - [X] Rural Electric Cooperative
  - [ ] Utility Distribution Company
  - [ ] Electric Service Provider
    - [ ] Transmission Service Provider
    - [ ] Meter Service Provider
    - [ ] Meter Reading Service Provider
    - [ ] Billing and Collection
    - [ ] Ancillary Services
    - [ ] Generation Provider
    - [ ] Aggregator/Broker
- [ ] **Other** (Specify)________________________________

STATISTICAL INFORMATION

Retail Information

	Number of Arizona Customers	Number of kWh Sold in Arizona
Residential		
Commercial		
Industrial		
Public Street and Highway Lighting		
Irrigation		
Total Retail		

Wholesale Information

	Number of Customers	Number of kWh Sold
Resale	6	2,500,616,000
Short-term Sales (durations of less than one year)	52	1,468,718,000
Total Wholesale		3,969,334,000

Total MWh Sold 3,969,334 MWh

Maximum Peak Load 736 MW

VERIFICATION
AND
SWORN STATEMENT
Intrastate Revenues Only

RECEIVED
UTILITIES DIVISION
2019 APR 15 A 10: 47
ARIZONA CORPORATION
COMMISSION

VERIFICATION

STATE OF ______________	COUNTY OF (COUNTY NAME) Cochise
I, THE UNDERSIGNED	NAME (OWNER OR OFFICIAL) TITLE Joe King, Controller of Finance & Rates
OF THE	COMPANY NAME Arizona Electric Power Cooperative, Inc.

DO SAY THAT THIS ANNUAL UTILITY REPORT TO THE ARIZONA CORPORATION COMMISSION

FOR THE YEAR ENDING

MONTH	DAY	YEAR
12	31	2018

HAS BEEN PREPARED UNDER MY DIRECTION, FROM THE ORIGINAL BOOKS, PAPERS AND RECORDS OF SAID UTILITY; THAT I HAVE CAREFULLY EXAMINED THE SAME, AND DECLARE THE SAME TO BE A COMPLETE AND CORRECT STATEMENT OF BUSINESS AND AFFAIRS OF SAID UTILITY FOR THE PERIOD COVERED BY THIS REPORT IN RESPECT TO EACH AND EVERY MATTER AND THING SET FORTH, TO THE BEST OF MY KNOWLEDGE, INFORMATION AND BELIEF.

SWORN STATEMENT

IN ACCORDANCE WITH THE REQUIREMENT OF TITLE 40, ARTICLE 8, SECTION 40-401, ARIZONA REVISED STATUTES, IT IS HEREIN REPORTED THAT THE GROSS OPERATING REVENUE OF SAID UTILITY DERIVED FROM ARIZONA INTRASTATE UTILITY OPERATIONS DURING CALENDAR YEAR 2018 WAS:

Arizona Intrastate Gross Operating Revenues Only ($)
$ 162,503,713

(THE AMOUNT IN BOX ABOVE INCLUDES $______________ IN SALES TAXES BILLED, OR COLLECTED)

****REVENUE REPORTED ON THIS PAGE MUST INCLUDE SALES TAXES BILLED OR COLLECTED. IF FOR ANY OTHER REASON, THE REVENUE REPORTED ABOVE DOES NOT AGREE WITH TOTAL OPERATING REVENUES ELSEWHERE REPORTED, ATTACH THOSE STATEMENTS THAT RECONCILE THE DIFFERENCE. (EXPLAIN IN DETAIL)**

Joe L. King
SIGNATURE OF OWNER OR OFFICIAL
520-586-5129
TELEPHONE NUMBER

SUBSCRIBED AND SWORN TO BEFORE ME

A NOTARY PUBLIC IN AND FOR THE COUNTY OF COUNTY NAME Cochise

THIS 11th **DAY OF** MONTH April ,2019

(SEAL)

Samantha Goodman
Notary Public State of Arizona Cochise County Commission Expires 11-13-19

Samantha Goodman
SIGNATURE OF NOTARY PUBLIC

MY COMMISSION EXPIRES 11-13-19

FINANCIAL INFORMATION

Attach to this annual report a copy of the Company year-end (Calendar Year 2018) financial statements. If you do not compile these reports, the Utilities Division will supply you with blank financial statements for completion and filing. **ALL INFORMATION MUST BE ARIZONA-SPECIFIC AND REFLECT OPERATING RESULTS IN ARIZONA.**

REPORT OF INDEPENDENT AUDITORS
AND FINANCIAL STATEMENTS

ARIZONA ELECTRIC POWER COOPERATIVE, INC.

December 31, 2018 and 2017

MOSSADAMS

Table of Contents

MOSSADAMS

Report of Independent Auditors

To the Board of Directors
Arizona Electric Power Cooperative, Inc.

Report on the Financial Statements

We have audited the accompanying financial statements of Arizona Electric Power Cooperative, Inc. (the Cooperative), which comprise the balance sheets as of December 31, 2018 and 2017, and the related statements of revenues, expenses and unallocated accumulated margins, 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 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 audits 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 Cooperative'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 Cooperative'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.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Arizona Electric Power Cooperative, Inc. as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 30, 2019 on our consideration of the Cooperative'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. 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 the Cooperative's internal control over financial reporting and compliance.

Moss Adams LLP

Portland, Oregon
March 29, 2019

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Arizona Electric Power Cooperative, Inc.
Balance Sheets

ASSETS

	December 31, 2018	December 31, 2017
UTILITY PLANT		
Plant in service	$ 708,150,376	$ 695,469,495
Construction work in progress	9,019,311	11,181,465
Total utility plant	717,169,687	706,650,960
Less accumulated depreciation	383,603,063	367,462,643
Utility plant, net	333,566,624	339,188,317
INVESTMENTS		
Restricted	7,250,977	7,950,171
Unrestricted	3,111,183	2,720,035
Total investments	10,362,160	10,670,206
CURRENT ASSETS		
Cash and cash equivalents		
General unrestricted	24,910,932	33,309,767
Restricted	2,245,933	2,119,321
Accounts receivable	26,993,256	22,856,612
Accumulated under-recovered fuel and purchased power costs	-	4,364,459
Inventories, at average cost		
Coal and natural gas	6,177,251	11,696,071
Materials and supplies	12,807,498	12,896,896
Prepayments and other current assets	3,513,314	2,974,299
Notes receivable	429,296	2,288,441
Total current assets	77,077,480	92,505,866
DEFERRED DEBITS	23,076,761	24,331,855
Total assets	$ 444,083,025	$ 466,696,244

See accompanying notes.

MEMBERSHIP CAPITAL AND LIABILITIES

	December 31, 2018	December 31, 2017
MEMBERSHIP CAPITAL		
Membership fees	$ 830	$ 830
Patronage capital	159,735,019	152,447,814
Unallocated accumulated margins	9,012,619	8,573,181
Total membership capital	168,748,468	161,021,825
LONG-TERM DEBT		
Federal Financing Bank	219,218,305	229,495,082
Advance payments unapplied	(64,672,568)	(39,559,813)
Solid Waste Disposal Revenue bonds	9,600,000	11,200,000
Cooperative Finance Corporation	3,942,868	4,924,113
Debt issuance costs	(315,339)	(474,735)
Capital lease obligation	353,688	558,752
Total long-term debt	168,126,954	206,143,399
CURRENT LIABILITIES		
Member advances and other investments	9,232,388	26,867,774
Current maturities of capital lease obligation	232,709	276,296
Current maturities of long-term debt	13,125,678	18,277,352
Accounts payable	20,261,586	15,467,511
Accrued property and business taxes	2,490,052	2,554,513
Accrued interest	81,499	62,385
Line of credit	30,000,000	10,000,000
Accumulated over-recovered fuel and purchase power costs	4,832,381	-
Other accrued liabilities	3,438,883	3,868,439
Total current liabilities	83,695,176	77,374,270
DEFERRED CREDITS AND OTHER LIABILITIES	23,512,427	22,156,750
Total membership capital and liabilities	$ 444,083,025	$ 466,696,244

See accompanying notes.

