MINNESOTA MUNICIPAL POWER AGENCY

Financial Statements

December 31, 2013 and 2012

(With Independent Auditors' Report Thereon)

MINNESOTA MUNICIPAL POWER AGENCY

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

Independent Auditors' Report

The Board of Directors
Minnesota Municipal Power Agency:

Report on Financial Statements

We have audited the accompanying financial statements of Minnesota Municipal Power Agency (the Agency), which comprise the statements of net position as of December 31, 2013 and 2012, and the related statements of revenues, expenses, and changes in net position and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; 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.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Minnesota Municipal Power Agency as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

Other Matter

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3 through 8 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with managements' responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

Minneapolis, Minnesota
April 18, 2014

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, 2013 and 2012. 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 statements of net position, the statements of revenues, expenses, and changes in net position, the statements of cash flows, and notes to the financial statements.

The statements of net position provide information about the nature and amount of assets and obligations (liabilities) of the Agency as of the end of each year reported. The statements of revenues, expenses, and changes in net position report revenues and expenses. 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 2013 with 2012

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

Condensed Statements of Net Position

	2013	2012	Dollar change	Percentage change
Capital assets, net	$ 281,014,770	257,842,596	23,172,174	9.0%
Current assets	60,403,201	50,350,412	10,052,789	20.0
Other noncurrent assets	53,373,491	57,978,614	(4,605,123)	(7.9)
Total assets	394,791,462	366,171,622	28,619,840	7.8
Deferred outflows of resources	—	98,140	(98,140)	(100.0)
Total assets and deferred outflows	$ 394,791,462	366,269,762	28,521,700	7.8
Current liabilities	$ 27,390,664	22,232,423	5,158,241	23.2
Long-term liabilities	290,974,213	280,223,528	10,750,685	3.8
Total liabilities	318,364,877	302,455,951	15,908,926	5.3
Deferred inflows of resources	35,215,990	28,665,491	6,550,499	22.9
Total liabilities and deferred inflows	353,580,867	331,121,442	22,459,425	6.8

Condensed Statements of Net Position

		2013	2012	Dollar change	Percentage change
Net position:					
Net investment in capital assets	$	9,719,015	8,010,528	1,708,487	21.3
Restricted for debt services		5,733,585	5,143,346	590,239	11.5
Unrestricted		25,757,995	21,994,446	3,763,549	17.1
Total net position		41,210,595	35,148,320	6,062,275	17.2
Total liabilities, deferred inflows, and net position	$	394,791,462	366,269,762	28,521,700	7.8

Condensed statements of net position highlights are as follows:

- The assets of the Agency exceeded its liabilities at the close of 2013 by approximately $41.2 million (net position) as compared with $35.1 million at the end of 2012. Net position provides necessary liquidity to the Agency and supports its investment-grade credit rating.
- Current assets increased by $10.1 million from 2012 to 2013, primarily the result of increased cash and cash equivalents. Current assets include cash and cash equivalents, accrued interest receivable, and short-term investments. Current assets also include power sales receivables, which did not change materially from 2012 to 2013.
- Other noncurrent assets, which include restricted cash and cash equivalents, prepaid expenses, and deferred costs, decreased by approximately $4.6 million from 2012 to 2013, primarily the result of the use of approximately $11.2 million of proceeds from the Agency's Series 2010A Electric Revenue Bonds for the Hometown BioEnergy project. This was partially offset by a $4.8 million increase in future recoverable costs related to the levelization of depreciation and bond interest and costs associated with the Agency's capital lease.
- Capital assets, net increased by approximately $23.2 million during 2013 primarily due to the construction of the Hometown BioEnergy project.
- Current liabilities increased by approximately $5.2 million from 2012 to 2013 primarily due to the increase of accounts payable, retainage payable, and bonds due within one year.
- Long-term liabilities increased by approximately $10.8 million from 2012 to 2013, primarily the result of the issuance of the Agency's Series 2013 bonds. This was partially offset by principal payments on Agency debt.
- Deferred inflows increased by $6.6 million, the result of the Agency making contributions to its rate stabilization account in 2013. Deferred inflows represent the Agency's rate stabilization account and other rate-related accruals.

