

› CENTER OF INNOVATION



2020 ANNUAL REPORT



Square Butte
ELECTRIC COOPERATIVE

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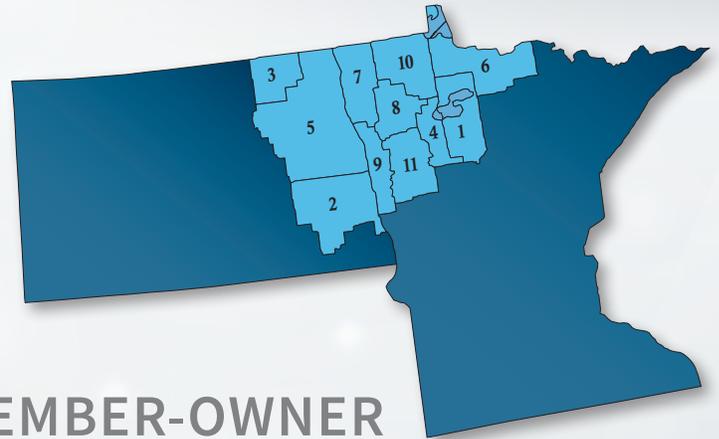
Center of
Innovation

Square Butte Electric Cooperative owns Unit 2 at the Milton R. Young Station, a 455-megawatt, mine-mouth generating station located near Center, N.D. The lignite-based facility is named after Milton R. Young, the late United States senator from North Dakota. Square Butte was organized May 24, 1972, and the Young 2 generating station began commercial operation on May 6, 1977.

Square Butte is affiliated with Minnkota Power Cooperative, headquartered in Grand Forks, N.D., by reason of common ownership and management. Minnkota, acting as agent, also operates and maintains Young 2.

During the first seven years of operation, Square Butte sold the entire plant output to Minnesota Power, based in Duluth, Minn. Over time, Minnkota has exercised additional energy purchase options. Currently, Minnesota Power and Minnkota each purchase 50% of the Young 2 output from Square Butte. Minnkota also purchases 28% of Minnesota Power's share under a separate agreement. Energy produced by Young 2 is transported via the 250-mile, 345-kilovolt (kV) Center to Grand Forks transmission line.

Since its inception, Square Butte has been committed to supplying reliable energy at the lowest possible cost while maintaining and preserving the natural environment.



MEMBER-OWNER COOPERATIVES

- 1. Beltrami Electric Cooperative**
Bemidji, Minn.
- 2. Cass County Electric Cooperative**
Fargo, N.D.
- 3. Cavalier Rural Electric Cooperative**
Langdon, N.D.
- 4. Clearwater-Polk Electric Cooperative**
Bagley, Minn.
- 5. Nodak Electric Cooperative**
Grand Forks, N.D.
- 6. North Star Electric Cooperative**
Baudette, Minn.
- 7. PKM Electric Cooperative**
Warren, Minn.
- 8. Red Lake Electric Cooperative**
Red Lake Falls, Minn.
- 9. Red River Valley Cooperative Power Association**
Halstad, Minn.
- 10. Roseau Electric Cooperative**
Roseau, Minn.
- 11. Wild Rice Electric Cooperative**
Mahnomens, Minn.

› REPORT TO THE MEMBERS



Paul Aakre
President



Mac McLennan
General Manager

When faced with the unprecedented challenges of the COVID-19 pandemic, Square Butte Electric Cooperative responded with strength and resiliency. The workforce at the Milton R. Young Station found innovative ways to ensure safety, reliability and environmental stewardship were maintained throughout 2020.

While there is no playbook on how to navigate a pandemic, employees at the coal-based power plant learned to work and communicate in new ways to advance projects and maintain business continuity. Mitigation strategies, such as face mask requirements, social distancing standards and enhanced disinfection methods, were all incorporated during the year to protect the safety and health of the workforce and essential contractors.

Despite pandemic-related distractions, the Young Station recorded an impressive year of safety with no lost-time injuries and only one OSHA-recordable injury. The Young Station's OSHA incident rate was 0.54, compared to an industry average of 1.4. Other safety performance indicators show that the plant is continually improving and emerging among the top performers in the industry. Safety is a job that is never done, and every effort will be made to further improve processes and procedures that protect employees from injury and illness.

The Square Butte-owned Unit 2 generator performed exceptionally well during the year, running reliably and meeting all land, water and air quality standards. The 455-megawatt (MW) unit was available to produce power 93% of the time, while also providing more flexible operation. More than ever before, Unit 2 was able to increase or decrease its net output based on system demands and economic indicators. The flexible operation strategy allowed the unit to run longer without the need to come offline for maintenance. In fact, plant operators were able to eliminate one maintenance outage during the year because of the successful implementation of this strategy. Work will continue in the coming year to ensure the plant can adjust its operating levels and perform safely in numerous scenarios.

During the year, Unit 2 generated 2,933,166,000 net kilowatt-hours (kWh) with an average plant load of 362 MW. Square Butte's average power cost was 54.8 mills per kWh compared to the 51.3 mills that was budgeted – a higher cost due to less kWh produced. By year-end, the cooperative's expenses added up to \$162.5 million, which was \$12.1 million under budget.

Outside of plant operations, additional cost savings were found through continued work with BNI Coal, the plant's fuel provider. Close collaboration with BNI has uncovered efficiencies and better utilization of

The Square Butte-owned Unit 2 generator performed exceptionally well during the year, running reliably and meeting all land, water and air quality standards.



While there is no playbook on how to navigate a pandemic, employees at the coal-based power plant learned to work and communicate in new ways to advance projects and maintain business continuity.

resources. Both entities will continue to work in partnership to find value, improvement areas and expense reductions.

