



REPORT OF INDEPENDENT AUDITORS
AND FINANCIAL STATEMENTS
WITH SUPPLEMENTARY INFORMATION

TOWN AND COUNTRY SUPPLY ASSOCIATION

December 31, 2019 and 2018

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Report of Independent Auditors

Board of Directors
Town and Country Supply Association

Report on Financial Statements

We have audited the accompanying financial statements of Town and Country Supply Association (the Association), which comprise the balance sheets as of December 31, 2019 and 2018, and the related statements of operations, comprehensive income, changes in patrons' equity, and cash flows for the years ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the 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 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 Town and Country Supply Association as of December 31, 2019 and 2018, and the results of its operations and its cash flows for the years ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Change in Accounting Principles

As discussed in Note 2, effective January 1, 2019, the Association adopted Accounting Standards Update (ASU) 2016-01, *Financial Instruments – Overall* (Subtopic 825-10): *Recognition and Measurement of Financial Assets and Financial Liabilities*.

As discussed in Note 2, effective January 1, 2019, the Association adopted Accounting Standards Codification (ASC) Topic 606, *Revenue from Contracts with Customers*.

Our opinion is not modified with respect to these matters.

Report on Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The supplementary information is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Moss Adams LLP

Yakima, Washington
April 23, 2020

Town and Country Supply Association

Balance Sheets

ASSETS

	December 31,	
	2019	2018
CURRENT ASSETS		
Cash and cash equivalents	\$ 1,977,579	\$ 1,248,522
Marketable securities	1,480,839	1,404,976
Receivables		
Trade, net	4,441,498	4,963,280
Other	1,222,596	617,360
Income tax	42,970	414,380
Prepayments with suppliers	956,606	2,425,871
Inventories	7,729,623	7,509,554
Prepaid income tax	-	28,746
Prepaid expenses	111,796	194,060
	<u>17,963,507</u>	<u>18,806,749</u>
Total current assets		
PROPERTY, PLANT, AND EQUIPMENT		
Land and improvements	5,130,704	5,348,205
Buildings	14,411,356	14,215,926
Equipment	16,355,381	15,581,158
Vehicles	3,942,663	4,010,681
Construction in process	185,320	257,504
	<u>40,025,424</u>	<u>39,413,474</u>
Less accumulated depreciation	<u>19,432,318</u>	<u>18,092,555</u>
	<u>20,593,106</u>	<u>21,320,919</u>
Total property, plant, and equipment, net		
PROPERTY HELD FOR SALE, net	<u>469,435</u>	<u>-</u>
INVESTMENTS AND OTHER ASSETS		
Investments in cooperatives	27,725,614	23,877,075
Other assets	350,941	350,941
Goodwill	100,000	100,000
	<u>28,176,555</u>	<u>24,328,016</u>
Total other assets		
	<u>\$ 67,202,603</u>	<u>\$ 64,455,684</u>

Town and Country Supply Association

Balance Sheets

LIABILITIES AND PATRONS' EQUITY

	December 31,	
	2019	2018
CURRENT LIABILITIES		
Note payable - operating line of credit	\$ -	\$ 1,836,026
Accounts payable	4,036,538	3,443,610
Accrued expenses	416,247	328,999
Patrons' credit balances	1,430,825	1,515,539
Patronage refunds payable in cash	685,000	545,000
Current portion of long-term debt and capital lease	952,000	958,000
	<hr/>	<hr/>
Total current liabilities	7,520,610	8,627,174
	<hr/>	<hr/>
OTHER LIABILITIES		
Long-term debt and capital lease, net of current portion	9,300,678	10,043,572
Interest rate swap	337,202	145,553
Deferred compensation	370,824	312,424
Deferred income tax	3,287,000	2,241,000
	<hr/>	<hr/>
Total liabilities	20,816,314	21,369,723
	<hr/>	<hr/>
PATRONS' EQUITY		
Capital stock and stock credits	22,499,059	22,245,902
Allocated reserve	2,503	2,503
Unallocated capital reserve	24,221,929	21,087,096
Accumulated other comprehensive loss	(337,202)	(249,540)
	<hr/>	<hr/>
Total patrons' equity	46,386,289	43,085,961
	<hr/>	<hr/>
	<u>\$ 67,202,603</u>	<u>\$ 64,455,684</u>

Town and Country Supply Association

Statements of Operations

	Year Ended December 31,	
	2019	2018
SALES	\$ 104,587,345	\$ 103,488,531
COST OF SALES	<u>(90,777,557)</u>	<u>(90,073,836)</u>
GROSS MARGIN	<u>13,809,788</u>	<u>13,414,695</u>
OPERATING EXPENSE		
Distribution	(7,718,327)	(7,670,430)
General	(4,155,969)	(4,146,241)
Administrative	<u>(1,005,270)</u>	<u>(952,426)</u>
Total operating expenses	<u>(12,879,566)</u>	<u>(12,769,097)</u>
GAIN ON SALE OF PROPERTY, PLANT, AND EQUIPMENT	<u>4,538</u>	<u>32,441</u>
OTHER EXPENSE, net	<u>(203,595)</u>	<u>(327,879)</u>
LOCAL SAVINGS	731,165	350,160
PATRONAGE RECEIVED	<u>4,970,526</u>	<u>3,043,957</u>
UNREALIZED GAIN ON MARKETABLE SECURITIES	<u>75,863</u>	<u>-</u>
SAVINGS BEFORE INCOME TAXES	5,777,554	3,394,117
PROVISION FOR INCOME TAX EXPENSE	<u>(1,031,439)</u>	<u>(714,265)</u>
NET SAVINGS	<u>\$ 4,746,115</u>	<u>\$ 2,679,852</u>

