

**MICHIGAN SOUTH CENTRAL  
POWER AGENCY**

Litchfield, Michigan

**FINANCIAL STATEMENTS**

Including Independent Auditor's Report

As of and for the Years Ended June 30, 2013 and 2012

# MICHIGAN SOUTH CENTRAL POWER AGENCY

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## INDEPENDENT AUDITORS' REPORT

To the Board of Commissioners  
Michigan South Central Power Agency  
Litchfield, Michigan

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the Michigan South Central Power Agency (the Agency), as of and for the years ended June 30, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the Agency's basic financial statements as listed in the table of contents.

### ***Management's Responsibility for the Financial Statements***

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

### ***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 audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the 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 over financial reporting relevant to the Agency'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 Agency'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.

To the Board of Commissioners  
Michigan South Central Power Agency

***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Agency as of June 30, 2013 and 2012, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

***Emphasis of Matter***

As discussed in the Note 1, the Agency adopted the provisions of GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, effective July 1, 2012. Our opinion is not modified with respect to this matter.

***Other Matter***

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and Schedule of Funding Progress information as listed in the table of contents be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the 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 management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the 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.

*Baker Tilly Virchow Krause, LLP*

Madison, Wisconsin  
August 19, 2013

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

# **MICHIGAN SOUTH CENTRAL POWER AGENCY**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS As of and for the Years Ended June 30, 2013 and 2012 UNAUDITED**

The management of the Michigan South Central Power Agency (the "Agency") offers all persons interested in the Agency's financial position this narrative overview and analysis of the Agency's financial performance during the years ending June 30, 2013 and 2012. Please read this narrative in conjunction with the accompanying financial statements and the accompanying notes to financial statements.

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### **OVERVIEW OF THE FINANCIAL STATEMENTS**

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Michigan South Central Power Agency is a public body politic and corporate of the State of Michigan. The Agency was organized on March 21, 1978, under the authority of Michigan Public Act 448 of 1976, to supply electricity to member municipalities in South Central Michigan. The Agency has five members: the Cities of Coldwater, Hillsdale, and Marshall; and the Villages of Clinton, and Union City.

This annual report consists of two parts: Management's Discussion and Analysis (this section) and the basic financial statements. These statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. The Agency uses the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission.

The Balance Sheet reports year end assets, liabilities and net position balances based on the original cost adjusted for any depreciation, amortization or unrealized gains/losses as appropriate. The Statement of Revenues, Expenses and Changes in Net Position presents information showing how the Agency's net position changed due to the Agency's business activity. The Statement of Cash Flows reports the cash provided and used for operating activities, as well as other cash sources such as investment income and cash payments for capital additions.

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### **AGENCY FINANCIAL ANALYSIS**

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Fiscal year 2013 was a busy year, operationally and financially. This year marked the eighth full year of Agency operations as a "Market Participant" in the Midwest Independent System Operator (MISO) Midwest Market Initiative energy market. This market, which commenced on April 1st, 2005, is meant to coordinate the provision of reliable, cost-effective energy. In 2013, the Agency received a net credit from MISO market charges of approximately \$421,000, while in 2012 the Agency received a net credit from MISO of approximately \$794,000. These amounts include rebates, refunds, etc., of previously expensed items and other direct credits through MISO.

Late in fiscal year 2004, the Agency began a relationship with American Municipal Power of Ohio (AMP) in order to facilitate the Agency's MISO market participation. For approximately \$95,000 in fiscal year 2013 annual fees, the Agency is able to utilize the services of AMP's energy control center. This arrangement has allowed the Agency to avoid creating and staffing its own control center.

The relationship with AMP has broadened to include the acceptance of the Agency's members as full AMP members in July of 2006 and services such as power supply planning and resource management, including the Agency's members participation in a 43 MW share of the American Municipal Power Fremont Energy Center (AFEC) and a 12 MW share of the Prairie State Energy Campus as well as several bi-lateral bridge power contracts.

On March 31, 2011, the Agency completed a full bond defeasance of its remaining bonds. The bond defeasance was in the amount of \$14,055,799 of principal and interest comprised of 2000 bonds totaling \$5,395,200 and 2004 series bonds totaling \$8,678,725 offset by an interest credit from defeasance funds.

See accompanying independent auditors' report.

# MICHIGAN SOUTH CENTRAL POWER AGENCY

## MANAGEMENT'S DISCUSSION AND ANALYSIS As of and for the Years Ended June 30, 2013 and 2012 UNAUDITED

### AGENCY FINANCIAL ANALYSIS (cont.)

On May 30, 2012, the Agency completed a sale of its Project 2 and Project 3 diesel-fired generators for gross proceeds of \$5.1 million. The assets had a remaining book value of \$5.5 million, resulting in an accounting loss of \$.4 million.

An analysis of the Agency's financial position begins with the review of the Balance Sheet, the Statement of Revenues, Expenses and Changes in Net Position and the Statement of Cash Flows report information. A summary of the Agency's Balance Sheet is presented in Table 1. The Statement of Revenues, Expenses and Changes in Net Position are summarized in Table 2 and Table 3 presents a summary of the Statement of Cash Flows.

Table 1  
Condensed Balance Sheets

	2013	2012	2011
Current assets	\$ 21,991,476	\$ 21,736,193	\$ 15,589,935
Noncurrent assets	12,414,448	9,344,982	8,212,555
Utility plant	19,360,902	20,530,911	25,549,360
Total Assets	<u>\$ 53,766,826</u>	<u>\$ 51,612,086</u>	<u>\$ 49,351,850</u>
Current liabilities	\$ 15,267,372	\$ 8,100,585	\$ 6,839,171
Non-current liabilities	197,929	1,017,892	232,331
Total Liabilities	<u>15,465,301</u>	<u>9,118,477</u>	<u>7,071,502</u>
Net Position			
Net Investment in capital assets	19,360,902	20,530,911	25,549,360
Unrestricted	18,940,623	21,962,698	16,730,988
Total Net Position	<u>38,301,525</u>	<u>42,493,609</u>	<u>42,280,348</u>
Total Liabilities and Net Position	<u>\$ 53,766,826</u>	<u>\$ 51,612,086</u>	<u>\$ 49,351,850</u>

See accompanying independent auditors' report.

