

**MICHIGAN SOUTH CENTRAL
POWER AGENCY**

Litchfield, Michigan

FINANCIAL STATEMENTS

Including Independent Auditors' Report

As of and for the Years Ended June 30, 2014 and 2013

MICHIGAN SOUTH CENTRAL POWER AGENCY

TABLE OF CONTENTS As of and for the Years Ended June 30, 2014 and 2013

Independent Auditors' Report	1 – 2
Management's Discussion and Analysis	3 – 10
Financial Statements	
Balance Sheets	11 – 12
Statements of Revenues, Expenses and Changes in Net Position	13
Statements of Cash Flows	14 – 15
Notes to Financial Statements	16 – 34
Required Supplementary Information	
Schedule of Funding Progress	35

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, 2014 and 2013, 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, 2014 and 2013, 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 Note 1, the Agency adopted the provisions of GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, effective July 1, 2013. 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 Viechow Krause, LLP

Madison, Wisconsin
August 21, 2014

MANAGEMENT'S DISCUSSION AND ANALYSIS

MICHIGAN SOUTH CENTRAL POWER AGENCY

MANAGEMENT'S DISCUSSION AND ANALYSIS As of and for the Years Ended June 30, 2014 and 2013

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, 2014 and 2013. Please read this narrative in conjunction with the accompanying financial statements and the accompanying notes to financial statements.

OVERVIEW OF THE FINANCIAL STATEMENTS

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, deferred inflows of resources, 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.

The Agency has implemented GASB Statement No. 65 resulting in the reclassification of certain assets and liabilities to deferred outflows and inflows of resources in the financial statements for fiscal 2014 and fiscal 2013.

AGENCY FINANCIAL ANALYSIS

Fiscal 2014 was a busy year, operationally and financially. This year marked the ninth full year of Agency operations as a "Market Participant" in the Midcontinent 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 2014, the Agency received a net credit from MISO market charges of approximately \$199,000, while in 2013 the Agency received a net credit from MISO of approximately \$421,000. These amounts include rebates, refunds, etc., of previously expensed items and other direct credits through MISO.

Late in fiscal 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 \$56,000 in fiscal 2014 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.

See accompanying independent auditors' report.

MICHIGAN SOUTH CENTRAL POWER AGENCY

MANAGEMENT'S DISCUSSION AND ANALYSIS
As of and for the Years Ended June 30, 2014 and 2013

AGENCY FINANCIAL ANALYSIS (cont.)

On May 30, 2012, the Agency completed a sale of its Project II and Project III 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.

Beginning in fiscal 2014, the Agency entered into purchase power agreements with N.E.W. Hydro, LLC to secure long-term hydro power supply for a twenty year term. 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 September 1, 2013.

On July 25, 2013, the Agency completed a purchase of a Fractionized Tire-Derived Fuel (FTF) 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 performed a turbine major outage for which the Agency had been billing and deferring member resources in prior years that were released during fiscal 2014 when the major overhaul was completed.

On February 10, 2014, the Agency entered into Project IV, consisting of agreements to purchase and install three natural gas generators and facilities capable of producing 13 MW of power. This purchase and installation is estimated at \$16 million dollars to be completed in early 2015 and is being funded with a floating rate bond with an option to fix the rate at the end of construction.

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.

MICHIGAN SOUTH CENTRAL POWER AGENCY

MANAGEMENT'S DISCUSSION AND ANALYSIS
As of and for the Years Ended June 30, 2014 and 2013

AGENCY FINANCIAL ANALYSIS (cont.)

Table 1
Condensed Balance Sheets

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Current assets	\$ 21,101,943	\$ 23,104,356	\$ 21,736,193
Noncurrent assets	10,824,539	11,301,568	9,344,982
Utility plant	<u>33,737,131</u>	<u>19,360,902</u>	<u>20,530,911</u>
 Total Assets	 <u>\$ 65,663,613</u>	 <u>\$ 53,766,826</u>	 <u>\$ 51,612,086</u>
 Current liabilities	 \$ 5,446,878	 \$ 4,812,320	 \$ 8,100,585
Noncurrent liabilities	<u>12,645,575</u>	<u>197,929</u>	<u>1,017,892</u>
 Total Liabilities	 <u>18,092,453</u>	 <u>5,010,249</u>	 <u>9,118,477</u>
 Deferred Inflows of Resources	 <u>3,643,242</u>	 <u>10,455,052</u>	 <u>-</u>
 Net Position			
Net investment in capital assets	28,918,169	19,360,902	20,530,911
Restricted for debt service	651	-	-
Unrestricted	<u>15,009,098</u>	<u>18,940,623</u>	<u>21,962,698</u>
 Total Net Position	 <u>43,927,918</u>	 <u>38,301,525</u>	 <u>42,493,609</u>
 Total Liabilities, Deferred Inflows of Resources and Net Position	 <u>\$ 65,663,613</u>	 <u>\$ 53,766,826</u>	 <u>\$ 51,612,086</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, 2014 and 2013

AGENCY FINANCIAL ANALYSIS (cont.)

