

SOUTHEAST ALASKA POWER AGENCY

Financial Statements and Supplementary Information

For the Years Ended
June 30, 2012 and 2011

(With Independent Auditor's Report Thereon)

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SOUTHEAST ALASKA POWER AGENCY

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Independent Auditors' Report

The Board of Directors
Southeast Alaska Power Agency

We have audited the accompanying basic financial statements of Southeast Alaska Power Agency, as of and for the years ended June 30, 2012 and 2011, as listed in the table of contents. These financial statements are the responsibility of Southeast Alaska Power Agency's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Southeast Alaska Power Agency as of June 30, 2012 and 2011, and the respective changes in its financial position and its cash flows thereof, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we also issued our report dated December 7, 2012 on our consideration of Southeast Alaska Power Agency's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Board of Directors
Southeast Alaska Power Agency

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

Mikunda, Cottrell & Co.

Anchorage, Alaska
December 7, 2012

MANAGEMENT'S DISCUSSION AND ANALYSIS

SOUTHEAST ALASKA POWER AGENCY

Management's Discussion and Analysis

June 30, 2012 and 2011

This presentation and analysis is intended to serve as an introduction to and a discussion of the June 30, 2012 and 2011 financial statements of Southeast Alaska Power Agency (Agency).

Financial Highlights

The Agency's assets exceeded liabilities at June 30, 2012 and June 30, 2011 by \$141,065,697 and \$141,187,502, respectively. This represents a decrease of \$121,805 for the year ended June 30, 2012 and a decrease of 324,730 for the year ended June 30, 2011.

Financial Position

Total assets, total liabilities and total net assets at June 30, 2012, 2011 and 2010 follows:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Assets:			
Current assets	\$ 22,125,895	19,605,084	18,435,879
Capital assets	134,411,504	138,148,449	140,226,712
Noncurrent assets	<u>669,045</u>	<u>1,079,801</u>	<u>1,142,042</u>
Total assets	<u>157,206,444</u>	<u>158,833,334</u>	<u>159,804,633</u>
Liabilities:			
Current liabilities	2,163,969	2,999,730	2,992,277
Noncurrent liabilities	<u>13,976,778</u>	<u>14,646,102</u>	<u>15,300,124</u>
Total liabilities	<u>16,140,747</u>	<u>17,645,832</u>	<u>18,292,401</u>
Net assets:			
Invested in capital assets, net of related debt	119,759,726	122,847,347	124,291,588
Restricted for debt service	1,355,863	1,355,513	1,354,563
Restricted under agreements with external parties	627,238	552,177	477,111
Restricted for project improvements	-	-	8,581
Unrestricted	<u>19,322,870</u>	<u>16,432,465</u>	<u>15,380,389</u>
Total net assets	<u>141,065,697</u>	<u>141,187,502</u>	<u>141,512,232</u>
Total liabilities and net assets	\$ <u>157,206,444</u>	<u>158,833,334</u>	<u>159,804,633</u>

Discussion of Financial Position

2012 Compared to 2011

Total assets decreased by \$1,626,890 and \$971,299 for the years ended June 30, 2012 and 2011, respectively.

SOUTHEAST ALASKA POWER AGENCY

Management's Discussion and Analysis, continued

The decrease for the year ended June 30, 2012 is attributable to capital asset related activity. Increases in capital projects, notably the first stage of an improved Supervisory Control and Data Acquisition (SCADA) system placed into service in fiscal year 12, are offset by depreciation expense on projects in operation. In addition, two feasibility projects began. The Swan Lake Increased Storage project has the potential to increase energy capacity at the present hydro facility and displace member utilities' diesel generation. The Tyee Lake Stream Gauge project would significantly improve lake level and stream flow measurements, as well as provide long-term water inflow data for the Tyee basin. The decrease for the year ended June 30, 2011 is also attributable to capital asset related activity. The Agency received an expected ILF credit from Alaska Energy Authority in fiscal year 11, which comprised the majority of the increase in cash and investments. In addition, the Agency transferred funds into an investment portfolio.

Total liabilities decreased by \$1,505,085 and \$646,569 for the years ended June 30, 2012 and 2011, respectively. The decrease for the year ended June 30, 2012 is attributable to a decrease in the rate rebate payable of \$850,000 and \$655,000 reduction in long-term debt due to principal payments. The decrease for the year ended June 30, 2011 is attributable to several factors; an increase in the rate rebate payable of \$932,240 was offset by reduction in long-term debt of \$635,000 through principal payments and accounts payable decrease of \$1,003,149.

Total net assets decreased by \$121,805 and \$324,730 for the years ended June 30, 2012 and 2011, respectively. This is mostly attributable to increases in depreciation expense as grant funded projects from fiscal year 2010 and older are placed into service. During years the Agency has capital projects funded by grants net assets tend to increase followed by decreases in net assets in subsequent years once those projects are placed into service and depreciation commences.