# MICHIGAN SOUTH CENTRAL POWER AGENCY

## MANAGEMENT'S DISCUSSION AND ANALYSIS As of and for the Years Ended June 30, 2013 and 2012 UNAUDITED

### AGENCY FINANCIAL ANALYSIS (cont.)

Table 2  
Condensed Statements of Revenues, Expenses and Changes in Net Position

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Operating revenues	\$ 54,805,738	\$ 45,776,324	\$ 43,501,777
Depreciation expense	2,823,618	3,263,683	3,198,975
Other operating expenses	<u>51,073,235</u>	<u>42,084,055</u>	<u>37,549,545</u>
Total Operating Expenses	<u>53,896,853</u>	<u>45,347,738</u>	<u>40,748,520</u>
Operating income	<u>908,885</u>	<u>428,586</u>	<u>2,753,257</u>
Investment and miscellaneous income	206,385	190,244	173,716
Interest and amortization expense	-	-	(927,119)
Other income and (expense)	(216,494)	(405,569)	(65,587)
Loss on bond defeasance	-	-	(695,182)
Member equity refund	<u>(5,090,860)</u>	<u>-</u>	<u>(247,384)</u>
Total Non-Operating Expenses	<u>(5,100,969)</u>	<u>(215,325)</u>	<u>(1,761,556)</u>
Change in Net Position	(4,192,084)	213,261	991,701
NET POSITION – Beginning of Year	<u>42,493,609</u>	<u>42,280,348</u>	<u>41,288,647</u>
<b>NET POSITION – END OF YEAR</b>	<u><b>\$ 38,301,525</b></u>	<u><b>\$ 42,493,609</b></u>	<u><b>\$ 42,280,348</b></u>

See accompanying independent auditors' report.



# MICHIGAN SOUTH CENTRAL POWER AGENCY

## MANAGEMENT'S DISCUSSION AND ANALYSIS As of and for the Years Ended June 30, 2013 and 2012 UNAUDITED

### AGENCY FINANCIAL ANALYSIS (cont.)

Table 3  
Condensed Statements of Cash Flows

	2013	2012	2011
Received sales to members and others	\$ 54,511,853	\$ 44,546,693	\$ 44,581,880
Received from members for future maintenance	1,500,000	800,000	-
Paid to suppliers for goods and services	(49,385,951)	(36,999,123)	(32,871,414)
Paid to employees for services	(4,707,248)	(4,427,777)	(4,439,269)
Cash Flows from Operating Activities	<u>1,918,654</u>	<u>3,919,793</u>	<u>7,271,197</u>
Debt principal and interest paid	-	-	(8,405,620)
Early defeasance of debt	-	-	(14,055,799)
Capital expenditures for utility plant	(2,070,979)	(2,002,246)	(1,276,900)
Net proceeds from sale and disposal of utility plant	<u>-</u>	<u>5,101,595</u>	<u>215,685</u>
Cash Flows from Capital and Related Financing Activities	<u>(2,070,979)</u>	<u>3,099,349</u>	<u>(23,522,634)</u>
Cash Flows from Investing Activities	<u>104,188</u>	<u>(1,843,571)</u>	<u>10,760,684</u>
<b>Net Change in Cash and Cash Equivalents</b>	<b>(48,137)</b>	<b>5,175,571</b>	<b>(5,490,753)</b>
CASH AND CASH EQUIVALENTS			
- Beginning of Year	<u>14,136,311</u>	<u>8,960,740</u>	<u>14,451,493</u>
<b>CASH AND CASH EQUIVALENTS - END OF YEAR</b>	<b><u>\$ 14,088,174</u></b>	<b><u>\$ 14,136,311</u></b>	<b><u>\$ 8,960,740</u></b>

### BALANCE SHEETS

"Current assets" increased by \$.3 million during fiscal year 2013, with cash decreasing \$.3 million, accounts receivable increasing by \$.4 million and other current assets increased by \$1.0 million, composed primarily of additional of prepayments of \$.9 million that were made towards the upcoming turbine major outage in the fall of 2013, offset by inventory decreasing \$.9 million. "Current assets" increased by \$6.1 million during fiscal 2012, with cash increasing \$6.1 million, primarily from the proceeds of the Project 2 and 3 diesel generator sale, accounts receivable increasing by \$1.3 million, offset by inventory decreasing .4 million and reclassifying \$.9 million for purchased power BTU's to be derived from an upcoming alternative fuel source to noncurrent assets.

## MICHIGAN SOUTH CENTRAL POWER AGENCY

### MANAGEMENT'S DISCUSSION AND ANALYSIS As of and for the Years Ended June 30, 2013 and 2012 UNAUDITED

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#### BALANCE SHEETS (cont.)

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"Noncurrent assets" increased by \$3.1 million in total during fiscal 2013. Long-term investments increased \$.3 million, along with prepaying \$2.1 million for prepaid renewable energy credits and prepaid BTU's to be derived from an alternative fuel source and an increase in other prepayments and noncurrent assets of \$.5 million. "Noncurrent assets" increased by \$1.1 million during fiscal year 2012 mostly related to an increase in long-term investments of \$1.0 million. In addition, prepaid purchased power BTUs increased \$.9 million through a reclassification from current assets to noncurrent, an increase in other prepayments and other noncurrent assets of \$.9, and a reduction, through a transfer, of \$1.7 million preliminary survey to construction in process.

The Agency's commitment to maintaining and improving the Plant in order to provide reliable, value-based electricity to its members is reflected in the stability of the Utility Plant balance. The change in fiscal 2013's Utility Plant number is primarily due to the depreciation of \$2.8 million and plant assets disposed with a net book value of \$.2 million, offset by \$1.8 million of projects capitalized (including work in progress) during the year. The change in fiscal 2012's Utility Plant number is primarily due to the depreciation of \$3.3 million and by plant assets sold, including the Project 2 and Project 3 diesel generators, with a net book value of \$5.5 million, offset by \$3.8 million of projects capitalized (including work in progress) during the year.

Total liabilities increased by \$6.3 million during fiscal 2013. Accounts payable decreased by \$.3 million, deferred resources for future maintenance increased by \$1.5 million and member rate stabilization funds increased by \$5.2 million primarily due to transferring monies from the fiscal 2012 Project 2 and Project 3 generator sale via a member equity refund. Total liabilities increased by \$2.0 million during fiscal 2012, due to accounts payable increasing by \$1.2 million primarily due to power purchases and deferred resources for future maintenance increasing by \$.8 million

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#### STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

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Fiscal 2013 operating revenues increased by 19.7 percent and expenses increased by 18.9 percent versus fiscal 2012. Fiscal 2013 operating revenues and expenses were significantly higher than fiscal 2012 primarily due to higher purchased power costs as new projects came on line, along with additional purchased power contracts. Fiscal 2012 operating revenues increased by 5.2 percent and expenses increased by 11.2 percent versus fiscal 2011. Fiscal 2012 operating revenues and expenses were significantly higher than fiscal 2011 primarily due to higher purchased power costs.

Operating income was slightly higher in fiscal 2013 than 2012, but lower than 2011 as the Agency completed the bond defeasance in fiscal 2011 and eliminated all bond covenant restrictions on operating income.

"Investment and miscellaneous income" was relatively unchanged for fiscal 2013 and fiscal 2012.

"Other income and expense" of \$.2 million for fiscal 2013 was due to a net loss on disposal of plant assets. "Other income and expense" of \$.4 million for fiscal 2012 was due primarily to a loss from the Project 2 and Project 3 diesel generator sale.

For fiscal 2011, "Loss on bond defeasance" of \$.7 million was due to the Agency completing a full defeasance of its outstanding bonds on March 31, 2011.

