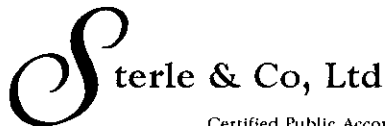


**PUBLIC UTILITIES COMMISSION**  
City of Hibbing, Minnesota

**FINANCIAL STATEMENTS**  
For the Years Ended  
December 31, 2006 and 2005

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Certified Public Accountants

### Independent Auditor's Report

To the Members of the  
Public Utilities Commission  
Hibbing, MN

We have audited the accompanying statements of net assets of the Public Utilities Commission, a component unit of the City of Hibbing, Minnesota, as of December 31, 2006 and 2005, and the related statements of revenues, expenses and changes in net assets, and cash flows for the years then ended, which collectively comprise the Commission's basic financial statements. These financial statements are the responsibility of the Commission's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the single-enterprise proprietary fund activities of the Hibbing Public Utilities Commission as of December 31, 2006 and 2005, and the respective changes in financial position and cash flows 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 have also issued our report dated June 1, 2007, on our consideration of the Commission'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 read in conjunction with this report in considering the results of our audit.

The management's discussion and analysis on pages 2 through 6 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

*Sterle & Co, Ltd*

June 1, 2007

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

Our discussion and analysis of the Hibbing Public Utilities Commission's financial performance provides an overview of the Utility's financial activities for the fiscal year ended December 31, 2006. Please read it in conjunction with the financial statements, which follow in this report.

### **FINANCIAL HIGHLIGHTS**

- The Utility's Net Assets increased by \$878,913.
- Total Operating Revenues decreased 4.8% from 2005 while Operating Expenses increased 4.7%
- Net Property, Plant and Equipment increased by \$1,832,411.
- Unrestricted Cash and Certificates of Deposit decreased by \$2,395,335.
- Investment in Laurentian Energy Authority increased by approximately \$3,981,833.

### **USING THIS ANNUAL REPORT**

This annual report consists of financial statements for the Hibbing Public Utilities Commission, a component unit of the City of Hibbing. The Commission reports its financial activities for the utilities of the City of Hibbing as a single-enterprise proprietary fund. The following analysis will discuss the Statement of Net Assets and the Statements of Revenues, Expenses and Changes in Net Assets related to this enterprise fund for the years 2006 and 2005.

### **STATEMENTS OF NET ASSETS**

A Statement of Net Assets is a statement of the financial position of a company which states the assets, liabilities and net assets at a particular point in time. The statements of net assets shown on pages 7 and 8 display the current and previous year's data. These statements reflect the Utility's financial position as of December 31, 2006 and 2005.

Table 1 Net Assets (below) is a summary of the Utility's Statement of Net Assets.

**Table 1**  
**NET ASSETS**  
(In Thousands)

	<u>As of 12/31/06</u>	<u>As of 12/31/05</u>
<b><u>ASSETS</u></b>		
Cash & Certificates of Deposit	\$2,629	\$5,024
Other Current Assets	\$5,328	\$5,903
Investment in LEA	\$9,082	\$5,079
Capital and Other Assets	\$33,610	\$31,674
<b>Total Assets</b>	<b>\$50,649</b>	<b>\$47,680</b>
<b><u>LIABILITIES</u></b>		
Current Liabilities	\$3,968	\$3,596
Long Term Bonds and Notes	\$6,800	\$5,089
Other Long Term Liabilities	\$960	\$953
<b>Total Liabilities</b>	<b>\$11,728</b>	<b>\$9,638</b>
<b><u>NET ASSETS</u></b>		
Invested In Capital Assets, Net of Debt	\$31,432	\$29,535
Restricted	\$467	\$356
Unrestricted	\$7,022	\$8,152
<b>Total Net Assets</b>	<b>\$38,922</b>	<b>\$38,043</b>

Unrestricted Cash & Certificates of Deposit have decreased by approximately \$2,395,000.

Long Term Bonds have increased by approximately \$1,711,000.

Total Net Assets has increased by approximately \$879,000.

**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND EQUITY**

The Statements of Revenues, Expenses and Changes in Net Assets display revenues, expenses and increases in net assets over a given period of time (calendar years 2005 and 2006).

Table 2 is an Income Statement Summary of the Statements of Revenues, Expenses and Changes in Net Assets shown in their entirety on page 9.

**Table 2**  
**INCOME STATEMENT SUMMARY**  
(In Thousands)

	<u>2006</u>	<u>2005</u>
<b><u>OPERATING</u></b>		
Revenue	\$20,901	\$21,966
Expense	\$(22,418)	\$(21,411)
Operating Income (Loss)	(\$1,517)	\$555
<b><u>NON-OPERATING</u></b>		
Revenue	\$2,534	\$483
Expense	\$(138)	\$(517)
Non-Operating Income	\$2,396	\$(34)
<b>INCREASE IN NET ASSETS</b>	<b>\$879</b>	<b>\$521</b>

Revenues from operations have decreased 4.8% over 2005.

Expenses from operations have increased 4.7% over 2005.

**CAPITAL ASSETS AND DEBT**

**Capital Assets**

2006 major completed projects included (in thousands):	
#3A Boiler Detroit Stoker Repair	\$ 436
#5 T/G 5 Year Inspection	\$ 363
Reverse Osmosis	\$ 348
Building Plant Improvements	\$ 262
30" Main Replacement by Jack & Don's	\$ 256
Civic Software / Hardware	\$ 240
Bucket Elevator Enclosure	\$ 186
Cooling Towers	\$ 182
#6 T/G Inspection	\$ 170
Install Governor Controls	\$ 169
Koskiville Sunnyside Alley Rebuild	\$ 111

## Debt

At year end the Utility had \$7.1 million in outstanding debt compared to \$5.2 million as of December 31, 2006 – an increase of 35.8% - See Table 3 below.

