

PUBLIC UTILITIES COMMISSION
City of Hibbing, Minnesota

FINANCIAL STATEMENTS
For the Years Ended
December 31, 2008 and 2007

TABLE OF CONTENTS

	Page
Independent Auditor's Report	1
Management's Discussion and Analysis (MD&A) (Unaudited)	2
Basic Financial Statements	
Statements of Net Assets	7
Statements of Revenues, Expenses and Changes in Net Assets	9
Statements of Cash Flows	10
Notes to Financial Statements	12
Required Supplementary Information	
Schedule of Funding Progress - Other Postemployment Benefits Plan	24
Independent Auditor's Report on Supplemental Information	25
Schedules of Departmental Revenues and Expenses	26
Report on Internal Control Over Financial Reporting and Compliance and Other Matters Based on an Audit of Financial Statements Performed In Accordance with <i>Government Auditing Standards</i>	27



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, 2008 and 2007, 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, 2008 and 2007, 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.

As discussed in Note 12 to the financial statements, during the year ended December 31, 2008, the Commission adopted Governmental Accounting Standards Board (GASB) Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 22, 2009, 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 and the other required supplementary information listed in the table of contents 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 22, 2009

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, 2008. Please read it in conjunction with the financial statements, which follow in this report.

FINANCIAL HIGHLIGHTS

- The Utility's Net Assets decreased by \$4,506,166.
- Total Operating Revenues increased 14.9% from 2007 while Total Operating Expenses increased 24.7% from 2007.
- Net Property, Plant and Equipment increased by \$572,827.
- Unrestricted Cash and Certificates of Deposit decreased by \$61,477.
- Investment in Laurentian Energy Authority decreased by \$394,047.
- GASB 45 was adopted in 2008 resulting in an expense of \$2,801,176 for the year.

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 Statements of Net Assets and the Statements of Revenues, Expenses and Changes in Net Assets related to this enterprise fund for the years 2008 and 2007.

STATEMENT OF NET ASSETS

A Statement of Net Assets is a statement of the financial position of an entity which states the assets, liabilities and equity at a particular point in time. The Statement of Net Assets shown on the following page displays the current and previous year's data. These statements reflect the Utility's financial position as of 12/31/08 and 12/31/07.

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 12/31/08</u>	<u>As of 12/31/07</u>
<u>ASSETS</u>		
Cash & Certificates of Deposit	\$720	\$1,279
Other Current Assets	\$11,002	\$8,839
Investment in LEA	\$7,831	\$8,225
Capital and Other Assets	\$34,414	\$33,841
Total Assets	\$53,967	\$52,184
<u>LIABILITIES</u>		
Current Liabilities	\$9,427	\$8,320
Long Term Bonds and Notes	\$8,616	\$6,283
Other Long Term Liabilities	\$3,835	\$986
Total Liabilities	\$21,878	\$15,589
<u>NET ASSETS</u>		
Invested In Capital Assets, Net of Debt	\$30,418	\$32,761
Restricted	\$513	\$647
Unrestricted	\$1,158	\$3,187
Total Net Assets	\$32,089	\$36,595

Long Term Bonds have increased by \$2,333.

Total Net Assets has decreased by \$4,506.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

The Statements of Revenues, Expenses and Changes in Net Assets display revenues, expenses and change in net assets over a given period of time (calendar years 2007 and 2008).

Table 2 is an Income Statement Summary of the Statements of Revenues, Expenses and Changes in Net Assets.

Table 2
INCOME STATEMENT SUMMARY
(In Thousands)

	<u>2008</u>	<u>2007</u>
<u>OPERATING</u>		
Revenue	\$25,871	\$22,524
Expense	<u>\$(30,153)</u>	<u>\$(24,190)</u>
Operating Income (Loss)	\$(4,282)	\$(1,666)
<u>NON-OPERATING</u>		
Revenue	\$589	\$547
Expense	<u>\$(813)</u>	<u>\$(1,207)</u>
Non-Operating Loss	\$(224)	\$(660)
INCREASE (DECREASE) IN NET ASSETS	\$(4,506)	\$(2,326)

Revenues from operations have increased 14.9% over 2007.

Expenses from operations have increased 24.7% over 2007.

The total decrease in Net Assets for 2008 is \$4,506 which represents a recovery of a negative 14.9% of Operating Expense compared to a negative 9.6% for 2007.