(Continued)

Comparison of 2012 with 2011

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

Condensed Statements of Net Position

	2012	2011	Dollar change	Percentage change
Capital assets, net	$ 257,842,596	267,396,382	(9,553,786)	(3.6)%
Current assets	50,350,412	37,445,049	12,905,363	34.5
Other noncurrent assets	57,978,614	54,631,008	3,347,606	6.1
Total assets	366,171,622	359,472,439	6,699,183	1.9
Deferred outflows of resources	98,140	475,300	(377,160)	(79.4)
Total assets and deferred outflows	$ 366,269,762	359,947,739	6,322,023	1.8
Current liabilities	$ 22,232,423	20,155,327	2,077,096	10.3
Long-term liabilities	280,223,528	291,743,748	(11,520,220)	(3.9)
Total liabilities	302,455,951	311,899,075	(9,443,124)	(3.0)
Deferred inflows of resources	28,665,491	18,100,199	10,565,292	58.4
Total liabilities and deferred inflows	331,121,442	329,999,274	1,122,168	0.3
Net position:				
Net investment in capital assets	8,010,528	6,618,366	1,392,162	21.0
Restricted	5,143,346	6,695,254	(1,551,908)	(23.2)
Unrestricted	21,994,446	16,634,845	5,359,601	32.2
Total net position	35,148,320	29,948,465	5,199,855	17.4
Total liabilities, deferred inflows, and net position	$ 366,269,762	359,947,739	6,322,023	1.8

Condensed statements of net position highlights are as follows:

- The assets of the Agency exceeded its liabilities at the close of 2012 by approximately $35.1 million (net position) as compared with $29.9 million at the end of 2011. Net position provides necessary liquidity to the Agency and supports its investment-grade credit rating.
- Current assets increased by $12.9 million from 2011 to 2012, primarily the result of increased cash and cash equivalents. 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 $0.4 million from 2011 to 2012.

- Other noncurrent assets, which include restricted cash and cash equivalents, prepaid expenses, and deferred costs, increased by approximately $3.3 million from 2011 to 2012, primarily the result of a $9.4 million increase in future recoverable costs related to the levelization of depreciation and bond interest and costs associated with the Agency's capital lease. This was partially offset by a $5.5 million decrease in restricted cash and cash equivalents related to final expenditures related to the Oak Glen Wind Farm project. Restricted cash and cash equivalents are used for construction needs of the Agency.
- Capital assets, net decreased by approximately $9.6 million during 2012 primarily due to the decrease in electric plant in service associated with a grant received by Oak Glen Wind Farm, LLC that reduced the cost basis of the Oak Glen Wind Farm project and by depreciation on capital assets in place. This was partially offset by the Agency applying capital lease accounting to a portion of its contract with the City of Chaska related to the Minnesota River Station, resulting in a capital lease asset.
- Current liabilities increased by approximately $2.1 million from 2011 to 2012 primarily due to the increase of accounts payable, accrued interest payable, and bonds due within one year. This was partially offset by a decrease in retainage payable.
- Long-term liabilities decreased by approximately $11.5 million from 2011 to 2012, primarily the result of the redemption of the Agency's Series 2010B bonds. This was partially offset by the Agency applying capital lease accounting to a portion of its contract with the City of Chaska related to the Minnesota River Station, resulting in a capital lease liability. Long-term liabilities consist of the bonds issued for construction of the Agency's generating facilities and the Agency's capital lease liability.
- Deferred inflows increased by $10.6 million, the result of the Agency making contributions to its rate stabilization account in 2012. Deferred inflows represent the Agency's rate stabilization account.

The following table summarizes the changes in financial position of the Agency for the years ended December 31, 2013 and 2012:

Condensed Statements of Revenues, Expenses, and Changes in Net Position

	2013	2012	Dollar change	Percentage change
Operating revenues, power sales	$ 106,103,819	101,116,338	4,987,481	4.9%
Other nonoperating revenues	949,652	1,192,174	(242,522)	(20.3)
Total revenues	107,053,471	102,308,512	4,744,959	4.6
Operating expenses	88,963,438	86,794,323	2,169,115	2.5
Other nonoperating expenses	16,615,086	14,802,125	1,812,961	12.2
Total expenses	105,578,524	101,596,448	3,982,076	3.9
Future recoverable costs	4,587,328	4,487,791	99,537	2.2
Change in net position	6,062,275	5,199,855	862,420	16.6
Beginning net position	35,148,320	29,948,465	5,199,855	17.4
Ending net position	$ 41,210,595	35,148,320	6,062,275	17.2

