



2022

Annual Report



Square Butte
ELECTRIC COOPERATIVE

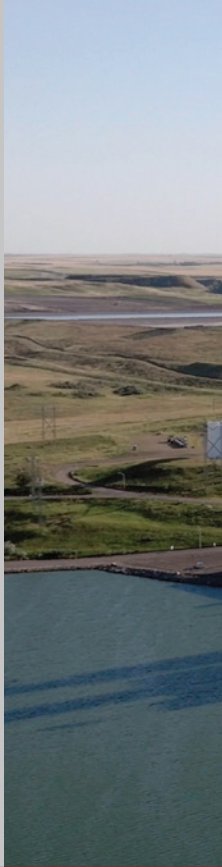
Cooperative Profile

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. In addition, Minnkota purchases 32% of Minnesota Power's share under a separate agreement.

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



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Member-Owner Cooperatives

01

Beltrami Electric Cooperative
Bemidji, Minn.

02

Cass County Electric Cooperative
Fargo, N.D.

03

Cavalier Rural Electric Cooperative
Langdon, N.D.

04

Clearwater-Polk Electric Cooperative
Bagley, Minn.

05

Nodak Electric Cooperative
Grand Forks, N.D.

06

North Star Electric Cooperative
Baudette, Minn.

07

PKM Electric Cooperative
Warren, Minn.

08

Red Lake Electric Cooperative
Red Lake Falls, Minn.

09

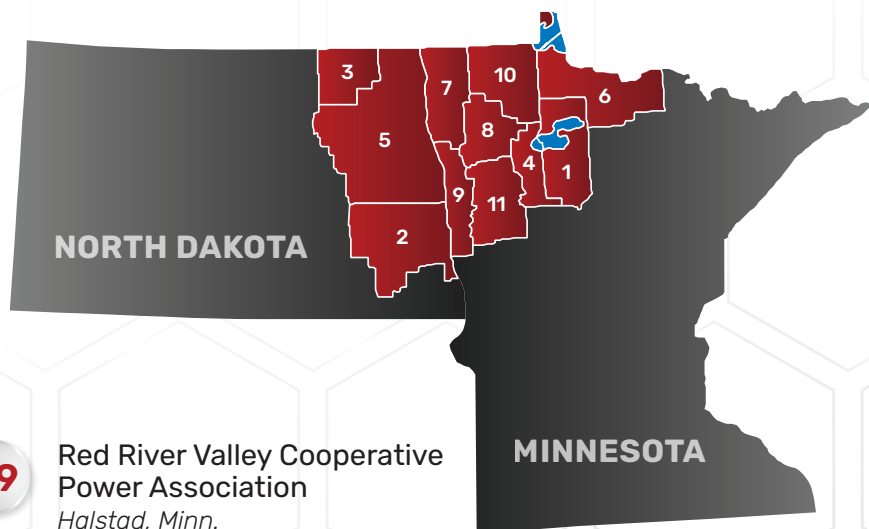
**Red River Valley Cooperative
Power Association**
Halstad, Minn.

10

Roseau Electric Cooperative
Roseau, Minn.

11

Wild Rice Electric Cooperative
Mahnomen, Minn.



Report to the Members



Paul Aakre
President

How does an electric cooperative calculate a successful year?

Is it by hours of reliable power over 365 days? Is it by number of employees safely navigating 52 weeks of generation? Is it by the quantity of innovative projects completed that make electricity more efficient and more resilient, while lowering carbon emissions?

By any of these standards, Square Butte Electric Cooperative realized exceptional success in 2022 – success that will serve as a foundation to cooperative achievements well into 2023 and beyond. Square Butte continues to meet and exceed the expectations of its members who power homes, farms and businesses across North Dakota and Minnesota, even

