



**MINNESOTA MUNICIPAL POWER AGENCY**

Financial Statements

December 31, 2008 and 2007

(With Independent Auditors' Report Thereon)



**KPMG LLP**  
4200 Wells Fargo Center  
90 South Seventh Street  
Minneapolis, MN 55402

## **Independent Auditors' Report**

The Board of Directors  
Minnesota Municipal Power Agency:

We have audited the accompanying balance sheets of Minnesota Municipal Power Agency (the Agency) as of December 31, 2008 and 2007, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Agency's management. 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Agency's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Minnesota Municipal Power Agency as of December 31, 2008 and 2007, and the changes in its financial position and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

The management's discussion and analysis on pages 2 through 7 is not a required part of the basic financial statements of the Agency, but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries with management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

**KPMG LLP**

April 21, 2009

# MINNESOTA MUNICIPAL POWER AGENCY

## Management's Discussion and Analysis

December 31, 2008 and 2007

### Financial Statements Overview

This discussion and analysis of Minnesota Municipal Power Agency's (the Agency) financial performance provides an overview of the Agency's activities for the fiscal years ended December 31, 2008 and 2007. The information presented should be read in conjunction with the financial statements and the accompanying notes to the financial statements.

The Agency follows the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission. The basic financial statements are prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles. The Agency's basic financial statements include the balance sheets, the statements of revenues, expenses, and changes in net assets, the statements of cash flows, and notes to the financial statements.

The balance sheets provide information about the nature and amount of assets and obligations (liabilities) of the Agency as of the end of each year being reported on. The statements of revenues, expenses, and changes in net assets report revenues and expenses for each year being reported on. The statements of cash flows report cash receipts, cash payments, and net changes in cash resulting from operating, capital and related financing activities, and investing activities.

### Financial Highlights

#### *Comparison of 2008 with 2007*

The following table summarizes the financial position of the Agency as of December 31:

	<b>Condensed Balance Sheets</b>		<b>Dollar change</b>	<b>Percentage change</b>
	<b>2008</b>	<b>2007</b>		
Capital assets, net	\$ 178,148,673	182,900,220	(4,751,547)	(2.6)%
Current assets	23,455,253	21,127,695	2,327,558	11.0
Other noncurrent assets	20,751,740	21,082,999	(331,259)	(1.6)
Total assets	<u>\$ 222,355,666</u>	<u>225,110,914</u>	<u>(2,755,248)</u>	(1.2)
Current liabilities	\$ 16,511,894	18,886,694	(2,374,800)	(12.6)
Long-term liabilities	187,824,170	190,490,677	(2,666,507)	(1.4)
Total liabilities	<u>204,336,064</u>	<u>209,377,371</u>	<u>(5,041,307)</u>	(2.4)
Net assets:				
Invested in capital assets, net of related debt	2,178,555	5,938,742	(3,760,187)	(63.3)
Restricted	3,293,767	2,865,135	428,632	15.0
Unrestricted	12,547,280	6,929,666	5,617,614	81.1
Total net assets	<u>18,019,602</u>	<u>15,733,543</u>	<u>2,286,059</u>	14.5
Total liabilities and net assets	<u>\$ 222,355,666</u>	<u>225,110,914</u>	<u>(2,755,248)</u>	(1.2)

## MINNESOTA MUNICIPAL POWER AGENCY

### Management's Discussion and Analysis

December 31, 2008 and 2007

Condensed balance sheet highlights are as follows:

- The assets of the Agency exceeded its liabilities at the close of 2008 by approximately \$18.0 million (net assets) as compared with \$15.7 million at the end of 2007. Net assets provide necessary liquidity to the Agency and support its investment grade credit rating.
- Current assets increased by approximately \$2.3 million from 2007 to 2008. Current assets include cash and cash equivalents, accrued interest receivable, and short-term investments. Current assets also include power sales receivables, which increased by approximately \$0.6 million from 2007 to 2008.
- Other noncurrent assets, which include restricted cash and cash equivalents, prepaid expenses, and deferred costs, decreased by approximately \$0.3 million from 2007 to 2008 as the remaining restricted construction funds were disbursed in connection with the close out of the construction project at Faribault that was completed in 2007. This decrease was partially offset by a \$3.2 million increase in future recoverable costs related to the levelization of depreciation and bond interest. Restricted cash and cash equivalents is used for operating, maintenance, working capital, and construction needs of the Agency.
- Capital assets, net decreased by approximately \$4.8 million during 2008 primarily due to the recognition of depreciation associated with the electrical generating plant in Faribault, Minnesota.
- Current liabilities decreased by approximately \$2.4 million from 2007 to 2008 primarily due to the payment of \$1.6 million in retainage owed to contractors for completion of the construction activities on the second phase of the electrical generating plant in Faribault. Current liabilities also include vendors payable, accrued interest payable, and short-term bonds payable.
- Long-term liabilities decreased by approximately \$2.7 million from 2007 to 2008 primarily due to the payment of principal on the Agency's revenue bonds. Long-term liabilities consist of the bonds issued for construction of the Faribault power generating plant.