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

- Operating revenues – power sales increased by approximately $5.0 million between 2013 and 2012 primarily due to higher rates. Operating revenues – power sales consist primarily of member power sales revenue, power sales to nonmembers, and other transmission revenue. Operating expenses increased by approximately $2.2 million between 2013 and 2012, primarily as a result of increased transmission and other operating expenses.
- Other nonoperating revenues decreased by approximately $0.2 million between 2013 and 2012 as there was no gain on bond retirement in 2013, whereas 2012 had a $0.2 million gain on bond retirement.
- Other nonoperating expenses increased by approximately $1.8 million in 2013 primarily due to a loss on the disposition of property related to the Agency discontinuing development efforts on a wind project.
- Future recoverable costs increased by approximately $0.1 million in 2013 primarily due to the application of the Agency's policy regarding the levelization of costs for generating assets financed by debt.

The following table summarizes the changes in financial position of the Agency for the years ended December 31, 2012 and 2011:

Condensed Statements of Revenues, Expenses, and Changes in Net Position

	2012	2011	Dollar change	Percentage change
Operating revenues, power sales	$ 101,116,338	97,094,061	4,022,277	4.1%
Other nonoperating revenues	1,192,174	1,469,876	(277,702)	(18.9)
Total revenues	102,308,512	98,563,937	3,744,575	3.8
Operating expenses	86,794,323	87,121,916	(327,593)	(0.4)
Other nonoperating expenses	14,802,125	10,503,886	4,298,239	40.9
Total expenses	101,596,448	97,625,802	3,970,646	4.1
Future recoverable costs	4,487,791	3,057,242	1,430,549	46.8
Change in net position	5,199,855	3,995,377	1,204,478	30.1
Beginning net position	29,948,465	25,953,088	3,995,377	15.4
Ending net position	$ 35,148,320	29,948,465	5,199,855	17.4

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

- Operating revenues – power sales increased by approximately $4.0 million between 2012 and 2011 primarily due to higher costs. Operating revenues – power sales consist primarily of member power sales revenue, power sales to nonmembers, and other transmission revenue. Operating expenses decreased by approximately $0.3 million between 2012 and 2011, primarily as a result of lower net purchased power costs because of the Agency's Oak Glen Wind Farm being in service for a full year.

- Other nonoperating revenues decreased by approximately $0.3 million between 2012 and 2011 as the result of lower grant revenue related to the Hometown GeoPower component unit.
- Other nonoperating expenses increased by approximately $4.3 million in 2012 primarily due to increased interest expense.
- Future recoverable costs increased by approximately $1.4 million in 2012 primarily due to the application of the Agency's policy regarding the levelization of costs for generating assets financed by debt to the Oak Glen Wind Farm project.

Debt Administration

As of December 31, 2013, the Agency had long-term debt outstanding of approximately $273.6 million.

The Agency redeemed the Series 2010B bonds in full on June 28, 2012.

On September 18, 2013, the Agency issued Electric Revenue Bonds Series 2013 in the amount of $17.915 million. The bonds were issued for the purpose of constructing a bioenergy facility.

The Agency received an A rating from Fitch in 2013. The Agency continued to hold an A3 rating from Moody's in 2013.