Operations

Components of the Agency's operating revenues, operating expenses, and non-operating revenues/expenses for the years ended June 30, 2012, 2011, and 2010 are as follows:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Operating revenues - revenue from power sales	\$ 11,608,217	11,099,706	10,615,895
Rate rebate	<u>(800,000)</u>	<u>(1,650,000)</u>	<u>(717,760)</u>
Net operating revenues	<u>10,808,217</u>	<u>9,449,706</u>	<u>9,898,135</u>
Operating expenses:			
Operating and maintenance	4,347,020	3,301,870	2,962,678
General and administrative	2,023,351	1,923,624	2,010,780
Depreciation expense	<u>3,922,821</u>	<u>3,827,841</u>	<u>2,611,262</u>
Total operating expenses	<u>10,293,192</u>	<u>9,053,335</u>	<u>7,584,720</u>
Operating income	\$ <u>515,025</u>	<u>396,371</u>	<u>2,313,415</u>

SOUTHEAST ALASKA POWER AGENCY

Management's Discussion and Analysis, continued

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Non-operating revenues (expenses):			
Investment income	\$ 131,582	163,236	138,321
Interest expense	(704,027)	(807,911)	(739,244)
Amortization of loan fees	(73,911)	(80,212)	(95,657)
Other	9,526	3,786	-
Capital grant revenue	-	-	5,580,600
Net non-operating revenues (expenses)	<u>(636,830)</u>	<u>(721,101)</u>	<u>4,884,020</u>
Income (loss) before special item	(121,805)	(324,730)	7,197,435
Special items:			
Restructure (2009)	-	-	(237,336)
ILF Intertie Credit AEA (2010)	<u>-</u>	<u>-</u>	<u>5,799,274</u>
Total special items	<u>-</u>	<u>-</u>	<u>5,561,938</u>
Change in net assets	(121,805)	(324,730)	12,759,373
Net assets - beginning of year	<u>141,187,502</u>	<u>141,512,232</u>	<u>128,752,859</u>
Net assets - end of year	\$ <u>141,065,697</u>	<u>141,187,502</u>	<u>141,512,232</u>

Discussion of Operations

2012 Compared to 2011

Revenue from power sales, before the rate rebate, was \$508,511 higher for the year ended June 30, 2012 compared to \$483,811 the year ended June 30, 2011. This was primarily due to higher utilization of the Tyee Lake facility.

Operating expenses were \$1,239,857 higher for the year ended June 30, 2012 compared to \$1,468,615 year ended June 30, 2011. This is primarily due to increases in operating and maintenance expenses related to projects placed into service in fiscal year 10 and 11. Notable increases are related to PFMA analysis, SCADA and helipad costs that are not considered capital investments, in addition to required routine maintenance on generation and distribution capital assets. Depreciation expense increased significantly for the year ended June 30, 2011 due to generation and distribution assets placed into service.

In summary, the change in net assets for the year ended June 30, 2012 was \$102,805 lower than for the year ended June 30, 2011. Total net assets at June 30, 2012 were \$141,065,697 compared to \$141,187,502 at June 30, 2011.

FINANCIAL STATEMENTS

SOUTHEAST ALASKA POWER AGENCY

Statements of Net Assets

June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
<u>Assets</u>		
Current assets:		
Cash and investments, including restricted cash and investments of \$1,915,234 and \$1,497,761 at June 30, 2012 and 2011, respectively	\$ 21,110,034	18,532,331
Accounts receivable	817,317	894,805
Accrued interest receivable	48,663	47,030
Inventory	8,143	-
Prepaid expenses and other assets	141,738	130,918
Total current assets	<u>22,125,895</u>	<u>19,605,084</u>
Noncurrent assets:		
Restricted cash and investments	364,675	700,320
Bond and loan issuance costs, net	304,370	379,481
Capital assets, net	134,411,504	138,148,449
Total noncurrent assets	<u>135,080,549</u>	<u>139,228,250</u>
Total assets	<u>\$ 157,206,444</u>	<u>158,833,334</u>
<u>Liabilities and Net Assets</u>		
Liabilities:		
Current liabilities:		
Accounts payable and accrued expenses	\$ 634,028	636,368
Rebate payable to members	800,000	1,650,000
Accrued interest payable	54,941	58,362
Current portion of long-term debt	675,000	655,000
Total current liabilities	<u>2,163,969</u>	<u>2,999,730</u>
Noncurrent liabilities:		
Long-term debt, net of current portion	14,100,000	14,775,000
Bond issue premium (discount), net	(123,222)	(128,898)
Total noncurrent liabilities	<u>13,976,778</u>	<u>14,646,102</u>
Total liabilities	<u>16,140,747</u>	<u>17,645,832</u>
Net assets:		
Invested in capital assets, net of related debt	119,759,726	122,847,347
Restricted for debt service	1,355,863	1,355,513
Restricted by agreements with external parties	627,238	552,177
Unrestricted	19,322,870	16,432,465
Total net assets	<u>141,065,697</u>	<u>141,187,502</u>
Total liabilities and net assets	<u>\$ 157,206,444</u>	<u>158,833,334</u>

See accompanying notes to financial statements.

SOUTHEAST ALASKA POWER AGENCY
Statements of Revenues, Expenses, and Changes in Net Assets
Years Ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Operating revenues:		
Revenue from power sales	\$ 11,608,217	11,099,706
Rate rebate	<u>(800,000)</u>	<u>(1,650,000)</u>
Net operating revenues	<u>10,808,217</u>	<u>9,449,706</u>
Operating expenses:		
Operating and maintenance	4,347,020	3,301,870
General and administrative	2,023,351	1,923,624
Depreciation expense	<u>3,922,821</u>	<u>3,827,841</u>
Total operating expenses	<u>10,293,192</u>	<u>9,053,335</u>
Operating income	515,025	396,371
Nonoperating revenues (expenses):		
Investment income	131,582	163,236
Interest expense	(704,027)	(807,911)
Amortization of bond issuance and other costs	(73,911)	(80,212)
Other	<u>9,526</u>	<u>3,786</u>
Net nonoperating expenses	<u>(636,830)</u>	<u>(721,101)</u>
Change in net assets	(121,805)	(324,730)
Net assets - beginning of year	<u>141,187,502</u>	<u>141,512,232</u>
Net assets - end of year	\$ <u>141,065,697</u>	<u>141,187,502</u>

See accompanying notes to financial statements.