**MINNESOTA MUNICIPAL POWER AGENCY**

Management's Discussion and Analysis

December 31, 2008 and 2007

***Comparison of 2007 with 2006***

The following table summarizes the financial position of the Agency as of December 31:

<b>Condensed Balance Sheets</b>				
	<u>2007</u>	<u>2006</u>	<u>Dollar change</u>	<u>Percentage change</u>
Capital assets, net	\$ 182,900,220	116,535,432	66,364,788	56.9%
Current assets	18,262,559	20,555,071	(2,292,512)	(11.2)
Other noncurrent assets	23,948,135	69,376,825	(45,428,690)	(65.5)
Total assets	<u>\$ 225,110,914</u>	<u>206,467,328</u>	<u>18,643,586</u>	9.0
Current liabilities	\$ 18,886,694	25,366,826	(6,480,132)	(25.5)
Long-term liabilities	190,490,677	166,367,284	24,123,393	14.5
Total liabilities	<u>209,377,371</u>	<u>191,734,110</u>	<u>17,643,261</u>	9.2
Net assets:				
Invested in capital assets, net of related debt	5,938,742	(538,057)	6,476,799	(1,203.7)
Restricted	2,865,135	2,768,817	96,318	3.5
Unrestricted	6,929,666	12,502,458	(5,572,792)	(44.6)
Total net assets	<u>15,733,543</u>	<u>14,733,218</u>	<u>1,000,325</u>	6.8
Total liabilities and net assets	<u>\$ 225,110,914</u>	<u>206,467,328</u>	<u>18,643,586</u>	9.0

Condensed balance sheet highlights are as follows:

- The assets of the Agency exceeded its liabilities at the close of 2007 by approximately \$15.7 million (net assets) as compared with \$14.7 million at the end of 2006. Net assets provide necessary liquidity to the Agency and support its investment grade credit rating.
- Current assets decreased by approximately \$2.3 million from 2006 to 2007. Current assets include cash and cash equivalents, accrued interest receivable, and short-term investments. Current assets also include power sales receivables, which decreased by approximately \$2.4 million from 2006 to 2007.
- Other noncurrent assets decreased by approximately \$45.4 million from 2006 to 2007 as restricted construction funds were spent in connection with the completion of the Faribault project. Other noncurrent assets include primarily restricted cash and cash equivalents being used for operating, maintenance, working capital, debt, and construction needs of the Agency.
- Capital assets, net increased by approximately \$66.4 million during 2007 primarily due to the completion in August of the 150-megawatt expansion of the electrical generating plant in Faribault, Minnesota, at a total cost of approximately \$139.6 million. Capital assets, net include telecommunication and transportation equipment with a historical cost of approximately \$0.8 million as of December 31, 2007.

**MINNESOTA MUNICIPAL POWER AGENCY**

Management's Discussion and Analysis

December 31, 2008 and 2007

- Current liabilities decreased by approximately \$6.5 million from 2006 to 2007 primarily due to the completion of the construction activities on the second phase of the electrical generating plant in Faribault. Current liabilities include vendors payable, accrued interest payable, and short-term bonds payable.
- Long-term liabilities increased by approximately \$24 million from 2006 to 2007 primarily due to the issuance of the 2007 series revenue bonds. Long-term liabilities represent the bonds issued for construction of the Faribault power generating plant.

The following table summarizes the changes in financial position of the Agency for the years ended December 31, 2008 and 2007:

**Condensed Statements of Revenues, Expenses, and Changes in Net Assets**

	<u>2008</u>	<u>2007</u>	<u>Dollar change</u>	<u>Percent change</u>
Operating revenues, power sales	\$ 97,719,770	90,705,829	7,013,941	7.7%
Other nonoperating revenues	876,188	1,192,891	(316,703)	(26.5)
Total revenues	<u>98,595,958</u>	<u>91,898,720</u>	<u>6,697,238</u>	7.3
Operating expenses	90,132,400	86,904,459	3,227,941	3.7
Other nonoperating expenses	9,444,436	5,252,395	4,192,041	79.8
Total expenses	<u>99,576,836</u>	<u>92,156,854</u>	<u>7,419,982</u>	8.1
Future recoverable costs	3,266,937	1,258,459	2,008,478	159.6
Change in net assets	2,286,059	1,000,325	1,285,734	128.5
Beginning net assets	<u>15,733,543</u>	<u>14,733,218</u>	<u>1,000,325</u>	6.8
Ending net assets	\$ <u><u>18,019,602</u></u>	<u><u>15,733,543</u></u>	<u><u>2,286,059</u></u>	14.5

Condensed statements of revenues, expenses, and changes in net assets highlights are as follows:

- Operating revenues – power sales increased by approximately \$7 million between 2008 and 2007 primarily due to higher costs. Operating revenues – power sales consist primarily of member power sales revenue, power sales to nonmembers, other transmission revenue and contributions to the rate stabilization account. Operating revenues from sales to counterparties other than members decreased from \$1.4 million in 2007 to \$0.8 million in 2008 continuing a trend of reduced activity in this area.
- Operating expenses increased by approximately \$3.2 million between 2008 and 2007 with the expansion of the Faribault plant, which lead to increases in depreciation, fuel, maintenance, insurance, and labor. The average price for purchased energy also increased. Power purchases and production fuel increased approximately \$2.8 million primarily due to higher costs and output and was attributable to decreased power sales to nonmembers.
- Other revenues decreased by approximately \$0.3 million due to decreased investment income.