MINNESOTA MUNICIPAL POWER AGENCY

Statements of Net Position

December 31, 2013 and 2012

Assets		2013	2012
Current assets:			
Cash and cash equivalents	$	41,035,465	33,442,632
Restricted cash and cash equivalents		5,633,179	5,039,754
Grant receivable		—	24,299
Accrued interest receivable		216,141	210,934
Power sales receivables		8,327,246	8,282,040
Other receivable		2,081,549	899,494
Fuel inventory		935,017	494,027
Plant inventory – spares		1,610,280	1,406,814
Prepaid expenses		564,324	550,418
Total current assets		60,403,201	50,350,412
Noncurrent assets:			
Capital assets:			
Equipment		765,116	661,394
Capital lease asset		29,080,531	29,080,531
Land		1,132,083	1,140,665
Electric plant		303,409,822	262,036,603
Rotable combustion turbine parts		6,063,531	6,063,531
Less accumulated depreciation		(64,035,094)	(53,885,376)
Property and equipment, net		276,415,989	245,097,348
Construction in progress		4,598,781	12,745,248
Total capital assets, net		281,014,770	257,842,596
Restricted cash and cash equivalents		283,156	11,761,080
Restricted investments		22,072,759	19,945,133
Prepaid expenses		591,948	622,653
Future recoverable costs		30,425,628	25,649,748
Total noncurrent assets		334,388,261	315,821,210
Total assets		394,791,462	366,171,622
Deferred Outflows			
Deferred outflows of resources		—	98,140
Total assets and deferred outflows of resources	$	394,791,462	366,269,762
Liabilities			
Liabilities:			
Current liabilities:			
Accounts payable and accrued liabilities	$	14,033,294	11,840,005
Retainage payable		1,147,679	—
Accrued interest payable		3,380,575	3,233,586
Long-term debt due within one year		8,058,334	6,333,333
Capital lease liability due within one year		770,782	727,359
Derivative instruments – futures		—	98,140
Total current liabilities		27,390,664	22,232,423
Long-term debt, net		269,381,358	257,859,891
Capital lease liability		21,592,855	22,363,637
Total noncurrent liabilities		290,974,213	280,223,528
Total liabilities		318,364,877	302,455,951
Deferred Inflows			
Deferred inflows of resources – rate stabilization		29,300,000	21,500,000
Deferred inflows of resources – other		5,915,990	7,165,491
Total liabilities and deferred inflows of resources		353,580,867	331,121,442
Net Position			
Net position:			
Net investment in capital assets		9,719,015	8,010,528
Restricted for debt service		5,733,585	5,143,346
Unrestricted		25,757,995	21,994,446
Total net position		41,210,595	35,148,320
Total liabilities and deferred inflows of resources and net position	$	394,791,462	366,269,762

See accompanying notes to financial statements.

MINNESOTA MUNICIPAL POWER AGENCY

Statements of Revenues, Expenses, and Changes in Net Position

Years ended December 31, 2013 and 2012

	2013	2012
Operating revenues:		
Power sales to members	$ 102,076,404	96,857,967
Power sales to nonmembers	4,027,415	4,258,371
Total operating revenues	106,103,819	101,116,338
Operating expenses:		
Power acquisition expense	48,813,970	49,324,302
Transmission	10,787,136	9,329,735
Other operating expenses	19,212,613	17,741,244
Depreciation	10,149,719	10,399,042
Total operating expenses	88,963,438	86,794,323
Operating income	17,140,381	14,322,015
Nonoperating revenues (expenses):		
Amortization of premium on long-term debt, net	138,554	197,631
Interest expense	(14,186,323)	(14,999,756)
Investment income	933,084	923,752
Loss on disposition of property	(2,567,317)	—
Gain on sale of investments	—	317
Gain on bond retirement	—	242,696
Grant revenue	16,568	25,409
Total nonoperating revenues (expenses), net	(15,665,434)	(13,609,951)
Change in net position before future recoverable costs	1,474,947	712,064
Future recoverable costs	4,587,328	4,487,791
Change in net position	6,062,275	5,199,855
Total net position, beginning of year	35,148,320	29,948,465
Total net position, end of year	$ 41,210,595	35,148,320

See accompanying notes to financial statements.