With the Young Station reaching significant performance milestones in 2020, it reinforces why Square Butte and Minnkota, the plant's operator, continue to evaluate Project Tundra – an effort to install carbon capture technology at the plant. After about five years of research and development, the project partners have gained a solid understanding of the engineering, geologic storage facility needs and overall economics. There is still more work to be done on all fronts, but the effort continues to advance in a positive direction. A decision on whether or not to continue forward with the project will likely be made by the end of 2021.

As Project Tundra progressed, we gained new partners and welcomed energy experts to our facility to help design these next-generation technologies. As many coal plants are scheduled for closure around the country, our future must be

driven by innovation. The enthusiasm for Project Tundra – from scientists to political leaders to our member-consumers – has helped us push forward through the adversity caused by COVID-19 and other external forces.

We remain grateful for our customers, Minnkota and Minnesota Power, and BNI Coal, our longstanding partner in power production. We would also like to thank all others, from contracted entities to community supporters, who helped us reliably power the region in 2020.

Paul Aakre
President

Mac McLennan
General Manager

› CENTER OF INNOVATION



During the year, two test wells (including the one pictured here) were drilled 10,000 feet to retrieve rock core samples and other geologic data.

Center, N.D., is quickly becoming a center of innovation.

Research, engineering and testing was conducted throughout the year at the coal-based Milton R. Young Station to evaluate the addition of carbon capture technology. The effort, known as Project Tundra, continued to make progress in 2020 as partners learned more about the strategies and technologies needed to reduce carbon dioxide (CO₂) emissions at the facility.

The Project Tundra CO₂ capture facility is designed to remove 90% of the CO₂ emissions from either generator at the plant, which amounts to about 4 million metric tons per year. This is the equivalent of permanently taking 800,000 gasoline-fueled vehicles off the road. State and federal funding helped initiate a Front-End Engineering and Design (FEED) study in 2020. When completed in early 2021, the

FEED will provide a detailed engineering design of the CO₂ capture facility, refined project economics and other vital technical data.

All captured CO₂ would be safely and permanently stored more than one mile underground in geologic formations. North Dakota's geology is ideal for CO₂ storage. A deep, porous rock layer will hold the CO₂ more than a mile underground and overlying cap rock layers will seal the CO₂ in the storage zones.

Research was conducted on the underground storage facility with leadership from the Energy and Environmental Research Center (EERC) at the University of North Dakota. During the year, two test wells were drilled down 10,000 feet to retrieve rock core samples and other geologic data, while additional seismic and geophysical survey work was

Project Tundra can serve as a blueprint for the rest of the world and show that CO₂ emissions can be addressed without sacrificing grid reliability.

also conducted around the plant site.

Safety and environmental stewardship are vitally important to the project. All data retrieved will be compiled and submitted as part of the permitting process, which is scheduled to begin in early 2021. These permits ensure the safe injection of CO₂, protection of groundwater resources, and the constant monitoring of the CO₂ to confirm it remains in the storage zone.

Historically, the hurdle for carbon capture has been economics. Now, however, Congress has opened the door with 45Q tax credits, which work similarly to the tax credits that have been utilized by wind and solar projects for many years. These tax credits will cover the vast majority of Project Tundra's estimated \$1.1 billion construction cost. Efforts are ongoing to find financial partners and develop an economic structure that helps the project be successful.

From a global perspective, Square Butte and

its members firmly believe leadership must come from the United States to build, demonstrate and ultimately drive down the costs of commercial carbon capture projects. Developing these first-of-a-kind projects in the U.S. will de-risk the technology for developing countries while ensuring they have the ability to continue using low-cost and reliable coal to grow their economies and improve the quality of life for their citizens. Project Tundra can serve as a blueprint for the rest of the world and show that CO₂ emissions can be addressed without sacrificing grid reliability.

It is anticipated that the Project Tundra research and evaluation process will be completed in 2021 and a decision will be made on whether to move forward with the project in the coming year. No matter the outcome, Square Butte and its members believe that the cooperative will live in a carbon-managed future, which will require new strategies and innovative technologies.



The Project Tundra CO₂ capture facility is capable of removing 90% of the CO₂ emissions from either generator at the plant (including Square Butte's Unit 2), which amounts to about 4 million metric tons per year.

› BOARD OF DIRECTORS



Paul Aakre
President
 PKM Electric Cooperative
 Warren, Minn.



Larry Sollie
Vice President
 Wild Rice Electric Cooperative
 Mahanomen, Minn.



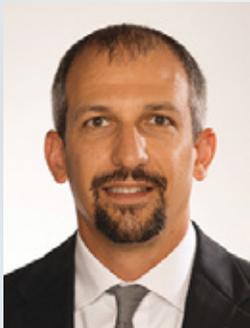
Roger Amundson
Secretary/Treasurer
 Roseau Electric Cooperative
 Roseau, Minn.



Anthony Ottem
Assistant Secretary/Treasurer
 Cavalier Rural Electric
 Cooperative
 Langdon, N.D.



Michael Hanson
 North Star Electric Cooperative
 Baudette, Minn.



Calvin Hoff
 Cass County Electric
 Cooperative
 Fargo, N.D.



Bill Lanners
 Clearwater-Polk Electric
 Cooperative
 Bagley, Minn.



Steve Linder
 Red Lake Electric Cooperative
 Red Lake Falls, Minn.



Murl Nord
 Beltrami Electric Cooperative
 Bemidji, Minn.



Paul Sigurdson
 Nodak Electric Cooperative
 Grand Forks, N.D.



Marvis Thompson
 Red River Valley Cooperative
 Power Association
 Halstad, Minn.