Town and Country Supply Association

Statements of Comprehensive Income

	Year Ended December 31,	
	2019	2018
NET SAVINGS	\$ 4,746,115	\$ 2,679,852
OTHER COMPREHENSIVE LOSS		
Unrealized loss on marketable securities	-	(172,412)
Unrealized loss on interest rate swap	(191,649)	(145,553)
COMPREHENSIVE INCOME	<u>\$ 4,554,466</u>	<u>\$ 2,361,887</u>

Town and Country Supply Association

Statements of Changes in Patrons' Equity

	Capital Stock and Credits	Allocated Reserve	Unallocated Capital Reserve	Accumulated Other Comprehensive Income (Loss)	Total
BALANCE, December 31, 2017	\$22,081,474	\$ 2,503	\$19,628,627	\$ 68,425	\$41,781,029
Other adjustments	(3,008)	-	2,617	-	(391)
Retirements	(511,564)	-	-	-	(511,564)
Net unrealized loss on marketable securities	-	-	-	(172,412)	(172,412)
Net unrealized loss on interest rate swap	-	-	-	(145,553)	(145,553)
Net savings	-	-	2,679,852	-	2,679,852
Provision for cash refunds	-	-	(545,000)	-	(545,000)
Refunds allocated for reinvestment	679,000	-	(679,000)	-	-
BALANCE, December 31, 2018, as previously reported	22,245,902	2,503	21,087,096	(249,540)	43,085,961
Cumulative adjustment for change in accounting policy for ASC 2016-01	-	-	(103,987)	103,987	-
BALANCE, December 31, 2018, as adjusted	22,245,902	2,503	20,983,109	(145,553)	43,085,961
Other adjustments	(3,650)	-	5,705	-	2,055
Retirements	(571,193)	-	-	-	(571,193)
Net unrealized loss on interest rate swap	-	-	-	(191,649)	(191,649)
Net savings	-	-	4,746,115	-	4,746,115
Provision for cash refunds	-	-	(685,000)	-	(685,000)
Refunds allocated for reinvestment	828,000	-	(828,000)	-	-
BALANCE, December 31, 2019	<u>\$22,499,059</u>	<u>\$ 2,503</u>	<u>\$24,221,929</u>	<u>\$ (337,202)</u>	<u>\$46,386,289</u>

Town and Country Supply Association

Statements of Cash Flows

	Year Ended December 31,	
	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from customers	\$ 104,555,651	\$ 102,729,051
Cash paid to suppliers and employees	(99,486,742)	(103,750,274)
Cash dividends from cooperative investments	967,670	701,714
Interest and dividends received	205,804	211,614
Interest paid	(546,364)	(618,602)
Income taxes received	414,717	1,313,058
Net cash from operating activities	6,110,736	586,561
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale of property, plant, and equipment	80,072	99,020
Purchase of property, plant, and equipment	(1,652,265)	(807,629)
Revolvements from cooperative investments	154,317	51,369
Net cash from investing activities	(1,417,876)	(657,240)
CASH FLOWS FROM FINANCING ACTIVITIES		
Advances on line of credit	3,553,623	8,442,882
Payments on line of credit	(5,389,649)	(7,916,633)
Additional borrowings	-	1,082,816
Principal payments on long-term debt and capital lease	(1,015,137)	(892,000)
Equity redeemed	(567,640)	(508,556)
Patronage dividends paid	(545,000)	(473,391)
Net cash from financing activities	(3,963,803)	(264,882)
NET INCREASE (DECREASE) IN CASH	729,057	(335,561)
CASH, beginning of year	1,248,522	1,584,083
CASH, end of year	\$ 1,977,579	\$ 1,248,522

Town and Country Supply Association

Statements of Cash Flows

	Year Ended December 31,	
	2019	2018
RECONCILIATION OF NET SAVINGS TO NET CASH FROM OPERATING ACTIVITIES		
Net savings	\$ 4,746,115	\$ 2,679,852
Adjustments to reconcile net savings to net cash from operating activities		
Depreciation	2,267,093	2,387,257
Gain on sale of property, plant, and equipment	(4,538)	(32,441)
Patronage allocation notifications received	(4,002,856)	(2,342,243)
Deferred income taxes	1,046,000	685,000
Deferred compensation	58,400	54,100
Provision for bad debt expense	-	41,940
Amortization of debt issuance costs in interest expense	1,007	8,351
Unrealized gain on marketable securities	(75,863)	-
Increase (decrease) in cash due to changes in assets and liabilities		
Receivables	(84,952)	(450,922)
Prepayments with suppliers	1,469,265	(1,444,504)
Inventories	(220,069)	(798,684)
Prepaid expenses	82,264	(120,908)
Accounts payable - trade	426,180	(958,019)
Accrued expenses	87,248	(68,523)
Patrons credit balances	(84,714)	(346,018)
Reserve for recourse obligations	-	(50,000)
Income taxes	400,156	1,342,323
Net adjustments	1,364,621	(2,093,291)
NET CASH FROM OPERATING ACTIVITIES	\$ 6,110,736	\$ 586,561

SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:

During the years ended December 31, 2019 and 2018, the Association financed property, plant, and equipment purchases of \$265,236 and \$276,490 with long-term debt and a capital lease obligation, respectively. Property, plant, and equipment purchases of \$166,748 and \$40,670 were included in accounts payable at December 31, 2019 and 2018, respectively.

During the year ended December 31, 2019, the Association canceled uncollectible receivables of \$1,498 against the corresponding patron's capital stock.

Town and Country Supply Association

Notes to Financial Statements

Note 1 – Description of Operations

Town and Country Supply Association (the Association) is incorporated under the laws of the state of Montana as a farm supply cooperative corporation, not exempt from income tax. Its primary business activities are supplying merchandise and services to patrons. The Association's merchandising operations consist of agronomy, petroleum products, propane, feed, hardware, and farm supply-related products, and convenience stores. Agronomy and retail centers are located in Billings, Bridger, Edgar, Hardin, Laurel, and Lockwood, Montana, with central offices and management also located in Laurel.

Note 2 – Summary of Significant Accounting Policies

Basis of accounting – The Association's financial statements are prepared on the accrual method of accounting.

Cash and cash equivalents – For purposes of the statement of cash flows, the Association considers all investments with an original maturity of three months or less to be cash equivalents. At times, the Association may have cash and cash equivalents on deposit with financial institutions in excess of federally insured limits.

Receivables – Trade receivables are generally unsecured and arise from the extension of credit to customers, patrons, and employees in the normal course of business.

The Association charges interest at 18% per annum on all trade accounts that are past due. The Association generally places accounts that exceed 60 days past due on cash on delivery status, and management evaluates receivables in excess of 180 days past due for impairment. At December 31, 2019 and 2018, the Association had receivables of \$87,839 and \$435,325, respectively, that were 90 days past due and were still accruing interest.

The Association provides an allowance for doubtful accounts, which is based upon a review of outstanding receivables, historical collection information, and existing economic conditions. The activity in the Association's allowance for doubtful accounts, is as follows:

	2019	2018
Beginning balance	\$ 152,328	\$ 51,115
Provision for bad debt expense	-	41,940
Recoveries of amounts previously written off	-	116,638
Less amounts written off	-	(107,365)
Plus amount reclassified from reserve for recourse obligations	-	50,000
Ending balance	<u>\$ 152,328</u>	<u>\$ 152,328</u>

Town and Country Supply Association

Notes to Financial Statements

Note 2 – Summary of Significant Accounting Policies (continued)

Concentration of credit risk – The Association supplies a variety of products and services to customers and patrons in Central Montana. Concentrations of credit risk with respect to receivables may arise based on the Association's limited geographical region.

Revenue recognition, adoption of new accounting principle – Effective January 1, 2019, the Association adopted Accounting Standards Codification (ASC) Topic 606, *Revenue from Contracts with Customers* (Topic 606). The Association recognizes revenue when its customer obtains control of the promised goods or services, in an amount that reflects the consideration that the Association expects to receive in exchange for those goods or services. To determine revenue recognition for arrangements that are within the scope of Topic 606, the Association performs the following five steps: (i) identify the contract(s) with a customer; (ii) identify the promises and distinct performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when (or as) the Association satisfies the performance obligations.

The Association provides a variety of products and services, ranging from sales of agriculture inputs, such as fuels, farm supplies, and agronomy products to retail store operations. Revenue is recognized when performance obligations are met, which generally occurs when control of the goods or services has transferred to the customer. For the majority of the Association's contracts, control transfers to customer at a point-in-time when the goods and services have been delivered, as that is generally when legal title, physical possession and the risks and rewards of goods and services transfer to the customer. Sales are measured at the fair value of the consideration received or receivable, net of discounts, allowances, returns or other adjustments that are based upon management's best estimates and historical experience. Shipping and handling amounts billed to a customer as a part of a sales transaction are included in revenues, and the related costs are included in cost of goods sold.

The Association's agronomy and energy divisions generally experience higher sales volumes in the spring, summer, and fall seasons when fuel usage by travelers and agriculture customers are highest and subject to weather and economic conditions in the local region. Other energy products experience higher volumes and profitability during the winter heating season. Reduced crop tillage, depressed priced for crops, and weather conditions may all reduce demand for the Association's energy and agronomy products.