MINNESOTA MUNICIPAL POWER AGENCY

Statements of Cash Flows

Years ended December 31, 2013 and 2012

		2013	2012
Cash flows from operating activities:			
Receipts from power sales	$	113,858,613	109,847,513
Payments for power acquisition/production and operating expenses		(79,679,643)	(72,676,765)
Net cash provided by operating activities		34,178,970	37,170,748
Cash flows from noncapital financing activity:			
Grant revenue received		40,867	66,997
Net cash provided by noncapital financing activity		40,867	66,997
Cash flows from capital and related financing activities:			
Construction of capital assets		(34,687,595)	(9,351,466)
Payments received from grant for capital asset construction		—	25,471,916
Proceeds from issuance of long-term debt		19,718,354	—
Principal payments on electric revenue bonds		(6,333,333)	(33,148,333)
Principal payments on capital lease		(727,359)	(686,382)
Payment of interest		(14,039,334)	(15,326,666)
Payment of debt issuance costs		(188,552)	—
Net cash used in capital and related financing activities		(36,257,819)	(33,040,931)
Cash flows from investing activities:			
Proceeds from sales of investments		15,700,812	15,619,310
Purchase of investments		(17,882,373)	(15,046,166)
Interest received		927,877	924,729
Net cash (used in) provided by investing activities		(1,253,684)	1,497,873
Net change in cash and cash equivalents		(3,291,666)	5,694,687
Cash and cash equivalents, beginning of year		50,243,466	44,548,779
Cash and cash equivalents, end of year	$	46,951,800	50,243,466
Cash components:			
Cash and cash equivalents	$	41,035,465	33,442,632
Restricted cash and cash equivalents		5,916,335	16,800,834
Cash and cash equivalents, end of year	$	46,951,800	50,243,466
Cash flows from operating activities:			
Operating income	$	17,140,381	14,322,015
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation		10,149,719	10,399,042
Changes in current assets and liabilities:			
Power sales receivables		(45,206)	(369,331)
Other receivables		(1,182,055)	(899,494)
Fuel inventory		(440,990)	(115,049)
Plant inventory – spares		(203,466)	(454,589)
Prepaid expenses		16,799	108,578
Accounts payable and accrued liabilities		2,193,289	3,614,284
Deferred revenue – rate stabilization		7,800,000	10,000,000
Deferred revenue – other		(1,249,501)	565,292
Total adjustments		17,038,589	22,848,733
Net cash provided by operating activities	$	34,178,970	37,170,748
Supplemental cash flow information and noncash capital and related financing activities:			
Amortization of premium on electric revenue bonds	$	138,554	197,631
Capital assets in retainage payable		1,147,679	—
Capitalized interest		218,023	—

See accompanying notes to financial statements.

(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, 2013, the Agency comprises 12 Minnesota municipalities. In 2013, the City of Elk River, by and through the Elk River Utilities Commission, joined the Agency, becoming its 12th member. Elk River will begin purchasing all of its power and energy needs from MMPA on October 1, 2018.

The accompanying financial statements present the Agency and its component units, entities for which the Agency is considered to be financially accountable. Blended component units, although legally separate entities, are, in substance, part of the Agency's operations.

Blended Component Units: The Agency owns 100% of Minnesota Renewable Energy, LLC. Minnesota Renewable Energy, LLC owns 100% of Oak Glen Wind Farm, LLC and 100% of Hometown BioEnergy, LLC. Oak Glen Wind Farm, LLC is responsible for the operation of Oak Glen Wind Farm, a 44 megawatt (MW) wind project located in Steele County, Minnesota. Hometown BioEnergy, LLC is responsible for the operation of the Hometown BioEnergy project, an 8 MW renewable energy project located in Le Sueur, Minnesota. The Agency owns 100% of Hometown GeoPower, LLC. Hometown GeoPower, LLC provides services to residents of the Agency's member municipalities. Complete financial statements for each of the individual component units may be obtained from the Agency.

The Agency sells power to its members under power sales contracts that extend to October 31, 2040. As of April 18, 2014, nine members have extended their power sales contracts to December 31, 2050. 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 accredited power and energy during 2013. The power capacity charge for 2013 is approximately $2.2 million. Capacity commitments and charges include 41 MW 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. During 2012, management determined that part of the Chaska agreement should have been historically treated as a capital lease. Accordingly, as of January 1, 2012, the net book value of assets was increased by $18,740,786, capital lease liability was increased by $23,777,378, and future recoverable costs were increased by $5,036,592. See note 4 for more information. 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:

	Megawatts
Year ending December 31:	
2014	96
2015	91
2016	76
2017	41
2018	41

The Agency has an agreement with Xcel Energy Corporation (Xcel Energy) to provide transmission services through December 31, 2015. The Agency is obligated to pay for these services at rates established by the Federal Energy Regulatory Commission (FERC), $36.50 per kilowatt per year at December 31, 2013, plus ancillary charges.

The Agency had a long-term contract with the Manitoba Hydro-Electric Board (Manitoba Hydro) that provided for 30 MW of capacity and on-peak energy from May 1, 2009 through April 30, 2012. The Agency also has an agreement with Rochester Public Utilities (RPU) to purchase 25 MW of capacity and energy from November 1, 2010 through May 31, 2015.

The Agency enters into contracts in connection with the purchase, generation, and sale of electric power to or from its member cities, the Midcontinent Independent System Operator (MISO) and other wholesale market participants. A substantial portion of these contracts are for the purchase of natural gas 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. Substantially all of the Agency's power purchases and sales are with MISO. 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 fair value in the Agency's financial statements with an offsetting deferral amount to reflect the effectiveness of the hedge.