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

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Operating revenues	<u>\$ 70,037,047</u>	<u>\$ 54,805,738</u>	<u>\$ 45,776,324</u>
Depreciation expense	1,700,177	2,823,618	3,263,683
Other operating expenses	<u>62,689,767</u>	<u>51,073,235</u>	<u>42,084,055</u>
Total Operating Expenses	<u>64,389,944</u>	<u>53,896,853</u>	<u>45,347,738</u>
Operating income	<u>5,647,103</u>	<u>908,885</u>	<u>428,586</u>
Investment and miscellaneous income	61,303	206,385	190,244
Interest and amortization expense	(918)	-	-
Debt issuance costs	(81,515)	-	-
Other income and (expense)	420	(216,494)	(405,569)
Member equity refund	-	<u>(5,090,860)</u>	-
Total Nonoperating Expenses	<u>(20,710)</u>	<u>(5,100,969)</u>	<u>(215,325)</u>
Change in Net Position	5,626,393	(4,192,084)	213,261
NET POSITION – Beginning of Year	<u>38,301,525</u>	<u>42,493,609</u>	<u>42,280,348</u>
NET POSITION – END OF YEAR	<u>\$ 43,927,918</u>	<u>\$ 38,301,525</u>	<u>\$ 42,493,609</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, 2014 and 2013

AGENCY FINANCIAL ANALYSIS (cont.)

Table 3
Condensed Statements of Cash Flows

	2014	2013	2012
Received sales to members and others	\$ 62,546,078	\$ 54,511,853	\$ 44,546,693
Received from members for major maintenance	750,000	1,500,000	800,000
Paid to suppliers for goods and services	(56,216,062)	(49,385,951)	(36,999,123)
Paid to employees for services	(5,121,409)	(4,707,248)	(4,427,777)
Cash Flows From Operating Activities	1,958,607	1,918,654	3,919,793
Capital expenditures for utility plant	(9,433,719)	(2,070,979)	(2,002,246)
Net proceeds from sale and disposal of utility plant	-	-	5,101,595
Debt issuance costs	(81,515)	-	-
Proceeds from debt issue	4,940,000	-	-
Interest payments on long term debt	(20,622)	-	-
Cash Flows From Capital and Related Financing Activities	(4,595,856)	(2,070,979)	3,099,349
Cash Flows From Investing Activities	1,070,216	104,188	(1,843,571)
Net Change in Cash and Cash Equivalents	(1,567,033)	(48,137)	5,175,571
CASH AND CASH EQUIVALENTS			
- Beginning of Year	14,088,174	14,136,311	8,960,740
CASH AND CASH EQUIVALENTS - END OF YEAR	\$ 12,521,141	\$ 14,088,174	\$ 14,136,311

BALANCE SHEETS

“Current assets” decreased by \$2.0 million during fiscal 2014, with cash decreasing \$1.1 million, accounts receivable decreasing by \$.1 million and other current assets decreased by \$.8 million, primarily due to expensing prepayments of \$1.0 million that were previously collected for the turbine major performed in the fall of 2013, offset by inventory increasing \$.1 million and regulatory assets increasing \$.1 million. “Current assets” increased by \$1.4 million during fiscal 2013, with cash decreasing \$.3 million, accounts receivable increasing by \$.4 million, regulatory assets increased by 1.3 million resulting from a reclassification from non-current assets, prepayments and other current assets increased by \$.9 million for items to be used during the upcoming turbine major in the fall of 2013, offset by inventory decreasing \$.9 million.

See accompanying independent auditors' report.

MICHIGAN SOUTH CENTRAL POWER AGENCY

MANAGEMENT'S DISCUSSION AND ANALYSIS
As of and for the Years Ended June 30, 2014 and 2013

BALANCE SHEETS (cont.)

"Noncurrent assets" decreased by \$.5 million in total during fiscal 2014. Long-term investments decreased \$1.6 million, restricted investments increased by \$.1 million. Prepaid renewable energy credits and prepaid BTU's to be derived from an alternative fuel source decreased by \$5.2 million and other prepayments and non-current assets decreased by \$1.3 million as these costs were capitalized as part of the fiscal 2014 purchase of the fractionized tire derived fuel facility. Regulatory assets increased by \$7.5 million representing a deferred earnout agreement in connection with the fractionized tire derived fuel facility purchase. "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.

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 2014's utility plant number is primarily due by \$16.1 million of projects capitalized (including work in progress) during the year, offset by \$1.7 million of depreciation recorded for the year. The primary capitalized items were the purchase of the fractionized tire-derived fuel facility located adjacent to Project I with an additional capitalized cost of \$12.0 million and the Project IV three natural gas generators (construction in progress) of \$5.0 million. 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.