Mac McLennan
General Manager

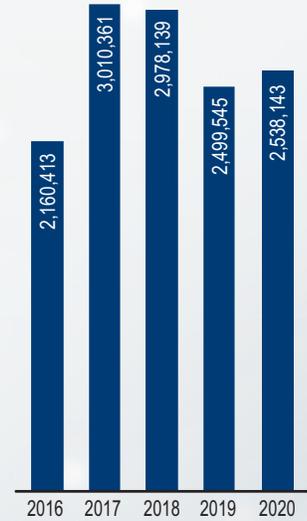


Gerad Paul
General Counsel

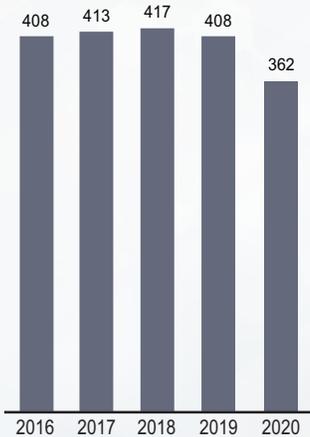
OPERATING STATISTICS <

	<u>2020</u>	<u>2019</u>	<u>2018</u>
Plant availability (percent)	93.0	80.4	94.0
Hours of operation	8,104	7,044	8,233
Hours of outage	680	1,716	527
Total hours in year	8,784	8,760	8,760
Gross generation (MWh)	3,229,431	3,149,525	3,762,059
Net generation (MWh)	2,933,166	2,871,092	3,435,235
Station service (MWh)	296,265	278,433	326,824
Station service (percent)	9.2	8.8	8.7
Average net generation (MW)	362	408	417
Coal burned (tons)	2,538,143	2,499,545	2,978,139

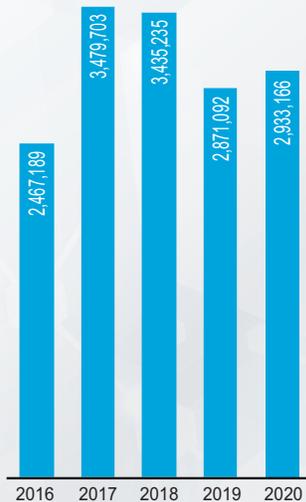
Coal Burned
(tons)



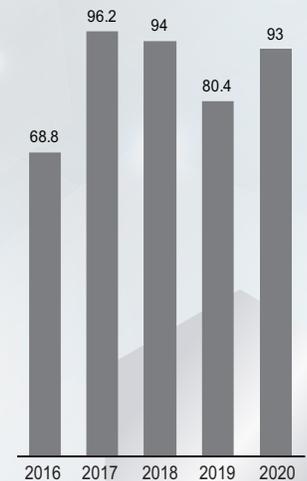
Average Net Generation
(MW)



Net Generation
(MWh)

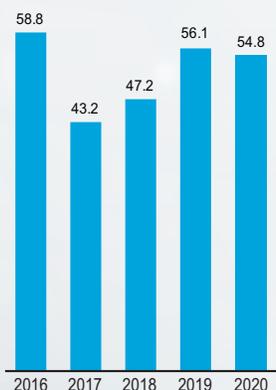


Plant Availability
(percent)



› POWER SOURCES & ENERGY SALES

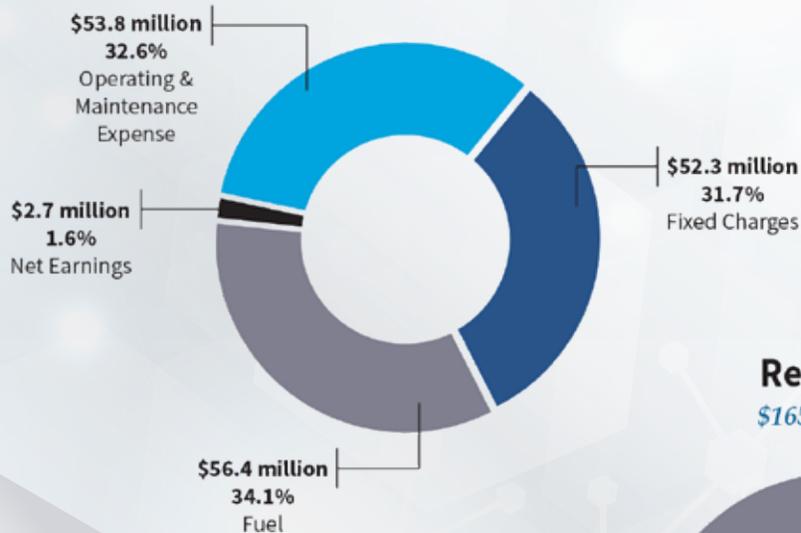
Average Power Cost
(mills/kWh)



	<u>2020</u>	<u>2019</u>	<u>2018</u>
Power sources (MWh)			
Net generation – Young 2	2,933,166	2,871,092	3,435,235
Total sources	2,933,166	2,871,092	3,435,235
Energy sales (MWh)			
Minnesota Power	1,466,583	1,435,546	1,717,618
Minnkota	1,466,583	1,435,546	1,717,617
Total sales	2,933,166	2,871,092	3,435,235

Expenses and Net Earnings

\$165.2 million



Revenues

\$165.2 million



TREASURER'S REPORT <

The average power cost for Square Butte in 2020 was 54.8 mills per kilowatt-hour (kWh) – up from the budgeted 51.3 mills per kWh and down from the 56.1 mills per kWh in 2019.

Reduced generation from economic derates resulted in a higher average power cost.

Revenues

Square Butte's revenues are set to cover expenses plus a calculated margin. Revenues in 2020 were \$165.2 million – down \$12.2 million from budget. This decrease is due to expenses being under budget by a similar amount. Square Butte expenses and margin are passed on to Square Butte's two customers, Minnesota Power and Minnkota Power Cooperative. Minnesota Power and Minnkota each contributed \$82.6 million, or 50%, of Square Butte's revenues in 2020.

Expenses

Square Butte's expenses consist of fuel, operating and maintenance costs and fixed charges. They totaled \$162.5 million in 2020, which is down \$12.1 million from budget.