Additionally, the Agency has agreements for dispatching, billing, maintenance services, and other general administration. The Agency has a contract with Avant Energy, Inc. to manage the Agency, which terminates on December 31, 2019.

(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 Governmental Accounting Standards Board (GASB) Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, as the guidance relates to Regulated Operations. The guidance allows for 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.

(c) Capital Assets

Capital assets are recorded at cost, including capitalized interest on borrowed funds during construction. 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 capitalized interest cost of $218,023 and $0 for the years ended December 31, 2013 and 2012, respectively.

The Agency follows a preventative and predictive approach to its maintenance of the Faribault Energy Park (FEP) facility. In doing so, it inspects the combustion turbine and steam turbine and performs major maintenance at intervals suggested by the turbine manufacturers. Periodically, one set of combustion parts is removed from the turbine and a replacement set is rotated into the turbine. The parts that have been removed are refurbished and are then ready to be rotated back into the turbine at the next major maintenance cycle. The Agency is depreciating the cost of the combustion turbine spare parts over the remaining life of the FEP asset. The amount on the statements of net position is the gross acquisition cost, with depreciation associated with the parts included in accumulated depreciation.

Equipment is recorded at cost and consists of telecommunication equipment, transportation equipment, and certain maintenance/testing 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.

(d) 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 statements of net position 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.

(e) Investments and Short-Term Investments

Investments include federal, state, and local bonds, which are reported at amortized cost, which approximates fair value, and certificates of deposit having an initial maturity of greater than one year when purchased. Short-term investments comprise certificates of deposit having an initial maturity of less than one year when purchased.

(f) 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 GASB 62, 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

(Continued)

members in future periods when the levelized costs of principal and interest on long-term debt exceed the then current depreciation and interest costs related to such issues.

(g) Unamortized Debt Premium/Discount

Debt premium/discount is amortized over the repayment period of the related issues using the straight-line method, which approximates the effective-interest method.

(h) Cash Flows

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

(i) 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.

(j) 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.

(k) 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.

(l) 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 MISO as revenue.

(m) 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.

(n) Income Taxes

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

(o) 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.

(p) Recently Adopted Accounting Principles

In November 2010, GASB Statement No. 61, *The Financial Reporting Entity: Omnibus – an amendment of GASB Statements No. 14 and No. 34*. (GASB 61), was issued which related to the financial reporting entity and component units. The Agency retrospectively adopted GASB 61 effective January 1, 2012, resulting in the Agency blending the Hometown GeoPower component unit that had previously been reported as a discrete component. There was no material effect on the financial statements as a result of adoption.

In December 2010, GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* (GASB 62), was issued which codified all generally accepted accounting principles into one source. The Agency retrospectively adopted GASB 62 effective January 1, 2012. There was no material effect on the financial statements as a result of adoption.

In June 2011, GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* (GASB 63), was issued and provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. In addition, GASB 63 identifies net position as the residual of all other elements presented in the statements of net position. The Agency retrospectively adopted GASB 63 effective January 1, 2012. There was no material effect on the financial statements as a result of adoption.

In March 2012, GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* (GASB 65), was issued and establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. The Agency retrospectively adopted GASB 65 effective January 1, 2012. There was no material effect on the financial statements as a result of adoption.

(q) Reclassifications

Certain amounts in the 2012 financial statements have been reclassified to conform with the 2013 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 agreement, bond resolution, and applicable state law. Funds and accounts are reported in the financial statements as follows:

		December 31	
		2013	**2012**
Current assets:			
Cash and cash equivalents	$	41,035,465	33,442,632
Restricted cash and cash equivalents		5,633,179	5,039,754
Total current assets		46,668,644	38,482,386
Noncurrent assets:			
Restricted cash and cash equivalents		283,156	11,761,080
Restricted investments		22,072,759	19,945,133
Total noncurrent assets		22,355,915	31,706,213
Total	$	69,024,559	70,188,599

At December 31, 2013, 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 and instrumentalities securities
- State and local securities
- Minnesota Joint Powers Investment Trusts
- Certificates of deposit
- Money market mutual funds – open-end, no-load
- Guaranteed investment contracts
- 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.