Arizona Electric Power Cooperative, Inc.
Statements of Revenues, Expenses and Unallocated Accumulated Margins

	Years Ended December 31, 2018	2017
OPERATING REVENUES		
Sales of electric energy		
Members		
Class A – Firm	$ 167,671,497	$ 158,566,683
Class D	19,878,298	8,551,014
(Over) under-recovery of fuel and purchase power costs	(4,781,923)	916,790
Nonmembers	18,322,793	12,230,425
Other, net	1,333,580	5,856,558
Total operating revenues	202,424,245	186,121,470
OPERATING EXPENSES		
Operations:		
Production	69,795,914	71,636,957
Transmission	4,575,329	4,021,954
Maintenance		
Production	13,894,632	14,227,707
Transmission	4,212,455	4,108,546
Other power supply	49,135,662	29,007,598
Administration and general	12,875,798	13,813,605
Depreciation, amortization, and accretion	18,663,171	17,923,630
Transmission	9,052,580	9,187,833
Property and other taxes	4,802,400	4,972,761
Total operating expenses	187,007,941	168,900,591
OPERATING MARGIN	15,416,304	17,220,879
Interest and interest related expenses, net	(10,335,242)	(10,922,422)
Other income, net	3,931,557	2,274,724
NET MARGIN	9,012,619	8,573,181
UNALLOCATED ACCUMULATED MARGINS, beginning of year	8,573,181	7,662,116
PATRONAGE CAPITAL ALLOCATION	(8,573,181)	(7,662,116)
UNALLOCATED ACCUMULATED MARGINS, end of year	$ 9,012,619	$ 8,573,181

See accompanying notes.

	Years Ended December 31, 2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net margin	$ 9,012,619	$ 8,573,181
Adjustments to reconcile net margin to net cash from operating activities		
Depreciation and amortization	18,822,567	18,093,170
Patronage capital allocations	(597,199)	(151,214)
Changes in assets and liabilities		
Accounts and notes receivable	(2,277,499)	(1,247,776)
Accumulated under-recovered fuel and purchased power costs	4,364,459	(4,364,459)
Inventories	5,608,218	6,662,267
Prepayments and other current assets	(539,015)	104,733
Deferred debits	1,095,698	(9,811,707)
Accounts payable	4,794,075	4,416,185
Accrued interest	19,114	5,558
Deferred credits	433,447	(2,692,878)
Accumulated over-recovered fuel and purchased power costs	4,832,381	(189,492)
Accrued property and business taxes and other	(494,017)	373,678
Net cash from operating activities	45,074,848	19,771,246
CASH FLOWS FROM INVESTING ACTIVITIES		
Construction expenditures, net	(12,119,248)	(13,950,589)
Redemptions of investments, net	905,245	584,761
Net cash from investing activities	(11,214,003)	(13,365,828)
CASH FLOWS FROM FINANCING ACTIVITIES		
Membership fees	-	200
Retirement of patronage capital credits	(1,285,976)	(842,833)
Member advances and other investments, net	(17,635,386)	5,862,105
Proceeds from long-term debt	22,024,317	21,028,000
Borrowing on line of credit	40,000,000	10,000,000
Payment on line of credit	(20,000,000)	-
Advance payments	(25,112,755)	(7,341,693)
Payments on long-term debt and capital lease obligation	(40,123,268)	(28,093,346)
Net cash from financing activities	(42,133,068)	612,433

Arizona Electric Power Cooperative, Inc.
Statements of Cash Flows

	Years Ended December 31,	
	2018	2017
CHANGE IN CASH AND CASH EQUIVALENTS	$ (8,272,223)	$ 7,017,851
CASH AND CASH EQUIVALENTS, beginning of year	35,429,088	28,411,237
CASH AND CASH EQUIVALENTS, end of year	$ 27,156,865	$ 35,429,088
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for interest, net of amount capitalized	$ 10,156,732	$ 10,747,324
Noncash investing activities		
Assets acquired under a capital lease	$ -	$ 518,227

See accompanying notes.

Note 1 – Organization

Arizona Electric Power Cooperative, Inc. (the Cooperative or AEPCO) is a member owned, nonprofit Arizona rural generation and transmission electric cooperative organized in 1961 to provide wholesale electric power and transmission and ancillary services to its member distribution cooperatives, municipalities and other customers.

Membership of the Cooperative is restricted to electric utilities. The Cooperative has four classes of members. Class A members consist of three distribution cooperatives with all requirements contracts and three distribution cooperatives with partial requirements contracts. Currently there are no Class B or C members. There are five Class D members, representing electric utilities other than Class A, B, or C with a written agreement for power and/or energy and/or substantial service, represented jointly by one director. Class A, Class B, Class C and Class D members are collectively referred to herein as members.

Note 2 – Summary of Significant Accounting Policies

System of accounts – The Cooperative maintains its accounts in accordance with policies and procedures as prescribed by the Rural Utilities Service (RUS) in conformity with the Uniform System of Accounts. The Cooperative's accounting policies conform to accounting principles generally accepted in the United States of America as applied in the case of regulated public utilities and are in accordance with the accounting requirements and rate-making practices of the RUS and the Arizona Corporation Commission (ACC), the regulatory authorities having jurisdiction.

Accounting for the effects of regulation – Due to the regulation of its rates by the ACC, the Cooperative prepares its financial statements in accordance with Regulated Operations. This accounting requires a cost-based, regulated enterprise to recognize revenues and expenses in the time periods when the revenues and expenses are included in rates. This may result in regulatory assets and liabilities until such time that the related revenues and expenses are included in rates.

Indenture – As of March 1, 2016, AEPCO has an Indenture of Deed of Trust, Security Agreement and Financing Statement (Indenture), approved by RUS that will allow the Cooperative to explore alternative financing providers in addition to RUS. The indenture consolidates all of AEPCO's secured debt under one trustee, who will manage the debt portfolio for RUS, reducing RUS reporting requirements, while still maintaining RUS oversight.

Utility plant – Utility plant, consisting primarily of coal and natural gas electric generation facilities and transmission facilities, is stated at historical cost and includes the costs of outside contractors, direct labor and materials, allocable overhead and interest charged during construction.

In accordance with the Uniform System of Accounts, the Cooperative capitalizes the interest costs associated with the borrowing of funds used to finance construction work in progress (CWIP). Interest income from construction funds held in trust, if any, is credited to CWIP. Interest costs capitalized on construction projects were approximately $98,000 and $148,000 for 2018 and 2017, respectively.

Note 2 – Summary of Significant Accounting Policies (continued)

Depreciation is computed on the straight-line basis over estimated useful lives of depreciable property in accordance with rates prescribed by RUS, averaging 2.52% and 2.46% in 2018 and 2017, respectively. Minor replacements and repairs are charged to expense as incurred. When utility plant is retired, sold, or otherwise disposed of, the original cost plus the cost of removal less salvage value is charged to accumulated depreciation, along with any corresponding gain or loss.

The Cooperative assesses its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the fair value is less than the carrying amount of the asset, a loss is recognized for the difference. The Cooperative has not recorded any losses resulting from impairment of its long-lived assets.

Asset retirement obligations – Accounting standards require the recognition of an Asset Retirement Obligation (ARO), measured at estimated fair value, for legal obligations related to decommissioning and restoration costs associated with the retirement of tangible long-lived assets in the period in which the liability is incurred. The initial capitalized asset retirement costs are depreciated over the life of the related asset, with accretion of the ARO liability classified as an operating expense (see Note 10 – Asset retirement obligation).

Investments – The Cooperative accounts for its investments in accordance with accounting for certain investments in debt and equity securities. At December 31, 2018 and 2017, all investment balances are recorded at fair market value (see Note 3), with the exception of investments in associated organizations and patronage capital. Investments in associated organizations and patronage capital are carried at cost, plus capital credits allocated and not retired.