**Table 3**  
**OUTSTANDING BONDS AND NOTES**  
(In Thousands)

	<u>As of 12/31/06</u>	<u>As of 12/31/05</u>
G.O. Public Utilities Revenue Note	\$1,147	\$1,212
2005 Public Utility Revenue Note	\$1,970	\$2,030
State of Minnesota Note	\$4,000	\$2,000
Total Debt	<u>\$7,117</u>	<u>\$5,242</u>
Less: Unamortized Bond Discounts and Deferred Loss on Bond Defeasance	<u>\$(26)</u>	<u>\$(28)</u>
Total Bonds and Notes on Statement of Net Assets	\$7,091	\$5,214

## ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The 2007 budget was developed as a joint effort of the Hibbing Public Utilities Management and Staff. Expense categories were reviewed for savings potential and utility sales projections were based on historical performance.

Following the expense review, the Hibbing Public Utilities Commission set a rate increase at 3.5% for water and maintaining the same rates as 2006 for the other three utilities, all to be effective January 1, 2007. These rate adjustments resulted in the following levels of budgeted expense recovery for 2007:

Electric	5.7%
Steam	7.6%
Gas	1.7%
Water	5.1%
Total from Operations	4.7%

Total capital expenditures are budgeted at \$3,857,000, a level consistent with previous years.

In 2003 the Hibbing Public Utilities, in a joint effort with the Virginia Public Utilities began to pursue the potential for the production of biomass fuel. This effort will enable the public utilities in these two small cities in rural Minnesota to better utilize their resources to meet the demand for renewable biomass electric energy needed by the state's largest utility, while benefiting the local economy by engaging independent loggers to harvest renewable biomass from the region's federal, state, county, tribal, and private lands.

Currently, the cities of Hibbing and Virginia own and operate coal-fired boilers that produce steam and electricity for their communities. Hibbing has about 1,200 commercial and residential steam customers, while Virginia has nearly 2,300. Both steam systems are under physical and financial stress, forcing each community to consider eliminating the steam systems with the consequent loss of jobs (70) and costs to convert residential and commercial customers to a new heat sources.

Meanwhile, studies by the University of Minnesota's Natural Resources Research Institute show that 500,000 green tons of biomass are annually available within a 75 mile radius of these plants as forest residue from existing logging operations. Utilization of forest-derived biomass would certainly improve the profitability of independent loggers, increase revenue for the different levels of government and private landholders, and have a dramatic and immediate positive effect on the local economy. A majority of the fuel, however, needs to be "closed loop" biomass. Closed loop refers to dedicated hybrid poplar (for the most part) grown using farming methods as a dedicated fuel source.

Thus, the Biomass Project plan is to repower both Hibbing and Virginia with new biomass boilers and connect them to the existing steam and electricity plants. In addition, modifications would be done at both Hibbing and Virginia to handle the new fuel resource and also to create a wood yard to insure inventory and quality control for the new biomass fuel. The Laurentian Energy Authority (LEA) has been formed as a Limited Liability Corporation (LLC) to initiate this effort. \$60-80 million would be invested by the LEA in this 20 year project.

The LEA has completed a Power Purchase Agreement with Xcel Energy to supply 35 megawatts of biomass-produced power for 20 years, half of which must be from closed loop fuel sources.

### **CONTACTING THE UTILITY'S FINANCIAL MANAGEMENT**

This financial report is designed to provide our citizens, taxpayers, customers, and creditors with a general overview of the Utility's finances and to show the Utility's accountability for the money it receives. If you have questions about this report or need additional financial information, please contact Kevin M Gargano, Director of Finance at the Hibbing Public Utilities Commission, PO Box 249, Hibbing, MN 55746 (218-262-7719)

**PUBLIC UTILITIES COMMISSION**

City of Hibbing, Minnesota

**STATEMENTS OF NET ASSETS**

December 31, 2006 and 2005

<i>ASSETS</i>	2006	2005
<b>Current Assets</b>		
Cash	\$ 628,916	\$ 4,024,251
Certificates of deposit	2,000,000	1,000,000
Accounts receivable, net of allowance for doubtful accounts of \$66,000 and \$63,000 for 2006 and 2005	1,779,432	1,903,329
Interest receivable	5,726	2,532
Unbilled revenues	2,177,500	2,744,780
Inventories	925,738	854,751
Prepaid expense	439,229	397,582
<b>Total Current Assets</b>	<b>7,956,541</b>	<b>10,927,225</b>
<b>Restricted Assets</b>		
Cash held for fuel assistance recipients	17,378	22,255
Cash held for customer deposits	171,335	170,716
Cash held for bond reserve account	466,762	466,762
Cash held to secure letter of credit	376,323	246,719
<b>Total Restricted Assets</b>	<b>1,031,798</b>	<b>906,452</b>
<b>Property, Plant and Equipment</b>	<b>32,579,022</b>	<b>30,746,611</b>
<b>Other Assets</b>		
Equity in joint venture	9,081,769	5,099,936
<b>Total Other Assets</b>	<b>9,081,769</b>	<b>5,099,936</b>
<b>TOTAL ASSETS</b>	<b>\$ 50,649,130</b>	<b>\$ 47,680,224</b>

(Continued)