The Agency had the following investments and maturities as of December 31, 2013 and 2012:

	December 31, 2013			December 31, 2012		
	Investment maturities (in years)			Investment maturities (in years)		
	Less than one year	Greater than one year	No maturity	Less than one year	Greater than one year	No maturity
Investment type:						
U.S. government agencies	$ 7,523,133	9,027,429	—	7,523,134	6,214,781	—
U.S. Treasuries	—	668,806	—	—	668,234	—
Certificates of deposit	—	291,000	—	679,000	291,000	—
State and local bonds	—	4,562,391	—	—	4,568,984	—
Money market accounts	—	—	5,815,929	—	—	16,697,241
Cash and cash equivalents	—	—	41,135,871	—	—	33,546,225
Total	$ 7,523,133	14,549,626	46,951,800	8,202,134	11,742,999	50,243,466

(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. The money market accounts and cash and cash equivalents are invested in short-term U.S. government securities and commercial paper.

The following tables list the credit quality ratings per Standard & Poor's and/or Moody's of the Agency's investments as of December 31, 2013 and 2012:

	December 31, 2013			
		Quality ratings		
	Amount reported	AA	AAA	Unrated
Investment type:				
U.S. government agencies	$ 16,550,562	16,550,562	—	—
U.S. Treasuries	668,806	668,806	—	—
Certificates of deposit	291,000	—	—	291,000
State and local bonds	4,562,391	4,562,391	—	—
Money market accounts	5,815,929	—	5,815,929	—
Cash and cash equivalents	41,135,871	—	—	41,135,871
Total	$ 69,024,559	21,781,759	5,815,929	41,426,871

	December 31, 2012			
		Quality ratings		
	Amount reported	AA	AAA	Unrated
Investment type:				
U.S. government agencies	$ 13,737,915	13,737,915	—	—
U.S. Treasuries	668,234	668,234	—	—
Certificates of deposit	970,000	—	—	970,000
State and local bonds	4,568,984	4,568,984	—	—
Money market accounts	16,697,241	—	16,697,241	—
Cash and cash equivalents	33,546,225	—	—	33,546,225
Total	$ 70,188,599	18,975,133	16,697,241	34,516,225

(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. The Agency's adopted and revised investment policy addresses, among other things, custodial credit risk. At December 31, 2013 and 2012, 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:

	2013			
	Beginning balance	Additions	Retirements/ Transfers	Ending balance
Nondepreciable capital assets:				
Construction work in progress	$ 12,745,248	36,447,168	(44,593,635)	4,598,781
Land	1,140,665	—	(8,582)	1,132,083
Depreciable capital assets:				
Telemetering and telecommunication	661,394	103,722	—	765,116
Capital lease asset	29,080,531	—	—	29,080,531
Electric plant	262,036,603	41,519,091	(145,872)	303,409,822
Rotable combustion turbine parts	6,063,531	—	—	6,063,531
Less accumulated depreciation for assets in service	(53,885,376)	(10,149,718)	—	(64,035,094)
Capital assets, net	$ 257,842,596	67,920,263	(44,748,089)	281,014,770

	2012			
	Beginning balance	Additions	Retirements/ Transfers	Ending balance
Nondepreciable capital assets:				
Construction work in progress	$ 7,699,559	5,612,093	(566,404)	12,745,248
Land	822,655	318,010	—	1,140,665
Depreciable capital assets:				
Telemetering and telecommunication	649,670	11,724	—	661,394
Capital lease asset	—	29,080,531	—	29,080,531
Electric plant	285,307,557	2,271,422	(25,542,376)	262,036,603
Rotable combustion turbine parts	6,063,531	—	—	6,063,531
Less accumulated depreciation for assets in service	(33,146,590)	(10,399,042)	(10,339,744)	(53,885,376)
Capital assets, net	$ 267,396,382	26,894,738	(36,448,524)	257,842,596

(4) Long-Term Debt

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

	2013	2012
Series 2004A, 3.40% – 5.25%, due October 1, 2010 to 2034	$ 46,465,000	47,395,000
Series 2005, 3.50% – 5.25%, due October 1, 2007 to 2035	99,685,000	102,185,000
Series 2007, 4.00% – 5.25%, due October 1, 2007 to 2037	23,905,000	24,435,000
Series 2009A, 1.40%, due October 1, 2009 to 2023	3,333,333	3,666,666
Series 2010A, 3.00% – 5.25%, due October 1, 2011 to 2035	82,340,000	84,380,000
Series 2013, 3.00% – 5.00%, due October 1, 2014 to 2023	17,915,000	—
Total bonds outstanding	273,643,333	262,061,666
Less current maturities	(8,058,333)	(6,333,333)
Add unamortized premium	3,796,358	2,131,558
	$ 269,381,358	257,859,891

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.