See accompanying independent auditors' report.

## **MICHIGAN SOUTH CENTRAL POWER AGENCY**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS As of and for the Years Ended June 30, 2013 and 2012 UNAUDITED**

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#### **STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION (cont.)**

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"Member equity refund" of \$5.1 million for fiscal 2013 was a refund of prior years equity related to the Project 2 and Project 3 generator sale that was distributed to the members rate stabilization funds. "Member equity refund" of \$.3 million for fiscal 2011 was a refund of prior years equity that were distributed to the members rate stabilization funds during that year.

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#### **STATEMENTS OF CASH FLOWS**

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"Cash and cash equivalents" are defined as investments which mature in 90 days or less, plus immediately accessible bank accounts. For fiscal 2013, the "Cash and cash equivalents" amount remained relatively unchanged. For fiscal 2012, the "Cash and cash equivalents" amount increased, as the Agency sold its Project 2 and Project 3 diesel generators for net proceeds of \$5.1 million. For fiscal 2011, the "Cash and cash equivalents" amount decreased primarily due to the Agency's decision to complete the March 31, 2011 bond defeasance, offset by using bond reserve long-term investments to complete the bond defeasance.

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#### **DEBT SERVICE COVERAGE**

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The Agency completed a full bond defeasance of its outstanding bonds on March 31, 2011 which eliminated its bond covenant requirements at the June 30, 2011 year end.

The Agency's bond documents required the Agency to maintain certain restrictive financial covenants, the most restrictive being the requirement that net revenues must equal at least 110% of the aggregate bond service for the year. Further details can be found in the Footnotes to the Financial Statements, under "Aggregate Bond Service Coverage."

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#### **FUTURE ECONOMIC EVENTS**

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The Agency has entered into purchase power agreements with N.E.W. Hydro, LLC to secure long-term hydro power supply for a twenty year term beginning in fiscal 2014. The agreements are for 5.75 MW from two hydro units located on the Menominee River, which commenced on July 1, 2013 and another 3.64 MW from two hydro units located in Oconto Falls on the Oconto River in Wisconsin, scheduled to commence on October 1, 2013.

On July 25, 2013, the Agency completed a purchase of a Fractionized Tire-Derived Fuel facility located in Litchfield, Michigan. This purchase will enable the Agency to have the ability to use a secondary alternative fuel source for its Endicott facility.

In the fall of 2013, The Agency's Endicott facility is anticipated to perform a turbine major outage for which the Agency has been billing and deferring member resources to be released when the major maintenance project is completed.

## **MICHIGAN SOUTH CENTRAL POWER AGENCY**

MANAGEMENT'S DISCUSSION AND ANALYSIS  
As of and for the Years Ended June 30, 2013 and 2012  
UNAUDITED

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### **CONTACTING AGENCY MANAGEMENT**

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This financial report is designed to provide our members, investors, and creditors with a general overview of Michigan South Central Power Agency's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to Michigan South Central Power Agency, 720 Herring Rd., Litchfield, MI 49252.

# MICHIGAN SOUTH CENTRAL POWER AGENCY

## BALANCE SHEETS As of June 30, 2013 and 2012

<b>ASSETS</b>		2013	2012
<b>CURRENT ASSETS</b>			
Cash and cash equivalents	\$	14,875,951	\$ 15,144,027
Accounts receivable		4,719,179	4,346,640
Interest receivable		21,703	29,873
Inventory		992,488	1,867,207
Prepayments and other current assets		1,382,155	348,446
Total Current Assets		<u>21,991,476</u>	<u>21,736,193</u>
<b>NONCURRENT ASSETS</b>			
Long-term investments		4,735,996	4,405,690
Preliminary survey and investigation		-	54,613
Prepayments and other non-current assets		1,348,462	821,869
Prepaid renewable energy credits and other commodities		5,223,300	3,136,532
Deferred costs recoverable in future years		1,106,690	926,278
Total Noncurrent Assets		<u>12,414,448</u>	<u>9,344,982</u>
<b>CAPITAL ASSETS</b>			
Utility plant (including construction work in progress)		92,131,750	91,154,842
Accumulated depreciation		<u>(72,770,848)</u>	<u>(70,623,931)</u>
Total Net Capital Assets		<u>19,360,902</u>	<u>20,530,911</u>
<b>TOTAL ASSETS</b>	\$	<u>53,766,826</u>	\$ <u>51,612,086</u>

<b>LIABILITIES AND NET POSITION</b>		
	<u>2013</u>	<u>2012</u>
<b>CURRENT LIABILITIES</b>		
Accounts payable and accrued expenses		
Accounts payable	\$ 4,494,135	\$ 4,778,239
Compensation and related amounts	318,185	336,808
Deferred resources for future maintenance	2,300,000	-
Deferred rate stabilization	8,155,052	2,985,538
Total Current Liabilities	<u>15,267,372</u>	<u>8,100,585</u>
<b>NONCURRENT LIABILITIES</b>		
Deferred resources for future maintenance	-	800,000
Supplemental retirement obligation	197,929	217,892
Total Noncurrent Liabilities	<u>197,929</u>	<u>1,017,892</u>
 Total Liabilities	 <u>15,465,301</u>	 <u>9,118,477</u>
<b>NET POSITION</b>		
Net investment in capital assets	19,360,902	20,530,911
Unrestricted	18,940,623	21,962,698
Total Net Position	<u>38,301,525</u>	<u>42,493,609</u>
 <b>TOTAL LIABILITIES AND NET POSITION</b>	 <u>\$ 53,766,826</u>	 <u>\$ 51,612,086</u>

# MICHIGAN SOUTH CENTRAL POWER AGENCY

## STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION For the Years Ended June 30, 2013 and 2012

	2013	2012
<b>OPERATING REVENUES</b>		
Sales to members	\$ 47,853,161	\$ 42,360,863
Other sales	6,952,577	3,415,461
Total Operating Revenues	<u>54,805,738</u>	<u>45,776,324</u>
<b>OPERATING EXPENSES</b>		
Operations	46,555,589	37,877,622
Maintenance	2,432,953	2,238,202
Administration and general	2,084,693	1,968,231
Depreciation	2,823,618	3,263,683
Total Operating Expenses	<u>53,896,853</u>	<u>45,347,738</u>
Operating Income	<u>908,885</u>	<u>428,586</u>
<b>NONOPERATING REVENUES (EXPENSES)</b>		
Investment and miscellaneous income	290,193	209,442
Net increase (decrease) in the fair value of investments	(83,808)	(19,198)
Loss on disposal of assets	(216,494)	(405,569)
Member equity refund	(5,090,860)	-
Total Nonoperating Expenses	<u>(5,100,969)</u>	<u>(215,325)</u>
<b>CHANGE IN NET POSITION</b>	(4,192,084)	213,261
NET POSITION - Beginning of Year	<u>42,493,609</u>	<u>42,280,348</u>
<b>NET POSITION - END OF YEAR</b>	<u>\$ 38,301,525</u>	<u>\$ 42,493,609</u>

See accompanying notes to financial statements and independent auditors' report.