Total liabilities increased by \$13.1 million during fiscal 2014. Accounts payable increased by \$.6 million, compensation and related accruals increased by \$.1 million, Bonds payable increased by \$4.9 million consisting of draws on a construction bond for the Project IV three natural gas generators and other non-current accrued liabilities increased consisting of deferred FTF earnout increased by \$7.5 million reflecting the future earnout agreement associated with the fractionized tire derived fuel purchase. Total liabilities decreased by \$4.1 million during fiscal 2013. Accounts payable decreased by \$.3 million, Member rate stabilization funds decreased by \$3.0 million as these funds were reclassified to Deferred Inflows of Resources during 2013 and deferred resources for future maintenance decreased by \$.8 million as these revenues were reclassified to Deferred Inflows of Resources for fiscal 2013.

Deferred Inflows of Resources decreased by \$6.8 million during fiscal 2014 as member rate stabilization funds decreased by \$4.5 million due to utilizing these funds for both the turbine major \$3.0 million and \$1.5 million used for member rate stabilization. Deferred resources for future maintenance decreased by \$2.3 million as this deferred revenue was recognized in fiscal 2014 along with the turbine major expenses. Deferred Inflows of Resources increased by \$10.5 million during fiscal 2013. Member Rate stabilization increased by \$8.2 million as \$3.0 million of funds were reclassified from current liabilities and \$5.2 million from transferring monies from the fiscal 2012 Project II and Project III generator sale via a member equity refund. The remaining variance was \$2.3 million of deferred resources for future maintenance reclassified from current liabilities.

MICHIGAN SOUTH CENTRAL POWER AGENCY

MANAGEMENT'S DISCUSSION AND ANALYSIS
As of and for the Years Ended June 30, 2014 and 2013

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

Fiscal 2014 operating revenues increased by 27.8 percent and expenses increased by 19.5 percent versus fiscal 2013. Fiscal 2014 operating revenues and expenses were significantly higher than fiscal 2013 primarily due to completing the turbine major in the fall of 2013, higher purchased power costs as new projects came on line, along with additional purchased power contracts. 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.

Operating income increased in fiscal 2014 due to two items. Capital reserve funding was offset by lower depreciation and member rate stabilization funds were used to offset the cost of the turbine major maintenance. Operating income was slightly higher in fiscal 2013 than 2012 due to increased sales.

"Investment and miscellaneous income" dropped significantly in Fiscal 2014 as investment income was no longer earned on the prepaid REC's and BTU's with the purchase of the FTF. "Investment and miscellaneous income" was relatively unchanged for fiscal 2013 and fiscal 2012.

"Other income and expense" was negligible for fiscal 2014, but included debt issuance costs of \$.1 million in connection with the construction bond for the Project IV generators. 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 II and Project III diesel generator sale.

"Member equity refund" of \$5.1 million for fiscal 2013 was a refund of prior years equity related to the Project II and Project III generator sale that was distributed to the members rate stabilization funds.

STATEMENTS OF CASH FLOWS

"Cash and cash equivalents" are defined as investments with original maturity of 90 days or less, plus immediately accessible bank accounts. For fiscal 2014, the "Cash and cash equivalents" amount decreased \$1.6 million. The large items were a construction bond for Project IV of \$4.9 million, offset by capital expenditures for that project and the fractionized tire facility purchase completed during the year. 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 II and Project III diesel generators for net proceeds of \$5.1 million.

DEBT SERVICE COVERAGE

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. The Agency met or exceeded all bond covenants for the years ended June 30, 2014. Further details can be found in the Footnotes to the Financial Statements, under "Aggregate Bond Service Coverage."

See accompanying independent auditors' report.

MICHIGAN SOUTH CENTRAL POWER AGENCY

MANAGEMENT'S DISCUSSION AND ANALYSIS
As of and for the Years Ended June 30, 2014 and 2013

FUTURE ECONOMIC EVENTS

The Agency has entered into purchase power agreements with AMP for two hydro generation projects with a total generation capacity of 18.7 MW. These projects currently consist of five hydro generation locations on existing lock and dam facilities located on the Ohio River and are expected to be in full operation by the end of calendar 2015. Four of these units are under construction and one existing unit becomes part of the project when the Meldahl facility becomes operational.

CONTACTING AGENCY MANAGEMENT

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, 2014 and 2013

ASSETS	<u>2014</u>	<u>2013</u>
CURRENT ASSETS		
Unrestricted cash and cash equivalents	\$ 13,750,213	\$ 14,875,951
Restricted cash and investments	6,377	-
Accounts receivable	4,648,338	4,719,179
Interest receivable	11,527	21,703
Inventory	1,064,503	992,488
Prepayments and other current assets	284,531	1,227,850
Regulatory assets - current portion	<u>1,336,454</u>	<u>1,267,185</u>
Total Current Assets	<u>21,101,943</u>	<u>23,104,356</u>
NONCURRENT ASSETS		
Unrestricted investments	3,168,549	4,735,996
Restricted investments	121,038	-
Prepayments and other non-current assets	-	1,342,272
Prepaid renewable energy credits and other commodities	-	5,223,300
Regulatory assets	<u>7,534,952</u>	<u>-</u>
Total Noncurrent Assets	<u>10,824,539</u>	<u>11,301,568</u>
CAPITAL ASSETS		
Utility plant (including construction work in progress)	108,196,881	92,131,750
Accumulated depreciation	<u>(74,459,750)</u>	<u>(72,770,848)</u>
Total Net Capital Assets	<u>33,737,131</u>	<u>19,360,902</u>
TOTAL ASSETS	<u>\$ 65,663,613</u>	<u>\$ 53,766,826</u>

