Southern Maryland Electric Cooperative, Inc.

Updated Filing for Designated Entity Status
Submitted to PJM Interconnection, L.L.C.

August 2023

Prepared by:

Southern Maryland Electric Cooperative, Inc.
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Hughesville, MD 20637
https://smeco.coop

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

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

Southern Maryland Electric Cooperative, Inc. (SMECO) has substantial internal expertise in the engineering, development, project management, construction, operation, and maintenance of transmission facilities, as well as an agreement with industry-leading consulting firms and contractors to assist as needed. SMECO's 230kV transmission system is managed by licensed professional engineers that oversee the construction, operations, and maintenance of the system.

In 2014 SMECO completed the Southern Maryland Reliability Project (SMRP), which included a new 230kV interconnect with PEPCO and 30 miles of new transmission line creating a 230kV loop in our service territory.

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

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

SMECO is an electric cooperative owned by the customers it serves and was founded in 1937 to provide electric service to the rural area of Southern Maryland. SMECO now provides electric service to over 175,000 customers in four counties in Southern Maryland.
SMECO has five 230kV switching stations and over 113 line miles of 230 kV transmission circuits including two miles of underground 230 kV submarine cable.

SMECO's 230 kV Southern Maryland Reliability Project (SMRP) was completed in 2014 and consisted of the following projects:

Aquasco to Holland Cliff (2008-2009)

Aquasco - New 230kV interconnect PEPCO source.
Aquasco to Holland Cliff - Upgrade 3.5 miles of existing dual circuit 230kV line #2350 / #2355.
Holland Cliff - New 230/69kV switching station.
Hawkins Gate – 230kV XFMR replacement to increase capacity at existing PEPCO source.

Holland Cliff to Hewitt Road (2012 -2014)

Holland Cliff to Sollers Wharf – New 18 miles of dual circuit 230kV line #2340 / #2345.
Sollers Wharf – New 230/69kV switching station.
Sollers Wharf to Hewitt Road – New 10 miles of dual circuit line #2330 / 2335.
Patuxent River Crossing – New 2 miles of underground XLPE 230kV line #2330.
Hewitt Road - 230kV XFMR replacement to increase capacity.

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

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

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

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

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

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

SMECO has a primary local control center responsible for the safe and reliable operation of SMECO's 230kV transmission system and switching stations , including lower voltage 69 kV and 15 kV facilities, in compliance with applicable NERC, PJM, and ReliabilityFirst requirements. This control center is staffed 24/7. All transmission system operators hold both NERC and PJM system operator certifications. SMECO also has a fully functional backup control center, which operates independently of the systems at the primary facility.

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

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

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

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

SMECO's Substation and Transmission Operations Department is responsible for remediation of any items found during SMECO's yearly inspections of its transmission lines. Inspections are performed by aerial inspection as well as foot patrol. Any repairs identified are documented and addressed as required.

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

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

Attached to this filing are the SMECO Financial Statements for 2020 through 2022 to demonstrate our financial capability. Below is a list of the financial statements being provided for this filing.

SMECO Financial Statements for 2020
SMECO Financial Statements for 2021
SMECO Financial Statements for 2022

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

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

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

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

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

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

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

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

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

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

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

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

Southern Maryland Electric Cooperative, Inc.
and SMECO Solar LLC
Financial Statements
December 31, 2020 and 2019

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ADAMS, JENKINS AND CHEATHAM
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS CONSULTANTS

Independent Auditor's Report

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

We have audited the accompanying consolidated financial statements of Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC (SMECO) which comprise the consolidated balance sheets as of December 31, 2020 and 2019 and the related consolidated statements of revenue, expenses and comprehensive income, changes in equities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

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

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

231 Wylderose Drive | Midlothian, VA 23113 | 804.323.1313

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of SMECO as of December 31, 2020 and 2019, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Adams, Jenkins & Cheatham

Richmond, Virginia
March 17, 2021

Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
Consolidated Balance Sheets
December 31, 2020 and 2019

	2020	2019
Assets		
Utility Plant, at Original Cost (Notes 2 and 3)	$ 1,256,453,681	$ 1,215,893,787
Less: Accumulated Depreciation and Amortization	(444,729,467)	(415,664,431)
Net utility plant	811,724,214	800,229,356
Nonutility Property (net)	2,814,995	2,901,710
Investments (Note 2):		
Investments in associated organizations, at cost (Notes 4 and 13)	19,580,548	18,443,609
Investment in an unconsolidated entity (Note 5)	1,293,390	1,266,980
Other investments	6,620,221	6,065,433
Total investments	27,494,159	25,776,022
Current Assets (Note 2):		
Cash and cash equivalents	5,475,763	5,589,009
Accounts receivable, net of allowance for doubtful accounts of $685,000 and $775,000, respectively	56,367,383	54,800,538
Materials and supplies inventory	12,760,300	13,254,635
Prepaid expenses	11,775,768	20,051,261
Other current assets	24,015,035	15,563,983
Total current assets	110,394,249	109,259,426
Regulatory Assets (Notes 2 and 6)	81,117,481	86,680,126
Deferred Charges and Other (Note 2)	53,601,672	35,954,309
Derivative Assets (Notes 2 and 14)	267,001	77,292
Total assets	$ 1,087,413,771	$ 1,060,878,241
Equities and Liabilities		
Equities (Note 8):		
Patronage capital	$ 290,308,522	$ 265,463,041
Other equities	38,687,316	36,338,181
Accumulated other comprehensive loss	(71,424,420)	(72,966,668)
Total equities	257,571,418	228,834,554
Long-Term Debt, Less Current Maturities (Notes 9 and 13)	617,180,854	642,348,123
Current Liabilities:		
Accounts payable	27,521,011	28,083,629
Current maturities of long-term debt (Note 9)	25,184,067	26,147,301
Notes payable (Note 9)	58,560,877	31,200,000
Current portion of accrued pension and postretirement benefits (Note 7)	1,263,441	1,497,586
Current portion of obligations under capital lease (Note 10)	621,386	704,099
Customer deposits	7,549,430	8,580,805
Other current liabilities	28,439,964	19,300,137
Total current liabilities	149,140,176	115,513,557
Accrued Pension and Postretirement Benefits (Note 7)	55,098,602	59,267,387
Noncurrent Portion of Obligations Under Capital Lease (Note 10)	1,154,309	1,631,070
Deferred Credits	3,403,670	2,469,174
Derivative Liabilities (Notes 2 and 14)	3,864,742	10,814,376
Commitments and Contingencies (Notes 11 and 12)	-	-
Total equities and liabilities	$ 1,087,413,771	$ 1,060,878,241

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

Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
Consolidated Statements of Revenue and Expenses
Years Ended December 31, 2020 and 2019

	2020	2019
Operating Revenue:		
Sales of electricity	$ 365,104,541	$ 407,090,522
Other	45,983,078	42,893,625
Total operating revenue	411,087,619	449,984,147
Operating Expenses:		
Purchased power (Note 11)	195,867,635	240,273,060
Power production	263,044	253,333
Transmission	3,397,491	4,416,785
Distribution - operations	10,790,305	11,805,210
Distribution - maintenance	21,257,905	18,827,947
Customer accounts	10,777,955	10,877,395
Customer service and information	24,850,598	21,115,760
Administrative and general	38,089,876	36,717,628
Depreciation and amortization	41,025,270	39,701,741
Taxes	16,441,626	15,744,868
Other	2,095,274	2,033,367
Total operating expenses	364,856,979	401,767,094
Operating margins	46,230,640	48,217,053
Interest Expense:		
Interest on long-term debt	24,157,026	25,284,878
Other interest	946,450	164,064
Total interest expense	25,103,476	25,448,942
Net Operating Margins	21,127,164	22,768,111
Other Patronage Allocations	3,911,104	3,444,195
Total operating margins	25,038,268	26,212,306
Nonoperating Margins	2,848,997	2,788,736
Net margins	$ 27,887,265	$ 29,001,042

Consolidated Statements of Comprehensive Income
Years Ended December 31, 2020 and 2019

	2020	2019
Net Margins	$ 27,887,265	$ 29,001,042
Other Comprehensive Income (Loss):		
Postretirement benefit plans actuarial (loss), net	(730,218)	(4,602,025)
Amortization of net loss and prior service costs	2,272,466	1,507,826
Prior service credit	-	1,001,762
Other comprehensive income (loss)	1,542,248	(2,092,437)
Comprehensive Income	$ 29,429,513	$ 26,908,605

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

Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
Consolidated Statements of Changes in Equities
Years Ended December 31, 2020 and 2019

	Patronage Capital	Other Equities	Accumulated Other Comprehensive (Loss) Income	Total
Balance, December 31, 2018	$ 243,236,445	$ 32,961,439	$ (70,874,231)	$ 205,323,653
Net margins	27,931,085	1,069,957	-	29,001,042
Retirement of capital credits	(5,704,489)	1,872,605	-	(3,831,884)
Prior year unclaimed capital credits	-	434,180	-	434,180
Other comprehensive loss	-	-	(2,092,437)	(2,092,437)
Balance, December 31, 2019	265,463,041	36,338,181	(72,966,668)	228,834,554
Net margins	27,109,541	777,724	-	27,887,265
Retirement of capital credits	(2,264,060)	1,566,142	-	(697,918)
Prior year unclaimed capital credits	-	5,269	-	5,269
Other comprehensive income	-	-	1,542,248	1,542,248
Balance, December 31, 2020	$ 290,308,522	$ 38,687,316	$ (71,424,420)	$ 257,571,418

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

Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
Consolidated Statements of Cash Flows
Years Ended December 31, 2020 and 2019

	2020	2019
Cash Flows From Operating Activities:		
Net margins	$ 27,887,265	$ 29,001,042
Adjustments to reconcile net margins to net cash provided by operating activities:		
Depreciation and amortization	41,025,270	39,701,741
Amortization of loss on reacquired debt	1,170,127	1,170,127
Amortization of debt issuance costs	17,311	17,311
Earnings in unconsolidated entities	(26,410)	(26,246)
Other patronage allocations	(3,911,104)	(3,444,195)
Change in operating assets and liabilities:		
Accounts receivable, net	(1,566,845)	822,553
Prepaid expenses	8,275,493	2,881,337
Derivative assets	(189,709)	256,601
Other current assets	(8,451,052)	(2,280,966)
Deferred charges and other	(18,817,490)	(3,697,653)
Regulatory assets	5,562,645	(9,122,411)
Accounts payable	(562,618)	4,472,964
Customer deposits	(1,031,375)	776,752
Other current liabilities	9,139,827	2,520,131
Deferred credits	939,765	(175,456)
Derivative liabilities	(6,949,634)	1,480,784
Accrued pension and postretirement benefits	(2,860,682)	(5,328,251)
Net cash provided by operating activities	49,650,784	59,026,165
Cash Flows From Investing Activities:		
Construction of utility plant	(55,528,796)	(45,936,801)
Plant removal cost	(880,867)	(1,819,788)
Proceeds from the salvage of utility plant	62,443	211,891
Contributions in aid of construction	4,448,626	4,662,499
Capitalized interest	(392,509)	(277,163)
Materials and supplies inventory	494,335	119,130
Disposition of nonutility property	86,715	105,122
Net change in other investments	(554,788)	(3,361,105)
Net redemption of capital term certificates	213,470	23,081
Net sale of associated investments	2,560,695	2,166,781
Net cash used in investing activities	(49,490,676)	(44,106,353)
Cash Flows From Financing Activities:		
Payments of long-term debt	(26,147,814)	(27,065,707)
Advances under line of credit agreements	129,400,000	164,700,000
Payments under line of credit agreements	(110,600,000)	(148,500,000)
Proceeds from Paycheck Protection Program (PPP) loan	8,560,877	-
Payments on capital lease obligations	(788,499)	(1,046,974)
Distribution of capital credits	(697,918)	(3,831,884)
Net cash used in financing activities	(273,354)	(15,744,565)
Net Decrease in Cash and Cash Equivalents	(113,246)	(824,753)
Cash and Cash Equivalents, Beginning of Year	5,589,009	6,413,762
Cash and cash equivalents, end of year	$ 5,475,763	$ 5,589,009
Non-Cash Investing Activity:		
Capital lease	$ 229,025	$ 65,205

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

Note 1: Description of Business

Southern Maryland Electric Cooperative, Inc. (SMECO) is an electric transmission and distribution cooperative that was initially formed as Southern Maryland Tri-County Cooperative Association on February 5, 1937. In 1942, the members voted to change the form of the organization from an association to a cooperative, nonprofit membership corporation under the Maryland Electric Cooperative Act and adopted the current name. SMECO serves about 170,000 customers in a 1,150 square-mile area in Southern Maryland comprised of Calvert, Charles, Prince George's and St. Mary's counties.

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

Note 2: Summary of Significant Accounting Policies

A. System of Accounts and Regulation – The accounting records are maintained in accordance with the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission (FERC). SMECO is subject to regulation by the Maryland Public Service Commission (PSC). The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The consolidated financial statements reflect the ratemaking policies of the PSC in conformity with guidance set forth by the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 980 as it relates to certain types of regulated industries. This standard allows SMECO to record certain regulatory assets and liabilities, which will be included in future rates and would not be recorded under GAAP for nonregulated entities in the United States (see Note 6).

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

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

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

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

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

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

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

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

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

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

J. Derivative Instruments – SMECO uses various methods, such as forward purchase contracts, option contracts, financial swaps and commodity swaps to manage the commodity and financial risks associated with meeting its power supply requirements. SMECO accounts for the aforementioned contracts in accordance with guidance as set forth by FASB as it relates to derivative instruments and hedging activities. This guidance requires all derivatives, subject to certain exceptions, to be accounted for at fair value. According to FASB guidance, the majority of SMECO's forward purchase contracts and option contracts qualify for the normal purchase and normal sales exception. As a result, these contracts are not recorded at fair value. Since all of SMECO's power supply related costs are subject to rate recovery, changes in the fair value of financial and commodity swaps are periodically reflected as derivative assets and regulatory liabilities or derivative liabilities and regulatory assets, respectively, under the provisions as set forth by FASB (see Note 2A). As of December 31, 2020, the change in fair value of SMECO's derivative instruments, excluding contracts accounted for as normal purchase/normal sale were as follows:

Derivatives	Balance Sheet Location	Change in Fair Value
Financial Gas	Regulatory assets and Derivative liabilities	$ (1,649,717)
Financial Energy	Regulatory assets and Derivative liabilities	(2,215,025)
Financial Transmission Rights	Derivative assets and Regulatory liabilities	267,001
Total		$ (3,597,741)

At December 31, 2020, total derivative contracts in a gross asset and gross liability position amounted to approximately $2.6 million and $6.2 million, respectively.

As of December 31, 2019, the change in fair value of SMECO's derivative instruments, excluding contracts accounted for as normal purchase/normal sale were as follows:

Derivatives	Balance Sheet Location	Change in Fair Value
Financial Gas	Regulatory assets and Derivative liabilities	$ (4,686,250)
Financial Energy	Regulatory assets and Derivative liabilities	(6,128,126)
Financial Transmission Rights	Derivative assets and Regulatory liabilities	77,292
Total		$ (10,737,084)

At December 31, 2019, total derivative contracts in a gross asset and gross liability position amounted to approximately $500,000 and $11.2 million, respectively.

Net gains and losses on financial and commodity swaps and Financial Transmission Rights are reflected in cost of power at the time they are settled. For the year ended December 31, 2020, the net realized loss on these transactions was as follows:

Derivatives	Net Realized Loss Recognized in Purchased Power
Financial Gas	$ (10,004,282)
Financial Energy	(3,564,996)
Financial Transmission Rights	(2,171,442)
Total	$ (15,740,720)

For the year ended December 31, 2019, the net realized loss on these transactions was as follows:

Derivatives	Net Realized Loss Recognized in Purchased Power
Financial Gas	$ (12,177,530)
Financial Energy	(1,360,009)
Financial Transmission Rights	3,826,238)
Total	$ (17,363,777)

As of December 31, 2020 and 2019, SMECO had entered into commitments for options totaling $10.0 million and $9.5 million, respectively.

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

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

L. Revenue Recognition – Revenue is recognized as service is rendered to customers. Recorded revenue includes an estimate of unbilled revenue for utility service rendered but not billed to customers as of year-end. Estimated unbilled revenue was approximately $20.5 million and $18.1 million as of December 31, 2020 and 2019, respectively.

SMECO has analyzed the provisions of ASC Topic 606, Revenue from Contracts with Customers and has concluded that no changes were necessary to conform to the standard. SMECO recognizes revenue from consumed electricity in the appropriate reporting period through its estimate of unbilled revenue, which complies with the requirements of ASC Topic 606.

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

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

SMECO Solar LLC is taxed as a corporation and is subject to federal and state income taxes. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences arising between the tax bases of assets and liabilities and their reported amounts in accordance with GAAP. At December 31, 2020 and 2019, there were no material deferred tax assets and liabilities reported on the consolidated balance sheets. SMECO Solar LLC had no significant uncertain tax positions or tax liability for tax benefits, interest or penalties accrued at December 31, 2020 and 2019.

N. Accumulated Other Comprehensive Income – This item consists of other gains and losses affecting equity that, under GAAP, are excluded from net income. During 2020 and 2019, such items relate to SMECO's unrecognized actuarial loss and amortization from the adoption of guidance issued by FASB as it relates to the accounting for defined benefit pension and other postretirement plans (see Note 7A).

O. Subsequent Events – Subsequent events have been evaluated through March 17, 2021, which is the date the consolidated financial statements were available to be issued.

P. Advertising Costs – Advertising costs are expensed as incurred.

Q. Renewable Portfolio Standard (RPS) – SMECO is subject to Maryland's Renewable Portfolio Standard (RPS), which requires retail suppliers of electricity to provide fifty percent of their retail sales using renewable resources by 2030. SMECO fulfills this obligation by purchasing renewable energy from various resources such as wind and solar, as well as by procuring Renewable Energy Credits (RECs) in the market.

Note 3: Utility Plant

The major classes of utility plant in service as of December 31, 2020 and 2019 are as follows:

	2020	2019
Distribution	$ 706,958,242	$ 691,060,377
Transmission	328,091,315	322,244,952
Generation	14,226,634	14,222,158
Other Production Plant	463,175	463,175
General	179,720,575	173,949,224
	1,229,459,941	1,201,939,886
Construction work in progress	26,993,740	13,953,901
Utility Plant	$1,256,453,681	$1,215,893,787

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

Distribution	3.42%
Transmission	2.77%
Generation	5.00%
General	4.40%

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

In accordance with the reporting requirements of FASB's guidance on asset retirement obligations and FERC Order 631, SMECO's accumulated provision for depreciation included a net salvage timing difference of approximately $14.0 million and $11.4 million for the years ended December 31, 2020 and 2019, respectively. This represents the differences in the timing of recognition of the period costs associated with net salvage.

SMECO capitalizes interest cost incurred on funds used to construct utility plant. The capitalized interest is recorded as part of the asset to which it relates and is amortized over the asset's estimated useful life and amounted to approximately $393,000 and $277,000, for the years ended December 31, 2020 and 2019, respectively.

Note 4: Investments in Associated Organizations

Investments in associated organizations consisted of the following as of December 31, 2020 and 2019:

	2020	2019
National Rural Utilities Cooperative Finance Corporation (CFC):		
Capital Term Certificates		
3%	$ 811,050	$ 1,000,650
5%	3,164,783	3,164,783
Noninterest bearing	138,411	162,281
Patronage capital certificates	3,766,996	3,476,724
CFC membership	1,000	1,000
	7,882,240	7,805,438
Federated Rural Electric Insurance Corporation	1,357,856	1,268,612
CoBank, ACB (CoBank)	9,981,752	9,011,960
Other	358,700	357,599
	$ 19,580,548	$ 18,443,609

Note 5: Equity Method Investments

Effective August 1, 2003, SMECO invested $1,000,000 for a membership and equity investment in Alliance for Cooperative Energy Services Power Marketing, LLC (subsequently renamed ACES). SMECO's proportionate share of ACES earnings was $26,410 in 2020 and $26,246 in 2019. As of December 31, 2020 and 2019, the carrying value of the investment was $1,293,390 and $1,266,980, respectively.