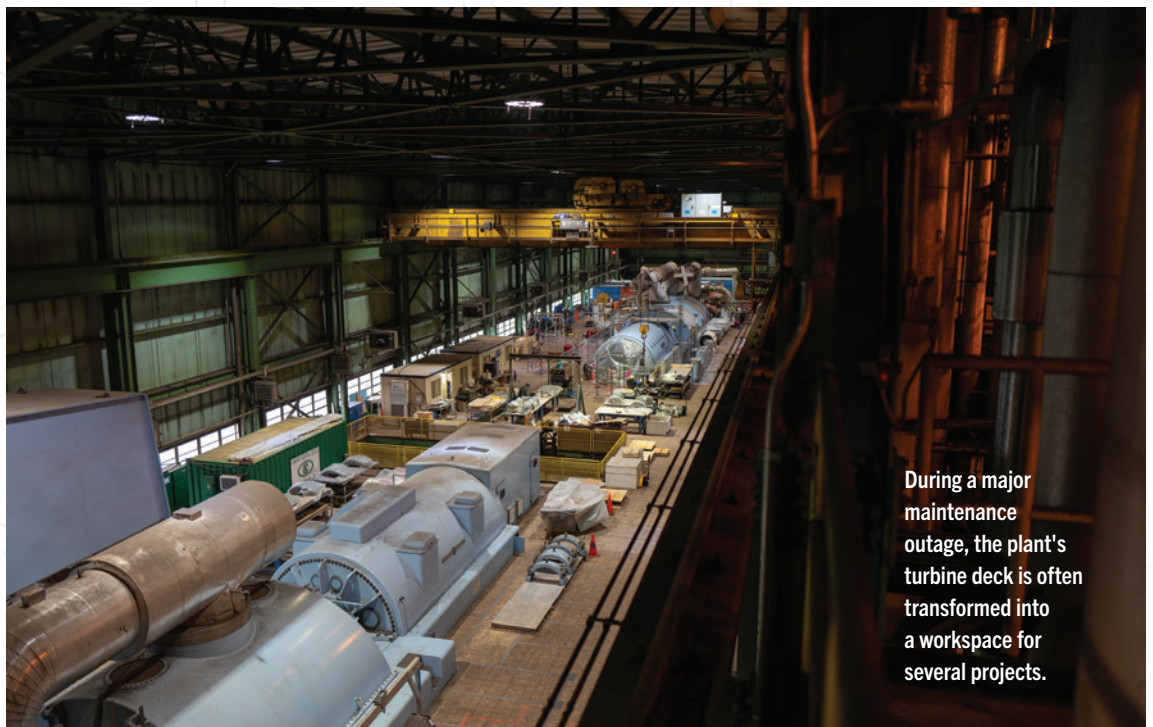
during a time of rapid industry change.

The Square Butte-owned Unit 2 generator performed well in 2022, even while incorporating one of the longest planned major outages in the Milton R. Young Station's history. The 455-megawatt (MW) unit was available to produce power 92% of the time, excluding the three months in the fall it was offline for scheduled maintenance.

The 13-week major maintenance outage – which ran from early September to early December – was an incredible undertaking, and we are grateful for our team of engineers, technicians, coordinators and others who navigated dozens of projects on schedule and near budget. Through the completion of



Mac McLennan
General Manager



During a major maintenance outage, the plant's turbine deck is often transformed into a workspace for several projects.



Roger Bauman and Sam Schwanberg inspect a heat transfer sensor during the Unit 2 outage.


\$35.1 million in capital projects and \$13.1 million in maintenance, this outage highlighted how a resilient workforce creates resilient power, in more ways than one.

Every day of the three-month outage, an average of 130 Minnkota employees and another 250 contractors convened at the Young Station to work on more than 50 Unit 2 maintenance projects throughout the facility. The outage team had to overcome challenges related to space coordination, material shortages, and other supply chain-related issues. However, not one of these challenges was enough to deter their success. Staff found innovative solutions to outage impediments that were beyond their control, such as renting a generator exciter – an essential piece of equipment – to ensure Unit 2

could operate during the winter months as they waited for the reconditioned exciter to arrive back on-site in 2023.

Safety was a top priority through all stages of the outage. As is customary on all major projects, all contractors were given a safety orientation at the start of outage work, and job safety plans were discussed for every project with contractor safety personnel. The plant's safety personnel consistently monitored work areas for potential hazards, and the entire team wrapped up the outage with an excellent safety record.

Throughout 2022, plant employees reported zero OSHA lost-time injuries, continuing a streak of safety that reached back more than

A photograph of two workers in a power plant. They are wearing yellow hard hats and dark safety vests. The worker on the right has 'ARIAT' written on his vest. They are standing on a metal walkway, looking at a complex system of pipes and structural beams in the background. The lighting is warm and industrial.

Bauman and Schwanberg discuss one of their larger projects – repairs to the Unit 2 pass hopper lower cone.

870 days. There were only four OSHA recordable injuries at the Young Station, none of which were considered serious. We would like to thank the Young Station employees for using best practices as you do the difficult work that keeps our power reliable.

During the year, Unit 2 generated nearly 2.4 million megawatt-hours (MWh) with an average plant load of 397 MW, up from 375 MW in 2021. Square Butte's 2022 average power cost was 75.1 mills per kilowatt-hour (kWh) compared to the 77.9 mills that was budgeted, with net power costs for the year \$9.4 million (5.4%) under budget.

Square Butte celebrated a sound year in terms of safety, reliability and economics, but also a milestone year for environmental accountability. The Young Station met all land, air and water

quality standards throughout the year, and progressed further into pioneering projects to significantly reduce carbon dioxide (CO₂) emissions.

Minnkota continues to progress in its efforts toward the realization of Project Tundra, an initiative to retrofit the Young Station with technology that will capture up to 4 million metric tons of CO₂ and safely and permanently store it more than a mile underground. Early in 2022, the North Dakota Industrial Commission (NDIC) approved a Class VI injection well permit allowing Minnkota to store CO₂ in ideal geologic formations near the plant site. Throughout the permit development process, Minnkota communicated the benefits of the project with area landowners and other stakeholders through various outreach efforts, most of which were met with support and positivity.



The resilience and innovation seen at the Young Station are a testament to the employees who power the plant.