The Agency redeemed the Series 2010B bonds in full on June 28, 2012.

Debt service requirements on the outstanding bonds are as follows:

Year	Principal	Interest	Total
2014	$ 8,058,333	13,492,925	21,551,258
2015	8,433,333	13,125,088	21,558,421
2016	8,818,333	12,735,746	21,554,079
2017	9,208,333	12,339,067	21,547,400
2018	9,663,333	11,885,750	21,549,083
2019–2023	55,826,668	51,817,038	107,643,706
2024–2028	56,160,000	38,319,788	94,479,788
2029–2033	79,970,000	22,426,531	102,396,531
2034–2037	37,505,000	3,055,800	40,560,800
	$ 273,643,333	179,197,733	452,841,066

The Agency has an agreement with the City of Chaska to purchase capacity, described more fully in note 1. A portion of the payments under this agreement are accounted for as a capital lease. Future minimum payments under the agreement are as follows:

Year		Principal	Interest	Executory costs	Payment
2014	$	770,782	1,279,593	590,692	2,641,067
2015		816,798	1,233,577	590,692	2,641,067
2016		865,561	1,184,815	590,692	2,641,068
2017		917,235	1,133,141	590,692	2,641,068
2018		971,994	1,078,382	590,692	2,641,068
2019–2023		5,802,853	4,449,025	2,953,462	13,205,340
2024–2028		7,754,543	2,497,334	2,953,462	13,205,339
2029–2031		4,463,871	320,339	1,378,282	6,162,492
	$	22,363,637	13,176,206	10,238,666	45,778,509

Long-term liability activity for the years ended December 31, 2013 and 2012 was as follows:

Long-term liabilities as of December 31, 2013		Beginning balance	Additions	Reductions	Ending balance
Long-term bonds	$	262,061,666	17,915,000	(6,333,333)	273,643,333
Less current maturities		(6,333,333)	(8,058,334)	6,333,333	(8,058,334)
Add unamortized premium, net		2,131,558	1,803,354	(138,554)	3,796,358
Long-term bonds, net	$	257,859,891	11,660,020	(138,554)	269,381,357
Capital lease liability	$	23,090,996	—	(727,359)	22,363,637

Long-term liabilities as of December 31, 2012		Beginning balance	Additions	Reductions	Ending balance
Long-term bonds	$	295,210,000	—	(33,148,334)	262,061,666
Less current maturities		(6,118,333)	(6,333,333)	6,118,333	(6,333,333)
Add unamortized premium, net		2,652,081	—	(520,523)	2,131,558
Long-term bonds, net	$	291,743,748	(6,333,333)	(27,550,524)	257,859,891
Capital lease liability	$	—	23,777,378	(686,382)	23,090,996

(5) Power Acquisition Expense

Power acquisition expense consists primarily of power purchases, production fuel, and related expenses. The Agency sells substantially all of the power and energy produced by its generating facilities into the MISO market and purchases substantially all of its power and energy needs for sales to members and others from the MISO market. The Agency reports its purchases from and sales to MISO on a net basis.

The components of power acquisition expense are as follows:

		2013	2012
Power purchases	$	31,296,512	32,864,538
Production fuel		17,517,458	16,459,764
Total power acquisition expense	$	48,813,970	49,324,302

(6) Credit Facilities

The Agency entered into a $5 million credit facility October 1, 2008. This facility was renewed in September 2011 and again in June 2013. The commitment fee is 0.45% per annum; interest on outstanding balances is tied to the prime rate. The facility can be renewed through June 30, 2016. There were no amounts outstanding as of December 31, 2013 or 2012.

(7) 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 related to public officials' liability. The Agency has a $60,000 deductible per occurrence, with a $200,000 annual maximum deductible for its liability coverage. The Agency also purchases municipal automobile coverage from the same public entity risk pool with a $1,000 deductible per occurrence.

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

The Agency also carries commercial insurance for its risks of property loss, business interruption, and general liability. The Agency's property loss has varying deductibles based on the equipment insured that range from $250,000 to $1,500,000. The Agency's business interruption insurance has a 60 day deductible.

The Agency also has an umbrella policy related to its municipal automobile insurance and general liability insurance.

Settled claims have not exceeded insurance coverage in any of the past three years for any of the Agency's insurance policies.

(8) 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.