Fuel costs totaled \$56.4 million in 2020, which was \$7.4 million under budget. Fuel costs consist primarily of coal provided by BNI Coal under a cost-plus contract and coal royalties paid to Minnkota at \$0.48 per ton. Fewer coal tons burned was the main reason for being under budget.

Operating and maintenance expenses amounted to \$53.8 million in 2020, which was \$3.2 million under budget. These expenses were under budget mainly due to reduced chemical usage and less boiler maintenance.

Fixed charges include interest, depreciation and income taxes. They totaled \$52.3 million in 2020, which is \$1.5 million under budget. These expenses are down mainly due to lower variable interest rates on short-term and long-term debt.

Net Earnings

Net earnings after income taxes were \$2.7 million in 2020 – down \$0.1 million from budget. Earnings consist of a margin calculated at 5% of the Square Butte operating and maintenance costs.

Earnings also include capital credits allocated by other cooperatives to Square Butte.

Assets

Net electric plant was \$318.2 million at Dec. 31, 2020, and includes construction work in progress of \$0.1 million. Net electric plant decreased by \$35.0 million in 2020, primarily due to an additional year of depreciation.

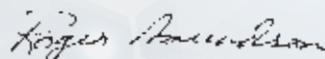
Also shown on the Balance Sheet are current assets of \$31.1 million, long-term investments of \$6.0 million and deferred expenses of \$9.7 million. Total assets were \$365.0 million at Dec. 31, 2020 – down \$38.7 million from last year.

Equities and Liabilities

Long-term debt amounted to \$221.2 million at Dec. 31, 2020 – a decrease of \$25.0 million from 2019. This decrease is mainly due to an additional year of debt principal payments. Other liabilities totaled \$87.4 million and include current liabilities, deferred credits and deferred income taxes. Retained earnings at Dec. 31, 2020, totaled \$56.4 million, including the net earnings in 2020 of \$2.7 million.

This has been a brief review of the 2020 financial statements. For further information, I urge you to review the financial statements, the notes to the financial statements and the independent auditor's report found in this annual report.

Respectfully submitted,



Roger Amundson,
Secretary-Treasurer



Roger Amundson,
Secretary-Treasurer

› BALANCE SHEET

Assets

As of December 31

ELECTRIC PLANT

In service	\$ 764,441,964	\$ 760,389,788
Construction work in progress	98,807	1,482,867
Total electric plant	764,540,771	761,872,655
Less accumulated depreciation	(446,371,236)	(408,658,173)
Net electric plant	\$ 318,169,535	\$ 353,214,482

OTHER PROPERTY AND INVESTMENTS

Investments in associated companies	\$ 6,008,823	\$ 5,833,222
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CURRENT ASSETS

Cash and cash equivalents	\$ 1,440,877	\$ 5,035,386
Accounts receivable –		
Minnkota Power Cooperative, Inc.	9,342,805	8,802,902
Minnesota Power	9,060,292	7,945,080
Other	4,760,513	4,930,537
Income taxes receivable	100,020	-
Inventories –		
Fuel	3,937,115	2,144,186
Materials and supplies	1,489,829	805,287
Prepayments	984,397	767,990
Total current assets	\$ 31,115,848	\$ 30,431,368

DEFERRED EXPENSES

	\$ 9,681,881	\$ 14,210,778
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TOTAL ASSETS

	\$ 364,976,087	\$ 403,689,850
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See Notes to Financial Statements

Equities & Liabilities

As of December 31

EQUITIES

Memberships issued

\$ 110

\$ 110

Retained earnings

56,384,596

53,642,832

Total equities

\$ 56,384,706

\$ 53,642,942

LONG-TERM DEBT

Less current maturities and unamortized debt issuance costs of \$524,563 in 2020 and \$1,010,458 in 2019

\$ 221,182,365

\$ 246,171,635

OTHER NONCURRENT LIABILITIES

Deferred income taxes

\$ 13,307,980

\$ 15,038,049

CURRENT LIABILITIES

Current maturities of long-term debt

\$ 32,984,617

\$ 33,840,882

Lines of credit

22,000,000

32,000,000

Accounts payable –

 Minnkota Power Cooperative, Inc.

3,954,193

5,148,502

 Other

8,366,192

10,211,293

Income tax payable

39,260

580,439

Accrued liabilities –

 Property and other taxes

204,914

232,883

 Interest

2,731,991

3,242,891

Total current liabilities

\$ 70,281,167

\$ 85,256,890

DEFERRED CREDITS

\$ 3,819,869

\$ 3,580,334

TOTAL EQUITIES AND LIABILITIES

\$ 364,976,087

\$ 403,689,850

See Notes to Financial Statements

› REVENUES, EXPENSES & RETAINED EARNINGS

For the Years Ended December 31

	<u>2020</u>	<u>2019</u>
OPERATING REVENUES		
Energy sales and other	\$ 162,462,533	\$ 162,831,852
OPERATING EXPENSES		
Fuel	\$ 56,414,458	\$ 57,762,949
Operating	32,499,080	32,099,494
Maintenance	21,302,764	20,348,797
Interest, net	13,292,801	15,123,727
Interest expense attributable to amortization of debt issuance costs	485,895	958,667
Depreciation	37,713,063	35,184,925
Total expenses	<u>\$ 161,708,061</u>	<u>\$ 161,478,559</u>
OPERATING MARGIN	\$ 754,472	\$ 1,353,293
NONOPERATING MARGIN		
Nonoperating revenue	<u>\$ 2,774,746</u>	<u>\$ 2,694,746</u>
NET EARNINGS BEFORE INCOME TAXES	\$ 3,529,218	\$ 4,048,039
Income taxes provision	787,454	1,393,828
Net earnings	<u>\$ 2,741,764</u>	<u>\$ 2,654,211</u>
RETAINED EARNINGS, BEGINNING OF YEAR	<u>53,642,832</u>	<u>50,988,621</u>
RETAINED EARNINGS, END OF YEAR	<u>\$ 56,384,596</u>	<u>\$ 53,642,832</u>