**PUBLIC UTILITIES COMMISSION**

City of Hibbing, Minnesota

**STATEMENTS OF NET ASSETS**

December 31, 2006 and 2005

<i>LIABILITIES AND NET ASSETS</i>		
	2006	2005
<b>Current Liabilities (Payable from current assets)</b>		
Accounts payable	\$ 2,340,483	\$ 2,276,179
Accrued expense	284,772	273,049
Due to City of Hibbing	319,678	296,532
Compensated absences payable	412,372	397,382
	<hr/>	<hr/>
	3,357,305	3,243,142
<b>Current Liabilities (Payable from restricted assets)</b>		
Current portion of general obligation revenue bonds payable	291,269	125,000
Accrued interest payable	130,968	34,312
Third party advances for fuel assistance	17,378	22,255
Customer deposits payable	171,335	170,716
	<hr/>	<hr/>
	610,950	352,283
<b>Total Current Liabilities</b>	<hr/>	<hr/>
	3,968,255	3,595,425
<b>Long-Term Liabilities</b>		
General obligation revenue bonds	6,799,358	5,089,233
Compensated absences payable	960,100	953,062
	<hr/>	<hr/>
	7,759,458	6,042,295
<b>Total Liabilities</b>	<hr/>	<hr/>
	11,727,713	9,637,720
<b>Net Assets</b>		
Invested in capital assets, net of related debt	31,432,022	29,534,611
Restricted for debt service	466,762	355,761
Unrestricted	7,022,633	8,152,132
	<hr/>	<hr/>
<b>Total Net Assets</b>	38,921,417	38,042,504
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<hr/> <hr/>	<hr/> <hr/>
	\$ 50,649,130	\$ 47,680,224

The accompanying notes to financial statements are an integral part of these statements.

**PUBLIC UTILITIES COMMISSION**

City of Hibbing, Minnesota

**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS**

For the Years Ended December 31, 2006 and 2005

	2006	2005
<b>Operating Revenues</b>		
Charges for services	\$ 20,880,017	\$ 21,964,480
Other	20,827	1,017
<b>Total Operating Revenues</b>	<u>20,900,844</u>	<u>21,965,497</u>
<b>Operating Expenses</b>		
Operation costs	16,668,989	15,949,268
Maintenance expense	601,049	556,543
Distribution expense	2,846,779	3,552,626
General overhead	2,301,517	1,352,551
<b>Total Operating Expenses</b>	<u>22,418,334</u>	<u>21,410,988</u>
<b>Operating Income (Loss)</b>	(1,517,490)	554,509
<b>Nonoperating Revenues (Expenses)</b>		
Interest income	166,113	207,013
Late payment penalties	166,801	186,520
Other income	193,146	90,293
Interest expense	(138,000)	(86,455)
Equity interest in joint venture increase (decrease) in net assets	1,422,318	(430,607)
Capital contribution from joint venture	586,025	-
<b>Total Nonoperating Revenues (Expenses)</b>	<u>2,396,403</u>	<u>(33,236)</u>
<b>Increase in Net Assets</b>	<u>\$ 878,913</u>	<u>\$ 521,273</u>
<b>Net Assets - Beginning of Year</b>	\$ 38,042,504	\$ 37,521,231
Increase in Net Assets	878,913	521,273
<b>Net Assets - End of Year</b>	<u>\$ 38,921,417</u>	<u>\$ 38,042,504</u>

**PUBLIC UTILITIES COMMISSION**

City of Hibbing, Minnesota

**STATEMENTS OF CASH FLOWS**

For the Years Ended December 31, 2006 and 2005

	2006	2005
<b>Cash Flows From Operating Activities</b>		
Receipts from customers	\$ 21,592,021	\$ 21,598,570
Payments to suppliers	(15,338,682)	(14,248,162)
Payments to employees	(4,644,924)	(4,295,993)
Other receipts	359,947	276,813
<b>Net Cash Provided by Operating Activities</b>	<b>1,968,362</b>	<b>3,331,228</b>
<b>Cash Flows From Capital and Related Financing Activities</b>		
Principal payments of general obligation revenue bonds	(125,000)	(718,000)
Net proceeds from long term borrowing	2,000,000	4,002,001
Payments for additions to property, plant and equipment	(3,675,411)	(1,538,690)
Interest paid	(138,578)	(87,556)
<b>Net Cash Provided by (Used in) Capital and Related Financing Activities</b>	<b>(1,938,989)</b>	<b>1,657,755</b>
<b>Cash Flows From Investing Activities</b>		
Purchases of certificates of deposit	(2,000,000)	(1,000,000)
Proceeds from maturities of certificates of deposit	1,000,000	1,960,000
Investment in joint venture	(2,462,281)	(4,978,780)
Interest income received	162,919	218,948
<b>Net Cash Used in Investing Activities</b>	<b>(3,299,362)</b>	<b>(3,799,832)</b>
<b>NET INCREASE (DECREASE) IN CASH</b>	<b>(3,269,989)</b>	<b>1,189,151</b>
<b>Cash - Beginning of Year</b>	<b>4,930,703</b>	<b>3,741,552</b>
<b>Cash - End of Year</b>	<b>\$ 1,660,714</b>	<b>\$ 4,930,703</b>

(Continued)

# PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

## STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2006 and 2005

	2006	2005
<b>Reconciliation of operating income to net cash provided by operating activities:</b>		
Operating income (loss)	\$ (1,517,490)	\$ 554,509
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	2,429,025	2,357,639
Amortization	1,394	24,259
Receipt of late payment penalties	166,801	186,520
Receipt of other income	193,146	90,293
(Increase) decrease in accounts receivable	123,897	(206,435)
(Increase) decrease in unbilled revenue	567,280	(163,835)
Decrease (increase) in inventories	(70,987)	12,668
Increase in prepaid expenses	(41,647)	(7,327)
Increase in accounts payable	64,304	476,491
Increase in compensated absences payable	22,028	17,856
Increase in accrued expenses	11,723	6,797
Increase (decrease) in due to City of Hibbing	23,146	(21,550)
Decrease in third party advances for fuel assistance	(4,877)	(9,997)
Increase in customer deposits payable	619	13,340
<b>Net Cash Provided by Operating Activities</b>	<b>\$ 1,968,362</b>	<b>\$ 3,331,228</b>
Cash is presented on the balance sheet as follows:		
Cash	628,916	4,024,251
Restricted assets	1,031,798	906,452
	<b>\$ 1,660,714</b>	<b>\$ 4,930,703</b>
<b>Supplemental Disclosure:</b>		
Noncash capital and related financing transaction:		
Equipment constructed by joint venture and transferred to Commission	\$ 586,025	\$ -

# PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

## NOTES TO FINANCIAL STATEMENTS

December 31, 2006 and 2005

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### NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Public Utilities Commission, City of Hibbing, Minnesota have been prepared in conformity with generally accepted accounting principles as applied to governmental enterprise units. The following summary of the more significant accounting policies are presented to assist the reader in interpreting the financial statements and other data in this report. These policies should be viewed as an integral part of the accompanying financial statements.