The Association has analyzed the provisions of the Topic 606, and has concluded that there are no material changes to the timing and pattern of revenue recognition for its current revenue streams in scope of Topic 606, and therefore, there were no changes to reporting periods prior to January 1, 2019. As such, the adoption of Topic 606 via the modified retrospective transition method did not have a significant or material impact on the Association's financial position, results of operations, or cash flows and no changes were required to previously reported revenues or net savings as a result of the adoption. Comparative information presented has not been adjusted and continues to be reported under ASC 605.

Upon adoption of Topic 606, management has elected the practical expedient relating to contract fulfillment. The Association will recognize the incremental costs to obtain or fulfill a contract as an expense when incurred if the amortization period for such costs will be one year or less. Accordingly, no costs incurred to obtain or fulfil a contract have been capitalized.

Town and Country Supply Association

Notes to Financial Statements

Note 2 – Summary of Significant Accounting Policies (continued)

Marketable securities – The Association’s marketable securities consist of CHS preferred stock, which has a readily determinable fair market value. The Association classifies this investment as marketable securities and values them at unadjusted quoted prices in active markets for identical assets. Effective January 1, 2019, the Association adopted Accounting Standards Update (ASU) 2016-01, *Financial Instruments – Overall* (Subtopic 825-10): *Recognition and Measurement of Financial Assets and Financial Liabilities*, which requires changes in fair value of equity investments previously classified as securities available for sale to be recognized in current earnings. Upon adoption, the Association recorded a cumulative adjustment of \$103,987 to reclassify accumulated other comprehensive loss to the unallocated capital reserve. This adjusted the accumulation of prior unrealized gains and losses at the beginning of the period of adoption. During the year ended December 31, 2019, the Association recognized the change in estimated market value of \$75,863 as a component of net savings. Realized gains and losses on marketable securities are determined by specific identification and continue to be charged or credited to current earnings in the period in which they occur.

Inventories – Inventories are stated at the lower of cost or net realizable value. Cost is determined using the average cost method, which approximates costs under the first-in, first-out method.

Property, plant, and equipment – Property, plant, and equipment are stated at cost. Expenditures for maintenance, repairs, and renewals are charged to expense as incurred whereas major purchases and improvements, including interest, are capitalized as additions to property, plant, and equipment. Depreciation is provided for using the straight-line method over the estimated useful lives of the assets. The ranges of estimated useful lives are as follows:

Buildings and improvements	15–40 years
Equipment	3–12 years
Vehicles	5–6 years

The Association recorded depreciation expense of \$2,267,093 and \$2,387,257 for the years ended December 31, 2019 and 2018, respectively.

One construction project with an estimated additional cost to complete of approximately \$5,000 was in progress at December 31, 2019.

At December 31, 2019, the Association had committed to a plan to sale certain real estate assets and has reclassified these assets as property held for sale. The Association has evaluated these assets for impairment and determined no impairment exists at December 31, 2019.

Impairment of long-lived assets – The Association’s management reviews the carrying value of capitalized long-lived assets on a regular basis. Based on management’s reviews, there were no impairments to the carrying value of such long-lived assets at December 31, 2019 and 2018.

Town and Country Supply Association

Notes to Financial Statements

Note 2 – Summary of Significant Accounting Policies (continued)

Investments in cooperatives – The Association's investments in other cooperatives are stated at cost, plus stated value of notified patronage allocations, less distributions received. There is no readily determinable market value. Any expected permanent decline in investment value is charged to operations in the year in which the permanency of the decline is established. Management has reviewed their cooperative investments and believe no investments are impaired at December 31, 2019 and 2018.

Other assets – Included in other assets are two liquor licenses that are carried at cost. Management believes there is no impairment to the carrying value of these assets at December 31, 2019 and 2018.

Goodwill – Goodwill resulted from the Association's prior business acquisition. Goodwill is not amortized but is reviewed at least annually for impairment. Management believes that no impairment of goodwill exists at December 31, 2019 and 2018.

Debt issuance costs – The Association presents debt issuance costs as a reduction of the debt and recognizes the amortization of the debt issuance costs as interest expense, which is in accordance with accounting principles generally accepted in the United States of America.

Federal and state income tax – The Association is not exempt from income tax and is therefore subject to tax with respect to nonpatronage income and margins realized from business done with nonmember patrons.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The Association's deferred tax assets and liabilities are classified as noncurrent in the Association's financial statements, which is in accordance with generally accepted accounting principles.

The Association recognizes the tax benefit from uncertain tax positions if it is more likely than not that the tax positions will be sustained on examination by the tax authorities, based on the technical merits of the position. The tax benefit is measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement.

Accounting for transactions with members – Patrons receive allocations based upon patronage with the Association, which is returned to them in the form of cash and equity allocations. Allocated equity can be retired at the discretion of the Board of Directors, upon patrons' death, or at retirement when patrons reach age 67 (see Note 10).

Town and Country Supply Association

Notes to Financial Statements

Note 2 – Summary of Significant Accounting Policies (continued)

Risk management – In an effort to stabilize financing rates, the Association is participating in an interest rate swap (see Note 7). The Association's interest rate swap qualifies as a derivative financing instrument and hedges the risk related to the variability of future earnings and cash flow caused by changes in interest rates. The derivative financial instrument is held only for the purpose of offsetting such risk, not for speculation. The interest differential to be paid or received is adjusted as interest rates change. The unrealized gains are recorded as an other asset and unrealized losses are recorded as a component of long-term debt, with an offset to other comprehensive income. Upon settlement or termination, realized gains or losses are recognized in earnings.