Note 6: Regulatory Assets

Regulatory assets consisted of the following:

A. Demand Response (DR) and EmPOWER Maryland Programs – Conservation expenditures pertaining to DR and EmPOWER Maryland programs are recognized as regulatory assets and amortized over a one-year or five-year period in accordance with PSC requirements. Conservation costs are recovered through a rate surcharge approved by the PSC that reflects expenditures and an allowed rate of return. The related amounts of regulatory assets for the DR and EmPOWER Maryland programs were $33,500,447 and $34,431,169 as of December 31, 2020 and 2019, respectively.

B. Advanced Metering Infrastructure (AMI) Implementation – Pursuant to PSC approval, a regulatory asset was established for the costs associated with an AMI staged implementation to determine whether the deployment of AMI in SMECO's service territory would achieve the operational savings anticipated. In 2013, the PSC approved the system-wide deployment of AMI and a regulatory asset was established. The deployment of AMI was completed in 2018. As of December 31, 2020 and 2019, the regulatory assets for these projects totaled $41,434,581.

C. Energy and Energy-Related Costs – As of December 31, 2020 and 2019, the regulatory asset pertaining to energy and energy-related costs was $3,864,742 and $10,814,376, respectively (see Note 2).

D. COVID-19 – Pursuant to PSC order, a regulatory asset was established to capture and track the incremental costs related to COVID-19 (see Note 12). As of December 31, 2020, the regulatory asset pertaining to these costs totaled $2,317,711.

Note 7: Employee Benefit Plans

A. Pension Plan and Other Postretirement Benefits – SMECO has a qualified, noncontributory, defined benefit pension plan which provides for retirement benefits based upon age, years of service and compensation. The Retirement Annuity Plan for Employees of SMECO was closed effective December 31, 2006, so that employees who were hired or re-hired on or after January 1, 2007, were not eligible to participate (or recommence participation) in the Pension Plan. SMECO continued to maintain the Pension Plan for current employees through December 31, 2010 at which time the Plan was frozen. The net effect was that a participant's benefits under the Pension Plan were calculated as if the participant terminated employment with SMECO on December 31, 2010. Annual provisions for accrued pension costs are based upon independent actuarial valuations dated as of December 31, 2020 and 2019. SMECO's policy is to fund accrued pension costs in accordance with provisions of the Employee Retirement Income Security Act of 1974 (ERISA).

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

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

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

	Pension Benefits	
	2020	2019
Benefit obligation at year end	$168,429,262	$155,613,514
Fair value of plan assets at year end	139,450,843	127,038,053
Funded status	$ (28,978,419)	$ (28,575,461)
Amounts recognized in the Balance Sheets:		
Accrued benefit cost	$ (28,978,419)	$ (28,575,461)
Deferred charges not included in equity	710,250	947,001
Amounts recognized as reduction in equity not yet recognized as periodic benefit cost:		
Net actuarial loss	72,018,832	68,360,913
Expected amortization for the next fiscal year	2,747,752	2,381,920
Weighted-average assumptions used to determine benefit obligations as of year end:		
Discount rate	2.70%	3.45%
Benefit cost	$ 864,918	$ 221,106
Employer contribution	3,876,084	5,707,887
Benefits paid	8,271,118	9,456,797
Weighted-average assumptions used to determine benefit costs:		
Discount rate	3.45%	4.40%
Expected return on plan assets	6.25%	7.00%
Expected contributions for year ending December 31, 2021:		
Employer	$ 1,728,512	
Employees	—	

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

2021	$ 8,219,998
2022	8,287,379
2023	8,427,818
2024	8,576,165
2025	8,537,612
2026-2030	43,257,744

Plan Assets:		
Equity Securities (a)	63%	57%
Fixed Income Securities (b)	37%	43%

(a) The portfolio's target asset allocation range is 60% equity with an allowable range of 30% to 60%.
(b) The portfolio's target asset allocation range is 40% fixed income with an allowable range of 30% to 60%.

Plan assets are considered Level 1 inputs on the fair value measurement hierarchy as described in Note 14. During the year, there were no significant changes in the valuation techniques or inputs.

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

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

	Other Postretirement Benefits	
	2020	2019
Benefit obligation at year end	$ 27,383,624	$ 32,189,512
Fair value of plan assets at year end	—	—
Funded status	$(27,383,624)	$(32,189,512)
Amounts recognized in the Balance Sheets:		
Accrued benefit cost	$(27,383,624)	$(32,189,512)
Deferred charges not Included in equity	—	—
Amounts recognized as reduction in equity not yet recognized as periodic benefit cost:		
Net actuarial loss	1,761,019	7,241,165
Net prior service (credit) costs	(2,355,431)	(2,635,410)
	(594,412)	4,605,755
Expected amortization for the next fiscal year	(279,979)	52,986
Weighted-average assumptions used to determine benefit obligations as of year end:		
Discount rate	2.70%	3.45%
Benefit cost	$ 1,143,106	$ 1,634,602
Employer contribution	748,827	1,279,779
Benefits paid	748,827	1,279,779
Weighted-average assumptions used to determine benefit costs:		
Discount rate	3.45%	4.40%

Expected contributions for year ending December 31, 2021 are $1,184,929.

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

2021	$ 1,184,929
2022	1,167,980
2023	1,075,627
2024	991,824
2025	1,050,512
2026-2030	6,140,041

For measurement purposes, a 6.25% medical trend rate was assumed for health care benefits and premiums for 2021. It is further assumed that this rate will decrease to 4.5% through 2027 and remain at that level thereafter.

On December 8, 2003, the President signed into law the Medicare Prescription Drug Improvement and Modernization Act of 2003. This Act introduces a prescription drug benefit under Medicare Part D as well as a federal subsidy to sponsors of retiree healthcare benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. SMECO has not, and does not intend to, apply for this subsidy for the years ended December 31, 2020 and 2019.

B. Health Insurance – SMECO is self-insured for medical and dental claims of its current employees and retirees and their covered dependents. SMECO is liable for claims of up to $150,000 per occurrence for medical claims and $2,000 per year per participant for dental claims. Catastrophic coverage is maintained to pay claims in excess of these amounts. Claims paid under this plan approximated $5.8 million in 2020 and $7.2 million in 2019. Provisions for claims incurred but not reported have been made based on claim experience and approximated $325,000 and $437,000 as of December 31, 2020 and 2019, respectively.

C. 401(k) Plans – SMECO maintains 401(k) plans for its management and bargaining unit employees. All full-time employees are eligible to participate in the plans after meeting minimum service requirements. SMECO matches employee contributions to the management plan up to 6% of annual compensation and for the bargaining plan, matches $.50 on the dollar up to 1% of annual straight time earnings. Effective with the freeze of the Pension Plan (see Note 7A), SMECO provides a non-elective employer contribution which varies based on length of service. For employees with 0 to less than 5 years of service, the contribution is 3% of base pay; 5 to less than 20 years of service, 8% of base pay; and 20 or more years of service, 10% of base pay. During 2020 and 2019, SMECO recorded 401(k) plan-related expenses of approximately $5.0 million and $4.7 million, respectively.

D. Workers' Compensation Trust – SMECO is self-insured for workers' compensation insurance through a separate trust which was established to pay workers' compensation claims. Contributions to the trust are based upon an actuarial valuation and SMECO maintains excess liability insurance coverage for claims exceeding $750,000. Part One of the policy covers the employer's statutory liabilities under state law up to $25 million. Part Two covers liability arising out of employee work-related injuries that do not fall under the workers' compensation statute up to $1 million. Transactions within the trust are not reflected in the accompanying consolidated financial statements. During 2020 and 2019, SMECO made aggregated contributions to the trust of approximately $793,000 and $752,000, respectively. At December 31, 2020 and 2019, the trust had estimated net assets available for benefits of $1,040,450 and $887,588, respectively. Maryland Loss Development Factors were used to calculate the 2020 estimate of net assets available for benefits.

Note 8: Patronage Capital and Other Equities

Assigned patronage capital consists of net operating margins that have been allocated to individual member patronage accounts. Patronage capital is applied against unpaid accounts receivable when customers leave SMECO. Patronage capital retirements to date represent amounts that have been paid to individual members. Patronage capital activity as of December 31, 2020 and 2019 consisted of the following:

	2020	2019
Assignable	$ 27,229,164	$ 27,947,419
Assigned to date	373,074,811	345,247,015
	400,303,975	373,194,434
Less: Retirements to date	(109,995,453)	(107,731,393)
Patronage capital	$290,308,522	$265,463,041

Other equities consist of donated capital from members and nonrefundable membership fees that were previously collected from new members upon joining SMECO. Non-patronage sourced margins are included as part of other equities.

Note 9: Long-Term Debt

SMECO has outstanding long-term debt from CFC and CoBank. On April 16, 2018, SMECO borrowed an additional $135 million in long-term debt by issuing First Mortgage Notes, Series 2018, 4.00% due April 16, 2048 to various investors in the private placement market. Certain debt issuance costs incurred for the private placement notes are being amortized over the life of the debt. SMECO's long-term debt is subject to the loan covenants that are described in its Indenture of Mortgage, Security Agreement and Financing Statement, dated as of March 15, 2015, as amended, and substantially all assets are pledged as collateral for the long-term debt. SMECO Solar LLC has obtained long-term debt from FFB, which is guaranteed by SMECO.

The following debt was outstanding as of December 31, 2020 and 2019:

Lender	Interest Rates	Maturity (Year)	2020	2019
SMECO				
CFC	1.93–4.15%	2023-45	$224,290,709	$232,195,092
CoBank	2.04–6.44%	2021-46	279,164,279	294,219,775
Private Placement	4.00%	2048	128,840,106	131,377,480
SMECO Solar LLC				
FFB	3.07%	2034	10,542,987	11,193,548
Total debt outstanding			642,838,081	668,985,895
Less: Current maturities			25,184,067	26,147,301
Unamortized portion of debt issuance costs			473,160	490,471
Long-term debt			$617,180,854	$642,348,123

At December 31, 2020, the required principal payments of the long-term debt are as follows:

2021	$ 25,184,067
2022	26,034,213
2023	26,753,137
2024	27,023,028
2025	26,844,178
Thereafter	510,999,458
Total	$642,838,081

Cash paid for interest totaled approximately $25.4 million and $25.9 million for the years ended December 31, 2020 and 2019, respectively.

SMECO maintains unsecured revolving line of credit agreements at variable interest rates with CoBank and CFC for its short-term borrowing needs. The CoBank agreement expires June 30, 2021. The CFC agreement automatically renews each March unless CFC or SMECO provides written notice not to renew at least 90 days in advance of the renewal date.

As of December 31, 2020, SMECO had authorized lines of credit of $175 million with CFC and $75 million with CoBank. There was no outstanding balance for the CFC line of credit as of December 31, 2020. The outstanding balance for the CFC line of credit and the respective interest rate as of December 31, 2019 was $10.2 million at 3.25%.

The outstanding balances for the CoBank lines of credit and their respective interest rates as of December 31, 2020, were $50.0 million at 2.45% and as of December 31, 2019, were $21.0 million at 3.34%.

On April 20, 2020, SMECO received loan proceeds from M&T Bank for approximately $8.6 million under the Paycheck Protection Program (PPP), which was established as part of the Coronavirus Aid, Relief and Economic Security Act (CARES Act). Such loans are subject to a term of two years at an interest rate of 1%. The loan and accrued interest can be forgiven as long as the borrower uses the loan proceeds for eligible purposes, including payroll costs, mortgage interest payments, rent or lease payments, and utility payments during the eight-week period following the loan disbursement. SMECO has used the proceeds for purposes consistent with the PPP and expects to receive forgiveness of the full amount of the loan.

As of December 31, 2020 and 2019, SMECO had outstanding letters of credit totaling $15.4 million and $11.3 million, respectively.

Note 10: Leases

SMECO is obligated under long-term capital leases for utility equipment and vehicles that expire at various dates through 2024. The future minimum lease payments required under the capital leases and the present value of the net minimum lease payments as of December 31, 2020 are as follows:

2021	$ 674,282
2022	647,680
2023	443,848
2024	122,989
Total minimum lease payments	1,888,799
Less: Amount representing interest	(113,104)
Present value of minimum lease payments	1,775,695
Less: Current obligations	(621,386)
Long-term capital lease obligation	$1,154,309

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

	2020	2019
Transmission	$4,600,700	$7,209,200
General	959,622	730,597
	5,560,322	7,939,797
Less: Accumulated depreciation	(1,216,751)	(1,853,470)
	$4,343,571	$6,086,327

Interest paid on the capital lease obligations for the years ended December 31, 2020 and 2019 was $80,481 and $114,674, respectively. The capital leases are collateralized by the assets leased under the agreements, which are recorded in the accompanying consolidated balance sheet. Depreciation expense at December 31, 2020 and 2019 relating to these assets was $155,927 and $222,615, respectively.

SMECO leases many of its vehicles and power-operated equipment for various terms under long-term, operating lease agreements. The leases expire at various dates through 2024. At the expiration of the scheduled lease term, SMECO can either purchase the equipment at fair market value, have the lessor sell the equipment on its behalf or renew the lease for twelve or twenty-four months. Operating lease expense amounted to $1,440,015 and $1,399,354 in 2020 and 2019, respectively.

The future minimum rental payments required under the operating lease agreements as of December 31, 2020, are as follows:

2021	$1,140,517
2022	1,030,148
2023	316,621
2024	184,187
Total	$2,671,473

Note 11: Commitments and Contingencies

SMECO contracts with various suppliers for energy and energy-related products to serve its native load requirements. As of December 31, 2020, SMECO had forward purchase commitments with multiple parties through December 2037 covering a significant portion of SMECO's power supply needs.

At December 31, 2020 and 2019, SMECO had made commitments for capital expenditures of approximately $16.5 million and $30.4 million, respectively.

SMECO and Local Union 1718 of the International Brotherhood of Electrical Workers have a collective bargaining unit agreement, which covers approximately 264 of the 470 employees of SMECO, or 56%. The current agreement expires on April 30, 2022.

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

Note 12: Concentration of Risk and COVID-19

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

Under Maryland's Electric Customer Choice and Competition Act and the Electric and Gas Utility Tax Reform Act, electric customers residing in Maryland are entitled to select or choose their electric energy supplier. As of December 31, 2020, SMECO had approximately 5,200 customers served by an alternative electricity supplier. SMECO continues to provide distribution service to all of its customers.

Residential rooftop solar systems continue to be installed throughout SMECO's service territory. Solar developers have installed over 6,600 residential rooftop solar systems through 2020, over four percent of the residential class. The output of these systems offsets energy sales from SMECO. Distribution sales revenue from these customers is reduced resulting in additional revenue recovery from all other residential customers. SMECO will work to pursue legislative and regulatory actions to reduce or eliminate this cost shifting within the residential class.

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

With the assistance of ACES (see Notes 5 and 11), SMECO has developed a more diversified market strategy to meet future power supply needs, that includes multiple suppliers and varied contract termination dates. This approach represents a significant departure from the traditional cooperative model of multiple year contracts with a sole supplier. SMECO has concluded that it is no longer operationally or economically prudent to engage in the traditional full-requirements contract with one supplier.

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

Financial instruments that subject SMECO to concentration of credit risks include customer accounts receivable. SMECO grants credit to customers, substantially all of whom are local residents of SMECO's four-county service area. SMECO places its cash on deposit with financial institutions located in the United States of America, which are insured by the Federal Deposit Insurance Corporation (FDIC). The FDIC provides insurance coverage for up to $250,000 of cash held by SMECO in each separate FDIC insured bank and savings institution. From time to time, SMECO may have amounts on deposit in excess of the insured limits. As of December 31, 2020, SMECO had approximately $3.6 million of deposits that exceeded the insured limits.

In December 2019, a novel strain of coronavirus (COVID-19) surfaced in Wuhan, China and has spread around the world, with resulting business and social disruption. COVID-19 was declared a Public Health Emergency of International Concern by the World Health Organization on January 30, 2020. The COVID-19 pandemic is having widespread, rapidly evolving, and unpredictable impacts on global society, economies, financial markets, and business practices. SMECO has not seen significant disruption or significant operational restrictions to date, but the substantial uncertainty and the nature and degree of the pandemic and resulting effects over time could result in disruption or restriction on SMECO's ability to operate normally. SMECO's members are also affected by the outbreak, which could delay their power bill payments. Although unlikely, plant construction projects may be delayed or cancelled and certain management accounting estimates and assumptions could be affected by future uncertainty. SMECO may also experience difficulties with suppliers or with vendors in their supply chain, which could have negative effects on operations. Overall, the future impact of the pandemic with respect to SMECO's territory is difficult to predict and could adversely impact its overall operations in the future.

Note 13: Fair Value of Financial Instruments

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

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

Cash and Cash Equivalents

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

Accounts Receivable

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

Investments in Associated Organizations

Fair value of capital term certificates was determined by computing the present value of estimated future cash flows, discounted at the long-term treasury rate of 1.65% and 2.39% as of December 31, 2020 and 2019, respectively. The fair value of patronage capital is not determinable since no legal obligation exists to retire capital credits. The fair value of the equity method investment is not estimated since there are no identified events or changes in circumstances that may have a significant adverse effect on the fair value and it is not practicable to estimate fair value. The carrying value of memberships approximates fair value.

Accounts Payable

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

Long-Term Debt

The carrying amount of SMECO's fixed long-term debt includes certain interest rates that are below quoted market prices for the same or similar issues. Therefore, the fair value of fixed long-term debt is estimated based on current market prices for the same or similar issues offered for debt of the same and remaining maturities which was 3.57% and 4.19% as of December 31, 2020 and 2019, respectively.

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

Customer Deposits

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

Fair Value

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

	Carrying Value (000 Omitted)		Fair Value (000 Omitted)	
	2020	2019	2020	2019
Assets:				
Capital Term Certificates	$ 4,114	$ 4,328	$ 8,160	$ 7,055
Liabilities:				
Long-term Debt	$(642,365)	$(668,495)	$(692,574)	$(683,495)

Note 14: Fair Value Measurements

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

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

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

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

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

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

	December 31, 2020 (000 Omitted)			
	Total	Level 1	Level 2	Level 3
Assets:				
Derivative Assets, net	$ 267	$ —	$ 267	$ —
Plan Assets for Pension and Other Benefits	139,451	139,451	—	—
Liabilities:				
Derivative Liabilities, net	$ (3,865)	$ —	$(3,865)	$ —

	December 31, 2019 (000 Omitted)			
	Total	Level 1	Level 2	Level 3
Assets:				
Derivative Assets, net	$ 77	$ —	$ 77	$ —
Plan Assets for Pension and Other Benefits	127,038	127,038	—	—
Liabilities:				
Derivative Liabilities, net	$ (10,814)	$ —	$(10,814)	$ —

Valuation Techniques

The fair value of derivative assets and liabilities (Level 2) is comprised of forward trades, power and gas positions and Financial Transmission Rights (FTRs). The fair value of all forward trades is calculated by a third party, ACES, using market prices when possible and modeled forward prices including constant heat rate projections, supply-demand simulation generated values, inflation escalated market prices, or a blend of these sources when market prices are not available. The power positions are valued at AEP Dayton – Dominion Zone, Brandywine, PJM_RTO, PJM East or PJM West and the gas positions are valued using NYMEX Henry Hub, TETCO M3, TRANSCO Zone 5 or TRANSCO Zone 6 Non-NY pricing. FTRs are marked-to-market based on data from the most recent FTR auction.