See Notes to Financial Statements

CASH FLOW <

For the Years Ended December 31

	<u>2020</u>	<u>2019</u>
OPERATING ACTIVITIES		
Net earnings	\$ 2,741,764	\$ 2,654,211
Adjustments to reconcile net earnings to net cash provided (used) by operating activities		
Depreciation	37,713,063	35,184,925
Interest expense attributable to amortization of debt issuance costs	485,895	958,667
Deferred income taxes	(1,730,069)	(11,970)
Amortization of deferred plant expenses	4,528,897	3,836,361
Addition of asset retirement obligations	239,535	932,071
Capital credit allocations	(681,744)	(724,882)
Effects on operating cash flows due to changes in:		
Accounts receivable	(1,585,111)	2,284,243
Inventories	(2,477,471)	309,064
Prepayments	(216,407)	(67,914)
Accounts payable	(3,039,410)	2,482,630
Accrued liabilities	(1,080,051)	(40,116)
Net cash provided (used) by operating activities	<u>\$ 34,898,891</u>	<u>\$ 47,797,290</u>
INVESTING ACTIVITIES		
Additions to electric plant, net	\$ (2,668,116)	\$ (13,321,440)
Additions to deferred plant expenses	-	(15,398,876)
Cash received from investments		
CoBank	419,793	398,929
Roughrider Electric Cooperative	9,440	87,417
National Rural Utilities Cooperative Finance Corporation	76,913	84,527
Net cash provided (used) by investing activities	<u>\$ (2,161,970)</u>	<u>\$ (28,149,443)</u>
FINANCING ACTIVITIES		
Proceeds (repayments) on lines of credit	\$ (10,000,000)	\$ 10,000,000
Repayments of long-term obligations	(26,331,430)	(25,111,909)
Net cash provided (used) for financing activities	<u>\$ (36,331,430)</u>	<u>\$ (15,111,909)</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	\$ (3,594,509)	\$ 4,535,938
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>5,035,386</u>	<u>499,448</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 1,440,877</u>	<u>\$ 5,035,386</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the year for interest paid	<u>\$ 14,625,382</u>	<u>\$ 17,172,097</u>
SUPPLEMENTAL DISCLOSURE OF NONCASH FINANCING ACTIVITIES		
Payment of long-term debt from cushion of credit	<u>\$ 24,208,526</u>	<u>\$ 6,850,039</u>

Notes to Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Square Butte Electric Cooperative (Square Butte or the Cooperative) is a North Dakota cooperative association organized in 1972 and is owned by eleven member-owner cooperatives. Membership in Square Butte is limited to organizations engaged in the business of generating, transmitting, or distributing electric power within the states of North Dakota and Minnesota.

The Cooperative's service area is located in northwestern Minnesota and eastern North Dakota. The service territory aggregates approximately 35,000 square miles with a population of approximately 300,000 people.

Minnkota Power Cooperative, Inc. ("Minnkota"), acting as agent for Square Butte, operates and maintains Young 2. Substantially, all maintenance and other operating expenses of Square Butte represent costs incurred by Minnkota on Square Butte's behalf under the operating agreement discussed in Note 10. Such expenses are billed to Square Butte at cost.

Basis of Accounting

The financial statements of Square Butte have been prepared on the basis of accounting prescribed under the Power Sales Agreements with Minnesota Power (MP) and Minnkota in accordance with accounting principles generally accepted in the United States of America (GAAP), as codified by the Financial Accounting Standards Board. The Cooperative maintains its accounting records in accordance with the chart of accounts as adopted by the Rural Utilities Service (RUS).

Regulatory Accounting

As a result of the rate making process, the Cooperative applies Accounting Standards Codification (ASC) 980, Regulated Operations. The application of generally accepted accounting principles by the Cooperative differs in certain aspects from the application by non-regulated businesses as a result of applying ASC 980. Such differences are generally related to the time at which certain items enter into the determination of net margins in order to follow the principle of matching costs and revenues.

Revenues under the Power Sales Agreements are established at amounts sufficient to cover all costs of Square Butte plus a defined profit. Depreciation under the Power Sales Agreements includes the amount of principal applied to reduce the debt on First Mortgage Bonds, Series 1998A, CoBank notes, First Mortgage notes, CFC notes, and RUS notes. If straight-line depreciation had been provided for these properties based on their estimated economic useful lives, depreciation expense would have decreased by approximately \$4,030,000 and \$2,303,000 for the years 2020 and 2019, respectively. Accumulated depreciation and amortization of the properties would have been increased by approximately \$81,468,000 and \$85,499,000 at December 31, 2020 and 2019, respectively.

Electric Plant and Retirements

The electric plant is stated at the book value plus the acquisition costs of formerly leased property, which includes certain indirect costs such as general and administrative expenses, interest and other financing costs. Normal repairs are charged to maintenance expense, whereas the costs of renewals and betterments of units of property are capitalized.

Depreciation

Depreciation of property, other than that financed by the First Mortgage Bonds, CoBank, First Mortgage Notes, CFC notes, and RUS notes discussed above, is provided based on the straight-line method at rates designed to amortize the original cost of the properties over the estimated useful lives of each of the various classes of property or the remaining original term of the Power Sales Agreement, whichever is less. Beginning in 2011, all non-financed property is depreciated over the estimated useful life not beyond 2042.

Cash and Cash Equivalents

For purposes of reporting cash flows, the Cooperative considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents.

Receivables and Credit Policies

Trade receivables are uncollateralized customer obligations due under normal trade terms requiring payment within 20 days from the billing date. Management has deemed that no late fees or interest charges are assessed to the receivables. Payments on trade receivables are allocated to the earliest unpaid billings. Management has determined that an allowance for doubtful accounts is not necessary, as all balances are considered fully collectible.