#### Reporting Entity

In evaluating how to define the entity for financial reporting purposes, management considered whether the Commission is a component unit of another primary government. The Commission is a business type activity providing water, electric power, natural gas and steam services to the City of Hibbing. The Commission's basic financial statements include the financial position and results of operations of the Commission. Management has determined that the Commission is appropriately noted as a component unit of the City of Hibbing following criteria set forth in generally accepted accounting principles.

The Public Utilities Commission was established pursuant to Minnesota Laws 1949, Chapter 422, which gives the Commission full and exclusive control over the provision of water, electric power, natural gas, and steam services and the facilities used in providing these services to the City of Hibbing. The Commission is composed of three members, all of whom are appointed by the Hibbing City Council, and all of whom serve three-year terms.

#### Basis of Accounting

The Commission is a single-enterprise proprietary fund and uses the accrual basis of accounting. Proprietary funds are used to account for operations that are financed in a manner similar to private business enterprise in that a periodic determination of revenues earned, expenses incurred and/or changes in net assets is appropriate for capital maintenance, public policy, management control, accountability or other purposes. Under this method, revenues are recorded when earned, and expenses are recognized as soon as they result in liabilities for the benefits provided.

The financial statements are prepared on the basis of Governmental Accounting Standards Board (GASB), Statement Number 34, *Basic Financial Statements, Management Discussion and Analysis for State and Local Governments* and related standards. This statement provides for significant changes in terminology and includes recognition of capital grants in the Statement of Revenues, Expenses and Changes in Net Assets; a presentation of net assets; as well as an inclusion of a management discussion and analysis; supplementary information as well as other changes.

The Commission applies all relevant Governmental Accounting Standards Board (GASB) pronouncements as well as Financial Accounting Standard Board (FASB) statements and interpretations. Accounting Principles Board (APB) Opinion, and Accounting Research Bulletins of the Committee on Accounting Procedure issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements. The Commission has elected not to follow FASB pronouncements issued after November 30, 1989 to its business-type activities recorded in the enterprise fund.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary funds' principle ongoing operations. The principle operating revenues of the Commission are charges to customers in the form of utility rates. Operating expenses include the cost of providing the utility services, administration expenses and depreciation on capital assets.

The Commission's measurement focus is all financial and economic resources. All assets and liabilities associated with the Commission's operations are included in the statement of net assets. Depreciation is reported as a cost of operation.

**PUBLIC UTILITIES COMMISSION**

City of Hibbing, Minnesota

**NOTES TO FINANCIAL STATEMENTS**

December 31, 2006 and 2005

---

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Cash and Investments**

Cash includes amounts on hand and in demand deposit accounts. Investments include certificates of deposit with original maturities of more than three months from the date of acquisition.

**Unbilled Revenues**

Unbilled revenues represent an estimate of December's services that were not billed to customers until the following year.

**Inventories**

Parts inventory is valued at weighted average cost. Fuel and bulk supplies inventories are valued at cost on a first-in, first-out basis.

**Restricted Assets**

Certain proceeds of the general obligation revenue bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the balance sheet because their use is limited by charter and applicable bond covenants. The bond reserve account is used to segregate resources accumulated for future debt service payments.

The Commission also holds cash that is restricted for the following specific uses:

- Customer deposits - Refundable deposits paid by customers at inception of service.
- Fuel assistance recipients - Amounts received from a third party that are to be applied against utility bills for qualifying low income utility users.
- Secure letter of credit - amounts held in conjunction with equity in joint venture as discussed in note 12.

**Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from these estimates.

**Property, Plant and Equipment**

Property, plant and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets as follows:

Buildings and grounds	5-50 Years
Production equipment	5-50 Years
Transmission and distribution equipment	5-50 Years
Furniture and equipment	4-40 Years

**Bond Discounts**

Bond discounts, which represent the difference between the proceeds received on the issuance of the general obligation revenue bonds and the face amount of the bonds, are being amortized over the life of the related bonds.

**Comparative Data**

Comparative data for the prior year has been presented to provide an understanding of the changes in the financial position and operations.

**PUBLIC UTILITIES COMMISSION**

City of Hibbing, Minnesota

**NOTES TO FINANCIAL STATEMENTS**

December 31, 2006 and 2005

**NOTE 2 DEPOSITS AND INVESTMENTS**

In 2005, the Commission adopted the provisions of GASB Statement 40, *Deposit and Investment Risk Disclosures*. This new standard revised the existing requirements regarding disclosure of custodial credit risk and establishes requirements for disclosures regarding credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. Adoption of GASB 40 had no effect on net assets and change in net assets in the prior or current year.

**Deposits**

Custodial credit risk is the risk that in the event of bank failure, a government's deposits may not be returned to it. The Commission's deposit policy for custodial credit risk requires compliance with the provisions of state law.

Minnesota Statutes require that all deposits, which are not U.S. government securities, be protected by insurance, surety bond, or collateral. The market value for collateral pledged must equal 110% of the deposits not covered by insurance or bonds (140% in the case of mortgage notes pledged).

Authorized collateral includes legal investments, as well as certain first mortgage notes, and certain state and local government obligations. Minnesota Statutes require that securities pledged as collateral be held in safekeeping by the Commission or in a financial institution other than that furnishing the collateral.