# MICHIGAN SOUTH CENTRAL POWER AGENCY

## STATEMENTS OF CASH FLOWS For the Years Ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Received from sales to members and others	\$ 54,511,853	\$ 44,546,693
Received from members for future maintenance	1,500,000	800,000
Paid to suppliers for goods and services	(49,385,951)	(36,999,123)
Paid to employees for services	(4,707,248)	(4,427,777)
Net Cash Flows from Operating Activities	<u>1,918,654</u>	<u>3,919,793</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Capital expenditures for utility plant	(2,070,979)	(2,002,246)
Proceeds from sale and disposal of utility plant	-	5,143,612
Cost of removal of property retired	-	(42,017)
Cash Flows From Capital and Related Financing Activities	<u>(2,070,979)</u>	<u>3,099,349</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from sales and maturities of investments	2,859,998	3,395,138
Purchases of investments	(2,970,365)	(5,413,406)
Interest received	214,555	174,697
Cash Flows from Investing Activities	<u>104,188</u>	<u>(1,843,571)</u>
<b>Net Change in Cash and Cash Equivalents</b>	(48,137)	5,175,571
CASH AND CASH EQUIVALENTS – Beginning of Year	<u>14,136,311</u>	<u>8,960,740</u>
<b>CASH AND CASH EQUIVALENTS – END OF YEAR</b>	<u>\$ 14,088,174</u>	<u>\$ 14,136,311</u>
<b>NONCASH INVESTING ACTIVITY</b>		
Unrealized gains (losses) on investments	<u>\$ (81,644)</u>	<u>\$ 26,902</u>
<b>NONCASH CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Gain (loss) on disposal of assets	<u>\$ (216,494)</u>	<u>\$ (405,569)</u>
Member equity refund to rate stabilization	<u>\$ 5,090,860</u>	<u>\$ -</u>



	2013	2012
<b>RECONCILIATION OF OPERATING INCOME TO NET CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Operating income	\$ 908,885	\$ 428,586
Noncash items included in operating income		
Depreciation	2,823,618	3,263,683
Changes in assets and liabilities		
Accounts receivable	(372,539)	(1,274,624)
Inventory	874,719	410,467
Prepayments and other non-current assets	(1,033,709)	(516,282)
Prepayments and other current assets	(526,593)	9,750
Prepaid renewable energy credits and commodities	(2,086,768)	(107,432)
Deferred costs	(180,412)	(24,672)
Accounts payable	(28,615)	888,175
Compensation and related amounts	(38,586)	(2,851)
Deferred rate stabilization	78,654	44,993
Deferred resources for future maintenance	1,500,000	800,000
<b>NET CASH FLOWS FROM OPERATING ACTIVITIES</b>	<u>\$ 1,918,654</u>	<u>\$ 3,919,793</u>
<b>RECONCILIATION OF CASH AND CASH EQUIVALENTS TO THE BALANCE SHEET</b>		
Cash and cash equivalents	\$ 14,875,951	\$ 15,144,027
Investments - non-current	4,735,996	4,405,690
Total Cash and Investments	19,611,947	19,549,717
Less: Long-Term Investments	(5,523,773)	(5,413,406)
<b>TOTAL CASH AND CASH EQUIVALENTS</b>	<u>\$ 14,088,174</u>	<u>\$ 14,136,311</u>

See accompanying notes to financial statements and independent auditors' report.

# MICHIGAN SOUTH CENTRAL POWER AGENCY

## NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended June 30, 2013 and 2012

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### NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND NATURE OF OPERATIONS

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The Michigan South Central Power Agency (the Agency) is a body politic and corporate, of the State of Michigan organized on March 21, 1978, under the authority of Michigan Public Act 448 of 1976 (the Act), to supply electricity to member municipalities in south central Michigan. The Act provides that the Agency will establish rates and charges so as to produce revenues sufficient to cover costs (excluding depreciation and amortization expense) including debt service, but it may not operate its projects for profit, except insofar as any such profit will insure to the benefit of the public.

The Agency's member municipalities are the Cities of Coldwater, Hillsdale and Marshall and the Villages of Clinton and Union City. Each member is a municipal corporation, organized under the laws of the State of Michigan, which owns and operates a municipal electric system. The member municipalities presently supply their customers with power and energy generated from the Agency's Project I, from the municipalities' existing generating facilities and with power purchased from other utility companies. Project I consists of a 55 MW coal fired generation facility and related transmission and substation equipment. Project II consisted of a series of diesel fired peaking units capable of producing 16.5 megawatts of power. Project III consisted of a series of diesel fired peaking units capable of producing 13.3 megawatts of power. The participants of Project I and Project III are the Cities of Coldwater, Hillsdale and Marshall, and the Villages of Clinton and Union City. All members except the Village of Union City were participants in Project II. Project II and III generators and related assets were sold by the agency in fiscal year 2012.

Each member municipality has entered into the following agreements with the Agency:

- > Economic Dispatch Agreement, which provides for the dispatch by the Agency of power and energy from certain existing generating facilities of the member municipalities on an economic basis and the member municipalities are required to sell to the Agency power generated by their facilities, defined as dedicated capacity.
- > The Power Sales Contract, which requires the Agency to provide, and the member municipalities to purchase from the Agency, all of the members' bulk power supply, as defined in the contracts.
- > The Substation Agreement requires the Agency to provide, and the municipalities to purchase, services of the municipalities' substation facilities for transmission, transformation and delivery of electric power and energy from the Agency to the municipalities.
- > Each member is also obligated to pay its share of the Agency's operating of Project I.

#### ***MEASUREMENT FOCUS, BASIS OF ACCOUNTING AND FINANCIAL STATEMENT PRESENTATION***

The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset used. Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place.

# MICHIGAN SOUTH CENTRAL POWER AGENCY

## NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended June 30, 2013 and 2012

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### NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND NATURE OF OPERATIONS (cont.)

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#### ***MEASUREMENT FOCUS, BASIS OF ACCOUNTING AND FINANCIAL STATEMENT PRESENTATION (cont.)***

The Agency complies with all applicable pronouncements of the Governmental Accounting Standards Board (GASB). Effective July 1, 2012, the Agency adopted GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. GASB Statement No. 62 incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance that is also included in the Financial Accounting Standards Board (FASB) and the American Institute of Certified Public Accountants (AICPA) pronouncements issued on or before November 30, 1989, which do not conflict with GASB pronouncements.

The Agency's accounts are maintained in accordance with the Uniform System of Accounts of the Federal Energy Regulatory Commission, as required by the Power Sales Contracts with the member municipalities, and in conformity with accounting principles generally accepted in the United States of America. A separate set of plant accounts is maintained for each of the Agency's projects.

In June 2011, GASB issued Statement No. 63 - *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. This statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Previous financial reporting standards did not include guidance for these elements, which are distinct from assets and liabilities. The Agency implement this standard effective July 1, 2012.