Investments

Investments are patronage allocations from cooperatives and other affiliates stated at cost.

Inventories

Fuel is recorded at cost using a LIFO (last-in, first-out) basis. Material and supplies are stated at lower of average cost or net realizable value.

Deferred Expenses

Deferred expenses consist of deferred outage expenses related to the Young 2 generation facility owned by the Cooperative, as well as deferred expenses related to the future retirement of long-lived assets. See also Note 4.

Allowance for Funds Used During Construction (AFUDC)

The allowance for funds used during construction is capitalized interest on all construction projects with a budgeted cost greater than \$50,000. AFUDC is classified as a reduction of interest expense.

Revenue Recognition

Revenues are primarily from electric sales to customers. Electric revenues are recognized over time as electricity is delivered to customers. Electric revenues are based on the reading of customer meters, which occurs on a systematic basis throughout each reporting period and represents the fair value of the electricity delivered.

Revenues are recognized equivalent to the value of the electricity supplied during each period, including amounts billed during each period and changes in amounts estimated to be billed at the end of each period. The Cooperative has elected to apply invoice method to measure progress towards completing performance obligations to transfer electricity to their customers.

Business and Credit Risk

The Cooperative maintains its cash balances in a locally owned bank. Such balances are insured by the Federal Deposit Insurance Corporation up to \$250,000. The cash balances exceeded insurance coverage at various times during the fiscal years.

Fair Value Measurements

The Cooperative has determined the fair value of certain assets and liabilities in accordance with GAAP, which provides a framework for measuring fair value.

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date. Valuation techniques should maximize the use of observable inputs and minimize the use of unobservable inputs.

A fair value hierarchy has been established, which prioritizes the valuation inputs into three broad levels. Level 1 inputs consist of quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the related asset or liability. Level 3 inputs are unobservable inputs related to the asset or liability.

The Cooperative does not have any assets or liabilities subject to the level 1, 2, or 3 valuation as of December 31, 2020 and 2019, and does not anticipate participating in transactions of this type in the future.

The fair value of the Cooperative's long-term debt was estimated based upon borrowing rates currently available to the Cooperative for bank loans with similar terms and average maturities. The estimated fair value of the Cooperative's long-term debt was \$288,000,000 and \$302,000,000 as of December 31, 2020 and 2019, respectively.

Accounting Estimates

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

Income Taxes

Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss and tax credit carry-forwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

The Cooperative's policy is to evaluate the likelihood that its uncertain tax positions will prevail upon examination based on the extent to which those positions have substantial support within the Internal Revenue Code and Regulations, Revenue Rulings, court decisions, and other evidence.

Debt Issuance Costs

Debt issuance costs are amortized over the period the related obligation is outstanding using the effective interest method. Debt issuance costs are included within long-term debt on the balance sheet. Amortization of debt issuance costs is included in interest expense attributable to amortization of debt issuance costs in the accompanying financial statements.

Recently Adopted Accounting Standards

In 2014, the FASB issued ASC 606, Revenue from Contracts with Customers (ASC 606), replacing the existing accounting standard and industry-specific guidance for revenue recognition with a five-step model for recognizing and measuring revenue from contracts with customers. The underlying principle of the standard is to recognize revenue to depict the transfer of goods or services to customers at the amount expected to be collected. ASC 606 became effective on January 1, 2019, and the Cooperative adopted it using the modified retrospective method applied to open contracts and only to the version of contracts in effect as of January 1, 2019. In accordance with the modified retrospective method, the Cooperative's previously issued financial statements have not been restated. The adoption of ASC 606 by the Cooperative had no significant impact on the timing of revenue recognition in either the current or prior year. As such, no cumulative effect adjustment to retained earnings was required, and there was no material impact to the amounts reported in the current year financial statements. ASC 606 did however require enhanced disclosures regarding the nature, amount, timing, and uncertainty of revenue and the related cash flows arising from contracts with customers, which are included in Note 6.

NOTE 2 - ELECTRIC PLANT

	2020	2019
Generation plant	\$ 747,885,662	\$ 743,837,176
Transmission plant	13,250,680	13,250,680
General plant	3,305,622	3,301,932
Electric plant in service	\$ 764,441,964	\$ 760,389,788
Construction work in progress	98,807	1,482,867
Total electric plant	\$ 764,540,771	\$ 761,872,655

The allowance for funds used during construction was \$10,832 and \$54,500 in 2020 and 2019, respectively.

NOTE 3 - INVESTMENTS IN ASSOCIATED COMPANIES

	2020	2019
Patronage capital allocations		
CoBank	\$ 5,280,369	\$ 5,303,524
Roughrider Electric Cooperative, Inc.	415,320	342,533
National Rural Utilities		
Cooperative Finance Corp. (CFC)	303,420	177,451
Minnkota Power Cooperative, Inc.	8,714	8,714
Memberships	1,000	1,000
Total investments in associated companies	\$ 6,008,823	\$ 5,833,222

NOTE 4 - DEFERRED EXPENSES

The Cooperative has an expense deferral plan pertaining to outage expenditures at the Young 2 facility. The plan is in accordance with accounting principles generally accepted in the United States of America and was approved by RUS in 2019. The total expenses are being charged to operations over a three- or six-year period. The Cooperative deferred \$0 and \$15,398,876 as of December 31, 2020 and 2019, respectively.

The Cooperative recorded a deferred expense as a result of the timing difference of accounting for costs associated with the retirement of long-lived assets for financial reporting pursuant to accounting principles generally accepted in the United States of America and for the purposes of rate-making. The Cooperative had total deferred expenses of \$3,819,869 and \$3,580,334 as of December 31, 2020 and 2019, respectively.