Cash and cash equivalents – The Cooperative considers all investments with an original maturity of 90 days or less to be cash equivalents. The Cooperative maintains its cash in bank accounts, which, at times, exceed federally insured limits and has not experienced any losses in such accounts. Restricted cash consists of special deposits and economic development funds which are restricted in use.

Concentration of credit risk – Financial instruments that are exposed to concentrations of credit risk consist primarily of cash, including temporary investments and receivables. Credit is extended to customers generally without collateral requirement; however, deposits are obtained from certain customers and formal shut-off procedures are in place.

Receivables – Receivables are recorded when invoices are issued and are written off when they are determined to be uncollectible. The allowance for doubtful accounts is estimated based on historical losses, review of specific problem accounts, the existing economic conditions in the industry and the financial stability of customers. Generally, accounts receivable are considered past due after 30 days. No allowance was deemed necessary at December 31, 2018 and 2017.

Inventories – Inventories, consisting of coal, natural gas and materials and supplies, are carried at the lower of average cost and net realizable value.

Note 2 – Summary of Significant Accounting Policies (continued)

Deferred debits and credits – Deferred debits and credits are recorded at cost and either: (1) amortized over their expected period of benefit or alternate period of time as may be mandated by ACC order or other regulatory order, if different, or (2) eliminated upon determination of their ultimate disposition.

Debt issuance costs – Debt issuance costs related to a recognized debt liability are presented on the balance sheet as a direct reduction from the carrying amount of that debt liability. These costs are amortized to interest expense over the life of the related debt using the effective interest method. As of December 31, 2018 and 2017, the total debt issuance costs net of accumulated amortization was $315,339 and $474,735, respectively.

Overhaul costs – The Cooperative accounts for major and minor overhauls using the deferral method. Accordingly, incurred overhaul costs are deferred and amortized over the overhaul benefit period, generally three years for minor overhauls and six years for major overhauls. The frequency of overhauls is based on the operating characteristics and operating profiles of each generating unit (see Note 7).

Revenues, purchased power, and fuel costs – Revenues are recognized as electric power, electric transmission and other energy service products and are delivered at rates approved by the ACC. Purchased power and fuel costs are charged to expense as incurred.

In its October 25, 2013 rate order, the ACC approved a new purchased power and fuel cost adjustor (the adjustor) for the Cooperative. Starting on November 1, 2013, the new adjustor enables the Cooperative to accumulate its over and under collection of fuel and purchased power costs and subsequently, as approved by the ACC, refund or collect from its members the amount of over or under collection of fuel and purchased power costs. Such amounts are recorded as revenue in the period the costs are incurred.

Fair value of financial instruments – All of the Cooperative's financial instruments are recorded at fair market value or carrying value, which approximates fair market value. Investments in associated organizations and patronage capital are not considered financial instruments because they represent nontransferable interests in associated organizations. The Cooperative has determined that its financial instruments fall into the Level 1 category. Level 1 asset valuations are based on assets at the quoted prices in active markets for identical assets, level 2 asset valuations are based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly and level 3 asset valuations are based on inputs that are unobservable and significant to the overall fair value measurement (see Note 3).

Use of estimates – The preparation of financial statements in conformity with generally accepted accounting principles 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. Significant estimates include the adjustor, depreciation, asset retirement obligation and overhaul amortization. Actual results could differ from these estimates.

Note 2 – Summary of Significant Accounting Policies (continued)

Recent accounting pronouncements – In May 2014, the FASB issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers.* Under the new standard, recognition of revenue occurs when a customer obtains control of promised goods or services in an amount that reflects the consideration to which the entity expects to receive in exchange for those goods or services. In addition, the standard requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The new standard was effective for fiscal years beginning after December 15, 2017, with early adoption permitted for fiscal years beginning after December 15, 2016, in certain instances. On July 9, 2015, the FASB affirmed its proposal to defer the effective date of the new revenue standard by one year to annual reporting periods beginning after December 15, 2018. The Cooperative is evaluating the impact of the pending adoption of the new standard on the consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases.* The new standard establishes a right-of-use ("ROU") model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2019, with early adoption permitted. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Cooperative is evaluating the impact of the pending adoption of the new standard on the consolidated financial statements.

Subsequent events – Accounting standards require disclosure of the date through which subsequent events have been evaluated, as well as whether the date is the date the financial statements were issued or the date the financial statements were available to be issued. The Cooperative has evaluated subsequent events through March 29, 2019, the date the financial statements were available to be issued.

Note 3 – Investments

Investments at December 31 consist of the following:

	2018	2017
Restricted – municipal bonds	$ 2,821,955	$ 2,956,765
Restricted – term certificates	4,474,022	5,536,984
Investment in associated organizations	1,305,610	1,305,610
Patronage capital	1,555,856	1,195,389
Other	249,717	219,036
Subtotal	10,407,160	11,213,784
Less investments classified as accounts receivable	45,000	543,578
Total	$ 10,362,160	$ 10,670,206

Contractual maturities of restricted investments at December 31 are as follows:

	2018	2017
Due from one year to five years	$ 2,779,955	$ 2,404,102
Due from six years to ten years	-	1,534,625
Due after ten years	4,516,022	4,555,022
	$ 7,295,977	$ 8,493,749

Municipal bonds – As a condition of National Rural Utilities Cooperative Finance Corporation's (CFC) guarantee of the Solid Waste Disposal Revenue Bonds (see Note 8), the Cooperative purchased a non-interest bearing Debt Service Reserve Certificate (the certificate) maturing in 2024 upon final payment of the debt. The proceeds of the certificate are held by CFC in a Debt Service Reserve Fund (DSRF). At December 31, 2017, the investments included one municipal bond for approximately $923,000, which bore interest at 2.22% per annum and cash of approximately $2,034,000. At December 31, 2018, the investments included two municipal bonds for approximately $923,000 and $1,819,000, which bear interest at 2.22% and 5% per annum, respectively, and cash of approximately $80,000.

Municipal bonds are valued based on quoted market prices for those or similar investments.

Note 3 – Investments (continued)

Term certificates – The Cooperative is a member of CFC, a not-for-profit cooperative financing institution. As a condition of membership, the Cooperative purchased Subscription Capital Term Certificates (SCTCs). The SCTCs, totaling $4,093,022 at December 31, 2018 and 2017, respectively, bear interest at 5.00% per annum and have maturity dates ranging from 2070 to 2080.

As a condition of the Solid Waste Disposal Revenue Bonds (see Note 8), which are guaranteed by CFC, the Cooperative purchased a Subordinated Term Certificate (STC). The STC, totaling $381,000 at December 31, 2018 and 2017, bears interest at 7.57% per annum and matures in full in 2024 upon final payment of the related debt. At December 31, 2018 and 2017, the current portion of the STC loan guarantee valued at $3,000 and $42,000, respectively, is recorded in current assets as an accounts receivable.

As a condition of the long-term debt due to CFC (see Note 8), the Cooperative purchased Zero Term Certificates (ZTCs). ZTCs totaling $0 and $519,384 at December 31, 2018 and 2017, respectively, bear interest at 3.04% per annum and matured in 2018. At December 31, 2018 and 2017, the current portion of the ZTC loan guarantee valued at $0 and $519,384, respectively, is recorded in current assets as an accounts receivable.

The SCTCs, STC and ZTCs are unrated, uncollateralized debt securities of CFC and valued at cost, which approximates fair value.

Investment in associated organizations – The Cooperative is a member of Sierra Southwest Cooperative Services, Inc. and Subsidiary (Sierra). The Cooperative's membership fee in Sierra was $2,000 as of December 31, 2018 and 2017, respectively, and is carried at cost. The Cooperative's investment in Sierra was $70,000 as of December 31, 2018 and 2017, respectively, and is carried at cost (see Note 17).