SOUTHEAST ALASKA POWER AGENCY

Statements of Cash Flows

Years Ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities:		
Receipts from customers and users	\$ 11,685,705	11,027,891
Payment of rate rebate	(1,650,000)	(717,760)
Payments to suppliers and employees	<u>(6,391,674)</u>	<u>(6,262,212)</u>
Net cash flows from operating activities	<u>3,644,031</u>	<u>4,047,919</u>
Cash flows from capital and related financing activities:		
Interest payments on long-term debt	(703,992)	(748,571)
Principal payments on long-term debt	(655,000)	(635,000)
Receipt of intertie loan fund credit	-	5,799,274
Proceeds from capital grants	-	35,827
Purchase of capital assets	<u>(185,876)</u>	<u>(1,749,578)</u>
Net cash flows from capital and related financing activities	<u>(1,544,868)</u>	<u>2,701,952</u>
Cash flows from investing activities - investment income received	<u>142,895</u>	<u>119,992</u>
Net increase in cash and cash equivalents	2,242,058	6,869,863
Cash and investments at beginning of year	<u>19,232,651</u>	<u>12,362,788</u>
Cash and investments at end of year	\$ <u><u>21,474,709</u></u>	\$ <u><u>19,232,651</u></u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 515,025	396,371
Adjustments to reconcile operating income to net cash flows from operating activities:		
Depreciation	3,922,821	3,827,841
Changes in assets and liabilities:		
(Increase) decrease in assets:		
Inventory	(8,143)	-
Prepaid expenses and other assets	(10,820)	(33,569)
Accounts receivable	77,488	(71,815)
Increase (decrease) in liabilities:		
Rebate payable to members	(850,000)	932,240
Accounts payable and accrued expenses	<u>(2,340)</u>	<u>(1,003,149)</u>
Net cash flows from operating activities	\$ <u><u>3,644,031</u></u>	\$ <u><u>4,047,919</u></u>

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements

June 30, 2012 and 2011

(1) **Organization and Operations**

The Southeast Alaska Power Agency (the Agency) is a joint action agency of the State of Alaska and was created pursuant to Alaska Statutes Section 42.45.300. The Agency (formerly known as The Four Dam Pool Power Agency (FDPPA)) was established in 2001 to take over ownership from the State (the Alaska Energy Authority) of the Terror Lake, Solomon Gulch, Tyee Lake, and Swan Lake hydroelectric projects. This transaction was completed on January 31, 2002. On February 24, 2009, the Agency completed a restructuring, whereby the Terror Lake and Solomon Gulch projects were transferred to Kodiak Electric Association and Copper Valley Electric Association, respectively. Effective with this transfer, the name of the Agency was changed to Southeast Alaska Power Agency (SEAPA).

The member cities (Ketchikan, Wrangell, and Petersburg) and utilities purchase power from the Agency at the same wholesale power rate. Ketchikan Public Utilities, serving the Ketchikan area, operates Swan Lake and the Thomas Bay Power Authority, a consortium of the City of Petersburg and the City and Borough of Wrangell, operates Tyee Lake, pursuant to an operating agreement.

The current bylaws that govern SEAPA provide for a total of five board members that are selected from each of the communities being served by the projects. Two board members are appointed by Ketchikan, one each from Wrangell and Petersburg, and a fifth board member that rotates annually between each of the projects (Swan Lake and Tyee Lake).

SEAPA is an independent agency of the State. SEAPA has the ability to finance its own projects. This independence was proven during the restructuring, completed in 2009, where SEAPA was able to sell its own bonds, secured by the power sales agreement between SEAPA and Ketchikan and Wrangell and Petersburg.

(2) **Summary of Significant Accounting Policies**

The Agency is a joint action agency under the authority of AS 42.45.300-320, of which the majority of the members are governments. Therefore, the Agency is treated as a special purpose local government and financial reporting is in accordance with the pronouncements of the Governmental Accounting Standards Board (GASB).

Basis of Accounting

The financial activities of the Agency are reported using the economic resources measurement focus and the accrual basis of accounting, whereby revenues are recorded when earned and expenses are recorded when goods or services are received or the related liability is incurred.

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Summary of Significant Accounting Policies, continued

Cash and Investments

For the purpose of the statement of cash flows, cash consists of cash, money market funds, and short-term commercial paper, whether unrestricted or restricted.

The Agency's investments are recorded at fair value in the financial statements. Unrealized gains and losses are included in earnings and are reported as investment income (loss).

Restricted Assets

As described in note 3, assets that are restricted for specific uses by bond indentures or other requirements are classified as restricted assets. When both restricted and unrestricted assets are available for use, it is the Agency's policy to use restricted assets first, then unrestricted assets, as they are required.