The method described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while SMECO believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair values of certain financial instruments could result in a different fair value measurement at the reporting date.

Note 15: Related Party Transactions

SMECO is a member of CFC and CoBank. Pursuant to the member relationships, SMECO has invested in, entered into various loan agreements with, and maintains unsecured lines of credit with these organizations (see Notes 4 and 9). SMECO earned interest income of approximately $188,000 in both 2020 and 2019 on investments with CFC. During years 2020 and 2019, SMECO paid interest expense of approximately $20.0 million and $20.4 million, respectively, on aggregated loans from CFC and CoBank.

SMECO invested in and became a member of ACES during 2003 to engage ACES' professional assistance in meeting future power supply needs (see Note 5). SMECO paid ACES approximately $1.1 million and $1.2 million for such services during 2020 and 2019, respectively.

SMECO invested in and became a member of National Renewables Cooperative Organization (NRCO) during 2008 to utilize NRCO's services in the analysis of renewable projects in which SMECO may choose to participate in order to fulfill the Maryland RPS obligations (see Notes 2Q and 4). SMECO paid NRCO approximately $36,000 and $50,000 for such services in 2020 and 2019, respectively.

SMECO is a member of Electric Research and Manufacturing Cooperative (ERMCO) and The Tarheel Electric Membership Association, Inc. (TEMA) and purchases materials and supplies from them (see Note 4). During years 2020 and 2019, SMECO made aggregated purchases to these organizations of approximately $377,000 and $639,000, respectively.

SMECO is a member of Federated Rural Electric Insurance Corporation (Federated) and purchases general liability and property insurance from them (see Note 4). SMECO paid Federated approximately $895,000 and $823,000 for such insurance in 2020 and 2019, respectively.

During 2020 and 2019, SMECO allocated administrative expenses of approximately $149,000 and $160,000 to SMECO Solar LLC, respectively. In accordance with the interconnection and power purchase agreement signed in 2011, SMECO Solar LLC sells all its generated electricity to SMECO. Sales were approximately $1.7 million and $1.8 million for the years ended December 31, 2020 and 2019, respectively. Inter-company receivables and payables have been eliminated upon consolidation.

Note 16: Storm Loss

In August 2020, Tropical Storm Isaias struck SMECO's service territory causing system damage totaling approximately $1.7 million. In early February 2021, the Federal Emergency Management Agency (FEMA) granted a disaster declaration for this storm. SMECO expects to receive funding from FEMA of approximately $1.0 million, which has been offset against the storm costs in the accompanying financial statements.

ADAMS, JENKINS AND CHEATHAM
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS CONSULTANTS

Independent Auditor's Report on Supplementary Information

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

We have audited the consolidated financial statements of Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC (SMECO) for the years ended December 31, 2020 and 2019, and our report thereon dated March 17, 2021, which expressed an unmodified opinion on those consolidated financial statements appears on pages 1 and 2. Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating financial information and consolidated comparative summary of operations is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual entities, and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

We also have previously audited, in accordance with auditing standards generally accepted in the United States of America, the balance sheets of SMECO as of December 31, 2019, 2018, 2017, and 2016, and the related statements of revenue, expenses and patronage capital and comprehensive income, and cash flows for each of the three years then ended (none of which is presented herein), and we expressed unmodified opinions on those financial statements. In our opinion, the comparative summary of operations is fairly stated in all material respects in relation to the basic consolidated financial statements from which it has been derived.

Adams, Jenkins & Cheatham

Richmond, Virginia
March 17, 2021

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Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
Consolidating Balance Sheets
December 31, 2020

	SMECO	SMECO Solar LLC	Eliminations	Total
Assets				
Utility Plant, at Original Cost (Notes 2 and 3)	$ 1,242,227,047	$ 14,226,634	$ -	$ 1,256,453,681
Less: Accumulated Depreciation and Amortization	(438,988,412)	(5,741,055)	-	(444,729,467)
Net utility plant	803,238,635	8,485,579	-	811,724,214
Nonutility Property (net)	2,814,995	-	-	2,814,995
Investments (Note 2):				
Investments in associated organizations, at cost (Notes 4 and 13)	19,580,548	-	-	19,580,548
Investment in an unconsolidated entity (Note 5)	1,293,390	-	-	1,293,390
Investment in SMECO Solar LLC	1,090,748	-	(1,090,748)	-
Other investments	6,620,221	-	-	6,620,221
Total investments	28,584,907	-	(1,090,748)	27,494,159
Current Assets (Note 2):				
Cash and cash equivalents	3,470,036	2,005,727	-	5,475,763
Accounts receivable, net of allowance for doubtful accounts of $685,000	56,367,383	-	-	56,367,383
Materials and supplies inventory	12,738,450	21,850	-	12,760,300
Prepaid expenses	11,677,011	98,757	-	11,775,768
Intercompany receivables	44,587	1,075,997	(1,120,584)	-
Other current assets	24,015,035	-	-	24,015,035
Total current assets	108,312,502	3,202,331	(1,120,584)	110,394,249
Regulatory Assets (Notes 2 and 6)	81,117,481	-	-	81,117,481
Deferred Charges and Other (Note 2)	53,601,672	-	-	53,601,672
Derivative Assets (Notes 2 and 14)	267,001	-	-	267,001
Total assets	$ 1,077,937,193	$ 11,687,910	$ (2,211,332)	$ 1,087,413,771
Equities and Liabilities				
Equities (Note 8):				
Patronage capital	$ 290,308,522	$ -	$ -	$ 290,308,522
Other equities	38,687,316	1,090,748	(1,090,748)	38,687,316
Accumulated other comprehensive loss	(71,424,420)	-	-	(71,424,420)
Total equities	257,571,418	1,090,748	(1,090,748)	257,571,418
Long-Term Debt, Less Current Maturities (Notes 9 and 13)	607,306,118	9,874,736	-	617,180,854
Current Liabilities:				
Accounts payable	27,511,423	9,588	-	27,521,011
Current maturities of long-term debt (Note 9)	24,515,816	668,251	-	25,184,067
Notes payable (Note 9)	58,560,877	-	-	58,560,877
Current portion of accrued pension and postretirement benefits (Note 7)	1,263,441	-	-	1,263,441
Current portion of obligations under capital lease (Note 10)	621,386	-	-	621,386
Customer deposits	7,549,430	-	-	7,549,430
Intercompany payables	1,075,997	44,587	(1,120,584)	-
Other current liabilities	28,439,964	-	-	28,439,964
Total current liabilities	149,538,334	722,426	(1,120,584)	149,140,176
Accrued Pension and Postretirement Benefits (Note 7)	55,098,602	-	-	55,098,602
Noncurrent Portion of Obligations Under Capital Lease (Note 10)	1,154,309	-	-	1,154,309
Deferred Credits	3,403,670	-	-	3,403,670
Derivative Liabilities (Notes 2 and 14)	3,864,742	-	-	3,864,742
Commitments and Contingencies (Notes 11 and 12)	-	-	-	-
Total equities and liabilities	$ 1,077,937,193	$ 11,687,910	$ (2,211,332)	$ 1,087,413,771

See Independent Auditor's Report on Supplementary Information.

Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
Consolidating Statements of Revenue and Expenses
Year Ended December 31, 2020

	SMECO	SMECO Solar LLC	Eliminations	Total
Operating Revenue:				
Sales of electricity	$ 365,104,541	$ 1,650,465	$ (1,650,465)	$ 365,104,541
Lease income	78,526	-	(78,526)	-
Other	45,983,078	-	-	45,983,078
Total operating revenue	411,166,145	1,650,465	(1,728,991)	411,087,619
Operating Expenses:				
Purchased power (Note 11)	197,518,100	-	(1,650,465)	195,867,635
Power production	-	341,570	(78,526)	263,044
Transmission	3,397,491	-	-	3,397,491
Distribution - operations	10,790,305	-	-	10,790,305
Distribution - maintenance	21,257,905	-	-	21,257,905
Customer accounts	10,777,955	-	-	10,777,955
Customer service and information	24,850,598	-	-	24,850,598
Administrative and general	38,026,169	63,707	-	38,089,876
Depreciation and amortization	40,313,957	711,313	-	41,025,270
Taxes	16,246,859	194,767	-	16,441,626
Other	2,095,274	-	-	2,095,274
Total operating expenses	365,274,613	1,311,357	(1,728,991)	364,856,979
Operating margins	45,891,532	339,108	-	46,230,640
Interest Expense:				
Interest on long-term debt	23,807,399	349,627	-	24,157,026
Other interest	946,450	-	-	946,450
Total interest expense	24,753,849	349,627	-	25,103,476
Net Operating Margins (Loss)	21,137,683	(10,519)	-	21,127,164
Other Patronage Allocations	3,911,104	-	-	3,911,104
Total operating margins (loss)	25,048,787	(10,519)	-	25,038,268
Nonoperating Margins	2,838,478	32,605	(22,086)	2,848,997
Net margins	$ 27,887,265	$ 22,086	$ (22,086)	$ 27,887,265

Consolidating Statements of Comprehensive Income
Year Ended December 31, 2020

	SMECO	SMECO Solar LLC	Eliminations	Total
Net Margins	$ 27,887,265	$ 22,086	$ (22,086)	$ 27,887,265
Other Comprehensive Income:				
Postretirement benefit plans actuarial (loss), net	(730,218)	-	-	(730,218)
Amortization of net loss and prior service costs	2,272,466	-	-	2,272,466
Other comprehensive income	1,542,248	-	-	1,542,248
Comprehensive Income	$ 29,429,513	$ 22,086	$ (22,086)	$ 29,429,513

See Independent Auditor's Report on Supplementary Information.

Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
Consolidated Comparative Summary of Operations
Years Ended December 31, 2020 - 2016

	2020	2019	2018	2017	2016
Operating Revenue:					
Sales of electricity	$ 365,104,541	$ 407,090,522	$ 415,643,743	$ 393,776,031	$ 412,091,512
Other	45,983,078	42,893,625	46,640,560	26,119,875	24,996,383
Total operating revenue	411,087,619	449,984,147	462,284,303	419,895,906	437,087,895
Operating Expenses:					
Purchased power	195,867,635	240,273,060	249,706,813	225,242,729	250,313,710
Power production	263,044	253,333	250,774	240,069	251,502
Transmission	3,397,491	4,416,785	3,827,626	3,662,300	3,640,137
Distribution - operations	10,790,305	11,805,210	11,445,363	10,616,908	10,614,462
Distribution - maintenance	21,257,905	18,827,947	20,718,862	18,797,371	20,203,136
Customer accounts	10,777,955	10,877,395	11,131,675	11,359,580	12,108,719
Customer service and information	24,850,598	21,115,760	26,390,181	22,505,156	21,942,948
Administrative and general	38,089,876	36,717,628	39,344,135	35,496,638	38,655,415
Depreciation and amortization	41,025,270	39,701,741	38,021,212	35,671,034	35,221,311
Taxes	16,441,626	15,744,868	15,715,740	14,941,871	15,104,610
Other	2,095,274	2,033,367	1,763,861	1,618,609	1,592,419
Total operating expenses	364,856,979	401,767,094	418,316,242	380,152,265	409,648,369
Operating margins	46,230,640	48,217,053	43,968,061	39,743,641	27,439,526
Interest Expense:					
Interest on long-term debt	24,157,026	25,284,878	24,206,522	22,069,422	21,875,522
Other interest	946,450	164,064	-	1,423,887	911,570
Total interest expense	25,103,476	25,448,942	24,206,522	23,493,309	22,787,092
Net Operating Margins	21,127,164	22,768,111	19,761,539	16,250,332	4,652,434
Other Patronage Allocations	3,911,104	3,444,195	4,619,298	4,494,232	4,618,308
Total operating margins	25,038,268	26,212,306	24,380,837	20,744,564	9,270,742
Nonoperating Margins	2,848,997	2,788,736	2,855,271	2,638,158	2,532,617
Net margins	$ 27,887,265	$ 29,001,042	$ 27,236,108	$ 23,382,722	$ 11,803,359
Electric Revenue:					
Residential	$ 242,396,128	$ 268,744,777	$ 276,362,221	$ 260,056,564	$ 272,862,159
General service	104,565,503	118,132,444	119,617,634	113,694,912	117,276,689
Large power	12,497,785	14,464,563	14,064,413	14,626,870	16,397,550
Street lights	2,639,767	2,566,188	2,549,742	2,573,565	2,509,594
Transmission	2,965,101	3,140,181	3,007,314	2,709,271	2,896,767
Solar facility/station power services	40,257	42,369	42,419	114,849	148,753
Total	$ 365,104,541	$ 407,090,522	$ 415,643,743	$ 393,776,031	$ 412,091,512
Megawatt-Hour Sales:					
Residential	2,136,051	2,180,188	2,276,786	2,056,626	2,112,651
General service	994,866	1,106,476	1,121,423	1,105,691	1,123,191
Large power	147,971	160,020	164,101	162,842	166,623
Street lights	8,900	8,615	8,367	8,052	7,856
Transmission	49,112	55,035	51,072	40,675	28,444
Solar facility/station power services	155	155	155	1,888	2,933
Total	3,337,055	3,510,489	3,621,904	3,375,774	3,441,698
Customers at Year End (Billings)	170,188	168,110	166,275	165,196	162,823

See Independent Auditor's Report on Supplementary Information.

Southern Maryland Electric Cooperative, Inc.
and SMECO Solar LLC
Financial Statements
December 31, 2021 and 2020

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ADAMS, JENKINS AND CHEATHAM
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS CONSULTANTS

Independent Auditor's Report

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

Opinion

We have audited the accompanying financial statements of Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC (the "Cooperative") which comprise the consolidated balance sheets as of December 31, 2021 and 2020, and the related consolidated statements of Revenue and expenses, comprehensive income, changes in equities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Southern Maryland Electric Cooperative and SMECO Solar LLC as of December 31, 2021 and 2020, 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.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for Audit of the Consolidated Financial Statements section of our report. We are required to be independent of Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about Southern Maryland Electric Cooperative and SMECO Solar's ability to continue as a going concern within one year after the date that the financial statements are available to be issued.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists.

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The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements, including omissions, are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgement made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgement and maintain professional skepticism throughout the audit.

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.

- Obtain an understanding of internal control relevant to the audit 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 Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC's internal control. Accordingly, no such opinion is expressed.

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.

- Conclude whether, in our judgement, there are conditions or events, considered in the aggregate, that raise substantial doubt about Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

Adams, Jenkins & Cheatham

Richmond, Virginia
April 8, 2022

Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
Consolidated Balance Sheets
December 31, 2021 and 2020

	2021	2020
Assets		
Utility Plant, at Original Cost (Notes 2 and 3)	$ 1,324,327,679	$ 1,256,453,681
Less: Accumulated Depreciation and Amortization	(466,695,124)	(444,729,467)
Net utility plant	857,632,555	811,724,214
Nonutility Property (net)	2,934,400	2,814,995
Investments (Note 2):		
Investments in associated organizations, at cost (Notes 4 and 13)	20,851,132	19,580,548
Investment in an unconsolidated entity (Note 5)	1,296,974	1,293,390
Other investments	3,792,708	6,620,221
Total investments	25,940,814	27,494,159
Current Assets (Note 2):		
Cash and cash equivalents	2,274,766	5,475,763
Accounts receivable, net of allowance for doubtful accounts of $685,000	57,571,257	56,367,383
Materials and supplies inventory	14,991,536	12,760,300
Prepaid expenses	5,022,140	11,775,768
Other current assets	41,527,068	24,015,035
Total current assets	121,386,767	110,394,249
Regulatory Assets (Notes 2 and 6)	76,084,785	81,117,481
Deferred Charges and Other (Note 2)	30,552,933	53,601,672
Derivative Assets (Notes 2 and 14)	10,309,587	267,001
Total assets	$ 1,124,841,841	$ 1,087,413,771
Equities and Liabilities		
Equities (Note 8):		
Patronage capital	$ 307,498,702	$ 290,308,522
Other equities	40,834,127	38,687,316
Accumulated other comprehensive loss	(52,832,884)	(71,424,420)
Total equities	295,499,945	257,571,418
Long-Term Debt, Less Current Maturities (Notes 9 and 13)	591,043,642	617,180,854
Current Liabilities:		
Accounts payable	39,879,590	27,521,011
Current maturities of long-term debt (Note 9)	26,039,421	25,184,067
Notes payable (Note 9)	92,200,000	58,560,877
Current portion of accrued pension and postretirement benefits (Note 7)	1,083,023	1,263,441
Current portion of obligations under capital lease (Note 10)	654,374	621,386
Customer deposits	6,798,634	7,549,430
Other current liabilities	21,671,795	28,439,964
Total current liabilities	188,326,837	149,140,176
Accrued Pension and Postretirement Benefits (Note 7)	34,642,793	55,098,602
Noncurrent Portion of Obligations Under Capital Lease (Note 10)	625,177	1,154,309
Deferred Credits	12,019,171	3,403,670
Derivative Liabilities (Notes 2 and 14)	2,684,276	3,864,742
Total equities and liabilities	$ 1,124,841,841	$ 1,087,413,771

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

Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
Consolidated Statements of Revenue and Expenses
Years Ended December 31, 2021 and 2020

	2021	2020
Operating Revenue:		
Sales of electricity	$ 393,540,887	$ 365,104,541
Other	48,267,212	45,983,078
Total operating revenue	441,808,099	411,087,619
Operating Expenses:		
Purchased power (Note 11)	229,120,187	195,867,635
Power production	260,498	263,044
Transmission	4,634,963	3,397,491
Distribution - operations	11,209,308	10,790,305
Distribution - maintenance	22,596,037	21,257,905
Customer accounts	11,070,083	10,777,955
Customer service and information	27,283,616	24,850,598
Administrative and general	38,858,656	38,089,876
Depreciation and amortization	42,694,847	41,025,270
Taxes	17,272,595	16,441,626
Other	2,256,963	2,095,274
Total operating expenses	407,257,753	364,856,979
Operating margins	34,550,346	46,230,640
Interest Expense:		
Interest on long-term debt	22,918,474	24,157,026
Other interest	1,469,986	946,450
Total interest expense	24,388,460	25,103,476
Net Operating Margins	10,161,886	21,127,164
Other Patronage Allocations	3,791,962	3,911,104
Total operating margins	13,953,848	25,038,268
Nonoperating Margins	10,190,858	2,848,997
Net margins	$ 24,144,706	$ 27,887,265

Consolidated Statements of Comprehensive Income
Years Ended December 31, 2021 and 2020

	2021	2020
Net Margins	$ 24,144,706	$ 27,887,265
Other Comprehensive Income:		
Postretirement benefit plans actuarial gain (loss), net	16,102,951	(730,218)
Amortization of net loss and prior service costs	2,488,585	2,272,466
Other comprehensive income	18,591,536	1,542,248
Comprehensive Income	$ 42,736,242	$ 29,429,513

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

Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
Consolidated Statements of Changes in Equities
Years Ended December 31, 2021 and 2020

	Patronage Capital	Other Equities	Accumulated Other Comprehensive (Loss) Income	Total
Balance, December 31, 2019	$ 265,463,041	$ 36,338,181	$ (72,966,668)	$ 228,834,554
Net margins	27,109,541	777,724	-	27,887,265
Retirement of capital credits	(2,264,060)	1,566,142	-	(697,918)
Prior year unclaimed capital credits	-	5,269	-	5,269
Other comprehensive income	-	-	1,542,248	1,542,248
Balance, December 31, 2020	290,308,522	38,687,316	(71,424,420)	257,571,418
Net margins	23,478,865	665,841	-	24,144,706
Retirement of capital credits	(6,288,685)	1,480,970	-	(4,807,715)
Other comprehensive income	-	-	18,591,536	18,591,536
Balance, December 31, 2021	$ 307,498,702	$ 40,834,127	$ (52,832,884)	$ 295,499,945