At December 31, 2006 and 2005, the carrying amount of the Commission's deposits were \$1,652,714 and \$4,922,703 and the bank balances were \$2,684,293 and \$4,865,683 respectively. As of December 31, 2006 the Commission's deposits were fully covered by depository insurance or by collateral held in the Commission's name by the pledging financial institution's correspondent bank. As of December 31, 2005, the Commission's deposits were under collateralized by \$990,000.

**Investments**

As of December 31, 2006 and 2005 the Commission invested \$2,000,000 and \$1,000,000 in bank certificates of deposit.

Custodial Credit Risk - The risk that in the event of bank failure, a government's investments may not be returned to it. The Commission's investment policy for custodial credit risk requires compliance with the provisions of state law. The certificates of deposit were fully collateralized as required by state law.

Interest Rate Risk - The Commission does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk - State law limits investments to obligations of the U.S. Treasury, commercial paper, corporate bonds or repurchase agreements. The City does not have an investment policy that would further limit its investment choices.

Concentration of Credit Risk - The Commission places no limit on the amount it may invest in any one issuer.

**NOTE 3 INVENTORIES**

Inventories consist of the following at December 31:

	2006	2005
Parts	\$ 866,300	\$ 791,276
Fuel and bulk supplies	59,438	63,475
	<u>\$ 925,738</u>	<u>\$ 854,751</u>

**PUBLIC UTILITIES COMMISSION**  
City of Hibbing, Minnesota

**NOTES TO FINANCIAL STATEMENTS**  
December 31, 2006 and 2005

**NOTE 4 PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment consist of the following at December 31:

	2006	2005
Buildings and grounds	\$ 6,044,042	\$ 5,901,565
Production equipment	41,311,667	39,666,272
Transmission and distribution system	42,390,090	42,256,977
Furniture and equipment	2,742,171	3,077,428
Construction in progress	759,379	412,931
	<u>93,247,349</u>	<u>91,315,173</u>
Less - Accumulated depreciation	60,668,327	60,568,562
	<u>\$ 32,579,022</u>	<u>\$ 30,746,611</u>
Depreciation for year	<u>\$ 2,429,025</u>	<u>\$ 2,357,639</u>

A summary of changes in capital assets during 2006 is as follows:

	Balance Jan. 1, 2006	Additions	Deletions	Balance Dec. 31, 2006
Buildings and grounds	\$ 5,901,565	\$ 142,477	\$ -	\$ 6,044,042
Production equipment	39,666,272	2,120,538	475,143	41,311,667
Transmission and distribution system	42,256,977	1,336,280	1,203,167	42,390,090
Furniture and equipment	3,077,428	315,693	650,954	2,742,167
Construction in progress	412,931	346,448	-	759,379
	<u>91,315,173</u>	<u>4,261,436</u>	<u>2,329,264</u>	<u>93,247,345</u>
Less - Accumulated depreciation	60,568,562	2,429,025	2,329,264	60,668,323
	<u>\$ 30,746,611</u>	<u>\$ 1,832,411</u>	<u>\$ -</u>	<u>\$ 32,579,022</u>

A summary of changes in capital assets during 2005 is as follows:

	Balance Jan. 1, 2005	Additions	Deletions	Balance Dec. 31, 2005
Buildings and grounds	\$ 5,970,217	\$ 305,232	\$ 373,884	\$ 5,901,565
Production equipment	38,479,543	1,186,729	-	39,666,272
Transmission and distribution system	41,700,148	556,829	-	42,256,977
Furniture and equipment	2,920,099	177,739	20,410	3,077,428
Construction in progress	1,100,770	(687,839)	-	412,931
	<u>90,170,777</u>	<u>1,538,690</u>	<u>394,294</u>	<u>91,315,173</u>
Less - Accumulated depreciation	58,605,217	2,357,639	394,294	60,568,562
	<u>\$ 31,565,560</u>	<u>\$ (818,949)</u>	<u>\$ -</u>	<u>\$ 30,746,611</u>

**PUBLIC UTILITIES COMMISSION**

City of Hibbing, Minnesota

**NOTES TO FINANCIAL STATEMENTS**

December 31, 2006 and 2005

**NOTE 5 COMPENSATED ABSENCES**

Employees of the Hibbing Public Utilities Commission may accumulate up to 180 days of sick leave. After ten years of service and upon termination of employment, employees are paid one-half of their unused accumulated sick leave. At December 31, 2006 and 2005, the liability for sick leave, which represents one-half of the accumulated sick leave, was \$960,100 and \$953,062, respectively. The remaining sick leave is available to employees only in the event of illness related absences and is not reflected in these financial statements.

Employees may also accrue vacation pay up to a maximum of 31 working days per year based on length of employment. A maximum of ten unused vacation days may be carried past the employee's anniversary date. No payments are given in lieu of vacation time. At December 31, 2006 and 2005, the Commission's liability for vacation pay was \$412,372 and \$397,382, respectively.

**NOTE 6 DUE TO CITY OF HIBBING**

The Commission acts as a collection agent for garbage and sewage charges billed by the City of Hibbing. The Commission includes these charges on its own monthly utility billings and remits collection of these charges to the City on a monthly basis. At December 31, 2006 and 2005, the Commission owed the City of Hibbing \$319,678 and \$296,532, respectively for such charges.