In addition to the storage permit victory, Project Tundra received a \$100 million loan from the state of North Dakota to help advance the initiative. The loan was authorized by the NDIC in May and will serve as a key component of the project's overall financing strategy. The loan will be furnished by the Bank of North Dakota through the state's new Clean Sustainable Energy Authority.

By the end of 2022, Project Tundra received additional support with the passage of the federal Inflation Reduction Act (IRA). The bill, signed into law in August, increased the 45Q tax credit for carbon capture and sequestration from \$50 per ton to \$85 per ton. These provisions may prove to be a financial game changer as we work with Minnkota on Project Tundra's final stage of development in 2023.

For Square Butte Electric Cooperative, initiatives to enhance the environmental attributes of our electricity are more than preparation for a carbon-managed future. Our people, our families, our friends, live and work in this region, and we will do all we can to

protect the remarkable quality of life we find in North Dakota and Minnesota. We understand that the balance of sustainability, reliability and affordability will be one our industry must continue to adjust to years into the future, and Square Butte – along with our power partners at Minnkota – will offer leadership in that journey.

It continues to be our great honor to serve as president and general manager of Square Butte Electric Cooperative. We are forever grateful for our customers, Minnkota and Minnesota Power, along with our longtime partner in power production, BNI Coal. To all of those who added the support, hours, sweat, commitment and optimism that calculated to the sum of success in 2022, we thank you for helping us bring light to the region once again.

Paul Aakre, President

Mac McLennan, General Manager

Board of Directors



Paul Aakre
President
PKM Electric Cooperative
Warren, Minn.



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



Murl Nord
Secretary/Treasurer
Beltrami Electric Cooperative
Bemidji, Minn.



Shawn Gust
Roseau Electric Cooperative
Roseau, Minn.



Michael Hanson
North Star Electric Cooperative
Baudette, Minn.



David Kent
Nodak Electric Cooperative
Grand Forks, N.D.



Terry Kraft
Cass County Electric
Cooperative
Fargo, N.D.



Bill Lanners
Clearwater-Polk Electric
Cooperative
Bagley, Minn.



John Martinson
Cavalier Rural Electric
Cooperative
Langdon, N.D.



Peter Mosbeck
Red Lake Electric Cooperative
Red Lake Falls, Minn.



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



Mac McLennan
General Manager



Gerad Paul
General Counsel

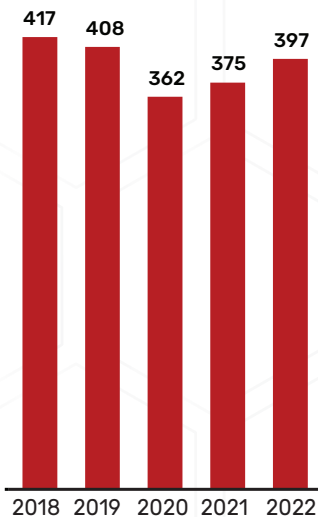
Operating Statistics

| | 2022 | 2021 | 2020 |
|------------------------------|-----------|-----------|-----------|
| Plant availability (percent) | 68.5 | 90.7 | 93.0 |
| Hours of operation | 6,003 | 7,947 | 8,104 |
| Hours of outage | 2,757 | 813 | 680 |
| Total hours in year | 8,760 | 8,760 | 8,784 |
| Gross generation (MWh) | 2,608,403 | 3,278,475 | 3,229,431 |
| Net generation (MWh) | 2,384,958 | 2,977,562 | 2,933,166 |
| Station service (MWh) | 223,445 | 300,913 | 296,265 |
| Station service (percent) | 8.6 | 9.2 | 9.2 |
| Average net generation (MW) | 397 | 375 | 362 |
| Coal burned (tons) | 2,142,140 | 2,620,453 | 2,538,143 |

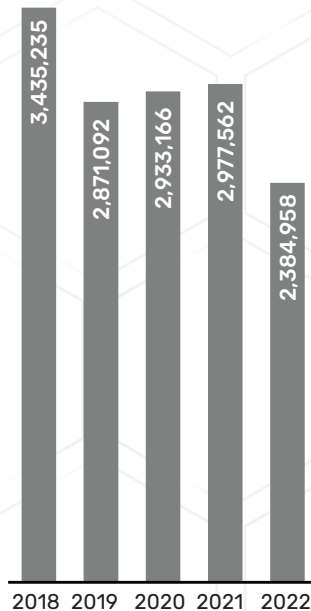
Coal Burned
(tons)



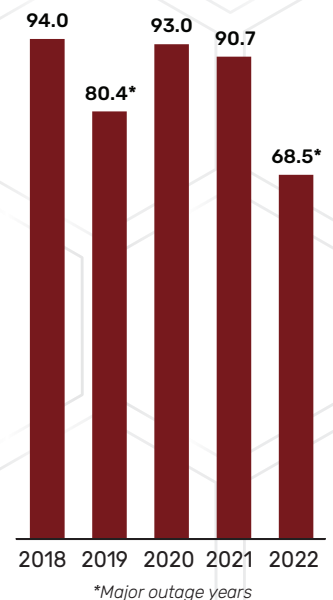
Average Net Generation
(MW)



Net Generation
(MWh)