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Management's Discussion and Analysis

December 31, 2008 and 2007

- Other nonoperating expenses increased \$4.2 million in 2008 primarily due to the recognition of bond interest expense associated with the plant expansion at Faribault and amortization of debt issuance cost.

The following table summarizes the changes in financial position of the Agency for the years ended December 31, 2007 and 2006:

**Condensed Statements of Revenues, Expenses, and Changes in Net Assets**

	<u>2007</u>	<u>2006</u>	<u>Dollar change</u>	<u>Percent change</u>
Operating revenues, power sales	\$ 90,705,829	85,448,481	5,257,348	6.2%
Other nonoperating revenues	1,192,891	963,694	229,197	23.8
Total revenues	<u>91,898,720</u>	<u>86,412,175</u>	<u>5,486,545</u>	6.3
Operating expenses	86,904,459	81,011,311	5,893,148	7.3
Other nonoperating expenses	5,252,395	3,349,898	1,902,497	56.8
Total expenses	<u>92,156,854</u>	<u>84,361,209</u>	<u>7,795,645</u>	9.2
Future recoverable costs	1,258,459	670,653	587,806	87.6
Change in net assets	1,000,325	2,721,619	(1,721,294)	(63.2)
Beginning net assets	<u>14,733,218</u>	<u>12,011,599</u>	<u>2,721,619</u>	22.7
Ending net assets	<u>\$ 15,733,543</u>	<u>14,733,218</u>	<u>1,000,325</u>	6.8

Condensed statements of revenues, expenses, and changes in net assets highlights are as follows:

- Operating revenues – power sales increased by approximately \$5.3 million between 2007 and 2006 due in part to higher energy sales combined with higher costs. Operating revenues – power sales consist primarily of member power sales revenue, power sales to nonmembers, other transmission revenue and contributions to the rate stabilization account. Operating revenues from sales to counterparties other than members decreased from \$7.4 million in 2006 to \$1.4 million in 2007 primarily as a result of reduced activity in this area.
- Operating expenses increased by approximately \$5.9 million between 2007 and 2006 with the expansion of the Faribault plant, which led to increases in depreciation, fuel, maintenance, insurance, and labor. The average price for purchased energy also increased. Power purchases and production fuel decreased approximately \$2.5 million and was attributable to decreased power sales to nonmembers.
- Other revenues increased by approximately \$0.2 million due to increased investment income.
- Other nonoperating expenses climbed \$1.9 million in 2007 primarily due to the recognition of bond interest expense associated with the plant expansion at Faribault and amortization of debt issuance cost.

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### Management's Discussion and Analysis

December 31, 2008 and 2007

#### **Debt Administration**

As of December 31, 2008, the Agency had long-term debt outstanding of approximately \$187.5 million. On August 25, 2004, the Agency issued two electric revenue bonds: Electric Revenue Bonds Series 2004A in the amount of \$50 million and Taxable Electric Revenue Bonds Series 2004B in the amount of \$15 million. The bonds were issued for the purpose of constructing a gas turbine power generation facility. On September 22, 2005, the Agency issued another electric revenue bond: Electric Revenue Bonds Series 2005 in the amount of \$115.18 million. These bonds were issued for the purpose of converting the Faribault Energy Park into a Combined Cycle power generation facility. On December 15, 2006, the Agency defeased the outstanding balance of the Taxable Electric Revenue Bonds Series 2004B. On December 1, 2007, the Agency issued Electric Revenue Bonds Series 2007 in the amount of \$27 million. The Series 2007 bonds were issued for the purpose of completing the conversion of the Faribault Energy Park into a Combined Cycle power generation facility. The Agency continues to hold an A3 rating from Moody's in 2008.

**MINNESOTA MUNICIPAL POWER AGENCY**

Balance Sheets

December 31, 2008 and 2007

<b>Assets</b>	<b>2008</b>	<b>2007</b>
	<hr/>	<hr/>
Noncurrent assets:		
Capital assets:		
Equipment	\$ 1,057,831	812,999
Land	785,585	785,585
Electric plant	186,739,226	187,165,325
Less accumulated depreciation	<u>(13,059,893)</u>	<u>(6,804,767)</u>
Property and equipment, net	175,522,749	181,959,142
Construction in progress	<u>2,625,924</u>	<u>941,078</u>
Total capital assets, net	<u>178,148,673</u>	<u>182,900,220</u>
Restricted cash and cash equivalents and short-term investments	13,836,735	17,717,742
Prepaid expenses	745,475	439,900
Deferred costs:		
Future recoverable costs	5,592,243	2,325,307
Unamortized debt issuance costs	<u>577,287</u>	<u>600,050</u>
Total deferred costs	<u>6,169,530</u>	<u>2,925,357</u>
Total noncurrent assets	<u>198,900,413</u>	<u>203,983,219</u>
Current assets:		
Cash and cash equivalents	10,859,110	10,653,038
Restricted cash and cash equivalents	3,293,797	2,865,136
Accrued interest receivable – restricted	151,803	91,043
Power sales receivables	7,178,570	6,537,340
Fuel inventory	705,108	201,600
Plant inventory – spares	656,012	41,489
Prepaid expenses	<u>610,853</u>	<u>738,049</u>
Total current assets	<u>23,455,253</u>	<u>21,127,695</u>
Total assets	<u>\$ 222,355,666</u>	<u>225,110,914</u>
<b>Net Assets and Liabilities</b>		
Liabilities:		
Long-term debt, net	\$ <u>187,824,170</u>	<u>190,490,677</u>
Current liabilities:		
Accounts payable and accrued liabilities	11,557,635	12,405,683
Retainage payable	—	1,594,027
Accrued interest payable	2,294,259	2,106,984
Deferred revenue – rate stabilization	100,000	100,000
Bonds due within one year	<u>2,560,000</u>	<u>2,680,000</u>
Total current liabilities	<u>16,511,894</u>	<u>18,886,694</u>
Total liabilities	<u>204,336,064</u>	<u>209,377,371</u>
Net assets:		
Invested in capital assets, net of related debt	2,178,555	5,938,742
Restricted for debt service	3,293,767	2,865,135
Unrestricted	<u>12,547,280</u>	<u>6,929,666</u>
Total net assets	<u>18,019,602</u>	<u>15,733,543</u>
Total liabilities and net assets	<u>\$ 222,355,666</u>	<u>225,110,914</u>