**NOTE 7 LONG-TERM DEBT - BONDS**

Bonds payable consist of the following at December 31:

	2006	2005
\$1,275,000 General Obligation Public Utilities Revenue Bond dated July 27, 2001, due in annual installments of \$39,777 to \$99,000 through August 20, 2020, interest at 3.05%.	1,147,000	1,212,000
\$2,030,000 Public Utilities Revenue Note Series 2005A, due in annual installments of \$30,000 to \$80,000 through December, 2025, interest at 4.1425 percent.	1,970,000	2,030,000
\$4,000,000 Promissory Note to the State of Minnesota dated July, 2005. Initial proceeds of \$2,000,000 were advanced in 2005 with an additional \$2,000,000 advanced in 2006. Initial interest rate of 3.5 percent. First interest payment due July 1, 2007. Thereafter quarterly payments of \$85,976 through 2022.	4,000,000	2,000,000
	7,117,000	5,242,000
Less - Current maturities	291,269	125,000
	6,825,731	5,117,000
Less - Unamortized bond discounts	26,373	27,767
Total Long-Term Debt - Bonds	\$ 6,799,358	\$ 5,089,233

**PUBLIC UTILITIES COMMISSION**

City of Hibbing, Minnesota

**NOTES TO FINANCIAL STATEMENTS**

December 31, 2006 and 2005

**NOTE 7 LONG-TERM DEBT - BONDS (Continued)**

A summary of changes in long-term debt during 2006 is as follows:

	Balance Jan. 1, 2006	Additions	Reductions	Balance Dec. 31, 2006
G.O. Public Utilities Revenue Bond	1,212,000	-	65,000	1,147,000
Public Utilities Revenue Note 2005A	2,030,000	-	60,000	1,970,000
State of Minnesota Promissory Note	2,000,000	2,000,000	-	4,000,000
	<u>\$ 5,242,000</u>	<u>\$ 2,000,000</u>	<u>\$ 125,000</u>	<u>\$ 7,117,000</u>

A summary of changes in long-term debt during 2005 is as follows:

	Balance Jan. 1, 2005	Additions	Reductions	Balance Dec. 31, 2005
G.O. Public Utilities Revenue Refunding Bonds of 1996	\$ 655,000	\$ -	\$ 655,000	\$ -
G.O. Public Utilities Revenue Bond	1,275,000	-	63,000	1,212,000
Public Utilities Revenue Note 2005A	-	2,030,000	-	2,030,000
State of Minnesota Promissory Note	-	2,000,000	-	2,000,000
	<u>\$ 1,930,000</u>	<u>\$ 4,030,000</u>	<u>\$ 718,000</u>	<u>\$ 5,242,000</u>

The annual requirements to amortize all long-term debt outstanding as of December 31, 2006, including interest payments of \$2,686,149 are as follows:

Year ending December 31,	Principal	Interest	Total
2007	\$ 291,269	\$ 371,550	\$ 662,819
2008	351,065	260,062	611,127
2009	360,585	246,853	607,438
2010	380,372	233,116	613,488
2011	390,435	221,026	611,461
2012 - 2016	2,177,512	861,044	3,038,556
2017 - 2021	2,510,552	421,043	2,931,595
2022 - 2026	655,210	71,455	726,665
	<u>\$ 7,117,000</u>	<u>\$ 2,686,149</u>	<u>\$ 9,803,149</u>

**NOTE 8 RISK MANAGEMENT**

The Commission 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 the Commission carries commercial insurance. There have been no significant reductions in coverage from prior years and settlements have not exceeded coverage in the past three years.

**PUBLIC UTILITIES COMMISSION**

City of Hibbing, Minnesota

**NOTES TO FINANCIAL STATEMENTS**

December 31, 2006 and 2005

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**NOTE 8 RISK MANAGEMENT (Continued)**

**Health Care Coverage**

The Commission provides health care coverage for its employees. As part of this benefit, the Commission pays the deductible and a portion of the co-pays. Medical claims are then processed by an insurance carrier. The carrier processes claims on behalf of the Commission and is reimbursed for the claims processed, in addition to an administrative fee based on a percentage of the dollar amount of claims processed.

The liability for unpaid claims at December 31 is calculated by obtaining actual claims paid for the following month subsequent to year end. Activity for the years ended December 31, 2006 and 2005, is as follows:

	2006	2005
January 1 liability	\$ 8,461	\$ 2,134
Current year claims	141,524	170,166
Claims paid during the year	(147,501)	(163,839)
December 31 liability	<u>\$ 2,484</u>	<u>\$ 8,461</u>

**NOTE 9 CONTINGENCIES AND COMMITMENTS**

The Commission has entered into several contracts, which expire at various times in the future, for the purchase of gas, coal and electricity. The purchase prices of all contracts are adjusted during the year based on pre-established formulas. The quantities that are purchased under these contracts are dependent upon the current production needs of the Commission.

The Commission has incurred expenses over several years related to the cleanup of its former gas plant site. Costs related to complete the cleanup at this time are not known, but management does not believe that the Commission will have any significant additional costs based on municipal liability limits.

**NOTE 10 DEFINED BENEFIT PENSION PLAN - STATEWIDE**

**Plan Description**

All full-time and certain part-time employees of the Commission are covered by defined benefit pension plans administered by the Public Employees Retirement Association of Minnesota (PERA). PERA administers the Public Employees Retirement Fund (PERF) which is a cost-sharing, multiple-employer plan. This plan is established and administered in accordance with Minnesota Statutes, Chapters 353 and 356. PERF members belong to either the Coordinated Plan or the Basic Plan. Coordinated Plan members are covered by social security benefits, and Basic Plan members are not. All new members must participate in the Coordinated Plan.

# PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

## NOTES TO FINANCIAL STATEMENTS

December 31, 2006 and 2005

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### NOTE 10 DEFINED BENEFIT PENSION PLAN - STATEWIDE (Continued)

PERA provides retirement benefits as well as disability benefits to members and benefits to survivors upon the death of eligible members. Benefits are established by state statute and vest after three years of credited service. The defined retirement benefits are based on a member's average salary for any five consecutive years of allowable service, age and years of credit at termination of service. Two methods are used to compute benefits for Coordinated and Basic members. The retiring member receives the higher of the step-rate benefit accrual formula (Method 1) or a level accrual formula (Method 2). Under Method 1, the annuity accrual rate for a Basic Plan member is 2.2 percent of average salary for each of the first 10 years of service and 2.7 percent for each remaining year. The annuity accrual rate for a Coordinated Plan member is 1.2 percent of average salary for each of the first 10 years and 1.7 percent for each remaining year. Under Method 2, the annuity accrual rate is 2.7 percent of average salary for Basic members and 1.7 percent for Coordinated members for each year of service. For PERF members hired prior to July 1, 1989 whose annuity is calculated using Method 1, a full annuity is available when age plus years of service equal 90. Normal retirement age is 65 for Basic and Coordinated members hired prior to July 1, 1989. Normal retirement age is the age for unreduced Social Security benefits capped at 66 for Coordinated members hired on or after July 1, 1989. A reduced retirement annuity is also available to eligible members seeking early retirement.