The Cooperative is an equity member of Alliance for Cooperative Energy Services Power Marketing, LLC (ACES). The Cooperative's investment in ACES was $961,610 as of December 31, 2018 and 2017 and is accounted for under the cost method of accounting.

The Cooperative invested in the capital of Grand Canyon State Electric Cooperative Association (GCSECA), which is accounted for under the cost method of accounting. The Cooperative's investment in GCSECA was $270,000 as of December 31, 2018 and 2017, respectively.

Note 3 – Investments (continued)

The Cooperative holds investments made in the Board of Directors deferred compensation plan program in Homestead Funds (see Note 14 – Deferred compensation programs). The balance in the account at December 31, 2018 and 2017 was $249,717 and $219,036, respectively and is carried at fair market value.

Patronage capital – Patronage capital represents capital credit allocation of margins due to the Cooperative. Such amounts are returned to the Cooperative in accordance with the associated organization's bylaws and/or at their discretion.

Note 4 – Restricted Cash and Cash Equivalents

Restricted cash and cash equivalents at December 31 consist of the following:

	2018	2017
Rural economic development revolving loan program	$ 188,425	$ 100,357
Other deposits on account	2,057,508	2,018,964
Total restricted cash and cash equivalents	$ 2,245,933	$ 2,119,321

Note 5 – Accounts Receivable

Accounts receivable at December 31 consist of the following:

	2018	2017
Member energy sales	$ 15,682,718	$ 13,994,899
Electric transmission sales	1,994,231	1,886,331
Nonmember energy sales	7,866,183	4,584,969
Due from related party	3,128	956,253
Other	1,446,996	1,434,160
Total accounts receivable	$ 26,993,256	$ 22,856,612

Member energy sales – Member energy sales consist of sales to members under their wholesale power sales contracts (see Note 11) and generally are not collateralized.

Electric transmission sales – Electric transmission sales consist of sales to members and nonmembers under transmission service agreements (see Note 11) and are generally not collateralized.

Nonmember energy sales – Nonmember energy sales consist of nonfirm sales to unrelated electric utilities and are generally not collateralized.

Note 6 – Notes Receivable

Related party promissory notes – The Cooperative replaced the balance of the short-term note to Sierra to finance construction of solar photovoltaic distributed generation facilities with two promissory notes (see Note 17). Each note between Sierra and AEPCO has an annual fixed interest rate of 3.00% and a term of 25 years. The combined notes receivable was $1,785,164 and $1,835,226 as of December 31, 2018 and 2017, respectively.

RUS rural economic development grant – In 1998, the Cooperative was awarded a $400,000 RUS Rural Economic Development Grant. The Cooperative contributed matching funds in the amount of $80,000. In accordance with grant guidelines, initial loans made to qualifying recipients at a zero interest rate were repaid over a ten-year period. The loan repayments were used to establish a revolving loan fund, which in turn, is used for providing loans to foster rural economic development. Loans made from repayments of the initial loans may carry an interest rate. In November 2010, March 2012, June 2015 and March 2017, the Cooperative issued loans in the amount of $300,000, $80,000, $280,000 and $100,000 respectively, at an interest rate of 3.00%. As of December 31, 2018 and 2017, the Cooperative has $188,245 and $100,357, respectively, of cash and cash equivalents restricted for use in this program (see Note 4).

Note 7 – Deferred Debits

Deferred debits at December 31 consist of the following:

	2018	2017
Deferred overhaul costs	$ 12,383,541	$ 14,971,683
Preliminary survey and investigation, land rights and other deferred debits	4,357,072	2,448,893
RS Plan prepayment (see Note 14)	6,308,709	6,857,293
Redemption premium	27,439	53,986
Total deferred debits and regulatory assets	$ 23,076,761	$ 24,331,855

Regulatory assets – The ACC authorized the recovery of the regulatory assets through the imposition of a specific charge (see Note 2). The regulatory assets, pursuant to an order from the ACC, are being amortized as revenues related to the regulatory assets that are collected. The credit represents revenue remaining to be recognized related to the regulatory assets. There were no regulatory assets as of December 31, 2018.

Note 8 – Long-Term Debt

Federal Financing Bank (FFB) – Long-term debt due to FFB is payable at interest rates based on long-term obligations of the United States Government as determined on the date of advance. Interest rates on existing FFB debt ranged from 1.13% to 8.24% in 2018 and 2017. Quarterly principal and interest installments on these obligations extend through 2035. The obligations are guaranteed by RUS. The Cooperative may prepay all outstanding notes by paying the principal amount plus either 1) the difference between the outstanding principal balance of the loan being refinanced and the present value of the loan discounted at a rate equal to the then current cost of funds to the Department of the Treasury for obligations of comparable maturity; 2) 100% of the amount of interest for one year on the outstanding principal balance of the loan being refinanced multiplied by the ratio of a) number of quarterly payment dates remaining to maturity bears to b) number of quarterly payment dates between year 13 of the loan and the maturity date; or 3) present value of 100% of the amount of interest for one year on the outstanding principal balance of the loan.

Solid Waste Disposal Revenue bonds – These bonds are repriced and sold semi-annually at six month intervals on March 1st and September 1st, and AEPCO has the option of redemption at each repricing. Principal on these bonds is due in annual installments through 2024. Interest rates on the bonds are variable and subject to revision semiannually. The interest rate in effect at December 31, 2018 and 2017 was 1.88% and 1.35%, respectively. Interest is paid semiannually. These bonds are guaranteed by CFC and are not subject to optional redemption prior to maturity.

Advance payments unapplied – RUS established a Cushion of Credit Payment Program, whereby borrowers may make advance payments on their RUS and FFB notes (Notes). These advance payments earn interest at the rate of 5.00% per annum. The advance payments, plus any accrued interest, can only be used for the payment of principal and interest on the Notes. The Cooperative's participation in the Cushion of Credit Payment Program totaled approximately $69,394,000 and $42,295,000 at December 31, 2018 and 2017, respectively. RUS allows borrowers to report a portion of the cushion of credit account balance as a reduction of the current maturities of RUS long-term debt. Accordingly, the Cooperative records the current year allocation under "Current maturities of long term debt" and the residual balance is recorded as a separate line item entitled "Advance payments unapplied" under long-term debt on the balance sheets. The amounts recorded under "Current maturities of long term debt" totaled approximately $4,721,000 and $2,734,000 at December 31, 2018 and 2017, respectively.

Cooperative Finance Corporation – Long-term debt due to CFC is payable at a fixed rate of 2.90% and a variable interest rate that is established monthly and effective on the first day of each month. The variable interest rate in effect at December 31, 2018 and 2017 was 2.50%. Quarterly principal and interest payments on these obligations extend through 2024. The variable interest rate on the debt is convertible to a fixed rate. The fixed rate would be equal to the rate of interest offered by CFC at the time of the conversion request. The Cooperative may prepay fixed rate notes in whole or in part, subject to a prepayment premium prescribed by CFC.

Note 8 – Long-Term Debt (continued)

Maturities of long-term debt – Maturities of long-term debt for the next five years and thereafter are as follows as of December 31, 2018:

2019	$ 13,125,678
2020	12,821,716
2021	11,708,028
2022	12,124,241
2023	12,352,351
Thereafter	118,766,930
	$ 180,898,944

Prior to March 1, 2016, AEPCO was subject under the covenants of the RUS Generation Loan Contract dated December 19, 1961 and secured by the Consolidated Mortgage, Security Agreement and Financing Statement, dated August 3, 2009 made by and among AEPCO, the United States of America (Government) acting by and through the Administrator of the RUS and the Mortgage and Security Agreement dated July 2, 2001 made by and among AEPCO, as successor by merger to SWTC, the Government acting by and through the Administrator of the RUS and CFC (collectively, the RUS Mortgage). Under the RUS Mortgage the Cooperative must among other things, obtain approvals from both RUS and CFC for certain transactions and contracts and design its rates with a view of maintaining, on an annual basis, an average times interest earned ratio of 1.05 and debt service coverage ratio of 1.00 calculated retrospectively using the highest ratios from two of the three most recent years.