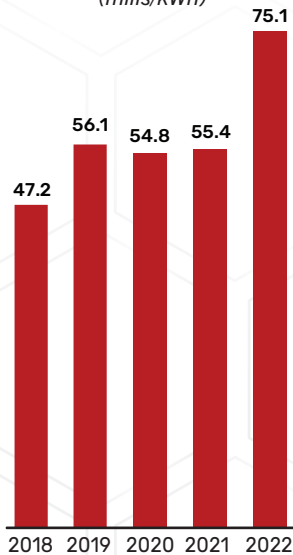


Plant Availability
(percent)



Power Sources & Energy Sales

Average Power Cost
(mills/kWh)



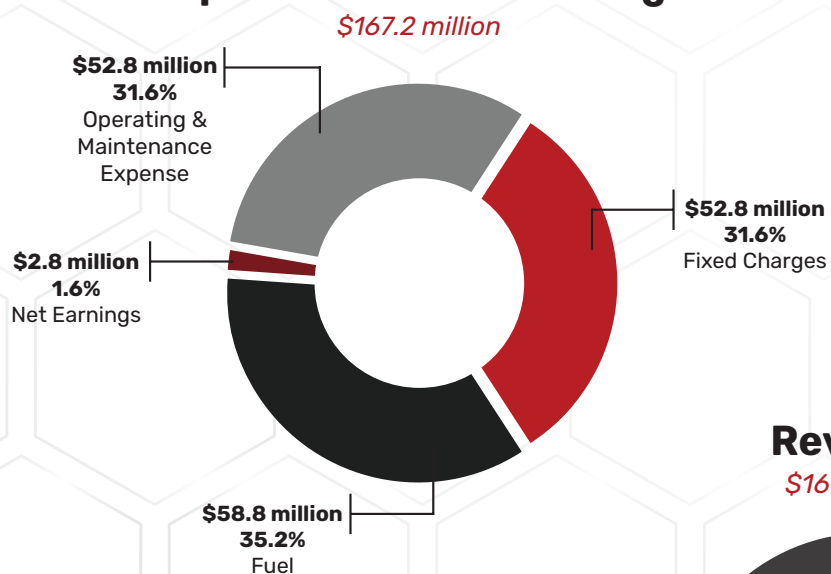
Power sources (MWh)

| | 2022 | 2021 | 2020 |
|--------------------------|-----------|-----------|-----------|
| Net generation – Young 2 | 2,384,958 | 2,977,562 | 2,933,166 |
| Total sources | 2,384,958 | 2,977,562 | 2,933,166 |

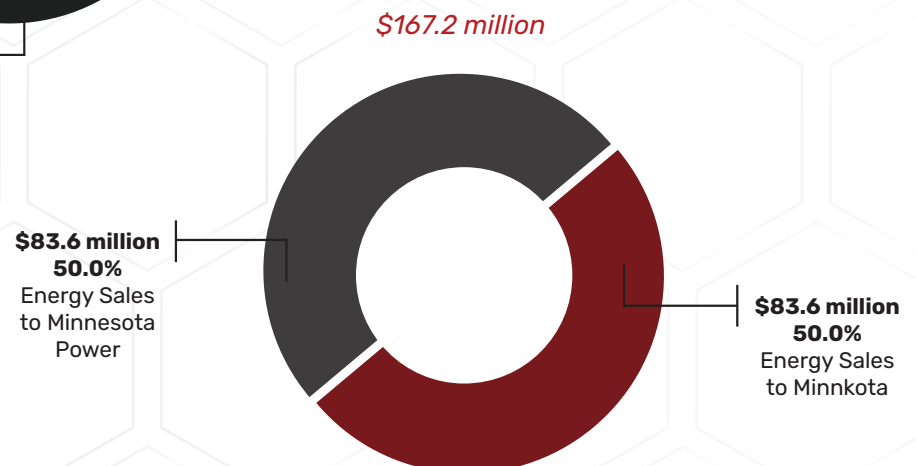
Energy sales (MWh)

| | 2022 | 2021 | 2020 |
|-----------------|-----------|-----------|-----------|
| Minnesota Power | 1,192,479 | 1,488,781 | 1,466,583 |
| Minnkota | 1,192,479 | 1,488,781 | 1,466,583 |
| Total sales | 2,384,958 | 2,977,562 | 2,933,166 |

Expenses and Net Earnings



Revenues



Treasurer's Report

The average power cost for Square Butte in 2022 was 75.1 mills per kilowatt-hour (kWh) – below the budgeted 77.9 mills per kWh and up from the 55.4 mills per kWh in 2021. Increased power costs were due to the major scheduled outage.

Revenues

Square Butte's revenues are set to cover expenses plus a calculated margin. Revenues in 2022 were \$167.2 million – down \$9.4 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 \$83.6 million, or 50%, of Square Butte's revenues in 2022.

Expenses

Square Butte's expenses consist of fuel, operating and maintenance costs and fixed charges. They totaled \$164.4 million in 2022, which is down \$9.4 million from budget.

Fuel costs totaled \$58.8 million in 2022, which was \$5.5 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. Lower coal cost per ton was the main reason for being under budget.