Retirement plans – The Association provides a 401(k) plan, which covers all employees who have met certain eligibility requirements. The basic contribution provisions provide that an employee may elect to contribute amounts to the Plan provided such amounts do not exceed limits set by federal laws. The Association matches 50% of employee contributions, up to 6%. Employees are immediately vested in their contributions and employer contributions vest over a 6-year period. The Association recorded employee retirement expense of \$69,709 and \$69,390 for the years December 31, 2019 and 2018, respectively, for its contributions to the Plan.

The Association has a nonqualified deferred compensation plan for a key employee that provides deferred compensation benefits after a 10-year service period. The benefits vest incrementally over the 10-year service period. The Association has recognized the accumulated benefit obligation of \$370,824 and \$312,424 at December 31, 2019 and 2018, respectively.

Shipping and handling costs – The Association capitalizes shipping and handling costs associated with obtaining product inventories, into inventory, and recognizes this as a component of cost of sales when the inventory is sold.

Advertising costs – The Association expenses advertising costs as they are incurred. Total advertising expense was \$179,239 and \$162,648 for the years ended December 31, 2019 and 2018, respectively.

Use of estimates – The preparation of financial statements in accordance 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. The Association bases its estimates on historical experience and various assumptions that are believed to be reasonable under the circumstances at the time such estimates are made. Actual results could differ from those estimates under different assumptions or conditions.

Recent accounting pronouncements – In February 2016, the Financial Accounting Standards Board (FASB) amended ASU and released ASU 2016-02, *Leases*. The core principle of the guidance is that an entity should recognize "lease assets" and "lease liabilities" for those leases classified as operating leases under current accounting principles generally accepted in the United States of America. ASU 2016-02 is effective for private entities for annual reporting periods beginning after December 15, 2020. The Association is currently evaluating the impact adopting this standard will have to their financial statements.

Town and Country Supply Association

Notes to Financial Statements

Note 3 – Marketable Securities

The Association's marketable securities consist of CHS, Inc., redeemable preferred stock, which has been classified according to management's intentions. The comparison of carrying value and estimated fair value of these investments are as follows:

December 31, 2019				
	Amortized Cost	Gross Unrealized		Estimated Market Value
		Gains	Losses	
CHS, Inc.				
Class B preferred stock	\$ 950,795	\$ -	\$ (59,720)	\$ 891,075
8% cumulative redeemable preferred stock	558,168	31,596	-	589,764
Total	<u>\$ 1,508,963</u>	<u>\$ 31,596</u>	<u>\$ (59,720)</u>	<u>\$ 1,480,839</u>
December 31, 2018				
	Amortized Cost	Gross Unrealized		Estimated Market Value
		Gains	Losses	
CHS, Inc.				
Class B preferred stock	\$ 950,795	\$ -	\$ (110,097)	\$ 840,698
8% cumulative redeemable preferred stock	558,168	6,110	-	564,278
Total	<u>\$ 1,508,963</u>	<u>\$ 6,110</u>	<u>\$ (110,097)</u>	<u>\$ 1,404,976</u>

Note 4 – Inventories

The Association's major classes of inventories at December 31 are as follows:

	2019	2018
Petroleum products	\$ 844,586	\$ 737,774
Agri-products	4,119,993	4,091,847
Farm and home products	2,765,044	2,679,933
	<u>\$ 7,729,623</u>	<u>\$ 7,509,554</u>

Town and Country Supply Association

Notes to Financial Statements

Note 5 – Investments – Other Cooperatives

The Association's investments in other cooperatives at December 31 are as follows:

	2019	2018
CHS, Inc.	\$ 26,421,615	\$ 22,650,500
Land O'Lakes	1,301,754	1,224,259
All others	2,245	2,316
	<u>\$ 27,725,614</u>	<u>\$ 23,877,075</u>

These investments consist of nonmarketable stock, equity certificates, or notices of noncash distributions. The Association records patronage income in the year in which the patronage activity relates to.

The Association has nonqualified equity certificates with CHS, Inc., of \$2,086,153 and \$2,125,294 at December 31, 2019 and 2018, respectively, that were received in previous years and were not recorded as cooperative investments. Management believes there is uncertainty regarding the future realization of these benefits; therefore, no amounts have been reflected in the accompanying financial statements for these previously received nonqualified equity certificates.

Note 6 – Note Payable – Operating Line of Credit

The Association has a demand operating line of credit with First Interstate Bank with available borrowings up to \$6,000,000 and outstanding borrowings of \$0 and \$1,836,026 at December 31, 2019 and 2018, respectively. Borrowings under the line of credit bear interest at 5.50%. The line of credit matures May 1, 2020, and is collateralized by substantially all assets of the Association. The line of credit is subject to certain financial covenants with which the Association must comply.