#### ***USE OF ESTIMATES***

Preparation of financial statements in conformity with generally accepted accounting principles in the United States (GAAP) 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 reported period. Actual results could differ from those estimates.

#### ***CAPITAL ASSETS – UTILITY PLANT***

The Agency capitalizes assets with an original cost of \$5,000 or more and a useful life of at least two years. The cost of utility plant includes direct and overhead costs. Interest incurred during construction is reflected in the capitalized value of assets, net of interest earned on the invested proceeds over the same period.

When property subject to depreciation is retired or otherwise disposed of in the normal course of business, its cost, together with the cost of removal less salvage, is charged to accumulated depreciation.

The cost of maintenance, repairs and replacements of minor items of property is charged to maintenance expense. The cost of replacements of property is charged to utility plant accounts.

# MICHIGAN SOUTH CENTRAL POWER AGENCY

## NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended June 30, 2013 and 2012

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### NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND NATURE OF OPERATIONS (cont.)

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#### ***CAPITAL ASSETS – UTILITY PLANT (cont.)***

Utility plant in service is depreciated using the straight-line method over the following useful lives:

	<u>Years</u>
Project I (composite) – Endicott Generation Station	30
Substation plant (composite)	30
Transmission facilities (composite)	55
Administrative and maintenance building	10 – 50
Transportation equipment	3 – 5
Furniture and fixtures	5 – 10

#### ***CASH EQUIVALENTS***

For purposes of the statement of cash flows, cash equivalents include checking accounts, savings accounts and institutional liquid assets, with initial maturities of three months or less from the date of acquisition.

#### ***INVESTMENTS***

The Agency follows GASB No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. This standard requires investments to be reported at fair value with gains and losses included in the Statements of Revenues, Expenses and Changes in Net Position. Market values may have changed significantly since year end.

#### ***INVENTORY***

Inventory is stated at average carrying cost and consists of coal, limestone and fuel oil.

#### ***PREPAYMENTS AND OTHER ASSETS***

These balances represent payments in the current year that will benefit future periods and the net cash surrender value of key retired employees' life insurance.

#### ***PREPAID RENEWABLE ENERGY CREDITS AND OTHER COMMODITIES***

This represents the amount of renewable energy credits (RECs) and BTUs due from Symbiotic under a pre-purchase agreement and includes accrued interest.

#### ***PRELIMINARY SURVEY AND INVESTIGATION***

The balance represents initial project engineering costs related to utility plant construction. The balance was capitalized upon commencement of the project.

# MICHIGAN SOUTH CENTRAL POWER AGENCY

## NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended June 30, 2013 and 2012

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### NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND NATURE OF OPERATIONS (cont.)

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#### *DEFERRED COSTS AND RESOURCES*

The Agency has adopted the provisions for regulatory accounting as outlined in GASB Statement No. 62. This statement incorporates the provisions of FASB ASC 980, *Regulated Operation*, which provides for the deferral of costs and revenues which will be recovered through future rate adjustments.

#### *OPERATING REVENUES*

The Agency distinguishes *operating* revenues and expenses from *nonoperating* items. Operating revenues and expenses generally result from providing services and producing and delivering electric service in connection with the Agency's principal ongoing operations. The principal operating revenues of the Agency are charges to members for sales and services. Operating expenses for the Agency include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Agency billings are rendered and recorded monthly based on month end metered usage. No accrual for unbilled service is necessary. As all payments are received from Agency members for current service, no allowance for doubtful accounts is considered necessary.

#### *MEMBER EQUITY REFUND*

In fiscal year 2013, the Board approved the transfer of proceeds from the sale of Project II and III generators and related assets to the member's rate stabilization funds according to their applicable participant percentage.

#### *INTEREST INCOME CREDIT*

If approved by the Agency's rate-making body, the Agency may grant to its members a credit for interest income earned from the pool of temporary investments held by the Agency. There were no interest income credits granted to the Agency's members for the years ended June 30, 2013 and 2012.

#### *TAXES*

The Agency is exempt from State and Federal income taxes.

#### *COMPENSATED ABSENCES AND RELATED AMOUNTS*

Under terms of employment, non-union employees are granted twelve sick and personal days per year on January 1st. This time cannot be carried over from year to year. However, the balance remaining of personal leave, up to five days, is transferred into the health care savings plan at year end. Vacation time does accrue for all employees, and up to one week (Union) or one-half of the annual accrual (non-union) may be carried over at year end. Sick leave and vacation benefits earned but not yet taken have been recorded in the financial statements. Union employees are granted three personal days per year which cannot be carried over from year to year.

The current portion of the supplemental retirement obligation, detailed in Note 8, is included with compensation and related amounts on the balance sheet.

## MICHIGAN SOUTH CENTRAL POWER AGENCY

### NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended June 30, 2013 and 2012

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#### NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND NATURE OF OPERATIONS (cont.)

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##### **COMPARATIVE DATA**

Certain amounts presented in the prior year data may have been reclassified in order to be consistent with the current year's presentation.

##### **EFFECT OF NEW ACCOUNTING STANDARDS ON CURRENT PERIOD FINANCIAL STATEMENTS**

GASB has approved GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*; Statement No. 66, *Technical Corrections - 2012 an amendment of GASB Statements No. 10 and No. 62*; Statement No. 67, *Financial Reporting for Pension Plans - an amendment of GASB Statement No. 25*; Statement No. 68, *Accounting and Financial reporting for Pensions - an amendment of GASB Statement No. 2*; Statement No. 69, *Government Combinations and Disposals of Government Operations*; and Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. Application of these standards may restate portions of these financial statements.

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#### NOTE 2 – CASH AND INVESTMENTS

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The Agency may make investments in U.S. Government and Federal Agency obligations, investment grade bonds, commercial paper rated at the highest classification established by at least two standard rating services, money market mutual funds, repurchase agreements, and pooled investment funds. The Agency's investment policy follows Michigan Public Act 20.

Investments are stated at fair value, which is the amount at which an investment could be exchanged in a current transaction between willing parties. Fair values are based on quoted market prices. No investments are reported at amortized cost. Adjustments necessary to record investments at fair value are recorded in the operating statement as increases or decreases in investment income. Market values may have changed significantly after year end.

As of June 30, 2013, deposits in each local and area bank are insured by the FDIC in the amount of \$250,000 for both interest bearing and noninterest bearing accounts. As of June 30, 2012, the FDIC coverage was \$250,000 for interest bearing accounts and unlimited for non-interest bearing accounts. The difference between the bank balance and carrying amount is due to outstanding checks, deposits in transit and/or market value adjustments

##### **CUSTODIAL CREDIT RISK**

##### ***Deposits***

Custodial credit risk is the risk that in the event of a financial institution failure, the Agency's deposits may not be returned to the Agency.

As of June 30, 2013 and 2012, none of the Agency's total bank balances of \$1,656,373 and \$43,982, respectively, were exposed to custodial credit risk.