Operating and maintenance expenses amounted to \$52.8 million in 2022, which was \$1.4 million under budget. These expenses were under budget mainly due to reduced chemical usage.

Fixed charges include interest, depreciation and income taxes. They totaled \$52.8 million in 2022, which is \$2.5 million under budget. These expenses are down mainly due to the timing of new financing.

Net Earnings

Net earnings after income taxes were \$2.8 million in 2022 – right on 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 \$277.0 million at Dec. 31, 2022, and includes construction work in progress of \$8.3 million. Net electric plant decreased by \$9.9 million in 2022, primarily due to an additional year of depreciation.

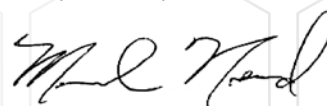
Also shown on the Balance Sheet are current assets of \$28.2 million, long-term investments of \$6.4 million and deferred expenses of \$16.4 million. Total assets were \$328.0 million at Dec. 31, 2022 – up \$2.6 million from last year.

Equities and Liabilities

Long-term debt amounted to \$171.3 million at Dec. 31, 2022 – a decrease of \$16.0 million from 2021. This decrease is mainly due to an additional year of debt principal payments. Other liabilities totaled \$94.8 million and include current liabilities, deferred credits and deferred income taxes. Retained earnings at Dec. 31, 2022, totaled \$61.9 million, including the net earnings in 2022 of \$2.8 million.

This has been a brief review of the 2022 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,



Murl Nord, Secretary-Treasurer



Murl Nord
Secretary-Treasurer

Balance Sheet

Assets

As of December 31

| | 2022 | 2021 |
|---------------------------------------|-----------------------|-----------------------|
| ELECTRIC PLANT | | |
| Plant in service | \$ 796,261,355 | \$ 766,233,138 |
| Construction work in progress | 8,301,857 | 7,067,816 |
| Total electric plant | 804,563,212 | 773,300,954 |
| Less accumulated depreciation | (527,577,361) | (486,448,449) |
| NET ELECTRIC PLANT | \$ 276,985,851 | \$ 286,852,505 |
| OTHER PROPERTY AND INVESTMENTS | | |
| Investments in associated companies | \$ 6,438,649 | \$ 6,265,096 |
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$ 1,079,543 | \$ 11,094 |
| Accounts receivable – | | |
| Minnkota Power Cooperative, Inc. | 10,738,026 | 11,295,043 |
| Minnesota Power | 10,454,245 | 10,731,317 |
| Income taxes receivable | - | 90,297 |
| Inventories – | | |
| Fuel | 4,337,320 | 2,820,635 |
| Materials and supplies | 658,745 | 1,153,072 |
| Prepayments | 909,696 | 1,031,050 |
| TOTAL CURRENT ASSETS | \$ 28,177,575 | \$ 27,132,508 |
| DEFERRED EXPENSES | \$ 16,418,583 | \$ 5,148,803 |
| TOTAL ASSETS | \$ 328,020,658 | \$ 325,398,912 |

See Notes to Financial Statements

Equities & Liabilities

As of December 31

| | 2022 | 2021 |
|--|-----------------------|-----------------------|
| EQUITIES | | |
| Memberships issued | \$ 110 | \$ 110 |
| Retained earnings | 61,872,525 | 59,103,329 |
| TOTAL EQUITIES | \$ 61,872,635 | \$ 59,103,439 |
| LONG-TERM DEBT | | |
| Less current maturities and unamortized debt issuance costs of \$452,351 in 2022 and \$488,458 in 2021 | \$ 171,344,320 | \$ 187,368,710 |
| OTHER NONCURRENT LIABILITIES | | |
| Deferred income taxes | \$ 6,901,211 | \$ 10,315,886 |
| CURRENT LIABILITIES | | |
| Current maturities of long-term debt | \$ 38,393,920 | \$ 34,787,614 |
| Lines of credit | 26,771,000 | 19,469,000 |
| Accounts payable – | | |
| Minnkota Power Cooperative, Inc. | 9,344,399 | 2,809,724 |
| Other | 7,620,000 | 4,846,061 |
| Income tax payable | 668,000 | 406,384 |
| Accrued liabilities – | | |
| Property and other taxes | 12,840 | 36,321 |
| Interest | 1,341,237 | 2,200,551 |
| TOTAL CURRENT LIABILITIES | \$ 84,151,396 | \$ 64,555,655 |
| DEFERRED CREDITS | \$ 3,751,096 | \$ 4,055,222 |
| TOTAL EQUITIES AND LIABILITIES | \$ 328,020,658 | \$ 325,398,912 |