Capital Assets

The Agency's capital assets are recorded at cost and depreciation is charged to operations by use of the straight-line method over their estimated useful lives. Repairs and maintenance charges are expensed as incurred.

The estimated useful lives of the capital assets are as follows:

Structures	15 – 50 years
Infrastructure	5 – 50 years
Generation and distribution	5 – 35 years
Furniture, fixtures, and other	3 – 15 years

Revenue Recognition

The primary source of the Agency's revenue is from power sales to the Agency's member cities and utilities (the Purchasers). Revenue is recognized on the accrual basis and is recorded monthly, based on the kilowatt-hours (Kwh) used by the members.

The Purchasers purchase power from SEAPA pursuant to conditions of the Power Sales Agreement, adopted at the close of Restructuring on February 24, 2009. The SEAPA Board of Directors sets the wholesale power rate annually. The estimated wholesale power rate for the years ended June 30, 2012 and 2011 was set at 6.8 cents per Kwh. The member utilities only pay for the amount of power used.

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Summary of Significant Accounting Policies, continued

Revenue Recognition, continued

The Purchasers buy power from the Agency at the same wholesale power rate. Rebates are given at the Board's discretion based on operating results. The following is the percentage of volume sold to each Purchaser for the years ended June 30:

	<u>2012</u>	<u>2011</u>
Ketchikan Public Utilities	53.0%	54.0%
Wrangell Municipal Light and Power	22.0	20.0
Petersburg Municipal Light and Power	<u>25.0</u>	<u>26.0</u>
	<u>100.0%</u>	<u>100.0%</u>

Operating Revenues and Expenses

The Agency considers all its revenues and expenses, except for contributions, investment income, capital grants, and interest expense, to be part of its principal ongoing operations and therefore classifies these revenues and expenses as operating in the statement of revenues, expenses, and changes in net assets.

Employee Benefits

Operating and maintenance personnel are employees of the Purchasers. All salaries and employee benefits, including compensated absences, health care, other insurance, and pension benefits, are paid by the Purchasers and reimbursed by the Agency.

Risk Management

The Agency is exposed to various risks of loss related to: torts; theft of, damage to and destruction of assets; errors and omissions; and natural disasters, for which it carries commercial insurance, subject to standard deductibles and limitations. Loss that is not covered by insurance, both in the form of uninsured property (transmission lines and submarine cables) and various insurance deductibles and self-insured retentions, are funded as part of the internal renewal and replacement fund (R&R fund). No settlements have occurred which exceeded its commercial deductible limits.

Environmental Issues

The Agency's policy relating to environmental issues is to record a liability when the likelihood of responsibility for clean-up is probable and the costs are reasonably estimable. At June 30, 2012 and 2011, there were no environmental issues that met both of these criteria and, accordingly, no provision has been made in the accompanying financial statements for any potential liability.

Income Taxes

The Internal Revenue Code provides that gross income for tax purposes does not include income accruing to a state or territory or any political subdivision thereof, which is derived from the exercise of any essential governmental function.

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Summary of Significant Accounting Policies, continued

Estimates

In preparing the financial statements, management of the Agency is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ from those estimates.

Grants

The Agency recognizes grant revenue under the provisions of GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, whereby revenue is recognized when all applicable eligibility requirements, including time requirements, are met.

(3) **Cash and Investments**

All revenues, including revenue received from the utilities for the purchase of power pursuant to the Long Term Power Sales Agreement, are deposited into the Revenue Fund. The Revenue Fund is held by the Agency. The R&R Fund is also an Agency-held fund. The R&R Fund is used to fund renewal and replacement projects, and the bond indenture requires that the account balance in this fund shall never be less than \$1,000,000. This Fund is also used as a source of funding for uninsured risk mitigation.

The Agency may also establish and hold a Rate Stabilization Fund and may at any time, from time to time, as determined by the Agency, deposit available revenues in the Rate Stabilization Fund.

The Agency has also established a Commercial Account from which all payments and obligations are paid.

The Bond Fund, consisting of the Interest Account and the Principal Account, is held by the Trustee. The Bond Reserve Fund is also held by the Trustee and is required to be maintained at all times at not less than the Bond Reserve Requirement.

The Reclamation Contingency Fund is an Agency-held, but restricted fund to satisfy certain conditions of the lease and easement agreements between the Agency and the Department of Natural Resources (DNR). The FDPPA (pre-restructured) was required to deposit \$75,000 annually into this fund. DNR and the Agency have been in discussions to amend this agreement to reflect the change in ownership of the projects.

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Cash and Investments, continued

The cash and investments were held in trust accounts for the following activities as of June 30, 2012:

	Cash and Cash <u>Equivalents</u>	<u>Investments</u>	<u>Total</u>
Unrestricted - current:			
Internal renewal and replacement fund	\$ 1,000,187	-	1,000,187
Dedicated renewal and replacement fund	6,581,534	-	6,581,534
Revenue fund	1,500,330	-	1,500,330
Commercial checking account	974	-	974
Subordinate debt	309	-	309
Investment fund	<u>112,822</u>	<u>-</u>	<u>112,822</u>
Total unrestricted	<u>9,196,156</u>	<u>-</u>	<u>9,196,156</u>
Unrestricted - noncurrent -			
Investment fund	<u>-</u>	<u>9,998,644</u>	<u>9,998,644</u>
Restricted - current:			
Insurance escrow fund	1	-	1
Reclamation contingency fund	627,238	-	627,238
2009 Trust series bond interest	113,497	-	113,497
2009 Trust series bond principal	112,534	-	112,534
2009 Trust series bond reserve	355,577	684,790	1,040,367
STI CD	<u>21,597</u>	<u>-</u>	<u>21,597</u>
Total restricted - current	<u>1,230,444</u>	<u>684,790</u>	<u>1,915,234</u>
Restricted - noncurrent -			
2009 Trust series bond reserve	<u>-</u>	<u>364,675</u>	<u>364,675</u>
Total cash and investments	<u>\$ 10,426,600</u>	<u>11,048,109</u>	<u>21,474,709</u>