**LIABILITIES, DEFERRED INFLOWS OF RESOURCES
AND NET POSITION**

	2014	2013
CURRENT LIABILITIES		
Accounts payable	\$ 5,057,563	\$ 4,494,135
Compensation and related amounts	383,589	318,185
Current Liabilities Payable from Restricted Assets		
Accrued interest payable	5,726	-
Total Current Liabilities	5,446,878	4,812,320
NONCURRENT LIABILITIES		
Long-term debt	4,940,000	-
Supplemental retirement obligation	170,623	197,929
Other accrued liabilities	7,534,952	-
Total Noncurrent Liabilities	12,645,575	197,929
Total Liabilities	18,092,453	5,010,249
DEFERRED INFLOWS OF RESOURCES		
Deferred resources for future maintenance	-	2,300,000
Deferred rate stabilization	3,643,242	8,155,052
Total Deferred Inflows of Resources	3,643,242	10,455,052
NET POSITION		
Net investment in capital assets	28,918,169	19,360,902
Restricted for debt service	651	-
Unrestricted	15,009,098	18,940,623
Total Net Position	43,927,918	38,301,525
TOTAL LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND NET POSITION	\$ 65,663,613	\$ 53,766,826

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

MICHIGAN SOUTH CENTRAL POWER AGENCY

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION For the Years Ended June 30, 2014 and 2013

	2014	2013
OPERATING REVENUES		
Sales to members	\$ 58,180,108	\$ 47,853,161
Sales to others	11,676,554	6,952,577
Other income	180,385	-
Total Operating Revenues	70,037,047	54,805,738
OPERATING EXPENSES		
Operations	51,696,121	46,555,589
Maintenance	8,907,011	2,432,953
Administration and general	2,086,635	2,084,693
Depreciation	1,700,177	2,823,618
Total Operating Expenses	64,389,944	53,896,853
Operating Income	5,647,103	908,885
NONOPERATING REVENUES (EXPENSES)		
Investment and miscellaneous income	72,368	290,193
Net decrease in the fair value of investments	(11,065)	(83,808)
Interest expense on long-term debt	(918)	-
Debt issuance costs	(81,515)	-
Gain (loss) on disposal of assets	420	(216,494)
Member equity refund	-	(5,090,860)
Total Nonoperating Expenses	(20,710)	(5,100,969)
CHANGE IN NET POSITION	5,626,393	(4,192,084)
NET POSITION - Beginning of Year	38,301,525	42,493,609
NET POSITION - END OF YEAR	\$ 43,927,918	\$ 38,301,525

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, 2014 and 2013

	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Received from sales to members and others	\$ 62,546,078	\$ 54,511,853
Received from members for major maintenance	750,000	1,500,000
Paid to suppliers for goods and services	(56,216,062)	(49,385,951)
Paid to employees for services	(5,121,409)	(4,707,248)
Net Cash Flows from Operating Activities	1,958,607	1,918,654
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Capital expenditures for utility plant	(9,433,719)	(2,070,979)
Debt issuance costs	(81,515)	-
Proceeds from debt issue	4,940,000	-
Interest payments on long-term debt	(20,622)	-
Cash Flows From Capital and Related Financing Activities	(4,595,856)	(2,070,979)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	2,835,386	2,859,998
Purchases of investments	(1,836,649)	(2,970,365)
Interest received	71,479	214,555
Cash Flows from Investing Activities	1,070,216	104,188
Net Change in Cash and Cash Equivalents	(1,567,033)	(48,137)
CASH AND CASH EQUIVALENTS – Beginning of Year	14,088,174	14,136,311
CASH AND CASH EQUIVALENTS – END OF YEAR	\$ 12,521,141	\$ 14,088,174
NONCASH INVESTING ACTIVITY		
Unrealized gains (losses) on investments	\$ 49,333	\$ (81,644)
NONCASH CAPITAL AND RELATED FINANCING ACTIVITIES		
Gain (loss) on disposal of assets	\$ -	\$ (216,494)
Member equity refund to rate stabilization	\$ -	\$ 5,090,860
Interest charged to construction	\$ 25,430	\$ -
Transfer prepaid renewable energy credits and other commodities to utility plant	\$ 5,223,300	\$ -
Transfer other assets to utility plant	\$ 1,342,272	\$ -