To minimize risk, the Agency's investment policy states, the Agency may only utilize depositories that have been authorized in the Banking and Depository Resolution.

# MICHIGAN SOUTH CENTRAL POWER AGENCY

## NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended June 30, 2013 and 2012

### NOTE 2 – CASH AND INVESTMENTS (cont.)

#### *CUSTODIAL CREDIT RISK (cont.)*

##### *Investments*

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Agency will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party.

As of June 30, 2013 and 2012, no investments were exposed to custodial credit risk.

The Agency's investment policy limits investing to security types that have been authorized by the Board and in compliance with the Michigan Public Act 20 as amended.

#### *CREDIT RISK*

Credit risk is the risk an issuer or other counterparty to an investment will not fulfill its obligations.

As of June 30, 2013, the Agency's investments were rated as follows:

Investment Type	Standard & Poor's	Moody's
US Agency securities	AAA & AA+	Aaa
Municipal bonds	AA & AA-	Aa3 & VMIG2
Seven day municipal bond floaters	A2	P2

As of June 30, 2012, the Agency's investments were rated as follows:

Investment Type	Standard & Poor's	Moody's
US Agency securities	AAA	AA+
Municipal bonds	AA & AA-	Aa3
Seven day municipal bond floaters	A2	P2

The Agency also held Governmental mutual funds at Fifth Third Bank that were not rated at June 30, 2013 and 2012.

The Agency's investment policy limits investing to security types that have been authorized by the Board and in compliance with the Michigan Public Act 20 as amended.

# MICHIGAN SOUTH CENTRAL POWER AGENCY

## NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended June 30, 2013 and 2012

### NOTE 2 – CASH AND INVESTMENTS

#### CONCENTRATION OF CREDIT RISK

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. At June 30, 2013 and 2012, the investment portfolio was concentrated as follows:

Investment Type	Issuer	Percentage of Investment Portfolio	
		2013	2012
US Government Agency Securities	Federal National Mortgage Association*	70%	74%
	Federal Home Loan Mortgage Corp*	14%	13%
Municipal Bonds	Saint Clair Cty, MI	5%	5%

\* Includes securities which collateralize the repurchase agreement.

This Agency's investment policy specifies that no single issuer shall comprise greater than 25% of the overall portfolio, excluding securities collateralizing the repurchase agreement, when measured at the last investment purchase date. Securities which are explicitly backed by the full faith and credit of the United States Government shall not be aggregated when measuring portfolio concentration.

#### INTEREST RATE RISK

Interest rate risk is the risk changes in interest rates will adversely affect the fair value of an investment.

As of June 30, 2013, the Agency's investments were as follows:

Investment Type	Fair Value	Maturity	
		Less than 1 Year	1 – 5 Years
US Government Agency Securities	\$ 5,251,870	\$ 3,055,000	\$ 2,196,870
Governmental Mutual Funds	458,241	458,241	-
Municipal Bonds	1,846,180	788,230	1,057,950
Repurchase Agreement – FNMA & FHLMC	10,541,112	10,541,112	-
Totals	\$ 18,097,403	\$ 14,842,583	\$ 3,254,820



# MICHIGAN SOUTH CENTRAL POWER AGENCY

## NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended June 30, 2013 and 2012

### NOTE 2 – CASH AND INVESTMENTS (cont.)

#### INTEREST RATE RISK (cont.)

As of June 30, 2012, the Agency's investments were as follows:

Investment Type	Fair Value	Maturity	
		Less than 1 Year	1 – 5 Years
US Government Agency Securities	\$ 5,362,750	\$ 2,542,100	\$ 2,820,650
Governmental Mutual Funds	25,163	25,163	-
Municipal Bonds	1,825,657	240,617	1,585,040
Repurchase Agreement – FNMA & FHLMC	12,562,517	12,562,517	-
Totals	<u>\$ 19,776,087</u>	<u>\$ 15,370,397</u>	<u>\$ 4,405,690</u>

This Agency's investment policy specifies operating funds shall be maintained in liquid investments such as money market funds, municipal investment pools, and savings accounts. Investments greater than five years are not allowed, however, upon the recommendation and approval of funds held for capital purposes, not expected to be paid within five years, may be invested in securities which mature in ten years or less.

### NOTE 3 – CHANGES IN CAPITAL ASSETS

A summary of changes in capital assets for 2013 and 2012 follows:

	2013			
	Balance 7/1/12	Additions/ Reclassifications	Deletions/ Reclassifications	Balance 6/30/13
Capital assets, not being depreciated				
Land	\$ 1,403,519	\$ -	\$ -	\$ 1,403,519
Construction work in progress	2,354,668	1,870,104	(1,830,824)	2,393,948
Total Capital Assets, Not Being Depreciated	<u>3,758,187</u>	<u>1,870,104</u>	<u>(1,830,824)</u>	<u>3,797,467</u>
Capital assets being depreciated				
Project I (composite) – Generation Station	81,790,728	1,698,346	(619,282)	82,869,792
General Plant	5,605,927	132,478	(273,914)	5,464,491
Total Capital Assets Being Depreciated	<u>87,396,655</u>	<u>1,830,824</u>	<u>(893,196)</u>	<u>88,334,283</u>
Total Capital Assets	<u>91,154,842</u>	<u>3,700,928</u>	<u>(2,724,020)</u>	<u>92,131,750</u>
Less: Accumulated depreciation				
Project I (composite) – Generation Station	66,195,132	2,611,468	(403,502)	68,403,098
General Plant	4,428,799	212,150	(273,199)	4,367,750
Total Accumulated Depreciation	<u>70,623,931</u>	<u>2,823,618</u>	<u>(676,701)</u>	<u>72,770,848</u>
Net Capital Assets	<u>\$ 20,530,911</u>			<u>\$ 19,360,902</u>

# MICHIGAN SOUTH CENTRAL POWER AGENCY

## NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended June 30, 2013 and 2012

### NOTE 3 – CHANGES IN CAPITAL ASSETS (cont.)

	2012			
	Balance 7/1/11	Additions/ Reclassifications	Deletions/ Reclassifications	Balance 6/30/12
Capital assets, not being depreciated				
Land	\$ 1,403,519	\$ -	\$ -	\$ 1,403,519
Construction work in progress	149,630	3,752,728	(1,547,690)	2,354,668
Total Capital Assets, Not Being Depreciated	1,553,149	3,752,728	(1,547,690)	3,758,187
Capital assets being depreciated				
Project I (composite) – Generation Station	81,008,103	1,093,133	(310,508)	81,790,728
Project II (composite) – Diesel Fired Peaking Unit	5,920,980	-	(5,920,980)	-
Project III	2,033,843	-	(2,033,843)	-
General Plant	5,275,477	454,557	(124,107)	5,605,927
Total Capital Assets Being Depreciated	94,238,403	1,547,690	(8,389,438)	87,396,655
Total Capital Assets	95,791,552	5,300,418	(9,937,128)	91,154,842
Less: Accumulated depreciation				
Project I (composite) – Generation Station	63,534,499	2,847,045	(186,412)	66,195,132
Project II (composite) – Diesel Fired Peaking Unit	1,858,503	164,471	(2,022,974)	-
Project III	492,352	57,908	(550,260)	-
General Plant	4,356,838	194,258	(122,297)	4,428,799
Total Accumulated Depreciation	70,242,192	3,263,682	(2,881,943)	70,623,931
Net Capital Assets	\$ 25,549,360			\$ 20,530,911

### NOTE 4 – NET DEFERRED COSTS RECOVERABLE IN FUTURE YEARS

Deferred costs recoverable in future years consist of costs incurred by the Agency which were not billed to the member municipalities during the period in which they were incurred.