There are different types of annuities available to members upon retirement. A single-life annuity is a lifetime annuity that ceases upon the death of the retiree -- no survivor annuity is payable. There are also various types of joint and survivor annuity options available which will be payable over joint lives. Members may also leave their contributions in the fund upon termination of public service, in order to qualify for a deferred annuity at retirement age. Refunds of contributions are available at any time to members who leave public service, but before retirement benefits begin.

The benefit provisions stated in the previous paragraphs of this section are current provisions and apply to active plan participants. Vested, terminated employees who are entitled to benefits but are not receiving them yet, are bound by the provisions in effect at the time they last terminated their public service.

PERA issues a publicly available financial report that includes financial statements and required supplementary information for PERF. That report may be obtained on the web at [mnpera.org](http://mnpera.org), by writing to PERA at 60 Empire Drive #200, St. Paul, MN 55103-1855 or by calling (651) 296-7460 or 1-800-652-9026.

#### Funding Policy

Minnesota Statutes Chapter 353 sets the rates for employer and employee contributions. These statutes are established and amended by the state legislature. The Commission makes annual contributions to the pension plans equal to the amount required by state statutes. PERF Basic Plan members and Coordinated Plan members were required to contribute 9.10% and 5.50%, respectively, of their annual covered salary. Contribution rates in the Coordinated Plan will increase in 2007 to 5.75%. The Commission is required to contribute the following percentages of annual covered payroll: 11.78% for Basic Plan PERF members and 6.0% for Coordinated Plan members. Employer contribution rates for the Coordinated plan will increase to 6.25% effective January 1, 2007. The Commission's contributions to the Public Employees Retirement Fund for the years ending December 31, 2006, 2005, and 2004 were \$266,428, \$230,386 and \$225,556, respectively. The Commission's contributions were equal to the contractually required contributions for each year as set by state statute.

# PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

## NOTES TO FINANCIAL STATEMENTS

December 31, 2006 and 2005

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### NOTE 11 POST RETIREMENT BENEFITS

The Commission provides health care and dental insurance benefits for retired Commission employees. Commission employees become eligible for such benefits upon retirement. The cost of such benefits is recognized as an expense as the premiums are paid. During the years ended December 31, 2006 and 2005, the Commission expended \$471,087, and \$434,027, respectively, in benefits for approximately 42 retirees in 2006 and 38 retirees in 2005.

### NOTE 12 EQUITY IN JOINT VENTURE

The Commission has entered into a joint venture with the Virginia Public Utilities Commission to form the Laurentian Energy Authority, LLC. The Authority is a limited liability company created under Minnesota Statutes, Sections 452.25 and 471.59 and organized on January 31, 2005, under Minnesota Statutes Chapter 322B. The Authority was created to supply 35 MW of new biomass fueled electricity to Northern States Power Company, an operating subsidiary of Excel Energy, as well as to supply steam to existing customers of the Hibbing and Virginia Public Utilities Commissions.

The management of the business and affairs of the Authority are governed by a Board of Directors. The Board consists of seven directors. The General Manager, Chairman, and Vice Chairman of the Hibbing Public Utilities as well as the General Manager, President, and Vice President of the Virginia Public Utilities comprise six seats on the Board. The remaining Board position is elected by a majority of the other directors.

Each Commission owns and operates a cogeneration power plant which provides both steam and electricity for distribution to its service area. The Authority is not regulated. Customer rates are set by the Board of Directors and existing operating and power agreements.

The Authority is a development stage organization. As of December 31, 2006, biomass fueled steam and electricity production has not yet started. The Authority began production in early 2007

As of December 31, 2006, the Commission has reported on its balance sheet an investment of \$9,081,769 in the joint venture, which represents its share of monies directly invested and costs incurred in the establishment of the joint venture as well as its 50 percent share of the change in the Authority's net assets for the year. In addition, interest of \$133,687 has been capitalized in conjunction with the development of the Authority.

The Commission has pledged \$376,323 of deposits to secure a letter of credit for the Authority. The deposits are reflected as restricted assets on the accompanying Commission statement of net assets.

Complete financial statements of the Authority can be obtained from the Commission's Director of Finance. The following represents information reflected in the Authority's financial statements:

	2006	2005
Current assets	\$ 5,051,566	\$ 1,442,432
Non-current restricted assets	10,236,430	52,087,872
Other assets	4,518,631	3,589,400
Capital assets	60,013,753	13,685,770
Total assets	79,820,380	70,805,474
Current liabilities	5,640,413	2,142,523
Revenue bonds	56,490,000	58,725,000
Total liabilities	61,924,219	60,647,506
Net assets	17,896,161	10,157,968
Total operating revenues	-	-
Operating expenses	855,409	779,565
Change in net assets	7,738,193	10,157,968

**Independent Auditor's Report on  
Supplemental Information**

To the Members of the  
Public Utilities Commission  
Hibbing, MN

Our report on our audits of the basic financial statements of the Public Utilities Commission, a component unit of the City of Hibbing, appears on page one. Those audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The Schedules of Departmental Revenues and Expenses for the years ended December 31, 2006 and 2005, are presented for the purpose of additional analysis and are not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