	<u>2014</u>	<u>2013</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH		
FLows FROM OPERATING ACTIVITIES		
Operating income	\$ 5,647,103	\$ 908,885
Noncash items included in operating income		
Depreciation	1,700,177	2,823,618
Changes in assets and liabilities		
Accounts receivable	70,841	(372,539)
Inventory	(72,015)	874,719
Prepayments and other non-current assets	-	(1,033,709)
Prepayments and other current assets	943,319	(526,593)
Prepaid renewable energy credits and commodities	-	(2,086,768)
Regulatory assets	(7,604,221)	(180,412)
Accounts payable	483,225	(28,615)
Compensation and related amounts	38,098	(38,586)
Other accrued liabilities	7,563,890	78,654
Deferred inflows of resources	<u>(6,811,810)</u>	<u>1,500,000</u>
NET CASH FLOWS FROM OPERATING ACTIVITIES	<u>\$ 1,958,607</u>	<u>\$ 1,918,654</u>
RECONCILIATION OF CASH AND CASH EQUIVALENTS TO		
THE BALANCE SHEET		
Unrestricted cash and cash equivalents	\$ 13,750,213	\$ 14,875,951
Restricted cash and investments	6,377	-
Restricted investments	121,038	-
Unrestricted investments	<u>3,168,549</u>	<u>4,735,996</u>
Total Cash and Investments	17,046,177	19,611,947
Less: Long-Term Investments	<u>(4,525,036)</u>	<u>(5,523,773)</u>
TOTAL CASH AND CASH EQUIVALENTS	<u>\$ 12,521,141</u>	<u>\$ 14,088,174</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, 2014 and 2013

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

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. During fiscal year 2014, the Agency purchased the fractional tire facility (FTF) which was built on land adjacent to Project 1. The FTF is a new heat technology which utilizes waste heat from the Project 1 coal burning facility to convert tires into gas which is used as fuel to generate electricity. Project IV consists of three natural gas fired peaking units capable of producing 13 megawatts of power. Coldwater is the only participant in Project IV.

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, 2014 and 2013

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

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 March 2012, GASB issued Statement No. 65 – *Items Previously Reported as Assets and Liabilities*. This statement 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 implemented this standard effective July 1, 2013.

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.

ASSETS, LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND NET POSITION

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.

MICHIGAN SOUTH CENTRAL POWER AGENCY

NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended June 30, 2014 and 2013

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

ASSETS, LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND NET POSITION (cont.)

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.

Restricted Assets

Mandatory segregations of assets are presented as restricted assets. Such segregations are required by bond agreements and other external parties. Current liabilities payable from these restricted assets are so classified.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are stated at the amount billed to members and non-members. Allowance for doubtful accounts is not considered necessary as MSCPA has not historically experienced delays in payments for service rendered.

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, the net cash surrender value of key retired employees' life insurance, and renewable energy credits.

Prepaid Renewable Energy Credits and Other Commodities

This represented the amount of renewable energy credits (RECs) and BTUs due from Symbiotic under a pre-purchase agreement and included accrued interest. The assets were converted as part of the FTF purchase in fiscal year 2014.

Regulatory Assets and Deferred Inflows of 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 recognized through future rate adjustments.

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. Total interest charged to construction for the year ended June 30, 2014 was \$25,430.

MICHIGAN SOUTH CENTRAL POWER AGENCY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2014 and 2013

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

ASSETS, LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND NET POSITION (cont.)

Capital Assets – Utility Plant (cont.)

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.

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
FTF structures	20
FTF equipment	10
Substation plant (composite)	30
Transmission facilities (composite)	55
Administrative and maintenance building	10 – 50
Transportation equipment	3 – 5
Furniture and fixtures	5 – 10

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 11, is included with compensation and related amounts on the balance sheet.

Long-term Obligations

Long-term debt and other obligations are reported as liabilities.

Accrued Liabilities

An expense or obligation that the Agency has incurred but not yet paid, including future payments required from the earn-out agreement with Symbiotic Energy (Symbiotic).

Deferred Inflows of Resources

A deferred inflow of resources represents an acquisition of net position that applies to a future period and therefore will not be recognized as an inflow of resources (revenue) until that future time.

MICHIGAN SOUTH CENTRAL POWER AGENCY

NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended June 30, 2014 and 2013

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

REVENUES AND EXPENSES

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.

TAXES

The Agency is exempt from State and Federal income taxes.

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

The Governmental Accounting Standards Board (GASB) has approved GASB 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. 27*; 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.

MICHIGAN SOUTH CENTRAL POWER AGENCY

NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended June 30, 2014 and 2013

NOTE 2 – CASH AND INVESTMENTS

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, 2014, deposits in each local and area bank are insured by the FDIC in the amount of \$250,000 for time and savings accounts (including NOW accounts) and \$250,000 for demand deposit accounts (interest and noninterest 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, 2014 and 2013, none of the Agency's total bank balances of \$1,885,693 and \$1,656,373, 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.

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, 2014 and 2013, 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.

MICHIGAN SOUTH CENTRAL POWER AGENCY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2014 and 2013

NOTE 2 – CASH AND INVESTMENTS (cont.)