The cash and investments were held in trust accounts for the following activities as of June 30, 2011:

	Cash and Cash <u>Equivalents</u>	<u>Investments</u>	<u>Total</u>
Unrestricted - current:			
Internal renewal and replacement fund	\$ 5,479,518	-	5,479,518
Revenue fund	1,501,207	-	1,501,207
Commercial checking account	56,910	-	56,910
Subordinate debt	309	-	309
Investment fund	<u>31,805</u>	<u>506,839</u>	<u>538,644</u>
Total unrestricted	<u>7,069,749</u>	<u>506,839</u>	<u>7,576,588</u>

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Cash and Investments, continued

	<u>Cash and Cash</u> <u>Equivalents</u>	<u>Investments</u>	<u>Total</u>
Unrestricted - noncurrent - Investment fund	\$ <u> -</u>	<u>9,457,982</u>	<u>9,457,982</u>
Restricted - current:			
Insurance escrow fund	1	-	1
Reclamation contingency fund	552,177	-	552,177
2009 Trust series bond interest	116,896	-	116,896
2009 Trust series bond principal	109,462	-	109,462
2009 Trust series bond reserve	11,205	686,450	697,655
STI CD	<u>21,570</u>	<u> -</u>	<u>21,570</u>
Total restricted - current	<u>811,311</u>	<u>686,450</u>	<u>1,497,761</u>
Restricted - noncurrent - 2009 Trust series bond reserve	<u> -</u>	<u>700,320</u>	<u>700,320</u>
Total cash and investments	\$ <u>7,881,060</u>	<u>11,351,591</u>	<u>19,232,651</u>

Investment Securities

General – Investment Policies, Portfolio Information, and Restrictions

The Agency's investments are governed by the terms of the Agency's Investment Policy. The Agency's cash and investments are either governed by long-term debt agreements or the Agency's Investment Policy. The Investment Policy for Agency-held funds was amended and adopted by the Board of Directors in June 2009. The following Agency-held securities are eligible for investment under the Investment Policy:

1. Obligations of, or obligations insured or guaranteed by, the United States;
2. Obligations of United States agencies or instrumentalities;
3. Corporate debt securities with a minimum rating of "A" or the equivalent by a nationally recognized rating organization;
4. United States Agency mortgage-backed securities issued by the Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, or Government National Mortgage Association;
5. Uncollateralized deposits at banks, to the extent that the deposits are insured by the Federal Deposit Insurance Corporation (FDIC);
6. Prime commercial paper bearing the highest rating of a nationally recognized rating organization; and
7. Money market mutual funds, whose portfolios consist entirely of instruments specified in 1 and 2 above and who meet the definition of SEC 2(a) 7 money-market fund.

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Cash and Investments, continued

Investment Securities, continued

Investments shall be diversified to minimize the risk of loss resulting from over concentration of investments in a specific issuer, maturity, or class of security. At the time of purchase, corporate securities may not exceed 25% of the market value of the total portfolio. With the exception of U.S. Agency mortgage-backed securities, no security may have a final maturity greater than five years. To further control interest rate risk, the overall duration of the portfolio may not exceed 120% of the Barclays 1-3 Year Governmental Index.

Should any security be downgraded below Investment Grade (BAA or equivalent) by a nationally recognized rating organization, the security will be sold in an orderly manner within 90 days of such downgrade. The following Trustee-held securities are eligible for investment under the Bond Indenture of Trust:

1. Obligations of the United States or of an agency or instrumentality of the United States;
2. Repurchase and reverse repurchase agreements secured by the Treasury of the United States or obligations of an agency or instrumentality of the United States; certificates of deposit, bankers' acceptances, and other similar obligations of a bank domiciled in the United States that has on the date of purchase:
 - Outstanding debt rated Aa or AA or higher by at least one of the nationally recognized rating services, including dollar-denominated obligations issued by a United States branch of a foreign bank, if the debt of the parent is rated A or higher; and
 - A combined capital and surplus aggregating at least \$500,000,000;
3. Commercial paper and other short-term taxable instruments that maintain the highest rating by at least two nationally recognized rating services on the date of purchase;
4. Obligations of a corporation domiciled in the United States or obligations of a municipality, if the obligations are rated on the date of purchase Aa or AA or higher by at least two nationally recognized rating services;
5. Certificates of deposit issued by a state or federally chartered financial institution that is a commercial or mutual bank, savings and loan association, or credit union, but only if, and to the extent, the institution's accounts are insured through the appropriate federal insuring agency of the United States;
6. Money market funds in which the securities of the fund consist of obligations listed above; and
7. Any other investment permitted under the Issuer's investment policy, as amended, from time to time in writing, which will not adversely affect the ratings of the Outstanding Bonds.