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

Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
Consolidated Statements of Cash Flows
Years Ended December 31, 2021 and 2020

	2021	2020
Cash Flows From Operating Activities:		
Net margins	$ 24,144,706	$ 27,887,265
Adjustments to reconcile net margins to net cash provided by operating activities:		
Depreciation and amortization	42,694,847	41,025,270
Amortization of loss on reacquired debt	1,170,127	1,170,127
Amortization of debt issuance costs	17,311	17,311
Earnings in unconsolidated entities	(3,584)	(26,410)
Other patronage allocations	(3,791,962)	(3,911,104)
Forgiveness of Paycheck Protection Program (PPP) loan	(8,560,877)	-
Change in operating assets and liabilities:		
Accounts receivable, net	(1,203,874)	(1,566,845)
Prepaid expenses	6,753,628	8,275,493
Derivative assets	(10,042,586)	(189,709)
Other current assets	(17,512,033)	(8,451,052)
Deferred charges and other	(2,745,280)	(18,817,490)
Regulatory assets	5,032,696	5,562,645
Accounts payable	12,358,579	(562,618)
Customer deposits	(750,796)	(1,031,375)
Other current liabilities	(6,768,169)	9,139,827
Deferred credits	8,615,501	939,765
Derivative liabilities	(1,180,466)	(6,949,634)
Accrued pension and postretirement benefits	(2,044,691)	(2,860,682)
Net cash provided by operating activities	46,183,077	49,650,784
Cash Flows From Investing Activities:		
Construction of utility plant	(66,923,912)	(55,528,796)
Plant removal cost	(3,189,941)	(880,867)
Proceeds from the salvage of utility plant	129,982	62,443
Contributions in aid of construction	6,342,033	4,448,626
Capitalized interest	(176,606)	(392,509)
Materials and supplies inventory	(2,231,236)	494,335
Disposition of nonutility property	(119,405)	86,715
Net change in other investments	2,827,513	(554,788)
Net redemption of capital term certificates	24,711	213,470
Net sale of associated investments	2,496,667	2,560,695
Net cash used in investing activities	(60,820,194)	(49,490,676)
Cash Flows From Financing Activities:		
Payments of long-term debt	(25,299,169)	(26,147,814)
Advances under line of credit agreements	170,800,000	129,400,000
Payments under line of credit agreements	(128,600,000)	(110,600,000)
Proceeds from Paycheck Protection Program (PPP) loan	-	8,560,877
Payments on capital lease obligations	(656,996)	(788,499)
Distribution of capital credits	(4,807,715)	(697,918)
Net cash provided by (used in) financing activities	11,436,120	(273,354)
Net Decrease in Cash and Cash Equivalents	(3,200,997)	(113,246)
Cash and Cash Equivalents, Beginning of Year	5,475,763	5,589,009
Cash and cash equivalents, end of year	$ 2,274,766	$ 5,475,763
Non-Cash Investing Activity:		
Capital lease	$ 160,852	$ 229,025

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

Notes to Consolidated Financial Statements
Years Ended December 31, 2021 and 2020

Note 1: Description of Business

Southern Maryland Electric Cooperative, Inc. (SMECO) is an electric transmission and distribution cooperative that was initially formed as Southern Maryland Tri-County Cooperative Association on February 5, 1937. In 1942, the members voted to change the form of the organization from an association to a cooperative, nonprofit membership corporation under the Maryland Electric Cooperative Act and adopted the current name. SMECO serves about 172,000 customers in a 1,150 square-mile area in Southern Maryland comprised of Calvert, Charles, Prince George's and St. Mary's counties.

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

Note 2: Summary of Significant Accounting Policies

A. System of Accounts and Regulation – The accounting records are maintained in accordance with the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission (FERC). SMECO is subject to regulation by the Maryland Public Service Commission (PSC). The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The consolidated financial statements reflect the ratemaking policies of the PSC in conformity with guidance set forth by the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 980 as it relates to certain types of regulated industries. This standard allows SMECO to record certain regulatory assets and liabilities, which will be included in future rates and would not be recorded under GAAP for nonregulated entities in the United States (see Note 6).

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

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

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

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

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

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

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

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

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

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

J. Derivative Instruments – SMECO uses various methods, such as forward purchase contracts, option contracts, financial swaps and commodity swaps to manage the commodity and financial risks associated with meeting its power supply requirements. SMECO accounts for the aforementioned contracts in accordance with guidance as set forth by FASB as it relates to derivative instruments and hedging activities. This guidance requires all derivatives, subject to certain exceptions, to be accounted for at fair value. According to FASB guidance, the majority of SMECO's forward purchase contracts and option contracts qualify for the normal purchase and normal sales exception. As a result, these contracts are not recorded at fair value. Since all of SMECO's power supply related costs are subject to rate recovery, changes in the fair value of financial and commodity swaps are periodically reflected as derivative assets and regulatory liabilities or derivative liabilities and regulatory assets, respectively, under the provisions as set forth by FASB (see Note 2A). As of December 31, 2021, the change in fair value of SMECO's derivative instruments, excluding contracts accounted for as normal purchase/normal sale were as follows:

Derivatives	Balance Sheet Location	Change in Fair Value
Financial Gas	Regulatory assets and Derivative liabilities	$ (2,684,276)
Financial Energy	Derivative assets and Regulatory liabilities	8,635,880
Financial Transmission Rights	Derivative assets and Regulatory liabilities	1,673,707
Total		$ 7,625,311

At December 31, 2021, total derivative contracts in a gross asset and gross liability position amounted to approximately $13.2 million and $5.6 million, respectively.

As of December 31, 2020, the change in fair value of SMECO's derivative instruments, excluding contracts accounted for as normal purchase/normal sale were as follows:

Derivatives	Balance Sheet Location	Change in Fair Value
Financial Gas	Regulatory assets and Derivative liabilities	$ (1,649,717)
Financial Energy	Regulatory assets and Derivative liabilities	(2,215,025)
Financial Transmission Rights	Derivative assets and Regulatory liabilities	267,001
Total		$ (3,597,741)

At December 31, 2020, total derivative contracts in a gross asset and gross liability position amounted to approximately $2.6 million and $6.2 million, respectively.

Net gains and losses on financial and commodity swaps and Financial Transmission Rights are reflected in cost of power at the time they are settled. For the year ended December 31, 2021, the net realized gain (loss) on these transactions was as follows:

Derivatives	Net Realized Gain (Loss) Recognized in Purchased Power
Financial Gas	$ (230,065)
Financial Energy	6,274,250
Financial Transmission Rights	(800,759)
Total	$ 5,243,426

For the year ended December 31, 2020, the net realized gain (loss) on these transactions was as follows:

Derivatives	Net Realized Gain (Loss) Recognized in Purchased Power
Financial Gas	$ (10,004,282)
Financial Energy	(3,564,996)
Financial Transmission Rights	(2,171,442)
Total	$ (15,740,720)

As of December 31, 2021 and 2020, SMECO had entered into commitments for options totaling $10.5 million and $10.0 million, respectively.

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

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

L. Revenue Recognition – Revenue is recognized as service is rendered to customers. Recorded revenue includes an estimate of unbilled revenue for utility service rendered but not billed to customers as of year-end. Estimated unbilled revenue was approximately $19.5 million and $20.5 million as of December 31, 2021 and 2020, respectively.

SMECO has analyzed the provisions of ASC Topic 606, Revenue from Contracts with Customers and has concluded that no changes are necessary to conform to the new standard. SMECO recognizes revenue from consumed electricity in the appropriate reporting period through its estimate of unbilled revenue, which complies with the requirements of ASC Topic 606.

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

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

SMECO Solar LLC is taxed as a corporation and is subject to federal and state income taxes. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences arising between the tax bases of assets and liabilities and their reported amounts in accordance with GAAP. At December 31, 2021 and 2020, there were no material deferred tax assets and liabilities reported on the consolidated balance sheets. SMECO Solar LLC had no significant uncertain tax positions or tax liability for tax benefits, interest or penalties accrued at December 31, 2021 and 2020.

N. Accumulated Other Comprehensive Income – This item consists of other gains and losses affecting equity that, under GAAP, are excluded from net income. During 2021 and 2020, such items relate to SMECO's unrecognized actuarial loss and amortization from the adoption of guidance issued by FASB as it relates to the accounting for defined benefit pension and other postretirement plans (see Note 7A).

O. Subsequent Events – Subsequent events have been evaluated through April 8, 2022, which is the date the consolidated financial statements were available to be issued.

P. Advertising Costs – Advertising costs are expensed as incurred.

Q. Renewable Portfolio Standard (RPS) – SMECO is subject to Maryland's Renewable Portfolio Standard (RPS), which requires retail suppliers of electricity to provide 52.5% of their retail sales using renewable resources by 2030. SMECO fulfills this obligation by purchasing renewable energy from various resources such as wind and solar, as well as by procuring Renewable Energy Credits (RECs) in the market.

Note 3: Utility Plant

The major classes of utility plant in service as of December 31, 2021 and 2020 are as follows:

	2021	2020
Distribution	$ 730,681,914	$ 706,958,242
Transmission	328,389,281	328,091,315
Generation	14,226,634	14,226,634
Other Production Plant	463,175	463,175
General	221,818,750	179,720,575
	1,295,579,754	1,229,459,941
Construction work in progress	28,747,925	26,993,740
Utility Plant	$1,324,327,679	$1,256,453,681

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

Distribution	3.42%
Transmission	2.77%
Generation	5.00%
General	4.40%

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

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

Note 4: Investments in Associated Organizations

Investments in associated organizations consisted of the following as of December 31, 2021 and 2020:

	2021	2020
National Rural Utilities Cooperative Finance Corporation (CFC):		
Capital Term Certificates		
3%	$ 811,050	$ 811,050
5%	3,164,783	3,164,783
Noninterest bearing	113,700	138,411
Patronage capital certificates	4,032,754	3,766,996
CFC membership	1,000	1,000
	8,123,287	7,882,240
Federated Rural Electric Insurance Corporation	1,467,580	1,357,856
CoBank, ACB (CoBank)	10,909,287	9,981,752
Other	350,978	358,700
	$ 20,851,132	$ 19,580,548

Note 5: Equity Method Investments

Effective August 1, 2003, SMECO invested $1,000,000 for a membership and equity investment in Alliance for Cooperative Energy Services Power Marketing, LLC (subsequently renamed ACES). SMECO's proportionate share of ACES earnings was $3,584 in 2021 and $26,410 in 2020. As of December 31, 2021 and 2020, the carrying value of the investment was $1,296,974 and $1,293,390, respectively.

Note 6: Regulatory Assets

Regulatory assets consisted of the following:

A. Demand Response (DR) and EmPOWER Maryland Programs – Conservation expenditures pertaining to DR and EmPOWER Maryland programs are recognized as regulatory assets and amortized over a one-year or five-year period in accordance with PSC requirements. Conservation costs are recovered through a rate surcharge approved by the PSC that reflects expenditures and an allowed rate of return. The related amounts of regulatory assets for the DR and EmPOWER Maryland programs were $31,965,928 and $33,500,447 as of December 31, 2021 and 2020, respectively.

B. Advanced Metering Infrastructure (AMI) Implementation – Pursuant to PSC approval, a regulatory asset was established for the costs associated with an AMI staged implementation to determine whether the deployment of AMI in SMECO's service territory would achieve the operational savings anticipated. In 2013, the PSC approved the system-wide deployment of AMI and a regulatory asset was established. The deployment of AMI was completed in 2018. As of December 31, 2021 and 2020, the regulatory assets for these projects totaled $41,434,581.

C. Energy and Energy-Related Costs – As of December 31, 2021 and 2020, the regulatory asset pertaining to energy and energy-related costs was $2,684,276 and $3,864,742, respectively (see Note 2).

D. COVID-19 – Pursuant to PSC order, a regulatory asset was established to capture and track the incremental costs related to COVID-19 (see Note 12). The regulatory asset pertaining to these costs was fully amortized during 2021. As of December 31, 2020, the regulatory asset pertaining to these costs totaled $2,317,711 (see Note 9).

Note 7: Employee Benefit Plans

A. Pension Plan and Other Postretirement Benefits – SMECO has a qualified, noncontributory, defined benefit pension plan which provides for retirement benefits based upon age, years of service and compensation. The Retirement Annuity Plan for Employees of SMECO was closed effective December 31, 2006, so that employees who were hired or re-hired on or after January 1, 2007, were not eligible to participate (or recommence participation) in the Pension Plan. SMECO continued to maintain the Pension Plan for current employees through December 31, 2010 at which time the Plan was frozen. The net effect was that a participant's benefits under the Pension Plan were calculated as if the participant terminated employment with SMECO on December 31, 2010. Annual provisions for accrued pension costs are based upon independent actuarial valuations dated as of December 31, 2021 and 2020. SMECO's policy is to fund accrued pension costs in accordance with provisions of the Employee Retirement Income Security Act of 1974 (ERISA).

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

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

In 2018, SMECO offered a voluntary Early Retirement Incentive Window to eligible employees. An employee had to have reached the age of 55 as of May 1, 2018, and have been hired before January 1, 2007. Excluded from the offering were officers, part-time employees and employees already separated from the organization. The offering also provided a monetary supplement to cover health care costs. The one-time benefit costs and related liabilities are included in the actuarial valuations that follow.

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

	Pension Benefits 2021	Pension Benefits 2020
Benefit obligation at year end	$161,781,584	$168,429,262
Fair value of plan assets at year end	150,343,140	139,450,843
Funded status	$ (11,438,444)	$ (28,978,419)
Amounts recognized in the Balance Sheets:		
Accrued benefit cost	$ (11,438,444)	$ (28,978,419)
Deferred charges not included in equity	473,499	710,250
Amounts recognized as reduction in equity not yet recognized as periodic benefit cost:		
Net actuarial loss	56,689,665	72,018,832
Expected amortization for the next fiscal year	2,327,628	2,747,752
Weighted-average assumptions used to determine benefit obligations as of year end:		
Discount rate	2.90%	2.70%
Benefit cost	$ (106,639)	$ 864,918
Employer contribution	1,860,374	3,876,084
Benefits paid	8,471,035	8,271,118
Weighted-average assumptions used to determine benefit costs:		
Discount rate	2.70%	3.45%
Expected return on plan assets	6.25%	6.25%

Expected contributions for year ending December 31, 2022:

Employer	$ 4,898,480
Employees	—

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

2022	$ 8,208,071
2023	8,442,944
2024	8,597,035
2025	8,568,860
2026	8,568,706
2027-2031	43,702,029

Plan Assets:		
Equity Securities (a)	51%	63%
Fixed Income Securities (b)	44%	37%
Real Estate	5%	0%

(a) The portfolio's target asset allocation range is 51% equity with an allowable range of 30% to 60%.

(b) The portfolio's target asset allocation range is 32% fixed income with an allowable range of 30% to 60%.

Plan assets are considered Level 1 inputs on the fair value measurement hierarchy as described in Note 14. During the year, there were no significant changes in the valuation techniques or inputs.

SMECO's investment strategy with respect to pension assets is designed to achieve a moderate level of overall portfolio risk in keeping with its desired risk objective, which is established after careful consideration of plan liabilities, plan funded status and SMECO's overall financial condition. The portfolio's target asset allocation is 51% equity, 32% fixed income, 9% alternatives and 8% cash/stable value with specified allowable ranges around these targets. The equity segment is broadly diversified across growth/value and small-, mid- and large-cap equities. The fixed income segment is diversified by investing in preferred stocks, corporate debt securities, real estate and obligations of the U.S. Government and its agencies. The expected rate of return on plan assets is determined by those assets' historical long-term investment performance, current asset allocation, and estimates of future long-term returns by asset class.

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

	Other Postretirement Benefits 2021	Other Postretirement Benefits 2020
Benefit obligation at year end	$ 24,287,372	$ 27,383,624
Fair value of plan assets at year end	—	—
Funded status	$(24,287,372)	$(27,383,624)
Amounts recognized in the Balance Sheets:		
Accrued benefit cost	$(24,287,372)	$(27,383,624)
Deferred charges not Included in equity	—	—
Amounts recognized as reduction in equity not yet recognized as periodic benefit cost:		
Net actuarial (gain) loss	(1,781,329)	1,761,019
Net prior service (credit) cost	(2,075,452)	(2,355,431)
	(3,856,781)	(594,412)

Expected amortization for the next fiscal year	(279,979)	(279,979)

Weighted-average assumptions used to determine benefit obligations as of year end:

Discount rate	2.90%	2.70%
Benefit cost	$ 1,007,737	$ 1,143,106
Employer contribution	841,620	748,827
Benefits paid	841,620	748,827

Weighted-average assumptions used to determine benefit costs:

Discount rate	2.70%	3.45%

Expected contributions for year ending December 31, 2022 are $1,004,543.

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

2022	$ 1,004,544
2023	977,959
2024	937,876
2025	987,304
2026	983,777
2027-2031	5,705,467

For measurement purposes, a 6.00% medical trend rate was assumed for health care benefits and premiums for 2022. It is further assumed that this rate will decrease to 4.5% through 2027 and remain at that level thereafter.

On December 8, 2003, the President signed into law the Medicare Prescription Drug Improvement and Modernization Act of 2003. This Act introduces a prescription drug benefit under Medicare Part D as well as a federal subsidy to sponsors of retiree healthcare benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. SMECO has not, and does not intend to, apply for this subsidy for the years ended December 31, 2021 and 2020.

B. Health Insurance – SMECO is self-insured for medical and dental claims of its current employees and retirees and their covered dependents. For 2021, SMECO was liable for claims of up to $150,000 per occurrence for medical claims and $2,000 per year per participant for dental claims. For 2022, SMECO is liable for claims up to $175,000 per occurrence for medical claims and $2,000 per year per participant for dental claims. Catastrophic coverage is maintained to pay claims in excess of these amounts. Claims paid under this plan approximated $8.7 million in 2021 and $5.8 million in 2020. Provisions for claims incurred but not reported have been made based on claim experience and approximated $335,000 and $325,000 as of December 31, 2021 and 2020, respectively.

C. 401(k) Plans – SMECO maintains 401(k) plans for its management and bargaining unit employees. All full-time employees are eligible to participate in the plans after meeting minimum service requirements. SMECO matches employee contributions to the management plan up to 6% of annual compensation and for the bargaining plan, matches $.50 on the dollar up to 1% of annual straight time earnings. Effective with the freeze of the Pension Plan (see Note 7A), SMECO provides a non-elective employer contribution which varies based on length of service. For employees with 0 to less than 5 years of service, the contribution is 3% of base pay; 5 to less than 20 years of service, 8% of base pay; and 20 or more years of service, 10% of base pay. During 2021 and 2020, SMECO recorded 401(k) plan-related expenses of approximately $5.2 million and $5.0 million, respectively.

D. Workers' Compensation Trust – SMECO is self-insured for workers' compensation insurance through a separate trust which was established to pay workers’ compensation claims. Contributions to the trust are based upon an actuarial valuation and SMECO maintains excess liability insurance coverage for claims exceeding $750,000. Part One of the policy covers the employer’s statutory liabilities under state law up to $25 million. Part Two covers liability arising out of employee work-related injuries that do not fall under the workers’ compensation statute up to $1 million. Transactions within the trust are not reflected in the accompanying consolidated financial statements. During 2021 and 2020, SMECO made aggregated contributions to the trust of approximately $818,000 and $793,000, respectively. At December 31, 2021 and 2020, the trust had estimated net assets available for benefits of $1,390,630 and $1,040,450, respectively. Maryland Loss Development Factors were used to calculate the 2021 estimate of net assets available for benefits.