CREDIT RISK

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

As of June 30, 2014, the Agency's investments were rated as follows:

Investment Type	Standard & Poor's	Moody's
US Agency securities	AA+	Aaa
Municipal bonds	AA-	Aa3

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	P-2

The Agency also held Governmental mutual funds at Fifth Third Bank that were not rated at June 30, 2014 and 2013.

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.

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, 2014 and 2013, the investment portfolio was concentrated as follows:

Investment Type	Issuer	Percentage of Investment Portfolio	
		2014	2013
US Government Agency Securities	Federal Home Loan Bank	7%	n/a
Municipal Bonds	Saint Clair Cty, MI	n/a	5%

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.

MICHIGAN SOUTH CENTRAL POWER AGENCY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2014 and 2013

NOTE 2 – CASH AND INVESTMENTS

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, 2014, the Agency's investments were as follows:

Investment Type	Fair Value	Maturity	
		Less than 1 Year	1 – 5 Years
US Government Agency Securities	\$ 2,596,629	\$ 300,270	\$ 2,296,359
Governmental Mutual Funds	227,056	227,056	-
Municipal Bonds	205,878	205,878	-
Repurchase Agreement – FNMA & FHLMC	12,238,766	12,238,766	-
Totals	<u>\$ 15,268,329</u>	<u>\$ 12,971,970</u>	<u>\$ 2,296,359</u>

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	\$ 1,996,870	\$ -	\$ 1,996,870
Governmental Mutual Funds	458,241	458,241	-
Municipal Bonds	1,846,180	788,230	1,057,950
Seven Day Municipal Bond Floaters	3,255,000	3,055,000	200,000
Repurchase Agreement – FNMA & FHLMC	10,541,112	10,541,112	-
Totals	<u>\$ 18,097,403</u>	<u>\$ 14,842,583</u>	<u>\$ 3,254,820</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.

MICHIGAN SOUTH CENTRAL POWER AGENCY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2014 and 2013

NOTE 3 – RESTRICTED ASSETS

Restricted Accounts

Certain proceeds of the Agency's debt, as well as certain resources set aside for their repayment, are classified as restricted assets on the statements of net position because their use is limited. The following accounts are reported as restricted assets:

Bond Service Fund - Used to pay the current portion of the bond principal and interest.

Construction Fund - Used to report debt proceeds restricted for use in construction.

Restricted Net Position

The following calculation supports the restricted net position:

	<u>2014</u>
Restricted Assets	
Bond Service Fund	\$ 6,377
Construction Fund	<u>121,038</u>
Total Restricted Assets	<u>127,415</u>
Less: Restricted Assets Not Funded by Revenues	
Construction Fund	<u>(121,038)</u>
Current Liabilities Payable from Restricted Assets	<u>(5,726)</u>
Total Restricted Net Position	<u><u>\$ 651</u></u>

MICHIGAN SOUTH CENTRAL POWER AGENCY

NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended June 30, 2014 and 2013

NOTE 4 – CHANGES IN CAPITAL ASSETS

A summary of changes in capital assets for 2014 and 2013 follows:

	2014			
	Balance 7/1/13	Additions/ Reclassifications	Deletions/ Reclassifications	Balance 6/30/14
Capital assets, not being depreciated				
Land	\$ 1,403,519	\$ -	\$ -	\$ 1,403,519
Construction work in progress	2,393,948	16,076,406	(13,138,867)	5,331,487
Total Capital Assets, Not Being Depreciated	<u>3,797,467</u>	<u>16,076,406</u>	<u>(13,138,867)</u>	<u>6,735,006</u>
Capital assets being depreciated				
Project I (composite) – Generation Station	82,869,792	13,055,468	-	95,925,260
General Plant	5,464,491	70,240	(11,275)	5,523,456
Menominee/Oconto	-	13,159	-	13,159
Total Capital Assets Being Depreciated	<u>88,334,283</u>	<u>13,138,867</u>	<u>(11,275)</u>	<u>101,461,875</u>
Total Capital Assets	<u>92,131,750</u>	<u>29,215,273</u>	<u>(13,150,142)</u>	<u>108,196,881</u>
Less: Accumulated depreciation				
Project I (composite) – Generation Station	68,403,098	1,522,645	-	69,925,743
General Plant	4,367,750	175,339	(11,275)	4,531,814
Menominee/Oconto	-	2,193	-	2,193
Total Accumulated Depreciation	<u>72,770,848</u>	<u>1,700,177</u>	<u>(11,275)</u>	<u>74,459,750</u>
Net Capital Assets	<u>\$ 19,360,902</u>			<u>\$ 33,737,131</u>

MICHIGAN SOUTH CENTRAL POWER AGENCY

NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended June 30, 2014 and 2013

NOTE 4 – CHANGES IN CAPITAL ASSETS (cont.)

	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>

NOTE 5 – REGULATORY ASSETS

Regulatory assets 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 2014 and 2013 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 regulatory assets as of June 30, 2014 and 2013 are as follows:

	2014	2013
Regulatory Assets		
Cost to be billed once allocation is determined	<u>\$ 8,871,406</u>	<u>\$ 1,267,185</u>

MICHIGAN SOUTH CENTRAL POWER AGENCY

NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended June 30, 2014 and 2013

NOTE 5 – REGULATORY ASSETS (cont.)