On March 1, 2016, AEPCO replaced the RUS Mortgage with the Indenture, pursuant to which AEPCO has granted a lien and a security interest in substantially all of its real and personal property to secure current indebtedness and other obligations and to secure other indebtedness (see Note 2 – Indenture). In connection with the adoption of the Indenture as a replacement for the RUS Mortgage, AEPCO and RUS amended and restated the existing loan contracts as the Amended and Restated Loan Contract (Contract), dated March 1, 2016 between AEPCO and the Government acting by and through the Administrator of the RUS. Under the covenants of the Contract, the Cooperative must, among other things, maintain a credit rating from at least two rating agencies and comply with covenants in the Indenture, which includes establishment and collection of rates for the use or sale of output, capacity or service of the system that together with other revenues available to the Cooperative are reasonably expected to yield margins for interest equal to at least 1.10 times secured interest charges. Management believes these financial covenants have been achieved as of December 31, 2018.

Long-term debt is collateralized by the pledge of all assets through the Indenture.

Note 8 – Long-Term Debt (continued)

Components of interest expense at December 31 consist of the following:

	2018	2017
Total interest costs and related amortization	$ 10,432,904	$ 11,070,380
Interest capitalized	(97,662)	(147,958)
Total interest expense	$ 10,335,242	$ 10,922,422

Note 9 – Member Advances and Other Investments

Member investment program – The Cooperative offers all members the ability to invest funds with the Cooperative on a short-term basis for periods of up to nine months. The Cooperative had recorded liabilities for notes of $7,021,394 and $24,848,810 at December 31, 2018 and 2017, respectively. The interest rate on these notes averaged 2.76% and 1.66% in 2018 and 2017, respectively. Interest expense on these notes was approximately $14,000 and $119,000 for the years ended December 31, 2018 and 2017, respectively.

Prepaid billing program – The Cooperative also offers a program for all members whereby the members may make interest-bearing prepayments of their monthly power and transmission billings. The prepayment and accrued interest are applied to the members' power and transmission billings on the date such billings become due. The Cooperative recorded no liabilities for prepayments at December 31, 2018 and December 31, 2017.

Note 10 – Deferred Credits and Other Liabilities

Southwest Public Power Agency – The Cooperative entered into an Energy Management Services Agreement (Agreement) with Southwest Public Power Agency (SPPA), a Class D member of AEPCO, on March 31, 2015 to provide accounting, reporting, scheduling, selling, purchasing and gas hedging services with respect to the energy available to SPPA under the Agreement. To enable AEPCO to provide credit services necessary to this Agreement, SPPA has provided a deposit to AEPCO in the amount of $1,000,000, which AEPCO has placed and will maintain in an interest bearing account separate from other sources. SPPA is entitled to all interest that accumulates in the deposit account. The balance in the deposit account was $1,037,524 and $1,016,469 for the years ended December 31, 2018 and 2017, respectively.

Note 10 – Deferred Credits and Other Liabilities (continued)

Metropolitan Water District of Southern California – The Cooperative entered into a Scheduling and Trading Services Agreement (Agreement) with the Metropolitan Water District of Southern California (MWD), a class D member of AEPCO, on August 28, 2017 to provide accounting, reporting, scheduling, selling and purchasing services as defined in the agreement through December 31, 2035 unless terminated under provisions within the agreement. To enable AEPCO to provide credit services necessary to this Agreement, MDW has provided a deposit to AEPCO in the amount of $1,000,000, which AEPCO has placed and will maintain in an interest bearing account separate from other sources. MWD is entitled to all interest that accumulates in the deposit account. The balance in the deposit account was $1,002,495 for the year ended December 31, 2018.

Deferred credits at December 31 consist of the following:

	2018	2017
Asset retirement obligation	$ 20,680,212	$ 19,757,982
Regulatory liability – ARO	2,809,671	2,358,189
Pension distribution liability	22,544	40,579
Total deferred credits and other liabilities	$ 23,512,427	$ 22,156,750

Asset retirement obligation – The Cooperative completed the ARO calculation for the Apache Station Generation Plant in Cochise, Arizona with the assumption that the assets will be in service through the year 2035. The useful life expectations used in the calculations of the ARO are based on the assumption that operations will continue without deviation from historical trends.

The asset retirement obligation related to generation assets at December 31 consists of the following:

	2018	2017
Liability at January 1	$ 19,757,982	$ 18,884,680
Decommission expense recognized	922,230	873,302
Liability at December 31	$ 20,680,212	$ 19,757,982

The regulatory liability related to the asset retirement obligation calculation at December 31 consists of the following:

	2018	2017
Liability at January 1	$ 2,358,189	$ 1,857,320
Estimated recovery included in rates	1,978,704	1,978,704
Less accretion & depreciation expense	(1,527,222)	(1,477,835)
Liability at December 31	$ 2,809,671	$ 2,358,189

Note 11 – Commitments and Contingencies

Class A Member power sales contracts – *Wholesale power sales contracts* – The Cooperative holds all requirements wholesale power sales contracts with three of its six Class A member cooperatives pursuant to which each Class A member agrees to purchase from the Cooperative all of its electric power requirements. These all requirements power contracts expire December 31, 2035, and will remain in effect thereafter until terminated by either party upon six months' notice. Management believes the Cooperative will be able to fulfill its requirements on these long-term contracts.

Class A Member power sales contracts – *Partial requirements wholesale power contracts* – The Cooperative holds partial requirements wholesale power sales contracts, expiring December 31, 2035, with three of its Class A member cooperatives pursuant to which the Class A members have agreed to purchase from the Cooperative electric energy up to and capacity at the member's allocated capacity percentage in the Cooperative's total resources existing at the time of execution of the contract.

Class A Member network service agreements – The Cooperative has agreements to provide network integration transmission service to deliver power to the all-requirements Class A distribution cooperative members. The Cooperative entered into separate agreements to provide network integration and point-to-point transmission services to the partial requirements Class A members. These agreements remain in effect so long as the associated wholesale power contract between AEPCO and the Class A member remains in effect, all of which terminate on December 31, 2035. In the opinion of management, the Cooperative will be able to provide service in accordance with these agreements (see Note 17).

Class D Member service contracts – Class D membership requires the member to enter into a service contract for a minimum term of 2 years. The service contract with each Cooperative's Class D member is renewed annually until terminated by either party upon a six months written notice. At December 31, 2018 and 2017, the Cooperative had five Class D members.

Nonmember power and services agreements – At December 31, 2018 and 2017 the Cooperative had six nonmember power and service agreements that have various termination notices.

Wholesale power purchase contracts – The Cooperative's current power supply includes the following purchase power agreements:

- Hydroelectric power purchases from Western Area Power Administration (Western), a federal power marketing agency. Under the terms of its Salt Lake City Integrated Project (formerly Colorado River Storage Project) contract, which expires September 30, 2024, the Cooperative can receive up to 2.4 MW during October through March and up to 11.7 MW during April through September for service to its Class A members. Additionally, under the terms of a contract with the Parker Davis Project, which expires September 30, 2028, the Cooperative receives 18.3 MW during October through February and 23.6 MW during March through September. Hoover (Boulder Canyon Project) hydroelectric power purchase from Arizona Power Authority and Western of approximately 2 MW each month October 2017-September 30, 2067.