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Cash and Investments, continued

Investment Securities, continued

Provided that it is expressly understood that the definition of Permitted Investments shall be, and be deemed to be, expanded, or new definitions and related provisions shall be added to this Indenture by a Supplemental Indenture, thus permitting investments with different characteristics from those permitted above, which the Issuer deems from time to time to be in the interest of the Issuer to include as Permitted Investments, if at the time of inclusion such inclusion will not, in and of itself, adversely affect the rating on the Outstanding Bonds.

At June 30, 2012 and 2011, the Agency had the following cash and investments:

	<u>2012</u>	<u>2011</u>
Money market	\$ 1,321,668	821,544
Demand deposits	9,083,335	7,037,946
U.S. government agencies	6,655,828	6,239,479
U.S. government bonds	2,120,230	3,025,028
Corporate bonds	2,272,051	2,087,084
Certificates of deposit	<u>21,597</u>	<u>21,570</u>
	<u>\$ 21,474,709</u>	<u>19,232,651</u>

Interest Rate

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of the investment's fair value to changes in the market interest rates.

Investment maturities at June 30 are as follows:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Investment Maturities (in Years)</u>	
		<u>Less Than 1</u>	<u>1-5</u>
2012:			
U.S. government agencies	\$ 6,655,828	-	6,655,828
U.S. government bonds	2,120,230	-	2,120,230
Corporate bonds	<u>2,272,051</u>	<u>-</u>	<u>2,272,051</u>
Total	<u>\$ 11,048,109</u>	<u>-</u>	<u>11,048,109</u>
2011:			
U.S. government agencies	\$ 6,239,479	1,193,289	5,046,190
U.S. government bonds	3,025,028	-	3,025,028
Corporate bonds	<u>2,087,084</u>	<u>-</u>	<u>2,087,084</u>
Total	<u>\$ 11,351,591</u>	<u>1,193,289</u>	<u>10,158,302</u>

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Cash and Investments, continued

Investment Securities, continued

Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The credit quality ratings of the Agency's investments as of June 30, 2012 and 2011, as described by nationally recognized statistical rating organizations, are shown below (using Standard & Poor's Corporation rating scale unless otherwise noted):

<u>Investment Type</u>	<u>Rating</u>	<u>Percent of Total</u>	
		<u>2012</u>	<u>2011</u>
U.S. government agencies	AAA	60.2%	55.0%
U.S. government bonds	AAA	19.2	26.6
Corporate bonds	AAA	<u>20.6</u>	<u>18.4</u>
		<u>100.0%</u>	<u>100.0%</u>

Custodial Credit Risk

Custodial credit risk is the risk that deposits may not be returned in the event of a bank failure. The Agency has not established a formal custodial credit risk policy for its investments. However, the Agency has a custodial agreement in place with their primary banking institution. At June 30, 2012 and 2011, \$83,465 and \$518,301, respectively, of bank deposits were uninsured and uncollateralized.

Concentration Risk

Concentration risk is the risk of loss attributed to the magnitude of the Agency's investment in a single issuer. Concentration limits are not established in the bond indentures and governing agreements for trust investments.

At June 30, 2012, the Agency's investments included the following concentrations greater than 5%:

<u>Investment Type</u>	<u>Investment at Fair Value</u>	<u>Percentage of Total Portfolio</u>
Federal Home Loan Mortgage Corporation	\$ 2,490,539	22.6%
Federal National Mortgage Association	2,594,579	23.5
U.S. Treasury Bond	2,120,230	19.2
Federal Home Loan Bank	1,570,710	14.2

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Cash and Investments, continued

Investment Securities, continued

At June 30, 2011, the Agency's investments included the following concentrations greater than 5%:

<u>Investment Type</u>	<u>Investment at Fair Value</u>	<u>Percentage of Total Portfolio</u>
Federal Home Loan Mortgage Association		
Discount Note	\$ 1,386,770	7.2%
Federal Home Loan Mortgage Corporation	1,789,469	9.3
Federal National Mortgage Association	1,514,131	7.9
U.S. Treasury bond	3,025,028	15.7
Federal Home Loan Bank	1,038,583	5.4

(4) **Capital Assets**

The components of the Agency's capital assets at June 30, 2012 and 2011 are as follows:

	<u>2012</u>	<u>2011</u>
Tyee Lake	\$ 25,968,384	25,920,629
Swan Lake	16,169,752	15,882,352
Swan-Tyee Intertie	111,484,555	112,341,261
SEAPA office - SCADA	707,427	-
Leasehold improvements	<u>52,566</u>	<u>52,566</u>
	154,382,684	154,196,808
Less accumulated depreciation	<u>(19,971,180)</u>	<u>(16,048,359)</u>
Total capital assets, net of accumulated depreciation	<u>\$ 134,411,504</u>	<u>138,148,449</u>

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Capital Assets, continued

Capital asset activity for the Agency for the year ended June 30, 2012 follows:

	Balance at June 30, <u>2011</u>	<u>Additions</u>	<u>Transfers and Deletions</u>	Balance at June 30, <u>2012</u>
Capital assets not being depreciated:				
Swan Lake construction in progress	\$ 35,264	184,231	68,074	151,421
Swan-Tyee construction in progress	959,393	-	856,707	102,686
SEAPA office - SCADA construction in progress	-	130,663	-	130,663
Tyee Lake construction in progress	<u>21,475</u>	<u>14,523</u>	<u>28,097</u>	<u>7,901</u>
Total capital assets not being depreciated	<u>1,016,132</u>	<u>329,417</u>	<u>952,878</u>	<u>392,671</u>
Capital assets being depreciated:				
Structures	11,415,466	-	-	11,415,466
Infrastructure	1,776,658	28,097	-	1,804,755
Generation and distribution	139,340,179	635,987	-	139,976,166
Furniture, fixtures and other	595,806	145,253	-	741,059
Leasehold improvements	<u>52,567</u>	<u>-</u>	<u>-</u>	<u>52,567</u>
Total capital assets being depreciated	<u>153,180,676</u>	<u>809,337</u>	<u>-</u>	<u>153,990,013</u>
Less accumulated depreciation:				
Structures	(3,137,930)	(363,120)	-	(3,501,050)
Infrastructure	(658,671)	(78,280)	-	(736,951)
Generation and distribution	(11,915,228)	(3,438,221)	-	(15,353,449)
Furniture, fixtures and other	(334,030)	(40,700)	-	(374,730)
Leasehold improvements	<u>(2,500)</u>	<u>(2,500)</u>	<u>-</u>	<u>(5,000)</u>
Total accumulated depreciation	<u>(16,048,359)</u>	<u>(3,922,821)</u>	<u>-</u>	<u>(19,971,180)</u>
Capital assets being depreciated, net	<u>137,132,317</u>	<u>(3,113,484)</u>	<u>-</u>	<u>134,018,833</u>
Total capital assets, net	\$ <u>138,148,449</u>	<u>(2,784,067)</u>	<u>952,878</u>	<u>134,411,504</u>

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Capital Assets, continued

Capital asset activity for the Agency for the year ended June 30, 2011 follows:

	Balance at June 30, <u>2010</u>	<u>Additions</u>	Transfers and <u>Deletions</u>	Balance at June 30, <u>2011</u>
Capital assets not being depreciated:				
Swan Lake construction in progress	\$ 41,603	79,702	86,041	35,264
Swan-Tyee construction in progress	570,451	388,942	-	959,393
Tyee Lake construction in progress	<u>1,101,864</u>	<u>1,229,058</u>	<u>2,309,447</u>	<u>21,475</u>
Total capital assets not being depreciated	<u>1,713,918</u>	<u>1,697,702</u>	<u>2,395,488</u>	<u>1,016,132</u>
Capital assets being depreciated:				
Structures	11,338,528	76,938	-	11,415,466
Infrastructure	1,668,030	108,628	-	1,776,658
Generation and distribution	137,343,050	1,997,129	-	139,340,179
Furniture, fixtures and other	358,704	237,102	-	595,806
Leasehold improvements	<u>25,000</u>	<u>27,567</u>	<u>-</u>	<u>52,567</u>
Total capital assets being depreciated	<u>150,733,312</u>	<u>2,447,364</u>	<u>-</u>	<u>153,180,676</u>
Less accumulated depreciation:				
Structures	(2,775,836)	(362,094)	-	(3,137,930)
Infrastructure	(583,834)	(74,837)	-	(658,671)
Generation and distribution	(8,572,755)	(3,342,473)	-	(11,915,228)
Furniture, fixtures and other	(288,093)	(45,937)	-	(334,030)
Leasehold improvements	<u>-</u>	<u>(2,500)</u>	<u>-</u>	<u>(2,500)</u>
Total accumulated depreciation	<u>(12,220,518)</u>	<u>(3,827,841)</u>	<u>-</u>	<u>(16,048,359)</u>
Capital assets being depreciated, net	<u>138,512,794</u>	<u>(1,380,477)</u>	<u>-</u>	<u>137,132,317</u>
Total capital assets, net	\$ <u>140,226,712</u>	<u>317,225</u>	<u>2,395,488</u>	<u>138,148,449</u>

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

(5) **Long-Term Debt**

In February 2002, the Alaska Industrial Development and Export Authority (AIDEA) loaned the Agency \$77.1 million at 6.5% to finance the purchase of the Swan Lake and Tye Lake facilities. The Agency used \$68 million for the purchase of assets and the remaining \$9.1 million to fund closing costs and the initial funding of required reserves. During 2004, the Agency made principal payments on the loan of \$1.5 million.

On October 6, 2004, the Agency issued an aggregate of \$62.175 million electric revenue refunding bonds, comprised of \$28.905 million Series 2004A (Tax-Exempt) fixed rate bonds and \$33.27 million Series 2004B (Taxable) weekly variable rate bonds. The bond proceeds, together with other available funds, were used to refund the AIDEA loan.

In February 2009, the 2004 bonds were advance refunded as part of the Agency's restructure, and the Agency issued \$16.495 million in Series 2009 (Tax-Exempt) electric revenue refunding bonds. Interest is payable on these bonds on June 1 and December 1, commencing December 1, 2009 at interest rates of 3.00% to 5.375%.

As part of the refunding, the Agency incurred loan origination costs of approximately \$497,000 and a bond issue discount of approximately \$125,000, both of which are being amortized over the life of the bonds.

The 2004 bonds were defeased by placing a portion of the proceeds of the new bonds in irrevocable trusts to provide for all future debt service payments on the old bonds. Accordingly, trust accounts are not included in these financial statements. At June 30, 2012, the amount of the bonds considered defeased was \$23,020,000.