The change in the components of regulatory assets for the years ended June 30, 2014 and 2013 are as follows:

	2014	2013
Accrued Vacation and Sick Leave	\$ 16,738	\$ (17,397)
Base Load Feasibility Project	(250,390)	-
ITC Utilization Estimate	290,692	(51,755)
ITC KVAR Estimate	12,229	232,167
FTF Recovery Earnout	7,534,952	-
Net Increase (Decrease) in Regulatory Costs	7,604,221	163,015
Balance at Beginning of Year	1,267,185	1,104,170
Balance at End of Year	\$ 8,871,406	\$ 1,267,185

NOTE 6 – DEFERRED RESOURCES FOR MAJOR MAINTENANCE

Management and the Board have identified a substantial turbine maintenance project which was completed 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, 2014 and 2013 is as follows:

	2014	2013
Balance at Beginning of Year	\$ 2,300,000	\$ 800,000
Resources accumulated	750,000	1,500,000
Resources recognized	(3,050,000)	-
Balance at End of Year	\$ -	\$ 2,300,000

NOTE 7 – DEFERRED RATE STABILIZATION

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 year 2013, the proceeds of the sale of Project II and Project III were deposited into the member rate stabilization fund according to the member's participation percentage. During fiscal year 2014, the board approved the distributions of the rate stabilization fund to finance the turbine maintenance project.

MICHIGAN SOUTH CENTRAL POWER AGENCY

NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended June 30, 2014 and 2013

NOTE 7 – 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 deferred inflow of resources as follows:

Fiscal Year	Balance 7/1	Contributions	Interest Accrued	Distributions	Balance 6/30
2014	\$ 8,155,052	\$ 886,233	\$ 22,749	\$ 5,420,792	\$ 3,643,242
2013	2,985,538	5,170,630	27,281	28,397	8,155,052

NOTE 8 – FRACTIONAL TIRE FACILITY EARN-OUT AGREEMENT

As part of the FTF purchase, the Agency entered into an earn-out agreement with Symbiotic which will require the Agency to pay a sum of money to Symbiotic as the facility generates net revenues. The future cost has been set up as a regulatory asset and associated liability has been set up to show the future payments required to Symbiotic. The cost will be recognized when the facility generates net revenues over expenses (as outlined in the agreement) and the liability will decrease at the same time as the payments are made. This allows the Agency to re-coup the related technology costs from their members as the related liability is being paid.

NOTE 9 – LONG-TERM OBLIGATIONS

On February 5, 2014, the Board authorized \$16,000,000 of Power Supply Revenue Bonds, Series 2014 (Taxable), for the purpose of acquiring, constructing, furnishing and equipping the greenhouse generators for Project IV. The Agency can make draws not to exceed the authorized amount. The first principal payment will not be due until one year from the close of the loan or when the last draw is taken.

Long-term debt activity for the year ended June 30, 2014 is as follows:

	Balance 7/1/13	Additions	Retirements	Balance 6/30/14	Due Within One Year
Revenue Bonds, Series 2014	\$ -	\$ 4,940,000	\$ -	\$ 4,940,000	\$ -

No repayment schedule has been finalized as there continues to be draws taken on the bonds.

Long-Term Obligations Summary

Long-term obligation activity for the year ended June 30, 2014 is as follows:

	Balance 7/1/13	Additions	Retirements	Balance 6/30/14	Due Within One Year
Long-term debt	\$ -	\$ 4,940,000	\$ -	\$ 4,940,000	\$ -
Supplemental retirement obligation	226,968	1,733	29,039	199,662	29,039
Other accrued liabilities	-	7,534,952	-	7,534,952	-
Total Long-term Obligations	\$ 226,968	\$ 12,505,623	\$ 29,039	\$ 12,703,552	\$ 29,039

MICHIGAN SOUTH CENTRAL POWER AGENCY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2014 and 2013

NOTE 9 – LONG-TERM OBLIGATIONS (cont.)

Long-Term Obligations Summary (cont.)

Long-term obligation activity for the year ended June 30, 2013 is as follows:

	Balance 7/1/13	Additions	Retirements	Balance 6/30/14	Due Within One Year
Supplemental retirement obligation Long-term debt	\$ 246,931	\$ 9,076	\$ 29,039	\$ 226,968	\$ 29,039

NOTE 10 – 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:

	2014	2013
Capital Assets		
Utility plant in service and work in progress	\$ 108,196,881	\$ 92,131,750
Allowance for depreciation	(74,459,750)	(72,770,848)
Sub-totals	33,737,131	19,360,902
Less: Capital related debt	(4,940,000)	-
Add: Unspent debt proceeds		
Construction fund	121,038	-
Total Net Investment in Capital Assets	\$ 28,918,169	\$ 19,360,902

MICHIGAN SOUTH CENTRAL POWER AGENCY

NOTES TO FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2014 and 2013

NOTE 11 – EMPLOYEE RETIREMENT PLAN

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 2014, 2013 and 2012, the Agency's annual pension cost of \$721,533, \$705,047, and \$698,120, respectively, for the MERS was equal to the Agency's required and actual contributions.