Town and Country Supply Association

Notes to Financial Statements

Note 7 – Long-Term Debt and Capital Lease

	2019	2018
Notes payable to First Interstate Bank, due in monthly installments ranging from \$1,930 to \$46,693 with interest ranging from 3.50% to 5.20%, maturing June 2020 through July 2031; secured by real estate, equipment, inventories, and investment securities.	\$ 9,859,000	\$ 10,766,602
Note payable to AGCO Finance, due in annual installments of \$57,551 with interest at 2.75%, maturing January 2024, and secured by equipment	215,056	-
Capital lease obligation	187,856	245,211
	10,261,912	11,011,813
Less current portion	952,000	958,000
Less unamortized debt issuance costs	9,234	10,241
	<u>\$ 9,300,678</u>	<u>\$ 10,043,572</u>

Debt issuance cost amortization, which is included in interest expense, was \$1,007 and \$8,351 for the years ended December 31, 2019 and 2018, respectively.

Future maturities of long-term debt and capital lease are as follows:

2020	\$ 952,000
2021	1,011,000
2022	1,028,000
2023	1,060,000
2024	1,060,000
Thereafter	5,150,912
	<u>\$ 10,261,912</u>

All notes payable to First Interstate Bank are subject to certain covenants regarding financial statement amounts, ratios, and activities of the Association.

The Association leases equipment under terms that meet the criteria for capitalization. The economic substance of this transaction is that the entity is financing the acquisition of the asset through the lease. Accordingly, the asset is capitalized and the related lease obligation is included in long-term liabilities. The Association records amortization on the leased asset as part of depreciation expense. The Association's leased asset consists of the following at December 31:

	2019	2018
Equipment	\$ 276,490	\$ 276,490
Less accumulated depreciation	46,082	15,361
	<u>\$ 230,408</u>	<u>\$ 261,129</u>

Town and Country Supply Association

Notes to Financial Statements

Note 7 – Long-Term Debt and Capital Lease (continued)

The following is a schedule of future minimum lease payments required under the capital lease, together with the present value of the minimum lease payments due under the capital lease as of December 31, 2019:

2020	\$ 52,008
2021	52,008
2022	52,008
2023	37,957
	<hr/>
	193,981
Less amount representing interest	<hr/> 6,125
Present value of minimum lease payments	<hr/> \$ 187,856

Interest rate swap – During 2018, the Association entered into an interest rate swap agreement with First Interstate Bank as the counterparty, to manage its floating interest rate risk. The Association's interest rate swap, which manages the interest rate risk associated with a portion of their respective debt, has a notional amount of \$5,950,087 and \$6,533,071 at December 31, 2019 and 2018, respectively, and expires February 15, 2028. The terms of this swap requires the Association's to pay a fixed rate of interest of 4.76% and allows the Association to receive payments based on the floating one-month LIBOR plus 1.80% on the date of the payment. All payments on the debt and related swap are paid on the same day.

The fair value of the interest rate swap is the estimated amount the Association would pay or receive to terminate the swap agreement at the reporting date. The estimated fair value of the swap in existence at December 31, 2019 and 2018, was \$337,202 and \$145,553, respectively. The estimates take into consideration current interest rates that determine the current interest spread on the agreements, and the creditworthiness of the counterparty that helps determine an appropriate risk-based discount factor. The notional amount on the swap decreases consistently with the principal repayments on the related note. The Association is exposed to the credit loss on the interest rate swap in the event of nonperformance by First Interstate Bank. The Association does not anticipate nonperformance by the counterparty.

Note 8 – Operating Lease Commitments

Lessee – The Association leases railroad property under operating leases, which are leased under perpetual agreements. Estimated future minimum lease commitments under these operating leases as of December 31, 2019, are as follows:

2020	\$ 20,000
2021	21,000
2022	21,000
2023	21,000
2024	21,000

The Association recorded rent expense of \$40,839 and \$86,510 for the years ended December 31, 2019 and 2018, respectively.

Town and Country Supply Association

Notes to Financial Statements

Note 8 – Operating Lease Commitments (continued)

Lessor – During the years ended December 31, 2019 and 2018, the Association subleased certain buildings to various unrelated lessees as operating leases. Lease income on all operating leases was \$63,590 and \$63,180 for the years ended December 31, 2019 and 2018, respectively, and is included in other income in the financial statements.

These noncancelable operating lease agreements expire in 2021 and 2024, and include renewal options for additional terms. Expected future minimum lease receipts under these operating leases as of December 31, 2019, are as follows:

2020	\$	63,000
2021		51,000
2022		52,000
2023		52,000
2024		34,000

Note 9 – Income Taxes

The Association operates as a cooperative not exempt from federal and state income taxes and, therefore, is subject to taxes on margin from nonmember business, nonpatronage sources, and net margin distributed to members in the form of nonqualified written notices of allocation.