Note 8: Patronage Capital and Other Equities

Assigned patronage capital consists of net operating margins that have been allocated to individual member patronage accounts. Patronage capital is applied against unpaid accounts receivable when customers leave SMECO. Patronage capital retirements to date represent amounts that have been paid to individual members. Patronage capital activity as of December 31, 2021 and 2020 consisted of the following:

	2021	2020
Assignable	$ 23,499,420	$ 27,229,164
Assigned to date	400,283,420	373,074,811
	423,782,840	400,303,975
Less: Retirements to date	(116,284,138)	(109,995,453)
Patronage capital	$ 307,498,702	$ 290,308,522

Other equities consist of donated capital from members and nonrefundable membership fees that were previously collected from new members upon joining SMECO. Non-patronage sourced margins are included as part of other equities.

Note 9: Debt

SMECO has outstanding long-term debt from CFC and CoBank. On April 16, 2018, SMECO borrowed an additional $135 million in long-term debt by issuing First Mortgage Notes, Series 2018, 4.00% due April 16, 2048 to various investors in the private placement market. Certain debt issuance costs incurred for the private placement notes are being amortized over the life of the debt. SMECO’s long-term debt is subject to the loan covenants that are described in its Indenture of Mortgage, Security Agreement and Financing Statement, dated as of March 15, 2015, as amended, and substantially all assets are pledged as collateral for the long-term debt. SMECO Solar LLC has obtained long-term debt from FFB, which is guaranteed by SMECO.

The following debt was outstanding as of December 31, 2021 and 2020:

Lender	Interest Rates	Maturity (Year)	2021	2020
SMECO				
CFC	1.93–4.15%	2023-45	$216,064,149	$224,290,709
CoBank	2.61–6.44%	2025-46	265,399,804	279,164,279
Private Placement	4.00%	2048	126,200,222	128,840,106
SMECO Solar LLC				
FFB	3.07%	2034	9,874,737	10,542,987
Total debt outstanding			617,538,912	642,838,081
Less: Current maturities			26,039,421	25,184,067
Unamortized portion of debt issuance costs			455,849	473,160
Long-term debt			$591,043,642	$617,180,854

At December 31, 2021, the required principal payments of the long-term debt are as follows:

2022	$ 26,039,421
2023	26,782,876
2024	27,026,752
2025	26,840,179
2026	26,578,147
Thereafter	484,271,537
Total	$617,538,912

Cash paid for interest totaled approximately $24.8 million and $25.4 million for the years ended December 31, 2021 and 2020, respectively.

SMECO maintains unsecured revolving line of credit agreements at variable interest rates with CoBank and CFC for its short-term borrowing needs. The CoBank agreement expires June 30, 2022. The CFC agreement automatically renews each March unless CFC or SMECO provides written notice not to renew at least 90 days in advance of the renewal date.

As of December 31, 2021, SMECO had authorized lines of credit of $175 million with CFC and $75 million with CoBank. The outstanding balance for the CFC line of credit and the respective interest rate as of December 31, 2021 was $34.0 million at 2.45%. There was no outstanding balance for the CFC line of credit as of December 31, 2020.

The outstanding balances for the CoBank lines of credit and their respective interest rates as of December 31, 2021, were $58.2 million at 2.41% and as of December 31, 2020, were $50.0 million at 2.45%.

On April 20, 2020, SMECO received loan proceeds from M&T Bank for approximately $8.6 million under the Paycheck Protection Program (PPP), which was established as part of the Coronavirus Aid, Relief and Economic Security Act (CARES Act). Such loans are subject to a term of two years at an interest rate of 1%. The loan and accrued interest can be forgiven as long as the borrower uses the loan proceeds for eligible purposes, including payroll costs, mortgage interest payments, rent or lease payments, and utility payments during the eight-week period following the loan disbursement. SMECO has used the proceeds for purposes consistent with the PPP and on June 17, 2021, the entire amount of the loan was forgiven. Of this amount, approximately $2.5 million was offset against the regulatory asset account established for COVID-19 (see Note 6) with the remaining approximately $6.1 million recorded under Nonoperating Margins in the Consolidated Statements of Revenue and Expenses.

As of December 31, 2021 and 2020, SMECO had outstanding letters of credit totaling $11.4 million and $15.4 million, respectively.

Note 10: Leases

SMECO is obligated under long-term capital leases for utility equipment and vehicles that expire at various dates through 2024. The future minimum lease payments required under the capital leases and the present value of the net minimum lease payments as of December 31, 2021 are as follows:

2022	$ 693,666
2023	480,071
2024	138,121
Total minimum lease payments	1,311,858
Less: Amount representing interest	(32,307)
Present value of minimum lease payments	1,279,551
Less: Current obligations	(654,374)
Long-term capital lease obligation	$ 625,177

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

	2021	2020
Transmission	$4,600,700	$4,600,700
General	346,502	959,622
	4,947,202	5,560,322
Less: Accumulated depreciation	(1,234,463)	(1,216,751)
	$3,712,739	$4,343,571

Interest paid on the capital lease obligations for the years ended December 31, 2021 and 2020 was $46,541 and $80,481, respectively. The capital leases are collateralized by the assets leased under the agreements, which are recorded in the accompanying consolidated balance sheet. Depreciation expense at December 31, 2021 and 2020 relating to these assets was $138,310 and $155,927, respectively.

SMECO leases many of its vehicles and power-operated equipment for various terms under long-term, operating lease agreements. The leases expire at various dates through 2026. At the expiration of the scheduled lease term, SMECO can either purchase the equipment at fair market value, have the lessor sell the equipment on its behalf or renew the lease for twelve or twenty-four months. Operating lease expense amounted to $1,408,669 and $1,440,015 in 2021 and 2020, respectively.

The future minimum rental payments required under the operating lease agreements as of December 31, 2021, are as follows:

2022	$1,395,495
2023	681,969
2024	396,498
2025	59,986
2026	3,006
Total	$2,536,954

Note 11: Commitments and Contingencies

SMECO contracts with various suppliers for energy and energy-related products to serve its native load requirements. As of December 31, 2021, SMECO had forward purchase commitments with multiple parties through December 2037 covering a significant portion of SMECO's power supply needs.

At December 31, 2021 and 2020, SMECO had made commitments for capital expenditures of approximately $607,000 and $16.5 million, respectively.

SMECO and Local Union 1718 of the International Brotherhood of Electrical Workers have a collective bargaining unit agreement, which covers approximately 261 of the 465 employees of SMECO, or 56%. The current agreement expires on April 30, 2023.

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

Note 12: Concentration of Risk and COVID-19

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

Under Maryland's Electric Customer Choice and Competition Act and the Electric and Gas Utility Tax Reform Act, electric customers residing in Maryland are entitled to select or choose their electric energy supplier. As of December 31, 2021, SMECO had approximately 5,000 customers served by an alternative electricity supplier. SMECO continues to provide distribution service to all of its customers.

Residential rooftop solar systems continue to be installed throughout SMECO's service territory. Solar developers have installed over 7,000 residential rooftop solar systems through 2021, over four percent of the residential class. The output of these systems offsets energy sales from SMECO. Distribution sales revenue from these customers is reduced resulting in additional revenue recovery from all other residential customers. SMECO will work to pursue legislative and regulatory actions to reduce or eliminate this cost shifting within the residential class.

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

With the assistance of ACES (see Notes 5 and 11), SMECO has developed a more diversified market strategy to meet future power supply needs that includes multiple suppliers and varied contract termination dates. This approach represents a significant departure from the traditional cooperative model of multiple year contracts with a sole supplier. SMECO has concluded that it is not operationally or economically prudent to engage in the traditional full-requirements contract with one supplier.

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

Financial instruments that subject SMECO to concentration of credit risks include customer accounts receivable. SMECO grants credit to customers, substantially all of whom are local residents of SMECO's four-county service area. SMECO places its cash on deposit with financial institutions located in the United States of America, which are insured by the Federal Deposit Insurance Corporation (FDIC). The FDIC provides insurance coverage for up to $250,000 of cash held by SMECO in each separate FDIC insured bank and savings institution. From time to time, SMECO may have amounts on deposit in excess of the insured limits. As of December 31, 2021, SMECO had approximately $2.0 million of deposits that exceeded the insured limits.

In December 2019, a novel strain of coronavirus (COVID-19) surfaced in Wuhan, China and has spread around the world, with resulting business and social disruption. COVID-19 was declared a Public Health Emergency of International Concern by the World Health Organization on January 30, 2020. The COVID-19 pandemic is having widespread, rapidly evolving, and unpredictable impacts on global society, economies, financial markets, and business practices. The substantial uncertainty and the nature and degree of the pandemic and resulting effects over time could result in disruption or restriction on SMECO's ability to operate normally. SMECO's members are also affected by the outbreak, which could delay their power bill payments. Although unlikely, plant construction projects may be delayed or cancelled and certain management accounting estimates and assumptions could be affected by future uncertainty. SMECO may also experience difficulties with suppliers or with vendors in their supply chain, which could have negative effects on operations. Overall, the future impact of the pandemic with respect to SMECO's territory is difficult to predict and could adversely impact its overall operations in the future.

Note 13: Fair Value of Financial Instruments

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

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

<u>Cash and Cash Equivalents</u>

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

<u>Accounts Receivable</u>

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

<u>Investments in Associated Organizations</u>

Fair value of capital term certificates was determined by computing the present value of estimated future cash flows, discounted at the long-term treasury rate of 1.90% and 1.65% as of December 31, 2021 and 2020, respectively. The fair value of patronage capital is not determinable since no legal obligation exists to retire capital credits. The fair value of the equity method investment is not estimated since there are no identified events or changes in circumstances that may have a significant adverse effect on the fair value and it is not practicable to estimate fair value. The carrying value of memberships approximates fair value.

<u>Accounts Payable</u>

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

Long-Term Debt

The carrying amount of SMECO's fixed long-term debt includes certain interest rates that are below quoted market prices for the same or similar issues. Therefore, the fair value of fixed long-term debt is estimated based on current market prices for the same or similar issues offered for debt of the same and remaining maturities which was 4.06% and 3.57% as of December 31, 2021 and 2020, respectively.

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

Customer Deposits

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

Fair Value

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

	Carrying Value		Fair Value	
	2021	2020	2021	2020
	(000 Omitted)		(000 Omitted)	
Assets:				
Capital Term Certificates	$ 4,090	$ 4,114	$ 7,455	$ 8,160
Liabilities:				
Long-term Debt	$(617,539)	$(642,838)	$(634,902)	$(692,574)

Note 14: Fair Value Measurements

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

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

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

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

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

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

	December 31, 2021 (000 Omitted)			
	Total	Level 1	Level 2	Level 3
Assets:				
Derivative Assets, net	$ 10,310	$ —	$ 10,310	$ —
Plan Assets for Pension and Other Benefits	150,343	150,343	—	—
Liabilities:				
Derivative Liabilities, net	$ (2,684)	$ —	$(2,684)	$ —

	December 31, 2020 (000 Omitted)			
	Total	Level 1	Level 2	Level 3
Assets:				
Derivative Assets, net	$ 267	$ —	$ 267	$ —
Plan Assets for Pension and Other Benefits	139,451	139,451	—	—
Liabilities:				
Derivative Liabilities, net	$ (3,865)	$ —	$(3,865)	$ —

Valuation Techniques

The fair value of derivative assets and liabilities (Level 2) is comprised of forward trades, power and gas positions and Financial Transmission Rights (FTRs). The fair value of all forward trades is calculated by a third party, ACES, using market prices when possible and modeled forward prices including constant heat rate projections, supply-demand simulation generated values, inflation escalated market prices, or a blend of these sources when market prices are not available. The power positions are valued at AEP Dayton – Dominion Zone, Brandywine, PJM_RTO, PJM East or PJM West and the gas positions are valued using NYMEX Henry Hub, TETCO M3, TRANSCO Zone 5 or TRANSCO Zone 6 Non-NY pricing. FTRs are marked-to-market based on data from the most recent FTR auction.

The method described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while SMECO believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair values of certain financial instruments could result in a different fair value measurement at the reporting date.

Note 15: Related Party Transactions

SMECO is a member of CFC and CoBank. Pursuant to the member relationships, SMECO has invested in, entered into various loan agreements with, and maintains unsecured lines of credit with these organizations (see Notes 4 and 9). SMECO earned interest income of approximately $183,000 and $188,000 on investments with CFC in 2021 and 2020, respectively. During years 2021 and 2020, SMECO paid interest expense of approximately $19.6 million and $20.0 million, respectively, on aggregated loans from CFC and CoBank.

SMECO invested in and became a member of ACES during 2003 to engage ACES' professional assistance in meeting future power supply needs (see Note 5). SMECO paid ACES approximately $1.1 million for such services during both 2021 and 2020.

SMECO invested in and became a member of National Renewables Cooperative Organization (NRCO) during 2008 to utilize NRCO's services in the analysis of renewable projects in which SMECO may choose to participate in order to fulfill the Maryland RPS obligations (see Notes 2Q and 4). SMECO paid NRCO approximately $42,000 and $36,000 for such services in 2021 and 2020, respectively.

SMECO is a member of Electric Research and Manufacturing Cooperative (ERMCO) and The Tarheel Electric Membership Association, Inc. (TEMA) and purchases materials and supplies from them (see Note 4). During years 2021 and 2020, SMECO made aggregated purchases to these organizations of approximately $385,000 and $377,000, respectively.

SMECO is a member of Federated Rural Electric Insurance Corporation (Federated) and purchases general liability and property insurance from them (see Note 4). SMECO paid Federated approximately $937,000 and $895,000 for such insurance in 2021 and 2020, respectively.

During 2021 and 2020, SMECO allocated administrative expenses of approximately $136,000 and $149,000 to SMECO Solar LLC, respectively. In accordance with the interconnection and power purchase agreement signed in 2011, SMECO Solar LLC sells all its generated electricity to SMECO. Sales were approximately $1.7 million for both years ended December 31, 2021 and 2020. Inter-company receivables and payables have been eliminated upon consolidation.

Note 16: Storm Loss

In August 2020, Tropical Storm Isaias struck SMECO's service territory causing system damage totaling approximately $1.7 million. In early February 2021, the Federal Emergency Management Agency (FEMA) granted a disaster declaration for this storm. SMECO expects to receive funding from FEMA of approximately $665,000 which has been offset against the storm costs in the accompanying financial statements.

Independent Auditor's Report on Supplementary Information

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

We have audited the consolidated financial statements of Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC (SMECO) for the years ended December 31, 2021 and 2020, and our report thereon dated April 8, 2022, which expressed an unmodified opinion on those consolidated financial statements appears on pages 1 and 2. Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating financial information and consolidated comparative summary of operations is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual entities, and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

We also have previously audited, in accordance with auditing standards generally accepted in the United States of America, the balance sheets of SMECO as of December 31, 2020, 2019, 2018, and 2017, and the related statements of revenue, expenses and patronage capital and comprehensive income, and cash flows for each of the three years then ended (none of which is presented herein), and we expressed unmodified opinions on those financial statements. In our opinion, the comparative summary of operations is fairly stated in all material respects in relation to the basic consolidated financial statements from which it has been derived.

Adams, Jenkins & Cheatham

Richmond, Virginia
April 8, 2022

231 Wylderose Drive | Midlothian, VA 23113 | 804.323.1313

Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
Consolidating Balance Sheets
December 31, 2021

	SMECO	SMECO Solar LLC	Eliminations	Total
Assets				
Utility Plant, at Original Cost (Notes 2 and 3)	$ 1,310,101,045	$ 14,226,634	$ -	$ 1,324,327,679
Less: Accumulated Depreciation and Amortization	(460,242,737)	(6,452,387)	-	(466,695,124)
Net utility plant	849,858,308	7,774,247	-	857,632,555
Nonutility Property (net)	2,934,400	-	-	2,934,400
Investments (Note 2):				
Investments in associated organizations, at cost (Notes 4 and 13)	20,851,132	-	-	20,851,132
Investment in an unconsolidated entity (Note 5)	1,296,974	-	-	1,296,974
Investment in SMECO Solar LLC	1,151,894	-	(1,151,894)	-
Other investments	3,792,708	-	-	3,792,708
Total investments	27,092,708	-	(1,151,894)	25,940,814
Current Assets (Note 2):				
Cash and cash equivalents	1,987,036	287,730	-	2,274,766
Accounts receivable, net of allowance for doubtful accounts of $685,000	57,571,257	-	-	57,571,257
Materials and supplies inventory	14,969,686	21,850	-	14,991,536
Prepaid expenses	5,017,810	4,330	-	5,022,140
Intercompany receivables	28,394	63,698	(92,092)	-
Other current assets	38,524,600	3,002,468	-	41,527,068
Total current assets	118,098,783	3,380,076	(92,092)	121,386,767
Regulatory Assets (Notes 2 and 6)	76,084,785	-	-	76,084,785
Deferred Charges and Other (Note 2)	30,552,933	-	-	30,552,933
Derivative Assets (Notes 2 and 14)	10,309,587	-	-	10,309,587
Total assets	$ 1,114,931,504	$ 11,154,323	$ (1,243,986)	$ 1,124,841,841
Equities and Liabilities				
Equities (Note 8):				
Patronage capital	$ 307,498,702	$ -	$ -	$ 307,498,702
Other equities	40,834,127	1,151,894	(1,151,894)	40,834,127
Accumulated other comprehensive loss	(52,832,884)	-	-	(52,832,884)
Total equities	295,499,945	1,151,894	(1,151,894)	295,499,945
Long-Term Debt, Less Current Maturities (Notes 9 and 13)	581,860,616	9,183,026	-	591,043,642
Current Liabilities:				
Accounts payable	39,780,292	99,298	-	39,879,590
Current maturities of long-term debt (Note 9)	25,347,710	691,711	-	26,039,421
Notes payable (Note 9)	92,200,000	-	-	92,200,000
Current portion of accrued pension and postretirement benefits (Note 7)	1,083,023	-	-	1,083,023
Current portion of obligations under capital lease (Note 10)	654,374	-	-	654,374
Customer deposits	6,798,634	-	-	6,798,634
Intercompany payables	63,698	28,394	(92,092)	-
Other current liabilities	21,671,795	-	-	21,671,795
Total current liabilities	187,599,526	819,403	(92,092)	188,326,837
Accrued Pension and Postretirement Benefits (Note 7)	34,642,793	-	-	34,642,793
Noncurrent Portion of Obligations Under Capital Lease (Note 10)	625,177	-	-	625,177
Deferred Credits	12,019,171	-	-	12,019,171
Derivative Liabilities (Notes 2 and 14)	2,684,276	-	-	2,684,276
Total equities and liabilities	$ 1,114,931,504	$ 11,154,323	$ (1,243,986)	$ 1,124,841,841

See Independent Auditor's Report on Supplementary Information.

Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
Consolidating Statements of Revenue and Expenses
Year Ended December 31, 2021

	SMECO	SMECO Solar LLC	Eliminations	Total
Operating Revenue:				
Sales of electricity	$ 393,540,887	$ 1,676,013	$ (1,676,013)	$ 393,540,887
Lease income	79,799	-	(79,799)	-
Other	48,267,212	-	-	48,267,212
Total operating revenue	441,887,898	1,676,013	(1,755,812)	441,808,099
Operating Expenses:				
Purchased power (Note 11)	230,796,200	-	(1,676,013)	229,120,187
Power production	-	340,297	(79,799)	260,498
Transmission	4,634,963	-	-	4,634,963
Distribution - operations	11,209,308	-	-	11,209,308
Distribution - maintenance	22,596,037	-	-	22,596,037
Customer accounts	11,070,083	-	-	11,070,083
Customer service and information	27,283,616	-	-	27,283,616
Administrative and general	38,805,940	52,716	-	38,858,656
Depreciation and amortization	41,983,515	711,332	-	42,694,847
Taxes	17,086,268	186,327	-	17,272,595
Other	2,256,963	-	-	2,256,963
Total operating expenses	407,722,893	1,290,672	(1,755,812)	407,257,753
Operating margins	34,165,005	385,341	-	34,550,346
Interest Expense:				
Interest on long-term debt	22,590,524	327,950	-	22,918,474
Other interest	1,469,986	-	-	1,469,986
Total interest expense	24,060,510	327,950	-	24,388,460
Net Operating Margins	10,104,495	57,391	-	10,161,886
Other Patronage Allocations	3,791,962	-	-	3,791,962
Total operating margins	13,896,457	57,391	-	13,953,848
Nonoperating Margins	10,248,249	3,755	(61,146)	10,190,858
Net margins	$ 24,144,706	$ 61,146	$ (61,146)	$ 24,144,706

Consolidating Statements of Comprehensive Income
Year Ended December 31, 2021

	SMECO	SMECO Solar LLC	Eliminations	Total
Net Margins	$ 24,144,706	$ 61,146	$ (61,146)	$ 24,144,706
Other Comprehensive Income:				
Postretirement benefit plans actuarial gain, net	16,102,951	-	-	16,102,951
Amortization of net loss and prior service costs	2,488,585	-	-	2,488,585
Other comprehensive income	18,591,536	-	-	18,591,536
Comprehensive Income	$ 42,736,242	$ 61,146	$ (61,146)	$ 42,736,242

See Independent Auditor's Report on Supplementary Information.

Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
Consolidated Comparative Summary of Operations
Years Ended December 31, 2021 - 2017

	2021	2020	2019	2018	2017
Operating Revenue:					
Sales of electricity	$ 393,540,887	$ 365,104,541	$ 407,090,522	$ 415,643,743	$ 393,776,031
Other	48,267,212	45,983,078	42,893,625	46,640,560	26,119,875
Total operating revenue	441,808,099	411,087,619	449,984,147	462,284,303	419,895,906
Operating Expenses:					
Purchased power	229,120,187	195,867,635	240,273,060	249,706,813	225,242,729
Power production	260,498	263,044	253,333	250,774	240,069
Transmission	4,634,963	3,397,491	4,416,785	3,827,626	3,662,300
Distribution - operations	11,209,308	10,790,305	11,805,210	11,445,363	10,616,908
Distribution - maintenance	22,596,037	21,257,905	18,827,947	20,718,862	18,797,371
Customer accounts	11,070,083	10,777,955	10,877,395	11,131,675	11,359,580
Customer service and information	27,283,616	24,850,598	21,115,760	26,390,181	22,505,156
Administrative and general	38,858,656	38,089,876	36,717,628	39,344,135	35,496,638
Depreciation and amortization	42,694,847	41,025,270	39,701,741	38,021,212	35,671,034
Taxes	17,272,595	16,441,626	15,744,868	15,715,740	14,941,871
Other	2,256,963	2,095,274	2,033,367	1,763,861	1,618,609
Total operating expenses	407,257,753	364,856,979	401,767,094	418,316,242	380,152,265
Operating margins	34,550,346	46,230,640	48,217,053	43,968,061	39,743,641
Interest Expense:					
Interest on long-term debt	22,918,474	24,157,026	25,284,878	24,206,522	22,069,422
Other interest	1,469,986	946,450	164,064	-	1,423,887
Total interest expense	24,388,460	25,103,476	25,448,942	24,206,522	23,493,309
Net Operating Margins	10,161,886	21,127,164	22,768,111	19,761,539	16,250,332
Other Patronage Allocations	3,791,962	3,911,104	3,444,195	4,619,298	4,494,232
Total operating margins	13,953,848	25,038,268	26,212,306	24,380,837	20,744,564
Nonoperating Margins	10,190,858	2,848,997	2,788,736	2,855,271	2,638,158
Net margins	$ 24,144,706	$ 27,887,265	$ 29,001,042	$ 27,236,108	$ 23,382,722
Electric Revenue:					
Residential	$ 263,356,258	$ 242,396,128	$ 268,744,777	$ 276,362,221	$ 260,056,564
General service	109,693,858	104,565,503	118,132,444	119,617,634	113,694,912
Large power	14,088,514	12,497,785	14,464,563	14,064,413	14,626,870
Street lights	2,676,046	2,639,767	2,566,188	2,549,742	2,573,565
Transmission	3,682,166	2,965,101	3,140,181	3,007,314	2,709,271
Solar facility/station power services	44,045	40,257	42,369	42,419	114,849
Total	$ 393,540,887	$ 365,104,541	$ 407,090,522	$ 415,643,743	$ 393,776,031
Megawatt-Hour Sales:					
Residential	2,225,670	2,136,051	2,180,188	2,276,786	2,056,626
General service	1,044,948	994,866	1,106,476	1,121,423	1,105,691
Large power	148,453	147,971	160,020	164,101	162,842
Street lights	9,244	8,900	8,615	8,367	8,052
Transmission	50,389	49,112	55,035	51,072	40,675
Solar facility/station power services	154	155	155	155	1,888
Total	3,478,858	3,337,055	3,510,489	3,621,904	3,375,774
Customers at Year End (Billings)	172,091	170,188	168,110	166,275	165,196

See Independent Auditor's Report on Supplementary Information.

Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC

Financial Statements
December 31, 2022 and 2021

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Independent Auditor's Report

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

Opinion

We have audited the accompanying financial statements of Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC (the "Cooperative") which comprise the consolidated balance sheets as of December 31, 2022 and 2021, and the related consolidated statements of revenue and expenses, comprehensive income, changes in equities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Southern Maryland Electric Cooperative and SMECO Solar LLC as of December 31, 2022 and 2021, 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.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for Audit of the Consolidated Financial Statements section of our report. We are required to be independent of Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about Southern Maryland Electric Cooperative and SMECO Solar's ability to continue as a going concern within one year after the date that the financial statements are available to be issued.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists.

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The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements, including omissions, are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgement made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgement and maintain professional skepticism throughout the audit.

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.

- Obtain an understanding of internal control relevant to the audit 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 Southern Maryland Electric Cooperative, Inc. and SMECO Solar, LLC's internal control. Accordingly, no such opinion is expressed.

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.

- Conclude whether, in our judgement, there are conditions or events, considered in the aggregate, that raise substantial doubt about Southern Maryland Electric Cooperative, Inc. and SMECO Solar, LLC's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

Adams, Jenkins & Cheatham

Richmond, Virginia
April 5, 2023

Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
Consolidated Balance Sheets
December 31, 2022 and 2021

	2022	2021
Assets		
Utility Plant, at Original Cost (Notes 2 and 3)	$ 1,366,132,393	$ 1,324,327,679
Less: Accumulated Depreciation and Amortization	(488,083,042)	(466,695,124)
Net utility plant	878,049,351	857,632,555
Nonutility Property (net)	2,811,212	2,934,400
Investments (Note 2):		
Investments in associated organizations, at cost (Notes 4 and 13)	22,048,010	20,851,132
Investment in an unconsolidated entity (Note 5)	1,305,529	1,296,974
Other investments	341,814	3,792,708
Total investments	23,695,353	25,940,814
Current Assets (Note 2):		
Cash and cash equivalents	4,331,413	2,274,766
Accounts receivable, net of allowance for doubtful accounts of $1,000,000 and $685,000, respectively	84,045,987	57,571,257
Materials and supplies inventory	18,960,731	14,991,536
Prepaid expenses	12,730,764	5,022,140
Other current assets	54,954,718	41,527,068
Total current assets	175,023,613	121,386,767
Regulatory Assets (Notes 2 and 6)	80,437,191	76,084,785
Deferred Charges and Other (Note 2)	26,210,365	30,552,933
Derivative Assets (Notes 2 and 14)	35,854,098	10,309,587
Total assets	$ 1,222,081,183	$ 1,124,841,841
Equities and Liabilities		
Equities (Note 8):		
Patronage capital	$ 312,229,712	$ 307,498,702
Other equities	43,222,562	40,834,127
Accumulated other comprehensive loss	(38,232,868)	(52,832,884)
Total equities	317,219,406	295,499,945
Long-Term Debt, Less Current Maturities (Notes 9 and 13)	710,376,012	591,043,642
Current Liabilities:		
Accounts payable	23,357,381	39,879,590
Current maturities of long-term debt (Note 9)	29,432,088	26,039,421
Notes payable (Note 9)	48,000,000	92,200,000
Current portion of accrued pension and postretirement benefits (Note 7)	801,241	1,083,023
Current portion of obligations under capital lease (Note 10)	1,624,393	654,374
Customer deposits	6,760,976	6,798,634
Other current liabilities	26,341,669	21,671,795
Total current liabilities	136,317,748	188,326,837
Accrued Pension and Postretirement Benefits (Note 7)	15,080,200	34,642,793
Noncurrent Portion of Obligations Under Capital Lease (Note 10)	2,285,179	625,177
Deferred Credits	39,260,157	12,019,171
Derivative Liabilities (Notes 2 and 14)	1,542,481	2,684,276
Total equities and liabilities	$ 1,222,081,183	$ 1,124,841,841

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

Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
Consolidated Statements of Revenue and Expenses
Years Ended December 31, 2022 and 2021

	2022	2021
Operating Revenue:		
Sales of electricity	$ 499,135,792	$ 393,540,887
Other	46,433,454	48,267,212
Total operating revenue	545,569,246	441,808,099
Operating Expenses:		
Purchased power (Note 11)	327,389,289	229,120,187
Power production	261,895	260,498
Transmission	4,785,472	4,634,963
Distribution - operations	11,919,328	11,209,308
Distribution - maintenance	25,481,056	22,596,037
Customer accounts	12,048,378	11,070,083
Customer service and information	24,949,384	27,283,616
Administrative and general	41,353,004	38,858,656
Depreciation and amortization	44,922,008	42,694,847
Taxes	18,605,071	17,272,595
Other	2,217,526	2,256,963
Total operating expenses	513,932,411	407,257,753
Operating margins	31,636,835	34,550,346
Interest Expense:		
Interest on long-term debt	24,334,435	22,918,474
Other interest	942,303	1,469,986
Total interest expense	25,276,738	24,388,460
Net Operating Margins	6,360,097	10,161,886
Other Patronage Allocations	3,638,563	3,791,962
Total operating margins	9,998,660	13,953,848
Nonoperating Margins	2,710,315	10,190,858
Net margins	$ 12,708,975	$ 24,144,706

Consolidated Statements of Comprehensive Income
Years Ended December 31, 2022 and 2021

	2022	2021
Net Margins	$ 12,708,975	$ 24,144,706
Other Comprehensive Income:		
Postretirement benefit plans actuarial gain, net	12,690,697	16,102,951
Amortization of net loss and prior service costs	1,909,319	2,488,585
Other comprehensive income	14,600,016	18,591,536
Comprehensive Income	$ 27,308,991	$ 42,736,242

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

Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
Consolidated Statements of Changes in Equities
Years Ended December 31, 2022 and 2021

	Patronage Capital	Other Equities	Accumulated Other Comprehensive (Loss) Income	Total
Balance, December 31, 2020	$ 290,308,522	$ 38,687,316	$ (71,424,420)	$ 257,571,418
Net margins	23,478,865	665,841	-	24,144,706
Retirement of capital credits	(6,288,685)	1,480,970	-	(4,807,715)
Other comprehensive income	-	-	18,591,536	18,591,536
Balance, December 31, 2021	307,498,702	40,834,127	(52,832,884)	295,499,945
Net margins	12,088,355	620,620	-	12,708,975
Retirement of capital credits	(7,357,345)	1,677,687	-	(5,679,658)
Prior year unclaimed capital credits	-	90,128	-	90,128
Other comprehensive income	-	-	14,600,016	14,600,016
Balance, December 31, 2022	$ 312,229,712	$ 43,222,562	$ (38,232,868)	$ 317,219,406

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

Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
Consolidated Statements of Cash Flows
Years Ended December 31, 2022 and 2021

	2022	2021
Cash Flows From Operating Activities:		
Net margins	$ 12,708,975	$ 24,144,706
Adjustments to reconcile net margins to net cash (used in) provided by operating activities:		
Depreciation and amortization	44,922,008	42,694,847
Amortization of loss on reacquired debt	1,170,127	1,170,127
Amortization of debt issuance costs	17,311	17,311
Earnings in unconsolidated entities	(8,555)	(3,584)
Other patronage allocations	(3,638,563)	(3,791,962)
Forgiveness of Paycheck Protection Program (PPP) loan	-	(8,560,877)
Payments on capital lease obligations - operating leases	(1,395,495)	-
Change in operating assets and liabilities:		
Accounts receivable, net	(26,474,730)	(1,203,874)
Prepaid expenses	(7,708,624)	6,753,628
Derivative assets	(25,544,511)	(10,042,586)
Other current assets	(13,427,650)	(17,512,033)
Deferred charges and other	(345,205)	(2,745,280)
Regulatory assets	(4,352,406)	5,032,696
Accounts payable	(16,522,209)	12,358,579
Customer deposits	(37,658)	(750,796)
Other current liabilities	4,669,874	(6,768,169)
Deferred credits	27,331,114	8,615,501
Derivative liabilities	(1,141,795)	(1,180,466)
Accrued pension and postretirement benefits	(5,244,359)	(2,044,691)
Net cash (used in) provided by operating activities	(15,022,351)	46,183,077
Cash Flows From Investing Activities:		
Construction of utility plant	(60,575,876)	(66,923,912)
Plant removal cost	(2,963,271)	(3,189,941)
Proceeds from the salvage of utility plant	60,650	129,982
Contributions in aid of construction	7,116,661	6,342,033
Capitalized interest	(530,720)	(176,606)
Materials and supplies inventory	(3,969,195)	(2,231,236)
Disposition of nonutility property	123,188	(119,405)
Net change in other investments	3,450,894	2,827,513
Net redemption of capital term certificates	25,538	24,711
Net sale of associated investments	2,416,146	2,496,667
Net cash used in investing activities	(54,845,985)	(60,820,194)
Cash Flows From Financing Activities:		
Advances on long-term debt	150,000,000	-
Payments of long-term debt	(27,292,273)	(25,299,169)
Advances under line of credit agreements	280,300,000	170,800,000
Payments under line of credit agreements	(324,500,000)	(128,600,000)
Payments on capital lease obligations	(903,086)	(656,996)
Distribution of capital credits	(5,679,658)	(4,807,715)
Net cash provided by financing activities	71,924,983	11,436,120
Net Increase (Decrease) in Cash and Cash Equivalents	2,056,647	(3,200,997)
Cash and Cash Equivalents, Beginning of Year	2,274,766	5,475,763
Cash and cash equivalents, end of year	$ 4,331,413	$ 2,274,766
Non-Cash Investing Activity:		
Capital lease additions	$ 2,160,118	$ 160,852
Capital leases added as a result of ASC 842 implementation	2,768,484	-
	$ 4,928,602	$ 160,852

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

Notes to Consolidated Financial Statements
Years Ended December 31, 2022 and 2021

Note 1: Description of Business

Southern Maryland Electric Cooperative, Inc. (SMECO) is an electric transmission and distribution cooperative that was initially formed as Southern Maryland Tri-County Cooperative Association on February 5, 1937. In 1942, the members voted to change the form of the organization from an association to a cooperative, nonprofit membership corporation under the Maryland Electric Cooperative Act and adopted the current name. SMECO serves about 174,000 customers in a 1,150 square-mile area in Southern Maryland comprised of Calvert, Charles, Prince George's and St. Mary's counties.

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

Note 2: Summary of Significant Accounting Policies

A. System of Accounts and Regulation – The accounting records are maintained in accordance with the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission (FERC). SMECO is subject to regulation by the Maryland Public Service Commission (PSC). The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The consolidated financial statements reflect the ratemaking policies of the PSC in conformity with guidance set forth by the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 980 as it relates to certain types of regulated industries. This standard allows SMECO to record certain regulatory assets and liabilities, which will be included in future rates and would not be recorded under GAAP for nonregulated entities in the United States (see Note 6).

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

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

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

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

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

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

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

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

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

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

J. Derivative Instruments – SMECO uses various methods, such as forward purchase contracts, option contracts, financial swaps and commodity swaps to manage the commodity and financial risks associated with meeting its power supply requirements. SMECO accounts for the aforementioned contracts in accordance with guidance as set forth by FASB as it relates to derivative instruments and hedging activities. This guidance requires all derivatives, subject to certain exceptions, to be accounted for at fair value. According to FASB guidance, the majority of SMECO's forward purchase contracts and option contracts qualify for the normal purchase and normal sales exception. As a result, these contracts are not recorded at fair value. Since all of SMECO's power supply related costs are subject to rate recovery, changes in the fair value of financial and commodity swaps are periodically reflected as derivative assets and regulatory liabilities or derivative liabilities and regulatory assets, respectively, under the provisions as set forth by FASB (see Note 2A). As of December 31, 2022, the change in fair value of SMECO's derivative instruments, excluding contracts accounted for as normal purchase/normal sale were as follows:

Derivatives	Balance Sheet Location	Change in Fair Value
Financial Gas	Regulatory assets and Derivative liabilities	$ (1,542,481)
Financial Energy	Derivative assets and Regulatory liabilities	32,664,992
Financial Transmission Rights	Derivative assets and Regulatory liabilities	3,189,106
Total		$ 34,311,617

At December 31, 2022, total derivative contracts in a gross asset and gross liability position amounted to approximately $45.3 million and $11.0 million, respectively.

As of December 31, 2021, the change in fair value of SMECO's derivative instruments, excluding contracts accounted for as normal purchase/normal sale were as follows:

Derivatives	Balance Sheet Location	Change in Fair Value
Financial Gas	Regulatory assets and Derivative liabilities	$ (2,684,276)
Financial Energy	Derivative assets and Regulatory liabilities	8,635,880
Financial Transmission Rights	Derivative assets and Regulatory liabilities	1,673,707
Total		$ 7,625,311

At December 31, 2021, total derivative contracts in a gross asset and gross liability position amounted to approximately $13.2 million and $5.6 million, respectively.

Net gains and losses on financial and commodity swaps and Financial Transmission Rights are reflected in cost of power at the time they are settled. For the year ended December 31, 2022, the net realized gain (loss) on these transactions was as follows:

Derivatives	Net Realized Gain (Loss) Recognized in Purchased Power
Financial Gas	$ 2,745,300
Financial Energy	(14,458,000)
Financial Transmission Rights	467,201
Total	$ (11,245,499)

For the year ended December 31, 2021, the net realized gain (loss) on these transactions was as follows:

Derivatives	Net Realized Gain (Loss) Recognized in Purchased Power
Financial Gas	$ (230,065)
Financial Energy	6,274,250
Financial Transmission Rights	(800,759)
Total	$ 5,243,426

As of December 31, 2022 and 2021, SMECO had entered into commitments for options totaling $5.4 million and $10.5 million, respectively.

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

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

L. Revenue Recognition – Revenue is recognized as service is rendered to customers. Recorded revenue includes an estimate of unbilled revenue for utility service rendered but not billed to customers as of year-end. Estimated unbilled revenue was approximately $28.7 million and $19.5 million as of December 31, 2022 and 2021, respectively.

SMECO has analyzed the provisions of ASC Topic 606, Revenue from Contracts with Customers and has concluded that no changes were necessary to conform to the new standard. SMECO recognizes revenue from consumed electricity in the appropriate reporting period through its estimate of unbilled revenue, which complies with the requirements of ASC Topic 606.

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

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

SMECO Solar LLC is taxed as a corporation and is subject to federal and state income taxes. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences arising between the tax bases of assets and liabilities and their reported amounts in accordance with GAAP. At December 31, 2022 and 2021, there were no material deferred tax assets and liabilities reported on the consolidated balance sheets. SMECO Solar LLC had no significant uncertain tax positions or tax liability for tax benefits, interest or penalties accrued at December 31, 2022 and 2021.