See accompanying notes to financial statements.

**MINNESOTA MUNICIPAL POWER AGENCY**

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended December 31, 2008 and 2007

	<b>2008</b>	<b>2007</b>
Operating revenues – power sales	\$ 97,719,770	90,705,829
Operating expenses:		
Production fuel	27,216,303	20,099,410
Power purchases	37,513,561	44,281,758
Transmission	5,212,376	5,104,493
Other operating expenses	13,935,034	13,860,104
Depreciation	6,255,126	3,558,694
Total operating expenses	90,132,400	86,904,459
Operating income	7,587,370	3,801,370
Nonoperating revenues (expenses):		
Amortization of premium and issuance costs on long-term debt, net	85,084	35,973
Interest expense	(9,244,304)	(5,288,368)
Investment income	876,188	1,192,891
Loss on disposition of property	(285,216)	—
Total nonoperating revenues (expenses), net	(8,568,248)	(4,059,504)
Change in net assets before future recoverable costs	(980,878)	(258,134)
Future recoverable costs	3,266,937	1,258,459
Change in net assets	2,286,059	1,000,325
Total net assets, beginning of year	15,733,543	14,733,218
Total net assets, end of year	\$ 18,019,602	15,733,543

See accompanying notes to financial statements.

**MINNESOTA MUNICIPAL POWER AGENCY**

Statements of Cash Flows

Years ended December 31, 2008 and 2007

	<b>2008</b>	<b>2007</b>
Cash flows from operating activities:		
Receipts from power sales	\$ 97,078,540	93,144,003
Payments for fuel	(27,719,811)	(19,989,841)
Payments for power production and operating expenses	(58,301,921)	(59,245,759)
Net cash provided by operating activities	11,056,808	13,908,403
Cash flows from capital and related financing activities:		
Construction of capital assets	(3,381,481)	(79,115,785)
Proceeds from issuance of temporary bonds	—	22,055,000
Proceeds from issuance of electric revenue bonds, net	—	26,912,571
Payment to redeem bonds	—	(22,047,667)
Principal payments on electric revenue bonds	(2,680,000)	(1,970,000)
Other, net	—	(62,333)
Payment of interest	(9,057,029)	(8,492,192)
Payment of debt issuance costs	—	(106,900)
Net cash used in capital and related financing activities	(15,118,510)	(62,827,306)
Cash flows from investing activities:		
Proceeds from sales of short-term investments	—	250,333
Purchase of short-term investments	(1,162,022)	—
Proceeds from other receivables	—	2,177,522
Interest received	815,428	2,614,272
Net cash (used in) provided by investing activities	(346,594)	5,042,127
Net change in cash and cash equivalents	(4,408,296)	(43,876,776)
Cash and cash equivalents, beginning of year	31,235,916	75,112,692
Cash and cash equivalents, end of year	\$ 26,827,620	31,235,916
Cash components:		
Cash and cash equivalents	\$ 10,859,110	10,653,038
Restricted cash and cash equivalents	15,968,510	20,582,878
Cash and cash equivalents, end of year	\$ 26,827,620	31,235,916
Cash flows from operating activities:		
Operating income	\$ 7,587,370	3,801,370
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	6,255,126	3,558,694
Changes in current assets and liabilities:		
Power sales receivables	(641,230)	2,438,174
Fuel inventory	(503,508)	151,058
Plant inventory – spares	(614,523)	(41,489)
Prepays	(178,379)	(441,367)
Accounts payable and accrued liabilities	(848,048)	4,441,963
Total adjustments	3,469,438	10,107,033
Net cash provided by operating activities	\$ 11,056,808	13,908,403
Supplemental cash flow information and noncash capital activities:		
Interest capitalized	\$ —	2,536,569
Amortization of premium on electric revenue bonds	106,507	54,178

See accompanying notes to financial statements.