The provision for income tax expense consists of the following:

	Years Ended December 31,	
	2019	2018
Current		
Federal benefit (expense)	\$ 14,323	\$ (28,647)
State benefit (expense)	238	(618)
	14,561	(29,265)
Deferred		
Federal and state expense	(1,046,000)	(685,000)
Provision for income tax expense	<u>\$ (1,031,439)</u>	<u>\$ (714,265)</u>

The income tax provision varies from the expected combined federal and state rate of approximately 27% due primarily to state income taxes, nondeductible expenses, and qualified patronage allocations, which are deductible for income tax purposes.

Town and Country Supply Association

Notes to Financial Statements

Note 9 – Income Taxes (continued)

Deferred income taxes are provided for the temporary differences related to methods used for financial accounting that differ from those used for income tax accounting. The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities are presented below:

	December 31,	
	2019	2018
Deferred income tax assets		
Allowance for doubtful accounts	\$ 41,000	\$ 41,000
Accrued expenses	33,000	70,000
Alternative minimum tax credit carryforward	14,000	29,000
Net operating loss carryforwards	1,147,000	975,000
Inventory	58,000	56,000
Unrealized loss on marketable securities	8,000	-
Deferred compensation	100,000	84,000
	<u>1,401,000</u>	<u>1,255,000</u>
Deferred income tax liabilities		
Property, plant, and equipment	(2,857,000)	(2,791,000)
Nonqualified equity certificates with CHS, Inc.	(1,632,000)	(594,000)
Qualified patronage dividends receivable	(199,000)	-
Other	-	(111,000)
	<u>(4,688,000)</u>	<u>(3,496,000)</u>
Net deferred income tax liability	<u>\$ (3,287,000)</u>	<u>\$ (2,241,000)</u>

The Association has a federal net operating loss carryforward of approximately \$4,800,000, of which \$3,400,000 will expire in 2038, and \$1,400,000 will carryforward indefinitely until utilized. The Association also has a Montana state net operating loss carryforward of approximately \$1,985,000, of which \$147,000 will expire in 2025 and \$1,838,000 will begin to expire in 2029.

The Association files income tax returns in the U.S. federal and state of Montana jurisdiction. The Association does not have any material uncertain tax positions, and as of December 31, 2019, there is no accrued interest or penalties recorded in the financial statements.

Note 10 – Patrons' Equity

Membership in the Association is obtained by the purchase of one share of common stock, and is limited to only agricultural producers or cooperative associations whose members are agricultural producers. Each member is entitled to one vote on matters impacting the Association.

Total annual net savings is derived from patronage source business and from sources other than patronage. The annual net savings derived from patronage source business is distributed annually to the patrons from whom the savings were earned. Patronage distributions shall be distributed in cash or in written notices of allocation or by any combination thereof designated by the Board of Directors. The annual net savings derived from sources other than patronage is retained by the Association as unallocated capital reserve.

Town and Country Supply Association

Notes to Financial Statements

Note 10 – Patrons' Equity (continued)

If, in any year, the Association's allocated and unallocated capital reserves fall below 30% of the paid-up capital stock, the Association shall set aside 10% of the total annual net savings, using annual net savings from patronage business if annual net savings from other sources is not sufficient to fund the 10% reserve amount.

Allocated equity can be retired at the discretion of the Board of Directors, upon patrons' death, or at retirement when patrons reach age 67.

Note 11 – Contract Commitments

At December 31, 2019, the Association had contract commitments to purchase and sell certain fuel products in future years, as follows:

Product	Year	Gallons Committed to Purchase	Gallons Committed to Sell
Propane	2020	87,000	(190,154)
Refined fuels	2020	8,337,000	(10,643,230)
Propane	2021	-	(300,000)
Refined fuels	2021	4,074,000	(4,074,000)

Note 12 – Recourse Obligations

The Association has entered into agreements with CHS Capital to partner in providing financing to producer members. Under the agreements, the Association acts as a guarantor with recourse for certain funds loaned to its members. The Association determines which contracts and what portion of the credit limit, from 0% to 100%, they are willing to accept recourse for. At December 31, 2019, the Association has exposure for one contract originating in 2016 that expires December 30, 2023. Due to the uncertainty of the performance of the recourse obligation and ultimate collection of this balance, the Association had accrued for possible contingent losses relating to this contract at December 31, 2017. During 2018, the Association reclassified the \$50,000 reserve for contingent losses to be reflected in their allowance for doubtful accounts. No amounts were accrued or reclassified during 2019.

Town and Country Supply Association

Notes to Financial Statements

Note 12 – Recourse Obligations (continued)

The table below reports the financing provided to producer members from CHS Capital, and for which the Association's has accepted recourse for:

	December 31,	
	2019	2018
Credit limit with CHS Capital	\$ 250,240	\$ 308,796
Balances outstanding with CHS Capital	\$ 171,900	\$ 232,445
Potential recourse obligation	\$ 42,975	\$ 74,030
Less amounts paid by the Association in prior years	(42,975)	(52,805)
Potential recourse obligation, as adjusted	\$ -	\$ 21,225
Reserve for recourse obligations	\$ -	\$ -

Note 13 – Concentrations

The Association purchases products from one major supplier. Cost of sales from this supplier was approximately 70% and 67% of total cost of sales for the years ended December 31, 2019 and 2018, respectively. Accounts payable due to this supplier accounted for approximately 43% and 37% of the Association's accounts payable at December 31, 2019 and 2018, respectively.