The following tables reflect the changes in long-term debt for the years ended June 30, 2012 and 2011, respectively:

	Balance at June 30, <u>2011</u>	<u>Additions</u>	<u>Deletions</u>	Balance at June 30, <u>2012</u>	Due Within <u>One Year</u>
Series 2009 Bonds	\$ <u>15,430,000</u>	<u>-</u>	<u>655,000</u>	<u>14,775,000</u>	<u>675,000</u>
	Balance at June 30, <u>2010</u>	<u>Additions</u>	<u>Deletions</u>	Balance at June 30, <u>2011</u>	Due Within <u>One Year</u>
Series 2009 Bonds	\$ <u>16,065,000</u>	<u>-</u>	<u>635,000</u>	<u>15,430,000</u>	<u>655,000</u>

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Long-Term Debt, continued

The minimum payments of the outstanding bonds for the years subsequent to June 30, 2012, based on scheduled maturities, are as follows:

Year Ending <u>June 30:</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2013	\$ 675,000	680,863	1,355,863
2014	700,000	658,925	1,358,925
2015	725,000	634,425	1,359,425
2016	745,000	612,675	1,357,675
2017	770,000	589,394	1,359,394
2018-2022	4,350,000	2,433,895	6,783,895
2023-2027	5,520,000	1,259,446	6,779,446
2028	<u>1,290,000</u>	<u>69,338</u>	<u>1,359,338</u>
	<u>\$ 14,775,000</u>	<u>6,938,961</u>	<u>21,713,961</u>

(6) **Operating Lease**

The Agency entered into a three-year lease agreement for office space in Ketchikan, Alaska in December 2011, which was a transfer from the previous lease with a five-year period. The Agency has the right to renew the lease for two consecutive five-year periods. Under the terms of the lease, the Agency will pay the following amounts in future years:

Year Ending <u>June 30:</u>	<u>Amount</u>
2013	\$ 47,780
2014	49,389
2015	50,997
2016	51,802
2017	52,606

During 2012 and 2011, the Agency expensed \$48,982 and \$42,513, respectively, under non-cancelable lease obligations.

(7) **Commitments and Contingencies**

During the normal course of business, the Agency may be subject to various claims and disputes related to the conduct of its business. Management believes the resolution of these matters will not have a material effect on financial position, results of operations, or cash flows.

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Commitments and Contingencies, continued

In 2007, as part of its Federal Energy Regulatory Commission (FERC) mandated engineering guidelines, the Agency assembled a team of engineers to review certain potential failure modes at the Solomon Gulch Project (“PFMA Analysis”). Because the outcome of this analysis and associated financial impacts were unknown prior to the closing of the Restructuring transaction, the pre-closing utilities agreed that any resultant costs would be shared between the utilities of the Agency (pre-closing). This agreement is included in the Asset Transfer Agreement. This Post-Closing obligation will continue until all issues related to the Solomon Gulch PFMA have been resolved with FERC, all actions required by FERC have been taken and completed, or a ten (10) year period from Closing has passed, whichever comes first. The total allowed expenses to satisfy this requirement for all members cannot exceed \$5,000,000. SEAPA’s maximum exposure would be limited to 45.8% or \$2,291,315.

SEAPA has taken the lead role in the PFMA Analysis studies, as well as the follow-up projects that were required to be completed as a result of the analysis. Two projects were identified as a result of the studies; the testing and installation of anchor bolts in penstock thrust blocks and the installation of a Low Level Outlet Works (LLOW). As of November 15, 2012, the installation of the anchor bolt project is 100% complete and the LLOW is approximately 95% complete. SEAPA’s remaining exposure is anticipated to be approximately \$25,000 and the project should be completely closed out in FY2013.

GOVERNMENT AUDITING STANDARDS

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With Government Auditing Standards

The Board of Directors
Southeast Alaska Power Agency

We have audited the financial statements of Southeast Alaska Power Agency as of and for the year ended June 30, 2012 and have issued our report thereon dated December 7, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of Southeast Alaska Power Agency is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered Southeast Alaska Power Agency's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Southeast Alaska Power Agency's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Southeast Alaska Power Agency's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

The Board of Directors
Southeast Alaska Power Agency

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Southeast Alaska Power Agency's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended for the information of Southeast Alaska Power Agency's management and Board of Directors, and is not intended to be and should not be used by anyone other than these specified parties.

Mikunda, Cottrell & Co.

Anchorage, Alaska
December 7, 2012

SOUTHEAST ALASKA POWER AGENCY

Schedule of Findings and Questioned Costs

Year Ended June 30, 2012

I. Summary of Auditor's Results

Financial Statements

Type of auditor's report issued

Unqualified

Internal control over financial reporting:

- Material weakness(es) identified? yes X no
- Significant deficiency(ies) identified? yes X no
- Noncompliance material to financial
statements noted? yes X no

II. Financial Statement Findings

None noted.

SOUTHEAST ALASKA POWER AGENCY

Summary Schedule of Prior Year Audit Findings

Year Ended June 30, 2012

Financial Statement Findings

There were no prior year audit findings.

SOUTHEAST ALASKA POWER AGENCY

Corrective Action Plan

Year Ended June 30, 2012

There are no current year findings; therefore, no corrective action plan is required.