	2020	2019
Deferred expenses – January 1	\$ 14,210,778	\$ 2,648,263
Deferred outage costs added	-	15,398,876
Retirement of long-lived assets	239,535	932,071
Deferred outage costs expensed	(4,768,432)	(4,768,432)
Deferred expenses – December 31	\$ 9,681,881	\$ 14,210,778

Deferred expense balances are summarized below:

	2020	2019
Young 2 deferred outage expenses	\$ 5,862,012	\$ 10,630,444
Deferred expenses – retirement of long-lived assets	3,819,869	3,580,334
Deferred expenses – December 31	\$ 9,681,881	\$ 14,210,778

NOTE 5 - LONG-TERM DEBT

The long-term debt of the Cooperative consists of:

	2020	2019
Rural Utilities Service (RUS) mortgage notes		
Fixed rate notes (2.05%-4.89%) due in quarterly installments through 2026	\$ 29,505,900	\$ 53,714,426
Less RUS advance payments - cushion of credit	(937,855)	(25,611,801)
	28,568,045	28,102,625
First Mortgage		
Bond Series 1998A, 6.79% due in semi-annual installments through 2024 (based upon effective interest rate of 7.74%)	52,607,000	66,908,000
Less unamortized debt issuance costs	(10,148)	(461,629)
Fixed rate notes (4.48%-5.78%) due in semi-annual and quarterly installments through 2042 (based upon effective interest rate of 5.00%)	74,471,915	76,407,770
Less unamortized debt issuance costs	(447,705)	(471,725)
Fixed rate note (4.65%) due in 2026	13,250,000	13,250,000
	139,871,062	155,632,416
CoBank mortgage notes		
Fixed and variable rate notes (1.36%-6.74%) due in quarterly installments through 2026 (based upon effective interest rate of 5.00%)	61,688,959	70,214,325
Less unamortized debt issuance costs	(66,710)	(77,104)
	61,622,249	70,137,221
National Rural Utilities Cooperative Finance Corporation (CFC) mortgage note - fixed rate (3.55%) due in quarterly installments through 2030	24,105,626	26,140,255
Total long-term debt	254,166,982	280,012,517
Less current maturities	(32,984,617)	(33,840,882)
Long-term debt	\$ 221,182,365	\$ 246,171,635

Future maturities of long-term debt are as follows:

Years ending December 31	Amount
2021	\$ 32,984,617
2022	34,787,619
2023	36,681,078
2024	23,702,976
2025	20,962,307
Thereafter	105,572,948
Debt issuance costs	(524,563)
Total long-term debt	\$ 254,166,982

All loan funds advanced by RUS are deposited in a special trust bank account, the disbursements from which are restricted by the provisions of the loan agreement to purposes approved by RUS. All loan funds advanced from First Mortgage, CoBank, and CFC are deposited in the general checking bank account. At December 31, 2020, there were no unadvanced loan funds to the Cooperative.

NOTE 6 - REVENUES FROM CONTRACTS WITH CUSTOMERS

The revenues of the Cooperative are primarily derived from providing wholesale electric service to its customers. Revenues from contracts with customers represent over 98% of all Cooperative revenues. Below is a disaggregated view of the Cooperative's revenues from contracts with customers as well as other revenues, including their location on the statement of revenues, expenses and retained earnings for December 31, 2020 and 2019:

	2020	
Revenue streams	Operating revenue	Nonoperating revenue
Energy sales to customers	\$ 161,780,789	\$ -
Other nonoperating revenue	-	2,774,746
Total revenue contracts with customers	\$ 161,780,789	\$ 2,774,746
Capital credit allocations	681,744	-
Total revenue	\$ 162,462,533	\$ 2,774,746

Notes to Financial Statements

NOTE 6 - REVENUES FROM CONTRACTS WITH CUSTOMERS

Timing of revenue recognition		
Services transferred over time	\$ 161,780,789	\$ 2,774,746
		2019
Revenue streams	Operating revenue	Nonoperating revenue
Energy sales to customers	\$ 162,106,970	\$ -
Other nonoperating revenue	-	2,694,746
Total revenue contracts with customers	162,106,970	2,694,746
Capital credit allocations	724,882	-
Total revenue	\$ 162,831,852	\$ 2,694,746
Timing of revenue recognition		
Services transferred over time	\$ 162,106,970	\$ 2,694,746

Electric Revenue

Electric revenues consist of wholesale electric power sales to customers through the power sales agreement. All of the electric revenues meet the criteria to be classified as revenue from contracts with customers and are recognized over time as energy is delivered. Revenue is recognized based on the metered quantity of electricity delivered or transmitted at the applicable contractual rates.

Other Nonoperating Revenue

Other nonoperating revenue represents revenue from coal yard services and license agreements. Revenue from the coal yard services and license agreements is recognized over time, based on an annual contracted fee.

Accounts receivable and contract balances with customers are as follows:

	Accounts Receivable	Liabilities
December 31, 2018	\$ 22,795,866	\$ -
December 31, 2019	21,678,519	-
December 31, 2020	23,163,610	-

NOTE 7 - LINE OF CREDIT

The Cooperative had a line of credit agreement with U.S. Bank of North Dakota with available borrowings totaling \$5,000,000 expiring June 30, 2021. The line of credit had a variable interest rate of 1.6875% and 3.25% at December 31, 2020 and 2019, respectively. Amounts outstanding on the line totaled \$0 as of December 31, 2020 and 2019.

The Cooperative also has a line of credit agreement with CFC available for \$55,000,000 expiring June 30, 2022. The line had a variable borrowing rate of 1.55% and 3.10% at December 31, 2020 and 2019, respectively. At December 31, 2020 and 2019, there were outstanding borrowings on this line of credit totaling \$22,000,000 and \$32,000,000, respectively.

The Cooperative also has two \$10,000,000 lines of credit available for use, one each with Minnkota and MP. These lines have a variable interest rate (1% below the prime rate) and are automatically renewed each year. There were no amounts outstanding on these lines as of December 31, 2020 and 2019.