Certain costs incurred during fiscal 2013 and 2012 were deferred until the appropriate allocation between members can be determined.

GAAP allows these items to be removed from the statements of revenues, expenses and changes in net position, and recorded as an asset or liability in the year in which they were incurred. These items are then recognized in future years when the items are included as allowable costs for rate-making purposes.

The components of the deferred costs recoverable in future years as of June 30, 2013 and 2012 are as follows:

	2013	2012
Deferred costs recoverable in future years		
Cost to be billed once allocation is determined	\$ 1,106,690	\$ 926,278

## MICHIGAN SOUTH CENTRAL POWER AGENCY

### NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended June 30, 2013 and 2012

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#### NOTE 4 – NET DEFERRED COSTS RECOVERABLE IN FUTURE YEARS (cont.)

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The change in the components of deferred costs recoverable in future years for the years ended June 30, 2013 and 2012, are as follows:

	2013	2012
ITC Utilization Estimate	\$ (51,755)	\$ 8,354
ITC KVAR Estimate	232,167	16,318
Net Increase (Decrease) in Deferred Costs	180,412	24,672
Balance at Beginning of Year	926,278	901,606
Balance at End of Year	<u>\$ 1,106,690</u>	<u>\$ 926,278</u>

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#### NOTE 5 – DEFERRED RESOURCES FOR FUTURE MAINTENANCE

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Management and the Board have identified a substantial turbine maintenance project which is scheduled in fiscal 2014. The Board approved the accumulation of funds in advance for this project.

GAAP allows these resources to be deferred, recorded on the balance sheet when collected and recognized as revenues in a future period when the maintenance costs are incurred.

The change in deferred resources for future maintenance for the years ended June 30, 2013 and 2012 is as follows:

	2013	2012
Balance at Beginning of Year	\$ 800,000	\$ -
Resources accumulated	1,500,000	800,000
Resources recognized	-	-
Balance at End of Year	<u>\$ 2,300,000</u>	<u>\$ 800,000</u>

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#### NOTE 6 – DEFERRED RATE STABILIZATION

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Management of the Agency has implemented a rate stabilization plan to provide its members with rate relief in future periods, through the withdrawal of members' accumulated resources.

During fiscal 2012, the Agency disposed of its Project II and Project III capital assets. During fiscal year 2013, the proceeds of the sale were deposited into the member rate stabilization fund according to the member's participation percentage.

## MICHIGAN SOUTH CENTRAL POWER AGENCY

### NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended June 30, 2013 and 2012

#### NOTE 6 – DEFERRED RATE STABILIZATION (cont.)

The Agency anticipates the member contributions will be distributed to its members in an indeterminable period in the future out of currently available unrestricted funds. Accordingly, the Agency has established a liability as follows:

<u>Fiscal Year</u>	<u>Balance 7/1</u>	<u>Contributions</u>	<u>Interest Accrued</u>	<u>Distributions</u>	<u>Balance 6/30</u>
2012	\$ 2,933,679	\$ 92,192	\$ 14,671	\$ 55,004	\$ 2,985,538
2013	2,985,538	5,170,630	27,281	28,397	8,155,052

#### NOTE 7 – NET POSITION

GASB No. 34 requires the classification of net position into three components - net investment in capital assets; restricted; and unrestricted. These classifications are defined as follows:

Net investment in capital assets – This component of net position consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds are not included in the calculation of net investment in capital assets. Rather, that portion of the debt is included in the same net position component as the unspent proceeds.

Restricted – This component of net position consists of constraints placed on net asset use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

Unrestricted net position – This component of net position consists of net position that do not meet the definition of “restricted” or “net investment in capital assets.”

When both restricted and unrestricted resources are available for use, it is the Agency’s policy to use restricted resources first, then unrestricted resources as they are needed.

The following calculation supports the net investment in capital assets:

	<u>2013</u>	<u>2012</u>
Capital Assets		
Utility plant in service and work in progress	\$ 92,131,750	\$ 91,154,842
Allowance for depreciation	<u>(72,770,848)</u>	<u>(70,623,931)</u>
Net Investment in Capital Assets	<u>\$ 19,360,902</u>	<u>\$ 20,530,911</u>

## MICHIGAN SOUTH CENTRAL POWER AGENCY

### NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended June 30, 2013 and 2012

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#### NOTE 8 – EMPLOYEE RETIREMENT PLAN

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##### *MUNICIPAL EMPLOYEES RETIREMENT SYSTEM OF MICHIGAN (MERS)*

The Agency contributes to the Municipal Employees Retirement System of Michigan (MERS), an agent defined benefit multiple-employer public employee retirement system that acts as a common investment and administrative agent for municipalities. The Agency's defined benefit pension plan provides retirement and disability benefits to covered employees and beneficiaries. The present benefit provisions of MERS are governed by Act No. 220 of the Public Acts of 1996, as amended and the MERS Plan Document as revised. The MERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Municipal Employees Retirement System of Michigan, 1134 Municipal Way, Lansing, Michigan 48917.

The Agency funds the entire cost of each employee's participation in MERS. Contribution requirements of employees and the Agency are established and may be amended by the MERS Board of Trustees.

For fiscal 2013, 2012, and 2011, the Agency's annual pension cost of \$705,047, \$698,120, and \$715,016, respectively, for the MERS was equal to the Agency's required and actual contributions.

The 2013 required contribution was determined as part of the December 31, 2012 actuarial valuation using the entry age normal cost method. This method seeks to provide a level pattern of cost as a percentage of salary throughout an employee's working lifetime. The actuarial assumptions included: (a) 8.0% investment rate of return in 2012, 2011, and 2010; (b) projected salary increases of 4.5% in 2012, 2011, and 2010; and (c) additional projected salary increases ranging from 0% to 13.0% in 2012 and 2011 and 0% to 8.4% in 2010, depending on age, attributable to seniority and merit. A level percentage of payroll amortization is used, with an amortization period not to exceed 30 years.