N. Accumulated Other Comprehensive Income – This item consists of other gains and losses affecting equity that, under GAAP, are excluded from net income. During 2022 and 2021, such items relate to SMECO's unrecognized actuarial loss and amortization from the adoption of guidance issued by FASB as it relates to the accounting for defined benefit pension and other postretirement plans (see Note 7A).

O. Subsequent Events – Subsequent events have been evaluated through April 5, 2023, which is the date the consolidated financial statements were available to be issued.

P. Advertising Costs – Advertising costs are expensed as incurred.

Q. Renewable Portfolio Standard (RPS) – SMECO is subject to Maryland's Renewable Portfolio Standard (RPS), which requires retail suppliers of electricity to provide 52.5% of their retail sales using renewable resources by 2030. SMECO fulfills this obligation by purchasing renewable energy from various resources such as wind and solar, as well as by procuring Renewable Energy Credits (RECs) in the market. In order to meet the requirement for 2021 Solar RECs, SMECO opted to pay a compliance fee of $3.9 million in 2022, which was more cost effective than fulfilling the remaining Solar REC needs on the market.

R. Recently Adopted Accounting Standards – In February 2016, FASB issued Accounting Standards Update (ASU) 2016-02 Leases (Topic 842). ASU 2016-02 replaced most existing lease guidance in U.S. GAAP when it became effective. ASU 2016-02 requires an entity to recognize most leases, including operating leases, on the balance sheet of the lessee. The guidance became effective for annual reporting periods beginning after December 15, 2021. SMECO implemented ASU 2016-02 for the year ended December 31, 2022. Operating leases are included in operating lease right-of-use ("ROU") assets, other current liabilities, and operating lease liabilities in the balance sheets. ROU assets represent the right to use an underlying asset for the lease term, and lease liabilities represent the obligation to make lease payments. Operating lease ROU assets and liabilities are recognized at the lease commencement date based on the present value of lease payments over the lease term. SMECO uses the implicit rate when it is readily determinable. Since most of SMECO's leases do not provide an implicit rate, to determine the present value of lease payments, the incremental borrowing rate based on the information available at lease commencement is used. Operating lease ROU assets also include any lease payments made and excludes any lease incentives. Lease expense for lease payments is recognized on a straight-line basis over the lease term. Lease terms may include options to extend or terminate the lease when it is reasonably certain that we will exercise that option.

Note 3: Utility Plant

The major classes of utility plant in service as of December 31, 2022 and 2021 are as follows:

	2022	2021
Distribution	$ 760,505,687	$ 730,681,914
Transmission	326,361,749	328,389,281
Generation	14,228,550	14,226,634
Other Production Plant	463,175	463,175
General	227,733,742	221,818,750
Right of Use Asset- Finance Lease	6,509,724	-
Right of Use Asset- Operating Lease	2,271,947	-
	1,338,074,574	1,295,579,754
Construction work in progress	28,057,819	28,747,925
Utility Plant	$1,366,132,393	$1,324,327,679

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

Distribution	3.42%
Transmission	2.77%
Generation	5.00%
General	4.40%

Right of Use (ROU) assets are amortized on a straight-line basis beginning with the first month the lease is in service until the earlier of the end of the lease term or the useful life of the asset using an accumulated amortization ROU asset account.

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

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

Note 4: Investments in Associated Organizations

Investments in associated organizations consisted of the following as of December 31, 2022 and 2021:

	2022	2021
National Rural Utilities Cooperative Finance Corporation (CFC):		
Capital Term Certificates		
3%	$ 811,050	$ 811,050
5%	3,164,783	3,164,783
Noninterest bearing	88,162	113,700
Patronage capital certificates	4,289,348	4,032,754
CFC membership	1,000	1,000
	8,354,343	8,123,287
Federated Rural Electric Insurance Corporation	1,533,907	1,467,580
CoBank, ACB (CoBank)	11,836,753	10,909,287
Other	323,007	350,978
	$ 22,048,010	$ 20,851,132

Note 5: Equity Method Investments

Effective August 1, 2003, SMECO invested $1,000,000 for a membership and equity investment in Alliance for Cooperative Energy Services Power Marketing, LLC (subsequently renamed ACES). SMECO's proportionate share of ACES earnings was $8,555 in 2022 and $3,584 in 2021. As of December 31, 2022 and 2021, the carrying value of the investment was $1,305,529 and $1,296,974, respectively.

Note 6: Regulatory Assets

Regulatory assets consisted of the following:

A. Demand Response (DR) and EmPOWER Maryland Programs – Conservation expenditures pertaining to DR and EmPOWER Maryland programs are recognized as regulatory assets and amortized over a one-year or five-year period in accordance with PSC requirements. Conservation costs are recovered through a rate surcharge approved by the PSC that reflects expenditures and an allowed rate of return. The related amounts of regulatory assets for the DR and EmPOWER Maryland programs were $36,208,648 and $31,965,928 as of December 31, 2022 and 2021, respectively.

B. Advanced Metering Infrastructure (AMI) Implementation – Pursuant to PSC approval, a regulatory asset was established for the costs associated with an AMI staged implementation to determine whether the deployment of AMI in SMECO's service territory would achieve the operational savings anticipated. In 2013, the PSC approved the system-wide deployment of AMI and a regulatory asset was established. The deployment of AMI was completed in 2018. As of December 31, 2022 and 2021, the regulatory assets for these projects totaled $41,432,065 and $41,434,581, respectively.

C. Energy and Energy-Related Costs – As of December 31, 2022 and 2021, the regulatory asset pertaining to energy and energy-related costs was $1,542,481 and $2,684,276, respectively (see Note 2).

D. COVID-19 – Pursuant to PSC order, a regulatory asset was established to capture and track the incremental costs related to COVID-19 (see Note 12). The regulatory asset pertaining to these costs was fully amortized during 2021 (see Note 9).

E. Public Electric Vehicle Charging Station Pilot Program – Pursuant to PSC order, a regulatory asset was established to capture and track the costs to install, own, and operate Level 2 and Direct Current Fast Chargers (DCFC) stations for use by the public on property leased, owned, or occupied by a unit of State, county, or municipal government. As of December 31, 2022, the regulatory asset pertaining to these costs totaled $1,251,371.

F. Federal Grant Opportunities for Utilities Under the Infrastructure Investment & Jobs Act – On November 15, 2021, the President of the United States signed into law the Infrastructure Investment and Jobs Act (IIJA). The IIJA provides for substantial investment of federal funds in utility infrastructure including grid resiliency and reliability, electric generation and transmission, access to clean water, and improved cybersecurity. Pursuant to PSC order, a regulatory asset was established to capture and track the incremental costs related to IIJA program funding. As of December 31, 2022, the regulatory asset pertaining to these costs totaled $2,626.

Note 7: Employee Benefit Plans

A. Pension Plan and Other Postretirement Benefits – SMECO has a qualified, noncontributory, defined benefit pension plan which provides for retirement benefits based upon age, years of service and compensation. The Retirement Annuity Plan for Employees of SMECO was closed effective December 31, 2006, so that employees who were hired or re-hired on or after January 1, 2007, were not eligible to participate (or recommence participation) in the Pension Plan. SMECO continued to maintain the Pension Plan for current employees through December 31, 2010 at which time the Plan was frozen. The net effect was that a participant's benefits under the Pension Plan were calculated as if the participant terminated employment with SMECO on December 31, 2010. Annual provisions for accrued pension costs are based upon independent actuarial valuations dated as of December 31, 2022 and 2021. SMECO's policy is to fund accrued pension costs in accordance with provisions of the Employee Retirement Income Security Act of 1974 (ERISA).

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

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

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

	Pension Benefits	
	2022	2021
Benefit obligation at year end	$118,952,058	$161,781,584
Fair value of plan assets at year end	116,706,447	150,343,140
Funded status	$ (2,245,611)	$ (11,438,444)
Amounts recognized in the Balance Sheets:		
Accrued benefit cost	$ (2,245,611)	$ (11,438,444)
Deferred charges not included in equity	236,749	473,499
Amounts recognized as reduction in equity not yet recognized as periodic benefit cost:		
Net actuarial loss	52,639,912	56,689,665
Expected amortization for the next fiscal year	852,657	2,327,628
Weighted-average assumptions used to determine benefit obligations as of year end:		
Discount rate	5.50%	2.90%
	2022	**2021**
Benefit cost	$ (575,116)	$ (106,639)
Employer contribution	4,324,169	1,860,374
Benefits paid	8,596,255	8,471,035
Weighted-average assumptions used to determine benefit costs:		
Discount rate	2.90%	2.70%
Expected return on plan assets	6.00%	6.25%
Expected contributions for year ending December 31, 2023:		
Employer	$ 1,558,439	
Employees	—	

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

2023	$ 8,407,490
2024	8,526,742
2025	8,507,526
2026	8,490,411
2027	8,568,653
2028-2032	43,642,090

Plan Assets:	2022	2021
Equity Securities (a)	28%	51%
Fixed Income Securities (b)	70%	44%
Real Estate	2%	5%

Portfolio Target Allocation

Funded Status (Accounting Basis)	Return Seeking (a)	Liability Hedging (b)
105-110%	0-10%	90-100%
100-105%	20-30%	70-80%
95-100%	35-45%	55-65%

Plan assets are considered Level 1 inputs on the fair value measurement hierarchy as described in Note 14. During the year, there were no significant changes in the valuation techniques or inputs.

SMECO's investment strategy with respect to pension assets is designed to achieve a moderate level of overall portfolio risk in keeping with its desired risk objective, which is established after careful consideration of plan liabilities, plan funded status and SMECO's overall financial condition. The portfolio's target asset allocation is based on the funded status, with allowable asset allocation ranges typically determined by the funded status percentage as outlined in the chart above. The equity segment is broadly diversified across growth/value and small-, mid- and large-cap equities. The fixed income segment is diversified by investing in preferred stocks, corporate debt securities, real estate and obligations of the U.S. Government and its agencies. The expected rate of return on plan assets is determined by those assets' historical long-term investment performance, current asset allocation, and estimates of future long-term returns by asset class.

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

	Other Postretirement Benefits	
	2022	2021
Benefit obligation at year end	$ 13,635,830	$ 24,287,372
Fair value of plan assets at year end	—	—
Funded status	$(13,635,830)	$(24,287,372)
Amounts recognized in the Balance Sheets:		
Accrued benefit cost	$(13,635,830)	$(24,287,372)
Deferred charges not Included in equity	—	—
Amounts recognized as reduction in equity not yet recognized as periodic benefit cost:		
Net actuarial gain	(12,611,571)	(1,781,329)
Net prior service (credit) cost	(1,795,473)	(2,075,452)
	(14,407,044)	(3,856,781)
Expected amortization for the next fiscal year	(279,979)	(279,979)
Weighted-average assumptions used to determine benefit obligations as of year end:		
Discount rate	5.50%	2.90%
Benefit cost	$ 695,772	$ 1,007,737
Employer contribution	797,051	841,620
Benefits paid	797,051	841,620
Weighted-average assumptions used to determine benefit costs:		
Discount rate	2.90%	2.70%

Expected contributions for year ending December 31, 2023 are $722,802.

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

2023	$ 722,802
2024	708,172
2025	749,451
2026	740,779
2027	732,757
2028-2032	3,961,471

For measurement purposes, a 5.75% medical trend rate was assumed for health care benefits and premiums for 2023. It is further assumed that this rate will decrease to 4.5% through 2027 and remain at that level thereafter.

On December 8, 2003, the President signed into law the Medicare Prescription Drug Improvement and Modernization Act of 2003. This Act introduces a prescription drug benefit under Medicare Part D as well as a federal subsidy to sponsors of retiree healthcare benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. SMECO has not, and does not intend to, apply for this subsidy for the years ended December 31, 2022 and 2021.

B. Health Insurance – SMECO is self-insured for medical and dental claims of its current employees and retirees and their covered dependents. For 2022, SMECO is liable for claims up to $175,000 per occurrence for medical claims and $2,000 per year per participant for dental claims. For 2021, SMECO was liable for claims of up to $150,000 per occurrence for medical claims and $2,000 per year per participant for dental claims. Catastrophic coverage is maintained to pay claims in excess of these amounts. Claims paid under this plan approximated $8.1 million in 2022 and $8.7 million in 2021. Provisions for claims incurred but not reported have been made based on claim experience and approximated $335,000 as of December 31, 2022 and 2021.

C. 401(k) Plans – SMECO maintains 401(k) plans for its management and bargaining unit employees. All full-time employees are eligible to participate in the plans after meeting minimum service requirements. SMECO matches employee contributions to the management plan up to 6% of annual compensation and for the bargaining plan, matches $.50 on the dollar up to 1% of annual straight time earnings. Effective with the freeze of the Pension Plan (see Note 7A), SMECO provides a non-elective employer contribution which varies based on length of service. For employees with 0 to less than 5 years of service, the contribution is 3% of base pay; 5 to less than 20 years of service, 8% of base pay; and 20 or more years of service, 10% of base pay. During 2022 and 2021, SMECO recorded 401(k) plan-related expenses of approximately $5.7 million and $5.2 million, respectively.

D. Workers' Compensation Trust – SMECO is self-insured for workers' compensation insurance through a separate trust which was established to pay workers' compensation claims. Contributions to the trust are based upon an actuarial valuation and SMECO maintains excess liability insurance coverage for claims exceeding $750,000. Part One of the policy covers the employer's statutory liabilities under state law up to $25 million. Part Two covers liability arising out of employee work-related injuries that do not fall under the workers' compensation statute up to $1 million. Transactions within the trust are not reflected in the accompanying consolidated financial statements. During 2022 and 2021, SMECO made aggregated contributions to the trust of approximately $794,000 and $818,000, respectively. At December 31, 2022 and 2021, the trust had estimated net assets available for benefits of $1,779,743 and $1,390,630, respectively. Maryland Loss Development Factors were used to calculate the 2022 estimate of net assets available for benefits.

Note 8: Patronage Capital and Other Equities

Assigned patronage capital consists of net operating margins that have been allocated to individual member patronage accounts. Patronage capital is applied against unpaid accounts receivable when customers leave SMECO. Patronage capital retirements to date represent amounts that have been paid to individual members. Patronage capital activity as of December 31, 2022 and 2021 consisted of the following:

	2022	2021
Assignable	$ 12,101,243	$ 23,499,420
Assigned to date	423,769,952	400,283,420
	435,871,195	423,782,840
Less: Retirements to date	(123,641,483)	(116,284,138)
Patronage capital	$ 312,229,712	$ 307,498,702

Other equities consist of donated capital from members and nonrefundable membership fees that were previously collected from new members upon joining SMECO. Non-patronage sourced margins are included as part of other equities.

Note 9: Debt

SMECO has outstanding long-term debt from CFC and CoBank. On April 16, 2018, SMECO borrowed an additional $135 million in long-term debt by issuing First Mortgage Notes, Series 2018, 4.00% due April 16, 2048 to various investors in the private placement market. Certain debt issuance costs incurred for the private placement notes are being amortized over the life of the debt. SMECO's long-term debt is subject to the loan covenants that are described in its Indenture of Mortgage, Security Agreement and Financing Statement, dated as of March 15, 2015, as amended, and substantially all assets are pledged as collateral for the long-term debt. SMECO Solar LLC has obtained long-term debt from FFB, which is guaranteed by SMECO.

The following debt was outstanding as of December 31, 2022 and 2021:

Lender	Interest Rates	Maturity (Year)	2022	2021
SMECO				
CFC	1.93–5.75%	2023-45	$207,537,385	$216,064,149
CoBank	2.61–6.44%	2025-52	400,072,542	265,399,804
Private Placement	4.00%	2048	123,453,686	126,200,222
SMECO Solar LLC				
FFB	3.07%	2034	9,183,025	9,874,737
Total debt outstanding			740,246,638	617,538,912
Less: Current maturities			29,432,088	26,039,421
Unamortized portion of debt issuance costs			438,538	455,849
Long-term debt			$710,376,012	$591,043,642

At December 31, 2022, the required principal payments of the long-term debt are as follows:

2023	$ 29,432,088
2024	29,878,989
2025	29,812,885
2026	29,661,111
2027	30,130,510
Thereafter	591,331,055
Total	$740,246,638

Cash paid for interest totaled approximately $26.5 million and $24.8 million for the years ended December 31, 2022 and 2021, respectively.

SMECO maintains unsecured revolving line of credit agreements at variable interest rates with CoBank, CFC and Bank of America for its short-term borrowing needs. The CoBank agreement expires June 30, 2025. The CFC agreement automatically renews each March unless CFC or SMECO provides written notice not to renew at least 90 days in advance of the renewal date. The Bank of America agreement expires on March 1, 2024.

As of December 31, 2022, SMECO had authorized lines of credit of $175 million with CFC, $100 million with CoBank and $25 million with Bank of America. The outstanding balance for the CFC line of credit and the respective interest rate as of December 31, 2022 was $41.0 million at 5.75% and as of December 31, 2021 was $34.0 million at 2.45%.

The outstanding balance for the CoBank line of credit and the respective interest rate as of December 31, 2021, was $58.2 million at 2.41%. There was no outstanding balance as of December 31, 2022.

The outstanding balance for the newly acquired Bank of America line of credit and the respective interest rate as of December 31, 2022 was $7.0 million at 5.77%.

The lines of credit for CFC and CoBank may be utilized to open irrevocable letters of credit. As of December 31, 2022 and 2021, SMECO had outstanding letters of credit totaling $20.0 million and $11.4 million, respectively.

On April 20, 2020, SMECO received loan proceeds from M&T Bank for approximately $8.6 million under the Paycheck Protection Program (PPP), which was established as part of the Coronavirus Aid, Relief and Economic Security Act (CARES Act). Such loans are subject to a term of two years at an interest rate of 1%. The loan and accrued interest can be forgiven as long as the borrower uses the loan proceeds for eligible purposes, including payroll costs, mortgage interest payments, rent or lease payments, and utility payments during the eight-week period following the loan disbursement. SMECO has used the proceeds for purposes consistent with the PPP and on June 17, 2021, the entire amount of the loan was forgiven. Of this amount, approximately $2.5 million was offset against the regulatory asset account established for COVID-19 (see Note 6) with the remaining approximately $6.1 million recorded under Nonoperating Margins in the Consolidated Statements of Revenue and Expenses.

Note 10: Leases

SMECO follows guidance issued by FASB Topic 842, accounting for leases. The guidance requires an entity to recognize most leases, including operating leases on the balance sheet of the lessee. The guidance became effective for annual periods beginning after December 15, 2021. SMECO has operating and financing leases for utility equipment, office space and vehicles that expire at various dates through 2027. At the expiration of some of the scheduled lease terms, SMECO can either purchase the equipment at fair market value, have the lessor sell the equipment on its behalf or renew the lease for twelve or twenty-four months.

The following summarizes the line items in the balance sheet which include amounts for operating and finance leases as of the year ended December 31, 2022:

Operating Leases	
Property Under Capital Leases - Operating	$ 2,271,947
Accumulated Depreciation	(1,106,298)
Property Under Capital Leases - Operating Net	$ 1,165,649
Obligations Cap Lease Operating - Current	$ 674,001
Obligations Cap Lease Operating - Non Current	455,065
Total Operating Lease Liabilities	$ 1,129,066
Finance Leases	
Property Under Capital Leases - Finance	$ 6,509,724
Accumulated Depreciation	(2,376,587)
Property Under Capital Leases - Finance Net	$ 4,133,137
Obligations Cap Lease Finance - Current	$ 950,392
Obligations Cap Lease Finance - Non Current	1,830,114
Total Finance Lease Liabilities	$ 2,780,506

The following summarizes the weighted average remaining lease terms and discount rate as of the year ended December 31, 2022:

Weighted Average Remaining Lease Term	
Operating leases	1.83 years
Finance leases	3.36 years
Weighted Average Discount Rate	
Operating leases	1.02 %
Finance leases	3.45 %

The following summarizes the components of lease expense reflected in the income statement as of the year ended December 31, 2022:

Operating Leases	
Total Operating Lease Costs included in Rent Exp	$ 1,359,026
Finance Leases	
Amortization of ROU Assets	$ 373,607
Interest on Lease Liability	58,341
Total Finance Lease Costs	$ 431,948

The future minimum lease payments required under the finance leases and the present value of the net minimum lease payments as of December 31, 2022 are as follows:

2023	$ 1,113,061
2024	739,592
2025	502,727
2026	379,726
2027	253,660
Total minimum lease payments	2,988,766
Less: Amount representing Interest	(208,260)
Present value of minimum lease payments	$ 2,780,506

SMECO leases many of its vehicles and power-operated equipment for various terms under long-term, operating lease agreements. The leases expire at various dates through 2026. Operating lease expense amounted to $1,395,495 and $1,408,669 in 2022 and 2021, respectively.