# MINNESOTA MUNICIPAL POWER AGENCY

Notes to Financial Statements

December 31, 2008 and 2007

## (1) Organization and Significant Accounting Policies

### (a) Organization and Operation

Minnesota Municipal Power Agency (the Agency) was created as a municipal corporation and a political subdivision of the State of Minnesota by an agency agreement recorded with the Secretary of the State of Minnesota on May 11, 1992. The Agency's purpose is to secure an adequate, economical, and reliable supply of electric energy for its member municipalities. As of December 31, 2008, the Agency is comprised of eleven Minnesota municipalities.

The Agency sells power to its members under power sales contracts that extend to October 31, 2040. Under the terms of these contracts, the Agency is obligated to furnish, and each member is obligated to take and pay for, the total power and energy required by each member.

The Agency has entered into agreements with various providers to purchase approximately 136 megawatts capacity of Mid-Continent Area Power Pool (MAPP) accredited power and energy during 2009. The power capacity charge for 2009 is approximately \$8,200,000. Capacity commitments and charges include 41 megawatts of capacity purchased pursuant to an agreement with the City of Chaska, a member of the Agency. Under the terms of that agreement and its amendment, the Agency has agreed to make certain payments to the City of Chaska in exchange for the peaking power capacity provided by specified generation facilities owned by the City of Chaska in an amount at least sufficient, together with certain available interest income, to pay the principal of and interest on the bonded indebtedness issued by the City of Chaska for the construction of the generation facility. Energy rates assessed by the Agency vary based on contract terms and production costs. Minimum commitments under the terms of the power sales agreements to purchase power capacity for the next five years are as follows:

	<u>Megawatts</u>
Year ending December 31:	
2009	136
2010	121
2011	96
2012	66
2013	66

The Agency has an agreement with Xcel Energy Corporation (Xcel Energy) to provide transmission services through at least April 30, 2012. The Agency is obligated to pay for these services at rates established by the Federal Energy Regulatory Commission (FERC), \$16.447/KW per year at December 31, 2008, plus ancillary charges.

The Agency has a long term contract with the Manitoba Hydro-Electric Board (Manitoba Hydro) that provides for 60 MW of capacity and on-peak energy through April 30, 2009, and 30 MW of capacity and on-peak energy from May 1, 2009 through April 30, 2012. The Agency also has two agreements with Rochester Public Utilities (RPU) to purchase 50 MW of capacity and on-peak energy through October 31, 2010, and 25 MW of capacity and on-peak energy from November 1,

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### Notes to Financial Statements

December 31, 2008 and 2007

2010 through October 31, 2015. The second agreement is a short-term capacity purchase of 15 MW through October 31, 2009.

The Agency enters into contracts in connection with the generation and sale of electric power to its member cities, the Midwest Independent System Operator or MISO and the wholesale market. A substantial portion of these contracts are for the purchase of natural gas and oil at power plants owned and operated by the Agency and for the physical delivery of power to designated interconnection points on the electric grid as a normal course of business. The Agency also enters into futures or forward contracts to manage exposure to unfavorable trends in the prices of fuel (natural gas) and electric power, which are directly related to the business of the Agency. Open positions at the end of the year are carried at cost in the Agency's financial statements. Gains and losses associated with the open positions are realized and recorded in the period in which the positions are closed out.

Additionally, the Agency has agreements for dispatching, billing, maintenance services, and other general administration.

**(b) Basis of Accounting**

The Agency follows the FERC's Uniform System of Accounts and maintains accounting records on an accrual basis in conformity with U.S. generally accepted accounting principles, including the application of Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation*, as the statement relates to the deferral of revenues and expenses to future periods in which the revenues are earned or the expenses are recovered through the rate-making process.

The Agency complies with all applicable pronouncements of the Governmental Accounting Standards Board (GASB). In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for the Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Agency has elected not to follow the guidance of Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins issued after November 30, 1989.

**(c) Capital Assets**

Capital assets are recorded at cost, including capitalized interest on borrowed funds during construction.

Equipment is recorded at cost and consists of telecommunication equipment and transportation equipment. Depreciation is provided over the estimated useful lives of the property and equipment by use of the straight-line method. Generally, the estimated useful life for the electric plant is 30 years and 5 years for telecommunications equipment and transportation equipment. Other specialized equipment may differ.

## MINNESOTA MUNICIPAL POWER AGENCY

### Notes to Financial Statements

December 31, 2008 and 2007

**(d) Capitalized Interest**

The Agency capitalizes interest in connection with major construction projects. The capitalized interest is recorded as part of the asset to which it relates and is amortized over the asset's estimated useful life. The Agency had no capitalized interest cost for the year ended December 31, 2008. There was \$2,536,569 of capitalized interest cost for the year ended December 31, 2007.

**(e) Restricted Cash and Cash Equivalents**

The Agency's bond resolution requires the segregation of bond proceeds and prescribes the application of the Agency's revenues. Amounts classified as restricted cash and cash equivalents on the balance sheets represent cash and cash equivalents whose use is restricted by the bond resolution. Investments in U.S. agency obligations that are purchased within one year of maturity are reported at cost, which approximates amortized cost. It is the Agency's policy to use restricted resources first for debt service, and then unrestricted resources as they are needed.

**(f) Short-Term Investments**

Short-term investments comprise certificates of deposits having an initial maturity of greater than one year when purchased.