The 2014 required contribution was determined as part of the December 31, 2013 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 2013, 2012, and 2011; (b) projected salary increases of 4.5% in 2013, 2012, and 2011; and (c) additional projected salary increases ranging from 0% to 13.0% in 2013, 2012, and 2011, 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.

<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, 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
December 31, 2013	11,735,131	13,149,284	1,414,153	89.2	3,419,740	41.4

MICHIGAN SOUTH CENTRAL POWER AGENCY

NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended June 30, 2014 and 2013

NOTE 11 – EMPLOYEE RETIREMENT PLAN (cont.)

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, 2012	\$ 14,601	\$ 29,039	\$ 246,931	198.9%
June 30, 2013	9,076	29,039	226,968	320.0%
June 30, 2014	1,733	29,039	199,662	1,675.1%

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 0.45% and 0.52% for the years ended June 30, 2014 and 2013, respectively. There are no separately issued statements or reports on this plan.

NOTE 12 – LONG-TERM SUPPLY AGREEMENTS

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, 2014 and 2013

NOTE 13 – MARKET PARTICIPATION

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, 2014 there was no balance drawn.

NOTE 14 – LEASE AGREEMENT

The Agency leased a portion of the land at Project I to Symbiotic Energy of Litchfield. The property leased had an estimated book value of \$1,941. This lease ended with the FTF purchase from Symbiotic during fiscal year 2014.

NOTE 15 – RISK MANAGEMENT

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.

NOTE 16 – COMMITMENTS AND CONTINGENCIES

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, 2014 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.

NOTE 17 – AGGREGATE BOND SERVICE COVERAGE

Section 12 of the Power Supply System Revenue Bond Resolution (the Resolution) dated February 5, 2014, requires – The Agency agrees that while any of the bonds are outstanding it shall from time to time fix rates and other charges for electric power and energy and any services or facilities furnished by the System at levels that, together with other current income, are reasonably expected to produce Net Revenues equal to at least 110% of debt service coming due on the Bonds in each fiscal year. The rates and charges shall be reviewed not less than once a year and shall be fixed and revised from time to time by the Agency as may be necessary to produce these amounts, and it is hereby covenanted and agreed to fix and maintain rates and charges for services furnished by the System at all times sufficient to provide for the foregoing.

MICHIGAN SOUTH CENTRAL POWER AGENCY

NOTES TO FINANCIAL STATEMENTS As of and for the Years Ended June 30, 2014 and 2013

NOTE 17 – AGGREGATE BOND SERVICE COVERAGE (cont.)

To comply with the requirements of the above Section of the Resolution, the Agency has prepared the Aggregate Bond Service Coverage Calculation for the twelve months ended June 30, 2014.

Definitions of the following terms included in the calculation discussed in the paragraph above are as indicated in Section 1 Definitions:

Adjusted Net Revenues
Net Revenues
Revenues
System

All references to Generally Accepted Accounting Principles in the above definitions are generally those currently in existence, except for those that are inconsistent with the Resolution, in which case the terms of the Resolution control.

June 30, 2014

NET REVENUES

Operating Revenues		\$	70,037,047
Less: Operating Expenses			
Operations	\$	51,696,121	
Maintenance		8,907,011	
Administration and General (a)		<u>2,026,635</u>	
Total			(62,629,767)
Plus:			
Investment and miscellaneous income	\$	72,368	
Net decrease in the fair value of investments		(11,065)	
Gain on disposal of assets		<u>420</u>	
Total			<u>61,723</u>
TOTAL NET REVENUES, AS DEFINED		\$	<u><u>7,469,003</u></u>
DEBT SERVICE		\$	<u><u>20,622</u></u>
COVERAGE OF DEBT SERVICE BY NET REVENUES			<u><u>362%</u></u>

(a) Excludes payment in lieu of taxes totaling \$60,000.

NOTE 18 – SIGNIFICANT CUSTOMERS

The Agency has three members who are considered significant customers. These members accounted for 93% of operating revenues for years ended June 30, 2014 and 2013.

MICHIGAN SOUTH CENTRAL POWER AGENCY

NOTES TO FINANCIAL STATEMENTS

As of and for the Years Ended June 30, 2014 and 2013

NOTE 19 – SUBSEQUENT EVENTS

The Agency evaluated subsequent events through August 21, 2014, the date that the financial statements were available to be issued, for events requiring recording or disclosure in the financial statements.

REQUIRED SUPPLEMENTARY INFORMATION

MICHIGAN SOUTH CENTRAL POWER AGENCY

REQUIRED SUPPLEMENTAL INFORMATION
As of June 30, 2014 and 2013

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, 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
December 31, 2013	11,735,131	13,149,284	1,414,153	89.2	3,419,740	41.4

See independent auditor's report.