The future minimum rental payments required under the operating lease agreements as of December 31, 2022, are as follows:

2023	$ 681,969
2024	396,498
2025	47,593
2026	3,006
Total minimum rental payments	$ 1,129,066

Note 11: Commitments and Contingencies

SMECO contracts with various suppliers for energy and energy-related products to serve its native load requirements. As of December 31, 2022, SMECO had forward purchase commitments with multiple parties through December 2037 covering a significant portion of SMECO's power supply needs.

At December 31, 2022 and 2021 SMECO had made commitments for capital expenditures of approximately $39,000 and $607,000, respectively.

SMECO and Local Union 1718 of the International Brotherhood of Electrical Workers have a collective bargaining unit agreement, which covers approximately 271 of the 491 employees of SMECO, or 55%. The current agreement expires on April 30, 2023. The new contract will go into effect on May 1, 2023 and expires on April 30, 2028.

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

Note 12: Concentration of Risk and COVID-19

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

Under Maryland's Electric Customer Choice and Competition Act and the Electric and Gas Utility Tax Reform Act, electric customers residing in Maryland are entitled to select or choose their electric energy supplier. As of December 31, 2022, SMECO had approximately 4,000 customers served by an alternative electricity supplier. SMECO continues to provide distribution service to all of its customers.

Residential rooftop solar systems continue to be installed throughout SMECO's service territory. Solar developers have installed over 7,600 residential rooftop solar systems through 2022, almost five percent of the residential class. The output of these systems offsets energy sales from SMECO. Distribution sales revenue from these customers is reduced resulting in additional revenue recovery from all other residential customers. SMECO will work to pursue legislative and regulatory actions to reduce or eliminate this cost shifting within the residential class.

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

With the assistance of ACES (see Notes 5 and 11), SMECO has developed a more diversified market strategy to meet future power supply needs that includes multiple suppliers and varied contract termination dates. This approach represents a significant departure from the traditional cooperative model of multiple year contracts with a sole supplier. SMECO has concluded that it is not operationally or economically prudent to engage in the traditional full-requirements contract with one supplier.

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

Financial instruments that subject SMECO to concentration of credit risks include customer accounts receivable. SMECO grants credit to customers, substantially all of whom are local residents of SMECO's four-county service area. SMECO places its cash on deposit with financial institutions located in the United States of America, which are insured by the Federal Deposit Insurance Corporation (FDIC). The FDIC provides insurance coverage for up to $250,000 of cash held by SMECO in each separate FDIC insured bank and savings institution. From time to time, SMECO may have amounts on deposit in excess of the insured limits. As of December 31, 2022, SMECO had approximately $3.4 million of deposits that exceeded the insured limits.

The COVID-19 pandemic continues to have widespread, rapidly evolving, and unpredictable impacts on global society, economies, financial markets, and business practices. The substantial uncertainty and the nature and degree of the pandemic and resulting effects over time could result in disruption or restriction on SMECO's ability to operate normally. SMECO's members are also affected by the outbreak, which could delay their power bill payments. Although unlikely, plant construction projects may be delayed or cancelled and certain management accounting estimates and assumptions could be affected by future uncertainty. SMECO may also experience difficulties with suppliers or with vendors in their supply chain, which could have negative effects on operations. Overall, the future impact of the pandemic with respect to SMECO's territory is difficult to predict and could adversely impact its overall operations in the future.

Note 13: Fair Value of Financial Instruments

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

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

Cash and Cash Equivalents

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

Accounts Receivable

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

Investments in Associated Organizations

Fair value of capital term certificates was determined by computing the present value of estimated future cash flows, discounted at the long-term treasury rate of 3.97% and 1.90% as of December 31, 2022 and 2021, respectively. The fair value of patronage capital is not determinable since no legal obligation exists to retire capital credits. The fair value of the equity method investment is not estimated since there are no identified events or changes in circumstances that may have a significant adverse effect on the fair value and it is not practicable to estimate fair value. The carrying value of memberships approximates fair value.

Accounts Payable

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

Long-Term Debt

The carrying amount of SMECO's fixed long-term debt includes certain interest rates that are below quoted market prices for the same or similar issues. Therefore, the fair value of fixed long-term debt is estimated based on current market prices for the same or similar issues offered for debt of the same and remaining maturities which was 6.41% and 4.06% as of December 31, 2022 and 2021, respectively.

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

Customer Deposits

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

Fair Value

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

	Carrying Value		Fair Value	
	2022	2021	2022	2021
	(000 Omitted)		(000 Omitted)	
Assets:				
Capital Term Certificates	$ 4,064	$ 4,090	$ 4,725	$ 7,455
Liabilities:				
Long-term Debt	$(740,247)	$(617,539)	$(632,883)	$(634,902)

Note 14: Fair Value Measurements

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

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

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

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

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

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

	December 31, 2022 (000 Omitted)			
	Total	Level 1	Level 2	Level 3
Assets:				
Derivative Assets, net	$ 35,854	$ —	$ 35,854	$ —
Plan Assets for Pension and Other Benefits	116,706	116,706	—	—
Liabilities:				
Derivative Liabilities, net	$ (1,542)	$ —	$ (1,542)	$ —

	December 31, 2021 (000 Omitted)			
	Total	Level 1	Level 2	Level 3
Assets:				
Derivative Assets, net	$ 10,310	$ —	$ 10,310	$ —
Plan Assets for Pension and Other Benefits	150,343	150,343	—	—
Liabilities:				
Derivative Liabilities, net	$ (2,684)	$ —	$ (2,684)	$ —

Valuation Techniques

The fair value of derivative assets and liabilities (Level 2) is comprised of forward trades, power and gas positions and Financial Transmission Rights (FTRs). The fair value of all forward trades is calculated by a third party, ACES, using market prices when possible and modeled forward prices including constant heat rate projections, supply-demand simulation generated values, inflation escalated market prices, or a blend of these sources when market prices are not available. The power positions are valued at AEP Dayton – Dominion Zone, Brandywine, PJM_RTO, PJM East or PJM West and the gas positions are valued using NYMEX Henry Hub, TETCO M3, TRANSCO Zone 5 or TRANSCO Zone 6 Non-NY pricing. FTRs are marked-to-market based on data from the most recent FTR auction.

The method described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while SMECO believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair values of certain financial instruments could result in a different fair value measurement at the reporting date.

Note 15: Related Party Transactions

SMECO is a member of CFC and CoBank. Pursuant to the member relationships, SMECO has invested in, entered into various loan agreements with, and maintains unsecured lines of credit with these organizations (see Notes 4 and 9). SMECO earned interest income of approximately $183,000 on investments with CFC in both 2022 and 2021, respectively. During years 2022 and 2021, SMECO paid interest expense of approximately $21.3 million and $19.6 million, respectively, on aggregated loans from CFC and CoBank.

SMECO invested in and became a member of ACES during 2003 to engage ACES' professional assistance in meeting future power supply needs (see Note 5). SMECO paid ACES approximately $1.1 million for such services during both 2022 and 2021.

SMECO invested in and became a member of National Renewables Cooperative Organization (NRCO) during 2008 to utilize NRCO's services in the analysis of renewable projects in which SMECO may choose to participate in order to fulfill the Maryland RPS obligations (see Notes 2Q and 4). SMECO paid NRCO approximately $43,000 and $42,000 for such services in 2022 and 2021, respectively.

SMECO is a member of Electric Research and Manufacturing Cooperative (ERMCO) and The Tarheel Electric Membership Association, Inc. (TEMA) and purchases materials and supplies from them (see Note 4). During years 2022 and 2021, SMECO made aggregated purchases to these organizations of approximately $609,000 and $385,000, respectively.

SMECO is a member of Federated Rural Electric Insurance Corporation (Federated) and purchases general liability and property insurance from them (see Note 4). SMECO paid Federated approximately $981,000 and $937,000 for such insurance in 2022 and 2021, respectively.

During 2022 and 2021, SMECO allocated administrative expenses of approximately $168,000 and $136,000 to SMECO Solar LLC, respectively. In accordance with the interconnection and power purchase agreement signed in 2011, SMECO Solar LLC sells all its generated electricity to SMECO. Sales were approximately $1.8 million and $1.7 million for years ended December 31, 2022 and 2021, respectively. Inter-company receivables and payables have been eliminated upon consolidation.

ADAMS, JENKINS AND CHEATHAM
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS CONSULTANTS

Independent Auditor's Report on Supplementary Information

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

We have audited the consolidated financial statements of Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC (SMECO) for the years ended December 31, 2022 and 2021, and our report thereon dated April 5, 2023, which expressed an unmodified opinion on those consolidated financial statements appears on pages 1 and 2. Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating financial information and consolidated comparative summary of operations is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual entities, and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

We also have previously audited, in accordance with auditing standards generally accepted in the United States of America, the balance sheets of SMECO as of December 31, 2021, 2020, 2019, and 2018, and the related statements of revenue, expenses and patronage capital and comprehensive income, and cash flows for each of the three years then ended (none of which is presented herein), and we expressed unmodified opinions on those financial statements. In our opinion, the comparative summary of operations is fairly stated in all material respects in relation to the basic consolidated financial statements from which it has been derived.

Adams, Jenkins & Cheatham

Richmond, Virginia
April 5, 2023

231 Wylderose Drive | Midlothian, VA 23113 | 804.323.1313

Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
Consolidating Balance Sheets
December 31, 2022

	SMECO	SMECO Solar LLC	Eliminations	Total
Assets				
Utility Plant, at Original Cost (Notes 2 and 3)	$ 1,351,903,843	$ 14,228,550	$ -	$ 1,366,132,393
Less: Accumulated Depreciation and Amortization	(480,919,275)	(7,163,767)	-	(488,083,042)
Net utility plant	870,984,568	7,064,783	-	878,049,351
Nonutility Property (net)	2,811,212	-	-	2,811,212
Investments (Note 2):				
Investments in associated organizations, at cost (Notes 4 and 13)	22,048,010	-	-	22,048,010
Investment in an unconsolidated entity (Note 5)	1,305,529	-	-	1,305,529
Investment in SMECO Solar LLC	1,416,235	-	(1,416,235)	-
Other investments	341,814	-	-	341,814
Total investments	25,111,588	-	(1,416,235)	23,695,353
Current Assets (Note 2):				
Cash and cash equivalents	2,988,946	1,342,467	-	4,331,413
Accounts receivable, net of allowance for doubtful accounts of $1,000,000	84,045,987	-	-	84,045,987
Materials and supplies inventory	18,938,881	21,850	-	18,960,731
Prepaid expenses	12,640,002	90,762	-	12,730,764
Intercompany receivables	49,690	100,763	(150,453)	-
Other current assets	52,924,286	2,030,432	-	54,954,718
Total current assets	171,587,792	3,586,274	(150,453)	175,023,613
Regulatory Assets (Notes 2 and 6)	80,437,191	-	-	80,437,191
Deferred Charges and Other (Note 2)	26,210,365	-	-	26,210,365
Derivative Assets (Notes 2 and 14)	35,854,098	-	-	35,854,098
Total assets	$ 1,212,996,814	$ 10,651,057	$ (1,566,688)	$ 1,222,081,183
Equities and Liabilities				
Equities (Note 8):				
Patronage capital	$ 312,229,712	$ -	$ -	$ 312,229,712
Other equities	43,222,562	1,416,235	(1,416,235)	43,222,562
Accumulated other comprehensive loss	(38,232,868)	-	-	(38,232,868)
Total equities	317,219,406	1,416,235	(1,416,235)	317,219,406
Long-Term Debt, Less Current Maturities (Notes 9 and 13)	701,906,854	8,469,158	-	710,376,012
Current Liabilities:				
Accounts payable	23,355,274	2,107	-	23,357,381
Current maturities of long-term debt (Note 9)	28,718,221	713,867	-	29,432,088
Notes payable (Note 9)	48,000,000	-	-	48,000,000
Current portion of accrued pension and postretirement benefits (Note 7)	801,241	-	-	801,241
Current portion of obligations under capital lease (Note 10)	1,624,393	-	-	1,624,393
Customer deposits	6,760,976	-	-	6,760,976
Intercompany payables	100,763	49,690	(150,453)	-
Other current liabilities	26,341,669	-	-	26,341,669
Total current liabilities	135,702,537	765,664	(150,453)	136,317,748
Accrued Pension and Postretirement Benefits (Note 7)	15,080,200	-	-	15,080,200
Noncurrent Portion of Obligations Under Capital Lease (Note 10)	2,285,179	-	-	2,285,179
Deferred Credits	39,260,157	-	-	39,260,157
Derivative Liabilities (Notes 2 and 14)	1,542,481	-	-	1,542,481
Total equities and liabilities	$ 1,212,996,814	$ 10,651,057	$ (1,566,688)	$ 1,222,081,183

See Independent Auditor's Report on Supplementary Information.

Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
Consolidating Statements of Revenue and Expenses
Year Ended December 31, 2022

	SMECO	SMECO Solar LLC	Eliminations	Total
Operating Revenue:				
Sales of electricity	$ 499,135,792	$ 1,834,618	$ (1,834,618)	$ 499,135,792
Lease income	84,852	-	(84,852)	-
Other	46,433,454	-	-	46,433,454
Total operating revenue	545,654,098	1,834,618	(1,919,470)	545,569,246
Operating Expenses:				
Purchased power (Note 11)	329,223,907	-	(1,834,618)	327,389,289
Power production	-	346,747	(84,852)	261,895
Transmission	4,785,472	-	-	4,785,472
Distribution - operations	11,919,328	-	-	11,919,328
Distribution - maintenance	25,481,056	-	-	25,481,056
Customer accounts	12,048,378	-	-	12,048,378
Customer service and information	24,949,384	-	-	24,949,384
Administrative and general	41,276,022	76,982	-	41,353,004
Depreciation and amortization	44,210,628	711,380	-	44,922,008
Taxes	18,427,264	177,807	-	18,605,071
Other	2,217,526	-	-	2,217,526
Total operating expenses	514,538,965	1,312,916	(1,919,470)	513,932,411
Operating margins	31,115,133	521,702	-	31,636,835
Interest Expense:				
Interest on long-term debt	24,027,634	306,801	-	24,334,435
Other interest	942,303	-	-	942,303
Total interest expense	24,969,937	306,801	-	25,276,738
Net Operating Margins	6,145,196	214,901	-	6,360,097
Other Patronage Allocations	3,638,563	-	-	3,638,563
Total operating margins	9,783,759	214,901	-	9,998,660
Nonoperating Margins	2,925,216	49,440	(264,341)	2,710,315
Net margins	$ 12,708,975	$ 264,341	$ (264,341)	$ 12,708,975

Consolidating Statements of Comprehensive Income
Year Ended December 31, 2022

	SMECO	SMECO Solar LLC	Eliminations	Total
Net Margins	$ 12,708,975	$ 264,341	$ (264,341)	$ 12,708,975
Other Comprehensive Income:				
Postretirement benefit plans actuarial gain, net	12,690,697	-	-	12,690,697
Amortization of net loss and prior service costs	1,909,319	-	-	1,909,319
Other comprehensive income	14,600,016	-	-	14,600,016
Comprehensive Income	$ 27,308,991	$ 264,341	$ (264,341)	$ 27,308,991

See Independent Auditor's Report on Supplementary Information.

Southern Maryland Electric Cooperative, Inc. and SMECO Solar LLC
Consolidated Comparative Summary of Operations
Years Ended December 31, 2022 - 2018

	2022	2021	2020	2019	2018
Operating Revenue:					
Sales of electricity	$ 499,135,792	$ 393,540,887	$ 365,104,541	$ 407,090,522	$ 415,643,743
Other	46,433,454	48,267,212	45,983,078	42,893,625	46,640,560
Total operating revenue	545,569,246	441,808,099	411,087,619	449,984,147	462,284,303
Operating Expenses:					
Purchased power	327,389,289	229,120,187	195,867,635	240,273,060	249,706,813
Power production	261,895	260,498	263,044	253,333	250,774
Transmission	4,785,472	4,634,963	3,397,491	4,416,785	3,827,626
Distribution - operations	11,919,328	11,209,308	10,790,305	11,805,210	11,445,363
Distribution - maintenance	25,481,056	22,596,037	21,257,905	18,827,947	20,718,862
Customer accounts	12,048,378	11,070,083	10,777,955	10,877,395	11,131,675
Customer service and information	24,949,384	27,283,616	24,850,598	21,115,760	26,390,181
Administrative and general	41,353,004	38,858,656	38,089,876	36,717,628	39,344,135
Depreciation and amortization	44,922,008	42,694,847	41,025,270	39,701,741	38,021,212
Taxes	18,605,071	17,272,595	16,441,626	15,744,868	15,715,740
Other	2,217,526	2,256,963	2,095,274	2,033,367	1,763,861
Total operating expenses	513,932,411	407,257,753	364,856,979	401,767,094	418,316,242
Operating margins	31,636,835	34,550,346	46,230,640	48,217,053	43,968,061
Interest Expense:					
Interest on long-term debt	24,334,435	22,918,474	24,157,026	25,284,878	24,206,522
Other interest	942,303	1,469,986	946,450	164,064	-
Total interest expense	25,276,738	24,388,460	25,103,476	25,448,942	24,206,522
Net Operating Margins	6,360,097	10,161,886	21,127,164	22,768,111	19,761,539
Other Patronage Allocations	3,638,563	3,791,962	3,911,104	3,444,195	4,619,298
Total operating margins	9,998,660	13,953,848	25,038,268	26,212,306	24,380,837
Nonoperating Margins	2,710,315	10,190,858	2,848,997	2,788,736	2,855,271
Net margins	$ 12,708,975	$ 24,144,706	$ 27,887,265	$ 29,001,042	$ 27,236,108
Electric Revenue:					
Residential	$ 337,175,400	$ 263,356,258	$ 242,396,128	$ 268,744,777	$ 276,362,221
General service	136,554,625	109,693,858	104,565,503	118,132,444	119,617,634
Large power	17,573,493	14,088,514	12,497,785	14,464,563	14,064,413
Street lights	2,901,430	2,676,046	2,639,767	2,566,188	2,549,742
Transmission	4,881,836	3,682,166	2,965,101	3,140,181	3,007,314
Solar facility	49,008	44,045	40,257	42,369	42,419
Total	$ 499,135,792	$ 393,540,887	$ 365,104,541	$ 407,090,522	$ 415,643,743
Megawatt-Hour Sales:					
Residential	2,236,761	2,225,670	2,136,051	2,180,188	2,276,786
General service	1,057,101	1,044,948	994,866	1,106,476	1,121,423
Large power	136,417	148,453	147,971	160,020	164,101
Street lights	8,614	9,244	8,900	8,615	8,367
Transmission	52,097	50,389	49,112	55,035	51,072
Solar facility	154	154	155	155	155
Total	3,491,144	3,478,858	3,337,055	3,510,489	3,621,904
Customers at Year End (Billings)	173,523	172,091	170,188	168,110	166,275

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