**(g) Deferred Costs to be Recovered in Future Periods**

Rates charged to members include amounts sufficient to pay levelized principal and interest payments on long-term debt. For financial reporting purposes, the Agency recognizes depreciation and amortization pertaining to fixed assets and other assets financed by long-term debt in addition to interest paid on such debt. As permitted by the application of the provisions of SFAS No. 71, the Agency defers the current depreciation, amortization, and interest costs in excess of levelized principal and interest costs on long-term debt. These costs will be recovered through rates charged to members in future periods when the levelized costs of principal and interest on long-term debt exceeds the then current depreciation and interest costs related to such issues.

**(h) Unamortized Debt Issuance Costs**

Debt issuance costs are amortized over the repayment period of the related issues using the straight-line method, which approximates the effective-interest method.

**(i) Cash Flows**

For purposes of the statements of cash flows, cash equivalents are cash and investments having an initial maturity of three months or less when purchased.

**(j) Power Sales Receivables**

Power sales receivables represent power sales for the period between the last billing date and the end of the period that are accrued in the period earned.

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Notes to Financial Statements

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**(k) *Fuel Inventory and Plant Inventory – Spares***

Fuel inventory and plant inventory – spares are valued on a cost basis, using the first-in, first-out (FIFO) method, which does not exceed market.

**(l) *Rates***

Rates and charges for providing wholesale power supply are reviewed and adopted by the Agency's board of directors. Power supply services provided by the Agency are not subject to state or federal regulation.

**(m) *Revenue Recognition***

The Agency recognizes revenue on sales when the electricity is provided to and used by the customers. The Agency reports only the net amount of operating revenues – power sales and power purchases expense resulting from its transactions with counterparties other than Agency members as revenue.

**(n) *Operating Revenues and Expenses***

Operating revenues result from exchange transactions associated with the principal activity of the Agency, the sale of electricity. Reported operating revenues are affected by contributions to or distributions from the rate stabilization account. Operating expenses are defined as expenses directly related to, or incurred in support of, the production and transmission of electricity to the participating members. All other expenses are classified as nonoperating expenses.

**(o) *Income Taxes***

The Agency is exempt from federal and state income taxes as it is a political subdivision of the State of Minnesota.

**(p) *Use of Estimates in the Preparation of Financial Statements***

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

**(q) *Reclassifications***

Certain 2007 financial statement amounts have been reclassified to conform with the 2008 presentation.

**(2) *Cash, Cash Equivalents, and Investments***

The agency agreement that established the Agency and the bond resolution, under which the Electric Revenue Bonds were issued, provides for the creation and maintenance of certain funds and accounts. The funds and accounts consist principally of deposits and investments in accordance with the agency

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agreement, bond resolution, and applicable state law. Funds and accounts are reported in the financial statements as follows:

	<b>December 31</b>	
	<b>2008</b>	<b>2007</b>
Current assets:		
Cash and cash equivalents	\$ 10,859,110	10,653,038
Restricted cash and cash equivalents	3,293,797	2,865,136
Total current assets	14,152,907	13,518,174
Noncurrent assets:		
Restricted cash and cash equivalents	12,674,713	17,717,742
Restricted short-term investments	1,162,022	—
Total noncurrent assets	13,836,735	17,717,742
Total	\$ 27,989,642	31,235,916

At December 31, 2008, all deposits for the Agency were insured or collateralized by securities held by the Agency's agent in the Agency's name.

In accordance with its investment policy, the Agency invests in the following types of investments, subject to the limitations and requirements of Minnesota statutes:

- Interest bearing checking accounts;
- U.S. treasury bills, bonds, and notes;
- U.S. government agencies & instrumentalities securities;
- Certificates of deposit;
- Money market mutual funds – open-end, no-load;
- Guaranteed investment contracts; and
- Repurchase agreements fully (100%) collateralized by U.S. Securities.

**(a) Interest Rate Risk**

Interest rate risk is the risk that the fair value of investments will be adversely affected by a change in interest rates.

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Notes to Financial Statements

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The Agency had the following investments and maturities as of December 31, 2008 and 2007:

	<u>December 31, 2008</u>			<u>December 31, 2007</u>	
	<u>Investment maturities (in years)</u>			<u>Investment maturities (in years)</u>	
	<u>Less than one year</u>	<u>Greater than one year</u>	<u>No maturity</u>	<u>Less than one year</u>	<u>No maturity</u>
Investment type:					
U.S. government agencies	\$ 7,523,135	—	—	7,604,633	—
Guaranteed investment contracts	—	—	4,420,514	—	6,150,670
Certificates of deposit	—	1,162,022	—	—	—
Money market accounts	—	—	4,024,861	—	16,646,707
Cash and cash equivalents	—	—	10,859,110	—	833,906
Total	\$ <u>7,523,135</u>	<u>1,162,022</u>	<u>19,304,485</u>	<u>7,604,633</u>	<u>23,631,283</u>

**(b) Credit Risk**

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Credit risk is measured using credit quality ratings of investments in debt securities as described by nationally recognized rating agencies such as Standard & Poor's and Moody's. The certificates of deposit are FDIC insured. At December 31, 2008, the guaranteed investment contract was collateralized by a security issued by U.S. government sponsored entities. The money market accounts and cash and cash equivalents are invested in short term U.S. government securities and commercial paper.