See Notes to Financial Statements

Revenues, Expenses & Retained Earnings

For the Years Ended December 31

| | 2022 | 2021 |
|---|----------------|----------------|
| OPERATING REVENUES | | |
| Energy sales and other | \$ 167,180,404 | \$ 166,979,411 |
| OPERATING EXPENSES | | |
| Fuel | \$ 58,843,964 | \$ 63,707,560 |
| Operating | 31,708,830 | 31,793,504 |
| Maintenance | 21,105,121 | 18,917,902 |
| Interest, net | 10,255,500 | 11,495,585 |
| Interest expense attributable to amortization of debt issuance costs | 36,105 | 36,105 |
| Depreciation | 41,185,952 | 40,077,213 |
| Total expenses | \$ 163,135,472 | \$ 166,027,869 |
| OPERATING MARGIN | \$ 4,044,932 | \$ 951,542 |
| NON-OPERATING MARGIN | | |
| Non-operating revenue | \$ - | \$ 2,450,308 |
| NET EARNINGS BEFORE INCOME TAXES | \$ 4,044,932 | \$ 3,401,850 |
| Income taxes provision | 1,275,736 | 683,117 |
| NET EARNINGS | \$ 2,769,196 | \$ 2,718,733 |
| RETAINED EARNINGS, BEGINNING OF YEAR | 59,103,329 | 56,384,596 |
| RETAINED EARNINGS, END OF YEAR | \$ 61,872,525 | \$ 59,103,329 |

See Notes to Financial Statements

Cash Flow

For the Years Ended December 31

| | 2022 | 2021 |
|---|------------------------|------------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net earnings | \$ 2,769,196 | \$ 2,718,733 |
| Adjustments to reconcile net earnings to net cash provided (used) by operating activities | | |
| Depreciation | 41,185,952 | 40,077,213 |
| Interest expense attributable to amortization of debt issuance costs | 36,105 | 36,105 |
| Deferred income taxes | (3,414,675) | (2,992,094) |
| Amortization of deferred plant expenses | 6,030,906 | 4,533,078 |
| Addition of asset retirement obligations | (304,126) | 235,353 |
| Capital credit allocations | (617,647) | (737,741) |
| Effects on operating cash flows due to changes in: | | |
| Accounts receivable | 924,386 | 1,146,973 |
| Inventories | (1,022,358) | 1,453,237 |
| Prepayments | 121,354 | (46,653) |
| Accounts payable | 9,308,614 | (4,664,600) |
| Accrued liabilities | (621,179) | (332,909) |
| NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES | \$ 54,396,528 | \$ 41,426,695 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Additions to electric plant, net | \$ (31,319,298) | \$ (8,760,183) |
| Additions to deferred plant expenses | (17,300,686) | - |
| Cash received from investments | | |
| CoBank | 360,224 | 407,090 |
| Roughrider Electric Cooperative | 39,824 | 21,939 |
| National Rural Utilities Cooperative Finance Corporation | 44,046 | 52,439 |
| NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES | \$ (48,175,890) | \$ (8,278,715) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Proceeds (repayments) on lines of credit | \$ 7,302,000 | \$ (2,531,000) |
| Proceeds from long-term obligations | 36,000,000 | - |
| Repayments of long-term obligations | (48,454,189) | (32,046,763) |
| NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES | \$ (5,152,189) | \$ (34,577,763) |
| NET CHANGE IN CASH AND CASH EQUIVALENTS | \$ 1,068,449 | \$ (1,429,783) |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR | 11,094 | 1,440,877 |
| CASH AND CASH EQUIVALENTS, END OF YEAR | \$ 1,079,543 | \$ 11,094 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION | | |
| Cash paid during the year for interest paid | \$ 11,503,666 | \$ 12,062,980 |
| NONCASH FINANCING ACTIVITIES | | |
| Payment of long-term debt from cushion of credit | \$ - | \$ 937,855 |

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, 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 \$7,600,000 and \$5,868,000 for the years 2022 and 2021, respectively. Accumulated depreciation and amortization of the properties would have been increased by approximately \$68,758,000 and \$75,600,000 at December 31, 2022 and 2021, 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 notes, 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 plus assigned capital credits less any capital paid to the Cooperative. Income from investments in cooperatives is recognized when capital credits are assigned.

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, 2022 and 2021 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 \$193,000,000 and \$237,000,000 as of December 31, 2022 and 2021, 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.

NOTE 2 - ELECTRIC PLANT

| | 2022 | 2021 |
|-------------------------------|-----------------------|-----------------------|
| Generation plant | \$ 779,677,200 | \$ 749,648,983 |
| Transmission plant | 13,250,677 | 13,250,680 |
| General plant | 3,333,478 | 3,333,475 |
| Electric plant in service | \$ 796,261,355 | \$ 766,233,138 |
| Construction work in progress | 8,301,857 | 7,067,816 |
| Total electric plant | <u>\$ 804,563,212</u> | <u>\$ 773,300,954</u> |

The allowance for funds used during construction was \$324,269 and \$26,229 in 2022 and 2021, respectively.