NOTE 8 - INCOME TAXES

Deferred tax assets and liabilities consist of the following components as of December 31, 2020 and 2019:

	2020	2019
Deferred tax assets		
Inventories	\$ (209,180)	\$ (303,330)
Alternative Minimum Tax (AMT)	-	(531,086)
Amortization	(618,821)	(721,692)
Total deferred tax asset	(828,001)	(1,556,108)
Deferred tax liability		
Depreciation	12,910,918	15,369,094
Capitalized interest	1,225,063	1,225,063
Total deferred tax liability	14,135,981	16,594,157
Net deferred tax liabilities	\$ 13,307,980	\$ 15,038,049

The provision for income taxes charged to income for the years ended December 31, 2020 and 2019, consists of the following:

	2020	2019
Current provision	\$ 2,517,523	\$ 1,405,798
Deferred expense (benefit)	(1,730,069)	(11,970)
Balance	\$ 787,454	\$ 1,393,828

The 2020 and 2019 effective tax rates may differ from the federal tax rate primarily due to state income taxes.

It is the opinion of management that the Cooperative has no significant uncertain tax positions that would be subject to change upon examination. The federal income tax returns of the Cooperative are subject to examination by the IRS, generally for three years after they were filed. All required filings are current.

NOTE 9 - DEFERRED CREDITS

The deferred credits balance is made up of an asset retirement obligation resulting from the production of power at the Young 2 facility.

The FASB has issued guidance which provides accounting requirements for retirement obligations associated with tangible long-lived assets. Retirement obligations associated with long-lived assets are those for which there is a legal obligation to settle under existing or enacted law, statute, ordinance, written or oral contract or by legal constructions under doctrine of promissory estoppel.

Assets considered for potential asset retirement obligations include generating plants and transmission assets on property under easement agreement or license.

Management has determined that the Cooperative has a legal obligation to close its ash and sludge disposal ponds upon reaching the end of their useful lives resulting in the recording, at a discounted present value, a deferred expense and asset retirement obligation of \$3,819,869 and \$3,580,334 at December 31, 2020 and 2019, respectively. The deferred expenses were recognized in accordance with U.S. GAAP.

Under the power sales agreements with Minnkota and MP, the pass-through of closure costs are not due until the actual closure costs are incurred. Asset retirement obligations for generation plant are not recorded as a liability, due to the fact that governmental authorization for construction did not impose post-closure obligations.

NOTE 10 - SALES, OPERATING AND COAL SUPPLY AGREEMENTS

Under the Power Sales Agreements dated May 29, 1998, which expire on January 2, 2027, MP was entitled to purchase 70.8333% and Minnkota was entitled to purchase 29.1667% of the entire output of Young 2 generation facility. Subsequent to the original agreement, certain options were available, and exercised, to increase Minnkota's percentage, respectively decreasing MP's percentage. Currently, MP and Minnkota each purchase 50% of the net capability of Young 2 as a result of exercising these options.

On December 30, 2009, Minnkota, Square Butte, and MP completed an agreement in which Minnkota receives additional energy and capability from Young 2. Between 2014 and 2026, Minnkota has the option to acquire MP's 50% allocation from Young 2. In 2014, Minnkota exercised this option and started purchasing an additional 22.5275% allocation of Young 2 from MP. This allocation increased to 28.022% on January 1, 2015. This allocation will increase by approximately 4.4% per year from 2022-2026. From 2027 through 2042, Minnkota will purchase 100% of the Young 2 output directly from Square Butte.

The power sales agreements provide for a pass-through on a percentage basis according to the respective entitlements to the output and capacity of Young 2, of all of Square Butte's costs, plus a margin of 5% of non-fuel operating expenses. Each purchaser is required to make full payment of the cost of power based on its percentage entitlement. The payment obligations of MP and Minnkota are several and not joint, and are not guarantees of any Square Butte obligations.

The Cooperative has an agreement with Minnkota whereby Minnkota operates Young 2. All costs associated with the operation of Young 2 are paid by the Cooperative. In addition, the Cooperative pays a minimum annual royalty of \$1,350,000 to Minnkota on coal purchased.

The Cooperative has a Coal Supply Agreement with BNI Coal Ltd. to purchase coal for Young 2. This agreement expires in 2037, with an additional 5-year extension at the Cooperative's option. The agreement provides for reimbursement to BNI Coal Ltd. of all fixed production costs and labor plus a specified profit on each ton of coal delivered. Billings from BNI Coal Ltd. to the Cooperative approximated \$55,443,000 and \$53,237,000 for the years ended December 31, 2020 and 2019, respectively.

NOTE 11 - RELATED PARTY TRANSACTIONS

During the years ended December 31, 2020 and 2019, the Cooperative contracted services provided by Minnkota. The transactions conducted between the Cooperative and Minnkota were as follows:

	2020	2019
Energy sales	\$ 80,309,525	\$ 80,472,607
Accounts receivable from Minnkota	\$ 9,342,805	\$ 8,802,902
Accounts payable to Minnkota	\$ 3,954,193	\$ 5,148,502

NOTE 12 - SUBSEQUENT EVENTS

No significant events occurred subsequent to the Cooperative's year end. Subsequent events have been evaluated through February 17, 2021, which is the date these financial statements were available to be issued.

Independent Auditor's Report

*The Board of Directors
Square Butte Electric Cooperative
Grand Forks, North Dakota*

Report on the Financial Statements

We have audited the accompanying financial statements of Square Butte Electric Cooperative, which comprise the balance sheets as of December 31, 2020 and 2019, and the related statements of revenues, expenses, and retained earnings, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the 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 the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Square Butte Electric Cooperative 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.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated February 17, 2021, on our consideration of Square Butte Electric Cooperative's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Square Butte Electric Cooperative's internal control over financial reporting and compliance.

Brady, Martz & Associates, P.C., Grand Forks, North Dakota – February 17, 2021



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