Note 11 – Commitments and Contingencies (continued)

- Power purchase agreement with Salt River Project to purchase up to 15 MW capacity and energy at a maximum of 44% capacity factor per month and priced at less than the market price for Peak Hours with a term to begin in January 2016 and ending 20 years thereafter. Beginning January 2017 through the remaining term of the contract, 1.755 MW will be allocated to Navopache Electric Cooperative.
- Power purchase agreement with Mesquite Power LLC to purchase up to 2 MW capacity and energy at a maximum of 100% capacity factor per month with a term to begin on January 1, 2015 and ending May 1, 2021.

Solar services agreements – The Cooperative's current power supply includes the following solar services agreements:

- Solar services agreement with Sierra to purchase up to 20 MW alternating current electricity at a maximum of 100% capacity factor per month with a term to begin on October 10, 2017 and ending on October 9, 2026 unless either party provides ninety days written notice of intent not to renew, the agreement shall be renewed for additional five year terms provided no renewal term extends beyond the termination date of the corresponding interconnection agreement.
- Solar services agreement with Sierra to purchase up to 2 MW alternating current electricity at a maximum of 100% capacity factor per month with a term to begin on August 17, 2017 and ending on August 16, 2026 unless either party provides ninety days written notice of intent not to renew, the agreement shall be renewed for additional five year terms provided no renewal term extends beyond the termination date of the corresponding interconnection agreement.

Wholesale transmission contracts – The Cooperative holds three separate point to point transmission agreements to provide point-to-point transmission services for delivering to other Southwest Reserve Sharing Group (SRSG) members under the SRSG Agreement and for the Joint Generation Contingency Reserve Plan (N-1 Plan). The first agreement provides for reserved transmission capacity of 30 MW for delivery of energy to other SRSG participants, the second agreement provides for reserved transmission capacity of 175 MW for the receipt of energy from other SRSG participants in the event of a loss of Apache generation and the third agreement provides for reserved transmission capacity of 110 MW as established in the N-1 Plan. Each of these agreements, which renew annually, are expected to remain in effect for the term of the members' network service agreements. In the opinion of management, the Cooperative will be able to provide service in accordance with these agreements.

Other transmission service agreements – The Cooperative provides separate transmission service agreements (Point to Point and Network Integration) with other entities in accordance with the Cooperative's Open Access Transmission Tariff (OATT) or other pre-OATT agreements. These other transmission service agreements provide for reserved transmission capacity and will remain in effect in accordance with each respective service agreement. In the opinion of management, the Cooperative will be able to provide service in accordance with these agreements.

Note 11 – Commitments and Contingencies (continued)

Transmission wheeling agreements – The Cooperative purchases transmission wheeling rights from other entities. There are currently ten (eight with Western Area Power Administration – Lower Colorado and two with Southern California Edison) transmission wheeling agreements under which the Cooperative purchases transmission to provide for deliveries to AEPCO's Class A members loads. There are currently eight wheeling agreements (two with Western Areas Power Administration – Lower Colorado, four with El Paso Electric, one with Tucson Electric Power and one with Salt River Project) under which the Cooperative moves power from market hubs into the Cooperative's service area. These transmission wheeling agreements expire at various times and may include associated roll-over rights.

Rate filing application – generation – On July 5, 2012, the Cooperative filed an application for rate relief requesting new rates to become effective on or after November 1, 2013 and the continuance of the Cooperative's purchased power and fuel cost adjustor. On October 25, 2013, the ACC issued a decision approving a 2.77% decrease in revenues and authorizing new rate tariffs and a purchased power and fuel adjustment clause, which became effective on November 1, 2013. Further, the ACC authorized the implementation of new depreciation rates effective November 1, 2013. On August 1, 2014, the Cooperative filed an application requesting to remove from its rates all costs and charges related to two purchase power contracts that expired on October 31, 2014. The application was approved by the ACC and the new tariff rates became effective November 1, 2014. On December 17, 2015, the ACC approved the form of the Cooperative's proposed environmental cost adjustment rider (ECAR) and plan of administration. The Cooperative filed an application to approve its initial Environmental Compliance Strategy (ECS) and revised ECAR tariff on May 27, 2016. The ACC approved the Cooperative's initial ECS and revised ECAR on September 19, 2016 and the Cooperative began collecting the costs associated with the activated carbon via the ECAR effective with the October 2016 billings.

Rate filing application – transmission – On August 3, 2012, the Cooperative filed an application for rate relief with the ACC requesting new rates to become effective on November 1, 2013 or at the same time as AEPCO's rates. On October 25, 2013, the ACC issued a decision approving a 28.61% decrease in revenues and authorizing new rate tariffs and a Network Transmission Revenue Adjustor (TRA) and Plan of Administration, which became effective on November 1, 2013. Further, the ACC authorized the implementation of new depreciation rates effective November 1, 2013. On September 3, 2015, the Cooperative filed a revised TRA, which became effective on December 1, 2015.

Fuel procurement contracts – *Coal supply agreements* – To ensure an adequate fuel supply, the Cooperative enters into various long-term fuel contracts. At December 31, 2018, these contracts consist of:

- A 60-month agreement that originally required the Cooperative to purchase approximately 3,220,000 tons of coal during the term of the agreement. The agreement has since been amended to replace the term of the agreement with January 1, 2013 through December 31, 2023 and limit the remaining base tonnage obligation to 1,060,000 tons effective January 1, 2016. The amendment further limits the purchase and delivery of coal to approximately 200,000 tons in 2017, 110,000 tons in year 2018, 110,000 tons in 2019, and 93,165 tons in year 2020.
- A 36-month agreement consisting of approximately 304,000 tons of coal to be delivered between January 1, 2017 and December 31, 2019.

Note 11 – Commitments and Contingencies (continued)

- A 36-month agreement consisting of approximately 161,000 tons of coal to be delivered between January 1, 2017 and December 31, 2019.
- A 1-month agreement consisting of approximately 14,000 tons of coal to be delivered between December 1, 2018 and December 31, 2018.

Coal railcar lease agreements – To provide for the shipment of the coal supply, the Cooperative entered into lease agreements for the lease of coal railcar trainsets (see Note 15 – Coal railcar trainsets).

Coal railcar maintenance agreement – The Cooperative entered into a railcar management services agreement, effective January 1, 2013, for the maintenance of the coal railcar trainset leased under the 20-year lease agreement (see Note 15 – Coal railcar trainsets). The term of the original maintenance agreement has been extended to December 31, 2020.

Collective bargaining agreement – Approximately 32% of the personnel employed by the Cooperative's work force is subject to a collective bargaining agreement. The Cooperative entered into a five-year collective bargaining agreement effective March 1, 2018.

Letters of credit – A letter of credit in the amount of $800,000 was obtained by the Cooperative from CFC for the purpose of providing credit support for a power purchase agreement with Salt River Project Agricultural Improvement and Power District (SRP). The letter of credit was issued to SRP December 1, 2015 and expires June 1, 2019. The interest rate, if draws were to occur, will be equal to a fixed rate set by CFC, not to exceed the Prevailing Bank Prime Rate, as published in the Money Rates column of The Wall Street Journal, plus one percent per annum. As a condition of the letter of credit, the Cooperative is required to remain in compliance with the terms and conditions of the Indenture and Contract (see Note 2 and Note 8).

Lines of credit – On June 5, 2014, the Cooperative entered into a five-year committed unsecured line of credit agreement with CFC for $50,000,000. The interest rate on advances will be calculated at a rate per annum as may be fixed by CFC from time to time or in the case of a LIBOR advance, at a fixed rate per annum equal to LIBOR plus the Applicable Margin. There was a $20,000,000 outstanding balance as of December 31, 2018 and no balance outstanding as of December 31, 2017.

On August 21, 2014, the Cooperative entered into a five-year committed unsecured line of credit agreement with CoBank for $50,000,000. The interest rate on advances will be calculated at a Base Rate Option, in which a rate per annum equal at all times to the Base Rate plus the Applicable Margin, or at a LIBOR Option, in which a fixed rate per annum equal to LIBOR plus the Applicable Margin. There was a $10,000,000 outstanding balance as of December 31, 2018 and no balance outstanding as of December 31, 2017.