The following table lists the credit quality ratings per Standard & Poor's and/or Moody's of the Agency's investments as of December 31, 2008 and 2007:

	<u>December 31, 2008</u>		
	<u>Fair value</u>	<u>Quality ratings</u>	
		<u>AAA</u>	<u>Unrated</u>
Investment type:			
U.S. government agencies	\$ 7,523,135	7,523,135	—
Guaranteed investment contracts	4,420,514	—	4,420,514
Certificates of deposit	1,162,022	—	1,162,022
Money market accounts	4,024,861	—	4,024,861
Cash and cash equivalents	10,859,110	—	10,859,110
Total	\$ <u>27,989,642</u>	<u>7,523,135</u>	<u>20,466,507</u>

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	December 31, 2007		
	Fair value	Quality ratings	
		AAA	Unrated
Investment type:			
U.S. government agencies	\$ 7,604,633	7,604,633	—
Guaranteed investment contracts	6,150,670	—	6,150,670
Money market accounts	16,646,707	—	16,646,707
Cash and cash equivalents	833,906	—	833,906
Total	\$ <u>31,235,916</u>	<u>7,604,633</u>	<u>23,631,283</u>

**(c) Custodial Credit Risk**

Custodial credit risk is the risk that, in the event of the failure of a counterparty, the Agency will not be able to recover the value of the investments, collateral securities, or deposits that are in the possession of the counterparty. In February 2008, the Agency adopted an investment policy addressing, among other things, custodial credit risk. At December 31, 2008 and 2007, all of the Agency's investments are insured and registered and are held by the counterparty's trust department or agent in the Agency's name.

**(d) Concentration of Credit Risk**

The Agency does not have an investment policy related to investing 5% or more of the Agency's portfolio in the securities of a single issue.

**(3) Capital Assets**

Capital assets activity was as follows:

2008	Beginning balance	Additions	Retirements	Ending balance
Nondepreciable capital assets:				
Construction work in progress	\$ 941,078	1,970,062	(285,216)	2,625,924
Land	785,585	—	—	785,585
Depreciable capital assets:				
Telemetry and telecommunication	812,999	244,832	—	1,057,831
Electric plant	187,165,325	343,337	(769,436)	186,739,226
Less accumulated depreciation for assets in service	<u>(6,804,767)</u>	<u>(6,255,126)</u>	<u>—</u>	<u>(13,059,893)</u>
Capital assets, net	\$ <u>182,900,220</u>	<u>(3,696,895)</u>	<u>(1,054,652)</u>	<u>178,148,673</u>

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<u>2007</u>	<u>Beginning balance</u>	<u>Additions</u>	<u>Transfers</u>	<u>Ending balance</u>
Nondepreciable capital assets:				
Construction work in progress	\$ 70,845,913	69,699,194	(139,604,029)	941,078
Land	785,585	—	—	785,585
Depreciable capital assets:				
Telemetry and telecommunication	806,232	6,767	—	812,999
Electric plant	47,343,775	217,521	139,604,029	187,165,325
Less accumulated depreciation for assets in service	<u>(3,246,073)</u>	<u>(3,558,694)</u>	<u>—</u>	<u>(6,804,767)</u>
Capital assets, net	\$ <u>116,535,432</u>	<u>66,364,788</u>	<u>—</u>	<u>182,900,220</u>

**(4) Long-Term Debt**

The Agency has issued the following Electric Revenue Bonds and Taxable Electric Revenue Bonds to finance its construction activities:

	<u>2008</u>	<u>2007</u>
Series 2004A, 3.40% – 5.25%, due October 1, 2010 to 2034	\$ 50,000,000	50,000,000
Series 2005, 3.50% – 5.00%, due October 1, 2007 to 2035	111,175,000	113,210,000
Series 2007, 4.00% – 5.00%, due October 1, 2007 to 2037	<u>26,355,000</u>	<u>27,000,000</u>
Total bonds outstanding	187,530,000	190,210,000
Less current maturities	(2,560,000)	(2,680,000)
Add unamortized premium	<u>2,854,170</u>	<u>2,960,677</u>
	\$ <u>187,824,170</u>	<u>190,490,677</u>

Electric Revenue Bonds are the major source of financing for the Agency’s construction activities. These bonds are secured by a pledge of the net revenues derived from the operation of the system.

Long-term debt issuance costs and the discount on long-term debt are amortized over the terms of the related bond issues on a straight-line basis.

During 2004, the Agency issued \$50,000,000 in Electric Revenue Bonds, Series 2004A. The proceeds of the Series 2004A bonds were used to acquire, construct, and install a simple-cycle, gas turbine peaking power electric generation facility with the capacity to produce approximately 150 MW of electricity.

During 2005, the Agency issued \$115,180,000 in Electric Revenue Bonds, Series 2005. The proceeds of the Series 2005 bonds were used to convert the Faribault Energy Park from a simple-cycle plant to a combined-cycle plant.

During 2007, the Agency issued \$22,000,000 of Series 2007 Temporary Bonds to provide interim financing for construction of a portion of the Faribault Energy Park. The Agency also issued \$27,000,000

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in Electric Revenue Bonds, Series 2007, the proceeds of which were used to redeem the Series 2007 Temporary Bonds and complete the conversion of the Faribault Energy Park to a combined-cycle plant.