For the years ended December 31, 2019 and 2018, the Association had sales to two and three customers that approximated 21% and 18% of total sales, respectively. Accounts receivable owed from these customers represented approximately 26% and 31% of total trade receivables at December 31, 2019 and 2018, respectively.

Note 14 – Contingencies

The Association maintains fuel and chemical inventories in the ordinary course of its business, which may have exposed it to certain contingencies related to environmental and real estate pollution. The accompanying financial statements do not provide for the possibility of past, present, or future liabilities with respect to environmental studies, clean up fees, penalties, or any other costs that may exist or be incurred incidental to environmental concerns relating to the Association's course of business.

During 2019, the Association was named in a suit along with Monsanto, an American agrochemical company. The suit alleges that exposure to Roundup weed killer, manufactured by Monsanto and subsequently purchased from the Association, caused their cancer. The likelihood of loss is reasonably possible however any estimate of the amount of loss is unknown at this time. Management believes any potential loss will be covered by the Association's insurance carrier and no amounts have been accrued in the financial statements at December 31, 2019.

Town and Country Supply Association

Notes to Financial Statements

Note 15 – Fair Value of Assets and Liabilities

The Association follows the fair value accounting guidance, which uses a framework for measuring fair value and requires disclosures about fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value accounting includes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

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

Level 2 – Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in active markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

The following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying balance sheet, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Marketable securities – The fair value is estimated using quoted market prices are available in an active market, therefore the securities are classified within Level 1 of the valuation hierarchy.

Interest rate swap agreement – The fair value is estimated by a third party using inputs that are observable or that can be corroborated by observable market data and, therefore, is classified within Level 2 of the valuation hierarchy.

Town and Country Supply Association

Notes to Financial Statements

Note 15 – Fair Value of Assets and Liabilities (continued)

The following table presents the fair value measurements of assets and liabilities recognized in the accompanying balance sheet measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall.

Fair Value as of December 31, 2019				
	Level 1	Level 2	Level 3	Total
Marketable securities	\$ 1,480,839	\$ -	\$ -	\$ 1,480,839
Interest rate swap agreement	-	(337,202)	-	(337,202)
	<u>\$ 1,480,839</u>	<u>\$ (337,202)</u>	<u>\$ -</u>	<u>\$ 1,143,637</u>
Fair Value as of December 31, 2018				
	Level 1	Level 2	Level 3	Total
Marketable securities	\$ 1,404,976	\$ -	\$ -	\$ 1,404,976
Interest rate swap agreement	-	(145,553)	-	(145,553)
	<u>\$ 1,404,976</u>	<u>\$ (145,553)</u>	<u>\$ -</u>	<u>\$ 1,259,423</u>

Note 16 – Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. The Association recognizes in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing the financial statements. The Association's financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date and before financial statements are available to be issued.

Subsequent to year end, an outbreak of a novel coronavirus (COVID-19) occurred in the United States and in various other countries globally. Management generally expects that this outbreak will result in a variety of negative economic consequences, the scope of which are not currently known or quantifiable. The duration and intensity of the impact of the coronavirus and resulting impact to the Association is unknown.

The Association has evaluated subsequent events through April 23, 2020, which is the date the financial statements are available to be issued.

Supplementary Information

Town and Country Supply Association

Schedule of Operating Expenses

	Years Ended December 31,	
	2019	2018
DISTRIBUTION		
Salaries	\$ 4,764,413	\$ 4,624,546
Payroll taxes	438,988	433,964
Employee insurance	517,257	510,387
Retirement	69,709	69,390
Delivery	1,286,343	1,376,926
Contracted services	414,251	462,394
Advertising and promotion	227,366	192,823
	<u>\$ 7,718,327</u>	<u>\$ 7,670,430</u>
GENERAL		
Depreciation	\$ 2,267,093	\$ 2,387,257
Insurance	528,602	555,078
Property and business taxes	381,677	277,490
Rent	40,839	86,510
Supplies, repairs, and uniforms	649,646	553,726
Utilities	288,112	286,181
	<u>\$ 4,155,969</u>	<u>\$ 4,146,242</u>
ADMINISTRATIVE		
Professional services	\$ 194,326	\$ 184,060
Bad debts and collection expense	17,946	42,383
Software and IT expense	99,055	72,664
Directors fees and expense	20,500	23,350
Meetings, schools, and travel	62,172	61,794
Office supplies	82,732	84,312
Credit card	386,464	350,656
Telephone	142,075	133,207
	<u>\$ 1,005,270</u>	<u>\$ 952,426</u>

Town and Country Supply Association

Schedule of Other Income and Expense

	Years Ended December 31,	
	2019	2018
OTHER INCOME (EXPENSE)		
Other income	\$ 188,741	\$ 128,415
Interest, dividends, and service charge income	205,804	211,614
Interest expense	(547,371)	(626,953)
Other expense	(50,769)	(40,955)
	<u>\$ (203,595)</u>	<u>\$ (327,879)</u>