NOTE 3 - INVESTMENTS IN ASSOCIATED COMPANIES

| | 2022 | 2021 |
|---|---------------------|---------------------|
| Patronage capital allocations | | |
| CoBank | \$ 5,607,739 | \$ 5,501,600 |
| Roughrider Electric Cooperative, Inc. | 422,294 | 397,926 |
| National Rural Utilities | | |
| Cooperative Finance Corp. (CFC) | 398,902 | 355,856 |
| Minnkota Power Cooperative, Inc. | 8,714 | 8,714 |
| Memberships | 1,000 | 1,000 |
| Total investments in associated companies | <u>\$ 6,438,649</u> | <u>\$ 6,265,096</u> |

NOTE 4 - DEFERRED EXPENSES

The Cooperative has expense deferral plans pertaining to outage expenditures at the Young 2 facility. The plans are in accordance with accounting principles generally accepted in the United States of America and were approved by RUS in 2019 and 2022. The total expenses are being charged to operations over a three and six year period for each respective plan. The Cooperative deferred expenses of \$17,300,686 and \$0 for the years ended December 31, 2022 and 2021, 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 such deferred expenses of \$3,751,096 and \$4,055,222 as of December 31, 2022 and 2021, respectively.

| | 2022 | 2021 |
|---------------------------------|----------------------|---------------------|
| Deferred expenses – January 1 | \$ 5,148,803 | \$ 9,681,881 |
| Deferred outage costs added | 17,300,686 | - |
| Retirement of long-lived assets | (304,126) | 235,354 |
| Deferred outage costs expensed | (5,726,780) | (4,768,432) |
| Deferred expenses – December 31 | <u>\$ 16,418,583</u> | <u>\$ 5,148,803</u> |

Deferred expense balances are summarized below:

| | 2022 | 2021 |
|---|----------------------|---------------------|
| Young 2 deferred outage expenses | \$ 12,667,487 | \$ 1,093,581 |
| Deferred expenses – retirement of long-lived assets | 3,751,096 | 4,055,222 |
| Deferred expenses – December 31 | <u>\$ 16,418,583</u> | <u>\$ 5,148,803</u> |

NOTE 5 - LONG-TERM DEBT

The long-term debt of the Cooperative consists of:

| | 2022 | 2021 |
|--|-----------------------|-----------------------|
| Rural Utilities Service (RUS) mortgage notes | | |
| Fixed rate notes (1.92%-4.77%) due in quarterly installments through 2026 | \$ 20,161,508 | \$ 24,894,941 |
| First Mortgage | | |
| Bond Series 1998A, 6.79% due in semi-annual installments through 2024 (based upon effective interest rate of 7.74%) | 21,026,000 | 37,335,000 |
| Less unamortized debt issuance costs | (6,766) | (8,457) |
| Fixed rate notes (4.48%-5.78%) due in semi-annual and quarterly installments through 2042 (based upon effective interest rate of 5.00%) | 70,330,116 | 72,450,212 |
| Less unamortized debt issuance costs | (399,665) | (423,685) |
| Fixed rate note (4.65%) due in 2026 | - | 13,250,000 |
| | <u>90,949,685</u> | <u>122,603,070</u> |
| CoBank mortgage notes | | |
| Fixed and variable rate notes (1.28%-6.74%) due in quarterly installments through 2026 (based upon effective interest rate of 5.00%) | 43,275,399 | 52,716,830 |
| Less unamortized debt issuance costs | (45,920) | (56,317) |
| | <u>43,229,479</u> | <u>52,660,513</u> |
| National Rural Utilities Cooperative Finance Corporation (CFC) mortgage notes - fixed rates (3.55%-4.42%) due in quarterly installments through 2037 | 55,397,568 | 21,997,800 |
| Total long-term debt | 209,738,240 | 222,156,324 |
| Less current maturities | (38,393,920) | (34,787,614) |
| Long-term debt | <u>\$ 171,344,320</u> | <u>\$ 187,368,710</u> |

Scheduled maturities of long-term debt are as follows:

| Years ending December 31 | Amount |
|--------------------------|-----------------------|
| 2023 | \$ 38,393,920 |
| 2024 | 25,492,776 |
| 2025 | 22,832,557 |
| 2026 | 24,099,180 |
| 2027 | 7,292,328 |
| Thereafter | 92,079,830 |
| Debt issuance costs | (452,351) |
| Total long-term debt | <u>\$ 209,738,240</u> |

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, 2022, 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 99 percent 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, 2022 and 2021:

| | 2022 | |
|--|-----------------------|-----------------------|
| | Operating Revenue | Non-Operating Revenue |
| Revenue Streams | | |
| Energy sales to customers | \$ 166,562,757 | \$ - |
| Other non-operating revenue | - | - |
| Total revenue contracts with customers | <u>\$ 166,562,757</u> | <u>\$ -</u> |
| Capital credit allocations | 617,647 | - |
| Total revenue | <u>\$ 167,180,404</u> | <u>\$ -</u> |
| Timing of revenue recognition | | |
| Services transferred over time | <u>\$ 166,562,757</u> | <u>\$ -</u> |

Notes to Financial Statements

NOTE 6 - REVENUES FROM CONTRACTS WITH CUSTOMERS

| | 2021 | |
|--|-------------------|-----------------------|
| Revenue | Operating Revenue | Non-Operating Revenue |
| Streams | | |
| Energy sales to customers | \$ 166,241,670 | \$ - |
| Other non-operating revenue | - | 2,450,308 |
| Total revenue contracts with customers | 166,241,670 | 2,450,308 |
| Capital credit allocations | 737,741 | - |
| Total revenue | \$ 166,979,411 | \$ 2,450,308 |
| Timing of revenue recognition | | |
| Services transferred over time | \$ 166,241,670 | \$ 2,450,308 |