Note 11 – Commitments and Contingencies (continued)

Capital lease – Capital lease property and the related liabilities are in substance asset purchases. Assets and liabilities under capital leases are recorded at the lesser of the present value of the minimum lease payments or the fair value of the assets. The assets are amortized over their related lease terms or their estimated useful lives, whichever is less.

On January 28, 2013, the Cooperative entered into a master lease agreement for the lease of substantially all of the Cooperative's vehicles. Individual lease schedules underlying the master lease agreement are entered into as individual vehicles are delivered. Each lease schedule includes a description of the vehicle, the lease term and the monthly rental and other payments due with respect to the vehicle. The term for each vehicle begins on the date each vehicle is delivered and continues as described in the individual schedule.

On October 22, 2013, the Cooperative entered into a master lease agreement to finance the purchase and installation of solar equipment. The period of the lease is sixty (60) months starting January 1, 2014.

Future minimum capital lease payments and present values of the minimum lease payments are as follows as of December 31, 2018:

Years ending December 31,	2019	$ 261,129
	2020	209,321
	2021	158,037
	2022	8,670
Total minimum lease payments		637,157
Less amount representing interest		50,760
Present value of net minimum lease payments		586,397
Less current portion		232,709
		$ 353,688

Legal – In the normal course of business, the Cooperative is party to claims and matters of litigation. The ultimate outcome of these matters cannot presently be determined; however, in the opinion of management of the Cooperative, the resolution of these matters will not have a material adverse effect on the Cooperative's financial position, results of operations, or liquidity.

Note 12 – Patronage Capital

Patronage capital allocation – In accordance with the Cooperative's bylaws, the Cooperative is obligated to account, on a patronage basis, to all its members for all amounts received and receivable from the sale and/or delivery of electric energy and other services in excess of the sum of:

- operating costs and expenses, including interest on debt service, properly chargeable against the sale and/or delivery of electric energy and other services; and,
- amounts required to offset any losses incurred during the current or any prior fiscal years.

All such amounts in excess of operating costs, expenses and prior losses at the moment of receipt by the Cooperative are received with the understanding that they are furnished by the members as capital. The Cooperative is obligated to pay by credits to a capital account for each member for all such amounts as credits in proportion to the value or quantity of the Cooperative's service used, received or purchased by each member during the applicable fiscal year in excess of operating costs and expenses and prior losses.

Patronage capital retirement – Per the Indenture, AEPCO may retire patronage capital without further restriction as long as aggregated margins and equity are maintained at a level that is at least 30% of total long term debt and equities. The retirements for 2018 and 2017 were $1,285,976 and $842,833, respectively.

Note 13 – Income Tax Status

The Cooperative is exempt from income taxes under the provisions of Section 501(c)(12) of the Internal Revenue Code, except to the extent of unrelated business income, if any. The Cooperative follows Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 740-10, relating to accounting for uncertain tax positions. As of December 31, 2018 and 2017, the Cooperative does not have any uncertain tax positions. The Cooperative files an exempt organization and unrelated business income tax return in the U.S. federal jurisdiction and the states of Arizona and California. Based upon its equity membership in ACES (see Note 3), returns are filed with the states of Arkansas, Georgia, Indiana, Maryland, Minnesota and North Carolina.

Note 14 – Employee Benefit Plans

Managed Time Off (MTO) – Employees earn paid time-off based on years of service and hours worked in the current period. The maximum accrued MTO for each employee is limited to a predetermined amount as established by policy of the Cooperative's Board of Directors. Any earned MTO not taken by an employee at the time of separation from employment in good standing may be paid in lump-sum as a termination benefit. Each year, employees with MTO exceeding 120 hours may convert up to 80 hours to cash at the employee's current base rate of pay.

Pension plans – The Cooperative has a defined benefit pension plan covering substantially all of its employees. Pension benefits are provided through participation in the National Rural Electric Cooperative Association (NRECA) Retirement Security Plan (RS Plan). The Cooperative contributes a percentage of salaried and union employees' earnings to the program, as prescribed by NRECA. The Cooperative's policy has been to fund retirement costs annually as they accrue. Withdrawal from the RS Plan may result in the Cooperative having a significant obligation to the program. The Cooperative does not currently intend to withdraw from the plan and accordingly, no provision has been included in the accompanying financial statements.

The NRECA RS Plan 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 plan sponsor's Employer Identification Number is 53-0116145 and the 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.

The Cooperative's contributions to the RS Plan in 2018 and 2017 represented less than 5 percent of the total contributions made to the plan by all participating employers. Contributions by the Cooperative to this plan approximated $2,876,000 and $2,997,000 for the years ended December 31, 2018 and 2017, respectively. Contributions in 2018 reflect a reduction in the contribution billing rate of approximately 25% resulting from the Cooperative's voluntary decision to prepay RS Plan contributions (See RS Plan prepayment).

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 percent funded on 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 RS Plan, funding improvement plans and surcharges are not applicable. Future contribution requirements are determined each year as part of the actuarial valuation of the plan and may change as a result of plan experience.

Note 14 – Employee Benefit Plans (continued)

The Cooperative offers participation in the NRECA SelectRE Pension Plan to non-union employees hired prior to January 1, 2012 and all union employees regardless of hire date who meet certain minimum service requirements. This plan has 401(k) salary deferral features. Under this plan, the Cooperative matches a percentage of the employees' contributions to the plan. The Cooperative's contributions to the plan were approximately $411,000 and $439,000 for the years ended December 31, 2018 and 2017, respectively.

The Cooperative offers participation in the 401(k) Pension Plan to all employees hired after December 31, 2011 who have no prior RS Plan participation history and meet certain minimum service requirements. This plan has 401(k) salary deferral features. Under this plan, the Cooperative matches a percentage of the employees' contributions to the plan. The Cooperative's contributions to the plan were approximately $185,000 and $162,000 for the years ended December 31, 2018 and December 31, 2017, respectively.

RS Plan prepayment – On April 29, 2013, the Cooperative voluntarily prepaid contributions of $9,600,211 to the NRECA RS Plan. The prepayment amount is the Cooperative's share as of January 1, 2013, of future contributions required to fund the RS Plan's unfunded value of benefits earned to date using RS Plan actuarial valuation assumptions. The prepayment was the equivalent of approximately 2.5 times the Cooperative's 2013 annual required contribution and will result in an approximate 25% reduction in the Cooperative's required contributions as of January 1, 2013. The 25% differential in billing rates is expected to continue for approximately 15 years. However, changes in interest rates, asset returns and other plan experience different from expected, plan assumption changes and other factors may have an impact on the differential in billing rates and the 15-year period. In accordance with the guidance provided by RUS to its borrowers, the Cooperative created a deferred debit and will amortize it over 17.5 years starting January 1, 2013.

Deferred compensation programs – The Cooperative offers a program to key employees whereby these employees may elect to set aside a portion of current compensation to be paid out at a later date upon a qualifying event including retirement, termination of employment, death or disability. As of December 31, 2018 and 2017, there was one participant in the program.

The Cooperative offers a program to the Cooperative's Board of Directors whereby a Director may elect to set aside a portion of current compensation to be paid out at a later date upon a qualifying event including retirement, termination of service, death or disability. As of December 31, 2018 and 2017, there was one participant in this program.

The Cooperative offered a program (Pension Restoration Plan) to a select group of management and highly compensated employees whose pension benefits from the RS Plan would be reduced because of limitations on retirement benefits payable under Sections 401(a)(17) or 415 of the Internal Revenue Code. Any benefits payable by the Cooperative under the program were credited by NRECA to an account under the RS Plan. This plan was discontinued effective March 1, 2016, and the former participant's accumulated benefits are being paid from the plan over a 60-month period.