Debt service requirements on the outstanding bonds are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2009	\$ 2,560,000	9,177,035	11,737,035
2010	3,505,000	9,074,635	12,579,635
2011	3,645,000	8,928,500	12,573,500
2012	3,805,000	8,773,845	12,578,845
2013	3,960,000	8,611,470	12,571,470
2014 – 2018	22,780,000	40,102,700	62,882,700
2019 – 2023	29,115,000	33,746,400	62,861,400
2024 – 2028	36,950,000	25,938,350	62,888,350
2029 – 2033	55,420,000	15,390,194	70,810,194
2034 – 2037	25,790,000	2,125,500	27,915,500
	<u>\$ 187,530,000</u>	<u>161,868,629</u>	<u>349,398,629</u>

Long-term liability activity for the years ended December 31, 2008 and 2007 was as follows:

<u>Long-term liabilities as of December 31, 2008</u>	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>
Long-term bonds	\$ 190,210,000	—	(2,680,000)	187,530,000
Less current maturities	(2,680,000)	(2,560,000)	2,680,000	(2,560,000)
Add unamortized premium, net	2,960,677	—	(106,507)	2,854,170
Long-term bonds, net	<u>\$ 190,490,677</u>	<u>(2,560,000)</u>	<u>(106,507)</u>	<u>187,824,170</u>

<u>Long-term liabilities as of December 31, 2007</u>	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>
Long-term bonds	\$ 165,180,000	27,000,000	(1,970,000)	190,210,000
Less current maturities	(1,970,000)	(2,680,000)	1,970,000	(2,680,000)
Add unamortized premium, net	3,157,284	—	(196,607)	2,960,677
Long-term bonds, net	<u>\$ 166,367,284</u>	<u>24,320,000</u>	<u>(196,607)</u>	<u>190,490,677</u>

**(5) Letters of Credit and Credit Facilities**

At December 31, 2008, the Agency had an unused standby letter of credit of \$850,000 to support energy and capacity purchases from Manitoba Hydro. The Agency has a second unused letter of credit of approximately \$73,000 required for the City of Faribault to support construction of the electric generation facility in Faribault which expires on June 24, 2009. The agreements provide for interest at the bank's reference rate plus 1%.

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On April 4, 2005, the Agency entered into a standby letter of credit arrangement for \$3,750,000 with a bank to support its energy and transmission purchases with the Midwest Independent Transmission System Operator. The stated expiration date of the standby letter of credit is April 30, 2009, but it will be automatically extended without amendment for one year from the stated expiration date, or any future expiration date, unless specified notice of nonrenewal is provided. On April 30, 2007, this standby letter of credit was reduced to \$100,000. In no event shall the standby letter of credit extend beyond April 30, 2010. There were no amounts outstanding as of December 31, 2008 and 2007.

The Agency entered into a \$5 million credit facility October 1, 2008. The commitment fee is .10% per annum; interest on outstanding balances is tied to the prime rate. The facility renews automatically through September 1, 2011. There were no amounts outstanding as of December 31, 2008.

#### **(6) Risk Management**

The Agency is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; and natural disasters. The Agency participates in a public entity risk pool to mitigate its exposure to these risks. Liability coverage is provided through a pooled self-insurance plan.

The Agency has a \$60,000 deductible per occurrence, with a \$200,000 annual maximum for its liability coverage. The public entity risk pool is responsible for all losses in excess of \$250,000 each year. Settled claims have not exceeded insurance coverage in any of the past three years.

The public entity risk pool has purchased a reinsurance policy to guard against excessive losses.

#### **(7) Contingencies**

The Agency is a party to various contracts for the sale, purchase, and transmission of power. In the ordinary course of business, contractual disputes sometimes occur between the Agency and its counterparties. The Agency does not expect the outcome of any existing dispute resolution proceedings to have a material adverse impact on financial position, results of operations, or cash flows.

The Agency is a market participant in the MISO "Day 2" electricity markets. MISO does not provide final settlement results for a trading day until 105 days after a trading day. The financial statements reflect the Agency's best estimates of final settlement results since the commencement of "Day 2" electricity markets on April 1, 2005.

#### **(8) Subsequent Events**

##### **(a) *MISO Revenue Sufficiency Guarantee (RSG) Resettlement***

In January 2009, MISO began assessing certain Revenue Sufficiency Guarantee (RSG) charges based on an interim FERC order. The RSG charges covered by this order are retroactive. The interim FERC order reversed a previous FERC order that had determined that these RSG costs would not be assessed retroactively. It is the Agency's position that assessment of these charges by MISO is improper and the Agency is contesting the practice in the D.C. circuit court. In the event the appeal is unsuccessful, the Agency could be liable for up to \$1.2 million under the terms of the interim FERC order. No amounts have been accrued in the financial statements as of December 31, 2008 or 2007.

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**(b) *Termination of Guaranteed Investment Contract***

A counterparty to the restricted cash and cash equivalents held in a guaranteed investment contract terminated the investment agreement on February 27, 2009. On March 2, 2009, the Agency received proceeds of approximately \$4,400,000 representing the carrying amount and accrued interest on the guaranteed investment contract.