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 Non-Operating Revenue

Other non-operating 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 | Contract Liabilities |
|-------------------|---------------------|----------------------|
| January 01, 2021 | \$ 23,163,610 | \$ - |
| December 31, 2021 | 22,026,360 | - |
| December 31, 2022 | 21,192,271 | - |

NOTE 7 - LINE OF CREDIT

The Cooperative has a line of credit agreement with U.S. Bank of North Dakota with available borrowings totaling \$5,000,000 expiring June 30, 2023. The line of credit had a variable interest rate of 6.02396% and 1.625% at December 31, 2022 and 2021, respectively. Amounts outstanding on the line totaled \$2,771,000 and \$1,469,000 as of December 31, 2022 and 2021, respectively.

The Cooperative also has a line of credit agreement with CFC available for \$55,000,000 expiring June 30, 2025. The line had a variable borrowing rate of 5.73% and 1.49% at December 31, 2022 and 2021, respectively. At December 31, 2022 and 2021, there were outstanding borrowings on this line of credit totaling \$24,000,000 and \$18,000,000, 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, 2022 and 2021.

NOTE 8 - INCOME TAXES

Deferred tax assets and liabilities consist of the following components as of December 31, 2022 and 2021:

| | 2022 | 2021 |
|------------------------------|--------------|---------------|
| Deferred tax assets | | |
| Inventories | \$ (278,734) | \$ (274,717) |
| Amortization | (421,100) | (515,950) |
| Total deferred tax asset | (699,834) | (790,667) |
| Deferred tax liability | | |
| Depreciation | 6,375,982 | 9,881,490 |
| Capitalized interest | 1,225,063 | 1,225,063 |
| Total deferred tax liability | 7,601,045 | 11,106,553 |
| Net deferred tax liabilities | \$ 6,901,211 | \$ 10,315,886 |

The provision for income taxes charged to income for the years ended December 31, 2022 and 2021 consists of the following:

| | 2022 | 2021 |
|----------------------------|--------------|--------------|
| Current provision | \$ 4,690,411 | \$ 3,675,211 |
| Deferred expense (benefit) | (3,414,675) | (2,992,094) |
| Balance | \$ 1,275,736 | \$ 683,117 |

The 2022 and 2021 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 \$3,751,096 and \$4,055,222 at December 31, 2022 and 2021, 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 percent 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 percent 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 percent 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, 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 were approximately \$56,084,000 and \$55,995,000 for the years ended December 31, 2022 and 2021, respectively.

NOTE 11 - RELATED PARTY TRANSACTIONS

During the years ended December 31, 2022 and 2021, the Cooperative contracted services provided by Minnkota. The transactions conducted between the Cooperative and Minnkota were as follows:

| | 2022 | 2021 |
|-----------------------------------|---------------|---------------|
| Energy sales | \$ 82,116,402 | \$ 82,539,962 |
| Accounts receivable from Minnkota | \$ 10,738,026 | \$ 11,295,043 |
| Accounts payable to Minnkota | \$ 9,344,399 | \$ 2,809,724 |

NOTE 12 - SUBSEQUENT EVENTS

No significant events occurred subsequent to the Cooperative's year end. Subsequent events have been evaluated through February 23, 2023, which is the date these financial statements were available to be issued.

Independent Auditor's Report

To the Members and the Board of Directors
Square Butte Electric Cooperative
Grand Forks, North Dakota

REPORT ON THE FINANCIAL STATEMENTS

Opinion

We have audited the accompanying financial statements of Square Butte Electric Cooperative, which comprise the balance sheets as of December 31, 2022 and 2021, 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.

In our opinion, the financial statements present fairly, in all material respects, the financial position of Square Butte Electric Cooperative as of December 31, 2022 and 2021, and the results of its operations and 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 audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Square Butte Electric Cooperative and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Responsibilities of Management 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, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about Square Butte Electric Cooperative's ability to continue as a going concern for twelve months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the 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 generally accepted auditing standards and *Government Auditing Standards* will always detect a material misstatement when it exists. 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 are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the 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 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 Square Butte Electric Cooperative'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 financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about Square Butte Electric Cooperative'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.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated February 23, 2023, 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 solely 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 effectiveness of Square Butte Electric Cooperative's 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.

Other Information Included in the Company's Annual Report

Management is responsible for the other information included in the Company's Annual Report. The other information comprises reports by management to the members, summarized statistical data, and the Officers and Director listing, but it does not include the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information, and we do not express an opinion or any form of assurance on it.

In connection with our audit of the financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the financial statements, or the other information otherwise appears to be materially misstated. If, based on the work performed, we conclude that an uncorrected material misstatement of the other information exists, we are required to describe it in our report.

BRADY, MARTZ & ASSOCIATES, P.C. GRAND FORKS, NORTH DAKOTA

February 23, 2023