*Sterle & Co, Ltd*

June 1, 2007

**PUBLIC UTILITIES COMMISSION**

City of Hibbing, Minnesota

**SCHEDULES OF DEPARTMENTAL REVENUES AND EXPENSES**

For the Years Ended December 31, 2006 and 2005

<b>2006</b>	<b>Electric</b>	<b>Steam</b>	<b>Gas</b>	<b>Water</b>	<b>Total</b>
<b>Operating Revenues</b>					
Sales and services	\$ 10,061,819	\$ 3,050,820	\$ 6,008,420	\$ 1,758,958	\$ 20,880,017
Other	20,827	-	-	-	20,827
<b>Total Operating Revenues</b>	<b>10,082,646</b>	<b>3,050,820</b>	<b>6,008,420</b>	<b>1,758,958</b>	<b>20,900,844</b>
<b>Operating Expenses</b>					
Operation costs	7,976,701	2,841,477	5,413,339	437,472	16,668,989
Maintenance expense	460,857	66,642	16,122	57,428	601,049
Distribution expense	1,057,944	591,018	479,837	717,980	2,846,779
General overhead	1,078,111	163,218	478,079	582,109	2,301,517
<b>Total Operating Expenses</b>	<b>10,573,613</b>	<b>3,662,355</b>	<b>6,387,377</b>	<b>1,794,989</b>	<b>22,418,334</b>
<b>Operating Income (Loss)</b>	<b>\$ (490,967)</b>	<b>\$ (611,535)</b>	<b>\$ (378,957)</b>	<b>\$ (36,031)</b>	<b>\$ (1,517,490)</b>
<b>2005</b>	<b>Electric</b>	<b>Steam</b>	<b>Gas</b>	<b>Water</b>	<b>Total</b>
<b>Operating Revenues</b>					
Sales and services	\$ 10,432,087	\$ 3,181,428	\$ 6,621,872	\$ 1,729,093	\$ 21,964,480
Other	1,017	-	-	-	1,017
<b>Total Operating Revenues</b>	<b>10,433,104</b>	<b>3,181,428</b>	<b>6,621,872</b>	<b>1,729,093</b>	<b>21,965,497</b>
<b>Operating Expenses</b>					
Operation costs	7,874,745	2,504,932	5,132,045	437,546	15,949,268
Maintenance expense	450,752	18,678	9,491	77,622	556,543
Distribution expense	1,399,527	723,649	630,396	799,054	3,552,626
General overhead	560,190	118,281	280,305	393,775	1,352,551
<b>Total Operating Expenses</b>	<b>10,285,214</b>	<b>3,365,540</b>	<b>6,052,237</b>	<b>1,707,997</b>	<b>21,410,988</b>
<b>Operating Income (Loss)</b>	<b>\$ 147,890</b>	<b>\$ (184,112)</b>	<b>\$ 569,635</b>	<b>\$ 21,096</b>	<b>\$ 554,509</b>



Certified Public Accountants

**Report on Internal Control Over  
Financial Reporting and Compliance and Other Matters  
Based on an Audit of Financial Statements Performed in  
Accordance with *Government Auditing Standards***

To the Members of the  
Public Utilities Commission  
Hibbing, MN

We have audited the financial statements of the single-enterprise proprietary fund activities of the Public Utilities Commission, a component unit of the City of Hibbing, Minnesota, as of and for the year ended December 31, 2006, which comprised the Commission's basic financial statements and have issued our report, thereon dated June 1, 2007. 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

In planning and performing our audit, we considered the Commission'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 the Commission's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Commission's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Commission's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Commission's financial statements that is more than inconsequential will not be prevented or detected by the Commission's internal control. We consider the deficiencies described in the following paragraph to be a significant deficiency in internal control over financial reporting.

The Commission has a lack of segregation of duties over the authorizing, recording, processing and reporting of the financial data due to the limited number of staff.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Commission's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we do not believe that the significant deficiency described above is a material weakness.

#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Commission's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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 that are required to be reported under *Government Auditing Standards*. We noted certain immaterial instances of noncompliance that we have reported to management in a separate letter dated June 1, 2007.

#### Minnesota Legal Compliance

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the provisions of the *Minnesota Legal Compliance Audit Guide for Local Government*, promulgated by the State Auditor pursuant to Minnesota Stat. Section 6.65. Accordingly, the audit included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The *Minnesota Legal Compliance Audit Guide for Local Government* contains seven main categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, claims and disbursements, TIF reporting and miscellaneous provisions. Our study included all of the applicable categories.

The results of our tests indicate for the items tested, the Commission complied with the material terms and conditions of applicable legal provisions, except as noted in the following paragraphs.

State statutes require contracts from \$10,000 to \$50,000 be awarded by use of quotes. Contracts in excess of \$50,000 are required be awarded through the use of bids. During the year the Commission entered into a contract in excess of \$50,000 without obtaining required bids. The Commission entered into the contract using emergency exemptions allowable under statute but failed to provide adequate documentation required by the provisions. In addition, two instances were noted in which required documentation was not available for purchases requiring quotes.

State statutes require a vendor to sign off on a declaration for payment that the claim is just and correct and that no part of it has been paid. It is common for governments to print the declaration above the endorsement line on the back of their checks. The Commission ordered new checks during the year in conjunction with its computer conversion and did not have the declaration printed on the back of the checks. Accordingly, the Commission failed to obtain the required declaration during the year.

Prior to making a final settlement with any contractor requiring the employment of employees for wages, the Commission is required to obtain a certificate from the Commissioner of Revenue that the contractor has complied with withholding requirements of MN Statute 290.92 (form IC-134). At times during the year the Commission did not obtain the required certificate.

This report is intended solely for the information and use of the audit committee and management, and is not intended to be and should not be used by anyone other than these specified parties.

*Sturle & Co, Ltd*

June 1, 2007