Valuation Date	Actuarial Asset Values	Actuarial Accrued Liability (AAL)	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
December 31, 2010	\$ 8,776,797	\$ 10,225,478	\$ 1,448,681	85.8%	\$ 2,996,714	48.3%
December 31, 2011	9,743,852	11,160,959	1,417,107	87.3	3,147,625	45.0
December 31, 2012	10,688,839	11,965,588	1,276,749	89.3	3,243,268	39.4

## MICHIGAN SOUTH CENTRAL POWER AGENCY

### NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended June 30, 2013 and 2012

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#### NOTE 8 – EMPLOYEE RETIREMENT PLAN (cont.)

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##### *SUPPLEMENTAL RETIREMENT PLAN*

The Agency has entered into a supplemental retirement plan with a key employee to provide defined cash benefits for fifteen years after retirement, or specified benefits to a designated beneficiary in the event of death. This plan was approved by the Board of Commissioners, who has the authority to negotiate any changes in benefits. This plan is funded on a pay as you go basis by the Agency and is ultimately financed by a key employee life insurance policy payable to the Agency. The key employee retired on June 30, 2006 and began collecting benefits on July 1, 2006.

<u>Fiscal Year End</u>	<u>Annual Pension Cost</u>	<u>Annual Payments</u>	<u>Net Pension Obligation</u>	<u>Payments as a Percentage of Annual Pension Cost</u>
June 30, 2011	\$ 17,688	\$ 29,039	\$ 261,370	164.2%
June 30, 2012	14,601	29,039	246,931	198.9%
June 30, 2013	9,076	29,039	226,968	320.0%

The net pension obligation is calculated at year end based on the present value of future cash flows. The assumptions include the known fixed future payments and five year average investment return of 0.52% and 1.15% for the years ended June 30, 2013 and 2012, respectively. There are no separately issued statements or reports on this plan.

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#### NOTE 9 – LONG-TERM SUPPLY AGREEMENTS

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The Agency and its Members have entered into multiple development agreements with AMP to secure long-term power supply for the future. There are currently four projects under various stages of development, including one new base load coal generation facility, two hydro generation projects, and a gas generation project. Unit 1 of the Prairie State coal facility became operational in June 2012, unit 2 became operational near the end of 2012. The hydro generation projects, which currently involve the development of five hydro generation facilities on existing lock and dam facilities located on the Ohio River, are expected to be in full operation by the end of 2015 (individual units in 2014 and 2015). The Agency and its Members have entered into long-term capacity and power purchase agreements with AMP for a total of 12 MW of the base load coal project and 18.7 MW of the hydro projects. The AMP Fremont Energy Center (AFEC) gas generation became operational in January 2012 with a capacity of 42.96 MW. The Agency has also secured an additional 27.98 MW of the gas generation project through May 2015.

Because some of these projects will not be in commercial operation until 2015, the Agency has entered into multiple bridge contracts to secure power supply for the interim. Currently, the Agency has secured fixed-priced contracts for 15 MW that started in January, 2009 and ended in December, 2012, 20 MW full service and 10 MW on-peak for 2013, and 15 MW full service and 5 MW on-peak for 2014.

The Agency has also entered into purchase power agreements with N.E.W. Hydro, LLC to secure long-term hydro power supply for a twenty year term beginning in fiscal 2014. The agreements are for 5.75 MW from two hydro units located on the Menominee River and another 3.64 MW from two hydro units located in Oconto Falls on the Oconto River in Wisconsin.

# **MICHIGAN SOUTH CENTRAL POWER AGENCY**

## **NOTES TO FINANCIAL STATEMENTS**

As of and for the Years Ended June 30, 2013 and 2012

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### **NOTE 10 – MARKET PARTICIPATION**

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The Agency is a participant in the Midwest Independent System Operator (MISO) energy market. MISO invoices the Agency for net generation sales or power purchases. These invoices are subject to future true-ups based on improved data. True-ups typically occur at various periods after the actual date of service. At year end the Agency is unable to estimate the amount of future adjustments relating to periods prior to year end. The Agency has a \$2,500,000 line of credit with MISO. At June 30, 2013 there was no balance drawn.

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### **NOTE 11 – LEASE AGREEMENT**

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The Agency has leased a portion of the land at Project I to Symbiotic Energy of Litchfield. The property leased is estimated at a book value of \$1,941.

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### **NOTE 12 – RISK MANAGEMENT**

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The Agency is exposed to various risks of loss related to torts, theft of, damage to, or destruction of assets, errors and omissions, workers compensation, and health care of its employees. These risks are covered through the purchase of commercial insurance with minimal deductibles. Settled claims have not exceeded the commercial liability in any of the past three years. There were no significant reductions in coverage compared to the prior year.

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### **NOTE 13 – COMMITMENTS AND CONTINGENCIES**

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The Agency has entered into contracts related to work to be commenced and completed subsequent to year end. Any service provided as of June 30, 2013 has been accrued in these financial statements.

From time to time, the agency is party to various pending claims and legal proceedings. Although the outcome of such matters cannot be forecasted with certainty, it is the opinion of management and the agency's legal counsel that the likelihood of a material adverse effect on the agency's financial position or results of operations is remote.

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### **NOTE 14 – SIGNIFICANT CUSTOMERS**

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The Agency has three members who are considered significant customers. These members accounted for 93% and 92% of operating revenues for years ended June 30, 2013 and 2012, respectively.

## MICHIGAN SOUTH CENTRAL POWER AGENCY

### NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended June 30, 2013 and 2012

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#### NOTE 15 – SUBSEQUENT EVENTS

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The Agency evaluated subsequent events through August 19, 2013, the date that the financial statements were available to be issued, for events requiring recording or disclosure in the financial statements.

During July 2013, the Board approved the purchase of the fractional tire facility (FTF) which was built on land adjacent to Project I. The FTF is a new technology which utilizes waste heat from the Project I coal burning facility to convert tires into gas which is used as fuel to generate electricity.

The Agency has also entered into purchase power agreements with N.E.W. Hydro, LLC to secure long-term hydro power supply for a twenty year term beginning in fiscal 2014. The agreements are for 5.75 MW from two hydro units located on the Menominee River, which commenced on July 1, 2013 and another 3.64 MW from two hydro units located in Oconto Falls on the Oconto River in Wisconsin, scheduled to commence on October 1, 2013.



**REQUIRED SUPPLEMENTARY INFORMATION**

# MICHIGAN SOUTH CENTRAL POWER AGENCY

## REQUIRED SUPPLEMENTAL INFORMATION As of June 30, 2013 and 2012

### *Schedule of Funding Progress*

<u>Valuation Date</u>	<u>Actuarial Asset Values</u>	<u>Actuarial Accrued Liability (AAL)</u>	<u>Unfunded AAL (UAAL)</u>	<u>Funded Ratio</u>	<u>Covered Payroll</u>	<u>UAAL as a Percentage of Covered Payroll</u>
December 31, 2010	\$ 8,776,797	\$ 10,225,478	\$ 1,448,681	85.8%	\$ 2,996,714	48.3%
December 31, 2011	9,743,852	11,160,959	1,417,107	87.3	3,147,625	45.0
December 31, 2012	10,688,839	11,965,588	1,276,749	89.3	3,243,268	39.4