Note 14 – Employee Benefit Plans (continued)

Effective March 1, 2016, the Cooperative offers a program (Top Hat Plan) to key employees whereby these employees may elect to set aside a portion of current compensation to be paid out at a later date selected by the employee upon initial participation in the plan or upon a qualifying event including retirement, termination of employment, death or disability. As of December 31, 2018, there was one participant in this program.

Effective March 1, 2016, the Cooperative offers a program (Executive Compensation 457(b) Plan) to a select group of management employees whereby these employees may elect to set aside a portion of current compensation to be paid out at a later date upon a qualifying event including retirement, termination of employment, death or severe financial hardship. Participants are eligible to make annual deferrals subject to the provisions of Section 457(e)(15) of the Internal Revenue Code of 1986 during any year the Cooperative is tax-exempt and subject to Code Section 457. As of December 31, 2018, there was one participant in the program.

Effective January 1, 2016, the Cooperative offers a program (Performance Incentive 457(f) Plan) to a select group of management, key employees or highly compensated employees within the meaning of the Employee Retirement Income Security Act of 1974 (ERISA), which is intended to be a nonqualified deferred compensation plan maintained in conformity with the requirements of Internal Revenue Code Section 457(f). All amounts deferred under the Plan shall constitute short-term deferrals for the purposes of Code Section 409A. Benefits payable under the Plan shall be payable only if the participant achieves the performance goal or goals outlined in the Plan addendum. As of December 31, 2018, there was one participant in the program.

Note 15 – Operating Leases

Computer equipment – The Cooperative entered into master lease agreements for the lease of substantially all the Cooperative's personal computers and peripheral equipment. Individual certificates of acceptance (COAs) underlying the master lease agreements are entered into as groups of computers and equipment are delivered. The terms of the COAs are for up to four years. Rent expense for the lease of the computer equipment was approximately $432,000 and $416,000 for the years ended December 31, 2018 and 2017, respectively, and is included in administration and general on the accompanying statements of revenues and expenses and unallocated accumulated margins.

Copier equipment – The Cooperative entered into three lease agreements for the lease of copier equipment. The terms of each lease is 60 months. Rent expense for the lease of copier equipment was approximately $49,000 and $46,000 for the years ended December 31, 2018 and 2017, respectively and is included in administration and general on the accompanying statements of revenues and expenses and unallocated accumulated margins.

Nitrogen bulk tank – The Cooperative entered into a lease agreement for the lease of a bulk tank to store nitrogen. The term of the lease is 60 months. Rent expense for the lease of the tank was approximately $49,000 and $7,600 for the years ended December 31, 2018 and 2017, respectively.

Note 15 – Operating Leases (continued)

Hydrogen bulk storage vessel – The Cooperative entered into a lease agreement for the lease of a storage vessel to store hydrogen gas. The term of the lease agreement is 60 months and is automatically renewed at the end of each term for 60 months unless either party gives written termination notice at least six (6) months before the expiration of the current term. The current 60-month period expires November 1, 2022. Rent expense for the lease of the storage vessel was approximately $33,000 and $31,000 for the years ended December 31, 2018 and 2017.

Coal railcar trainsets – The Cooperative entered into lease agreements for the lease of coal railcar trainsets. Lease payments are included as a component of fuel expense. At December 31, 2018, these lease agreements consist of the following:

- A 20-year lease agreement, effective December 17, 2002. Lease payments under this agreement totaled approximately $449,000 in 2018 and 2017. The Cooperative has the option of canceling this agreement effective December 31, 2012 subject to the following: (1) the Cooperative notifies the lessor in writing on or before 180 days prior to the effective date of the termination, and (2) the Cooperative pays an additional amount of $5,971 per car for each car terminated.
- A 36-month lease agreement, effective December 1, 2014, which was not renewed. This is a full service lease agreement for four railcars to supplement AEPCO's primary train set. Lease payments under this agreement totaled approximately $22,800 in 2017. There were no lease payments under this agreement in 2018.
- A 24-month lease agreement, effective March 1, 2017. This is a full service lease agreement for fourteen railcars. Lease payments under this agreement was approximately $46,200 and $0 for the years ended December 31, 2018 and 2017, respectively.
- A 24-month lease agreement, effective March 1, 2017. This is a full service lease agreement for seven railcars. Lease payments under this agreement was approximately $23,100 and $0 for the years ended December 31, 2018 and 2017, respectively.
- A 24-month lease agreement, effective February 1, 2018. This is a full service lease agreement for five railcars. Lease payments under this agreement was approximately $6,900 and $0 for the years ended December 31, 2018 and 2017, respectively.

Note 15 – Operating Leases (continued)

Solar equipment – The Cooperative entered into a lease agreement for the lease of solar equipment. The lease was effective November 1, 2017 and has a term of 12 months. Rent expense for the lease was approximately $13,300 and $2,700 for the years ended December 31, 2018 and 2017, respectively.

The following summarizes the future minimum lease payments under operating leases that had initial or remaining lease terms in excess of one year at December 31, 2018:

Years ending December 31,	2019	$	761,683
	2020		653,679
	2021		586,353
	2022		551,086
	2023		143,285
	Thereafter		72,361
		$	2,768,447

Note 16 – Concentration of Customers and Credit Risk

Revenue and accounts receivable for the year ended December 31, 2018 included amounts from three customers, whom each individually represented more than 10% of the total operating revenue and accounts receivable. Revenue from these customers collectively represented approximately 63% of total operating revenue for 2018. The amounts owed from these customers collectively represented approximately 38% of the total accounts receivable balance at December 31, 2018.

Revenue and accounts receivable for the year ended December 31, 2017 included amounts from three customers, whom each individually represented more than 10% of the total operating revenue and accounts receivable. Revenue from these customers collectively represented approximately 76% of total operating revenue for 2017. The amounts owed from these customers collectively represented approximately 62% of the total accounts receivable balance at December 31, 2017.

Note 17 – Related Parties

The Cooperative is a member of Sierra. Sierra is a member-owned, nonprofit Arizona cooperative corporation organized to provide electric power and energy related products and services to its members and other patrons. The Cooperative is represented by two delegates. Each delegate is seated as a director on the Cooperative's Board of Directors and is entitled to one vote on each matter submitted to a vote at a meeting of the directors.

The Cooperative entered into an agreement with Sierra to lease certain real property (Property) to Sierra for the purpose of constructing and operating a 20 megawatt (MW) AC solar photovoltaic generating facility system (Generating Facility), which will be located on a portion of the Property. The term of the agreement is effective October 16, 2017 through December 31, 2045 and shall be automatically renewed as long as the Generating Facility remains in commercial operation. The Cooperative recorded solar site rental income from Sierra totaling approximately $10,000 and $2,000 for the years ended December 31, 2018 and 2017, respectively.

The Cooperative entered into an agreement with Sierra to finance construction of solar photovoltaic distributed generation facilities with two promissory notes (see Note 6). The combined notes receivable was $1,785,164 and $1,835,226 as of December 31, 2018 and 2017, respectively.

As of December 31, 2018, the Cooperative has recorded approximately $130,000 accounts payable to Sierra and there were approximately $279,000 accounts receivable from Sierra. As of December 31, 2017, the Cooperative has recorded no accounts payable to Sierra and there were approximately $956,000 accounts receivable from Sierra. The net receivables or payables are included in the accompanying balance sheets as accounts receivable or payable.

Report Required by *Government Auditing Standards*

MOSSADAMS

Report of Independent Auditors 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
Arizona Electric Power Cooperative, Inc.

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 financial statements of Arizona Electric Power Cooperative, Inc. (the Cooperative) as of and for the year ended December 31, 2018, and have issued our report thereon dated March 29, 2019.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Cooperative'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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Cooperative's internal control. Accordingly, we do not express an opinion on the effectiveness of the Cooperative's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's 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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Cooperative's 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 controls and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Cooperative'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 Cooperative's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Moss Adams LLP

Portland, Oregon
March 29, 2019

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