CAPITAL ASSETS AND DEBT

Capital Assets

2008 major completed projects included (in thousands):	
# 1 Boiler Superheater Retubing	\$ 283
# 5 Turbine Condenser Rehabilitation	\$ 158
Mesabi Location 5 th / 6 th Avenue West	\$ 153
Kerr / Leetonia Location – Morton Road	\$ 142
Economizer Tube Replacement	\$ 142
# 3 Turbine Condenser Rehabilitation	\$ 101
Plant Silo Enclosure	\$ 101
New Gas Service Relocation	\$ 97
Park Hotel Water Main Replacement	\$ 88
Replace Ash System Piping	\$ 81
Circulating Water Pump Upgrade	\$ 80

Debt

At year end the Utility had \$9.3 million in outstanding debt compared to \$6.7 million as of 12/31/07 – an increase of 38.6% - See Table 3 below.

Table 3
OUTSTANDING BONDS AND NOTES
(In Thousands)

	<u>As of 12/31/08</u>	<u>As of 12/31/07</u>
2001 Public Utilities Revenue Bond	\$1,011	\$1,080
2005 Public Utility Revenue Note	\$1,830	\$1,900
State of Minnesota Note	\$3,467	\$3,733
MCMU Water Project Note	\$2,585	0
Real Estate Mortgage	\$400	0
Total Debt	<u>\$9,293</u>	<u>\$6,713</u>
Less: Unamortized Bond Discounts	<u>\$(24)</u>	<u>\$(25)</u>
Total Bonds and Notes on Statement of Net Assets	\$9,269	\$6,688

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The 2009 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 15.4% for Electric, 15.4% for Steam, and 15.4% for Water and maintaining the same rate as 2008 for the Gas Utility. In addition, HPUC increased all Service Charges by \$6.00 per Service Charge. \$3.00 is allotted for Operating Expenses and \$3.00 is allotted for Capital Improvements. All to be effective January 1, 2009. These rate adjustments resulted in the following levels of budgeted expense recovery for 2009:

Electric	6.1%
Steam	4.6%
Gas	11.3%
Water	2.4%
Total from Operations	6.5%

Total capital expenditures are budgeted at \$5,455,100 with projected actual expenditures to be approximately \$2,730,000.

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, 2008 and 2007

<i>ASSETS</i>		
	2008	2007
Current Assets		
Cash	\$ -	\$ 61,477
Accounts receivable - Customers, net of allowance for doubtful accounts of \$62,000 and \$76,490 for 2008 and 2007	1,787,980	1,698,608
Accounts receivable - Joint venture	4,224,020	3,554,254
Unbilled revenues	2,112,882	2,080,505
Inventories	1,255,790	1,111,902
Prepaid expense	405,728	393,047
Total Current Assets	9,786,400	8,899,793
Restricted Assets		
Cash held for fuel assistance recipients	31,029	25,946
Cash held for customer deposits	175,522	157,741
Cash held for bond reserve account	513,287	646,744
Cash held to secure letter of credit	-	387,353
Amounts held in escrow account	1,215,083	-
Total Restricted Assets	1,934,921	1,217,784
Net Property, Plant and Equipment	34,413,910	33,841,083
Other Assets		
Equity in joint venture	7,831,289	8,225,335
TOTAL ASSETS	\$ 53,966,520	\$ 52,183,995

(Continued)

PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

STATEMENTS OF NET ASSETS

December 31, 2008 and 2007

<i>LIABILITIES AND NET ASSETS</i>		
	2008	2007
Current Liabilities (Payable from current assets)		
Accounts payable	\$ 5,791,286	\$ 4,880,445
Notes payable	1,500,000	1,500,000
Accrued expense	99,285	291,263
Due to City of Hibbing	361,586	337,415
Compensated absences payable	395,403	418,889
	<u>8,147,560</u>	<u>7,428,012</u>
Current Liabilities (Payable from restricted assets)		
Current portion of long-term debt - bonds and notes payable	652,667	405,667
Accrued interest payable	419,718	302,829
Third party advances for fuel assistance	31,029	25,946
Customer deposits payable	175,522	157,741
	<u>1,278,936</u>	<u>892,183</u>
Total Current Liabilities	9,426,496	8,320,195
Long-Term Liabilities		
Long-term debt - bonds and notes payable	8,616,415	6,282,687
Compensated absences payable	1,033,623	986,137
Accrued post employment benefits	2,801,176	-
	<u>12,451,214</u>	<u>7,268,824</u>
Total Liabilities	21,877,710	15,589,019
Net Assets		
Invested in capital assets, net of related debt	30,417,910	32,761,083
Restricted for debt service	513,287	646,744
Unrestricted	1,157,613	3,187,149
	<u>32,088,810</u>	<u>36,594,976</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 53,966,520</u>	<u>\$ 52,183,995</u>

PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

For the Years Ended December 31, 2008 and 2007

	2008	2007
Operating Revenues		
Charges for services	\$ 25,835,717	\$ 22,520,707
Other	35,177	2,921
Total Operating Revenues	<u>25,870,894</u>	<u>22,523,628</u>
Operating Expenses		
Operation costs	21,080,365	18,489,663
Maintenance expense	152,957	140,982
Distribution expense	3,329,608	3,014,916
General overhead	2,788,630	2,544,047
Post employment benefits	2,801,176	-
Total Operating Expenses	<u>30,152,736</u>	<u>24,189,608</u>
Operating Loss	(4,281,842)	(1,665,980)
Nonoperating Revenues (Expenses)		
Interest income	6,225	102,727
Late payment penalties	199,978	181,614
Other income	182,810	262,106
Interest expense	(419,290)	(350,475)
Equity interest in joint venture decrease in net assets	(394,047)	(856,433)
Capital grants	200,000	-
Total Nonoperating Revenues (Expenses)	<u>(224,324)</u>	<u>(660,461)</u>
Decrease in Net Assets	<u>\$ (4,506,166)</u>	<u>\$ (2,326,441)</u>
Net Assets - Beginning of Year	\$ 36,594,976	\$ 38,921,417
Decrease in Net Assets	(4,506,166)	(2,326,441)
Net Assets - End of Year	<u>\$ 32,088,810</u>	<u>\$ 36,594,976</u>

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

PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2008 and 2007

	2008	2007
Cash Flows From Operating Activities		
Receipts from customers	\$ 25,079,378	\$ 22,696,421
Payments to suppliers	(19,194,973)	(18,111,933)
Payments to employees	(4,908,098)	(4,658,094)
Other receipts	382,788	443,720
Net Cash Provided by Operating Activities	1,359,095	370,114
Cash Flows From Capital and Related Financing Activities		
Principal payments of general obligation revenue bonds	(640,666)	(403,667)
Proceeds from long term borrowing	3,220,000	-
Debt proceeds placed into escrow account	(1,215,083)	-
Proceeds from short term borrowing	1,500,000	3,500,000
Payments on short term borrowing	(1,500,000)	(2,000,000)
Payments for additions to property, plant and equipment	(3,186,593)	(3,777,739)
Interest paid	(302,401)	(178,614)
Capital grant proceeds	200,000	-
Net Cash Used in Capital and Related Financing Activities	(1,924,743)	(2,860,020)
Cash Flows From Investing Activities		
Proceeds from maturities of certificates of deposit	-	2,000,000
Interest income received	6,225	108,453
Net Cash Provided by Investing Activities	6,225	2,108,453
NET DECREASE IN CASH	(559,423)	(381,453)
Cash - Beginning of Year	1,279,261	1,660,714
Cash - End of Year	\$ 719,838	\$ 1,279,261

Cash is presented on the balance sheet as follows:

Cash	\$ -	\$ 61,477
Restricted assets	719,838	1,217,784
	\$ 719,838	\$ 1,279,261

(Continued)

PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2008 and 2007

	2008	2007
Reconciliation of operating income to net cash provided by operating activities:		
Operating loss	\$ (4,281,842)	\$ (1,665,980)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation	2,613,766	2,515,679
Amortization	1,394	1,394
Receipt of late payment penalties	199,978	181,614
Receipt of other income	182,810	262,106
(Increase) decrease in accounts receivable	(89,372)	80,824
Increase in receivable from joint venture	(669,766)	(3,554,254)
(Increase) decrease in unbilled revenue	(32,377)	96,995
Increase in inventories	(143,888)	(186,164)
(Increase) decrease in prepaid expenses	(12,681)	46,182
Increase in accounts payable	910,840	2,539,962
Increase in compensated absences payable	24,000	32,554
Increase (decrease) in accrued expenses	(191,978)	6,491
Increase in due to City of Hibbing	24,171	17,737
Increase in third party advances for fuel assistance	5,083	8,568
Increase (decrease) in customer deposits payable	17,781	(13,594)
Increase in accrued post employment benefits	2,801,176	-
Net Cash Provided by Operating Activities	<u>\$ 1,359,095</u>	<u>\$ 370,114</u>

PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

NOTES TO FINANCIAL STATEMENTS

December 31, 2008 and 2007

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, 2008 and 2007

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.

Accounts Receivable

Accounts receivable are reported net of allowance for uncollectibles, which were established based on current collection experience.

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 statute 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 13.

A third party also holds assets in an escrow account on the Commission's behalf in conjunction with a 2008 debt issue as discussed in Note 8.

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. The Commission has not adopted a formal capitalization policy. 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.

PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

NOTES TO FINANCIAL STATEMENTS

December 31, 2008 and 2007

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Comparative Data

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

NOTE 2 DEPOSITS AND INVESTMENTS

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.

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, 2008 and 2007, the carrying amount of the Commission's deposits were \$719,838 and \$1,271,261 and the bank balances were \$1,271,414 and \$2,370,775 respectively. As of December 31, 2008 and 2007 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.

Investments

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.

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 Commission 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.

As of December 31, 2008 and 2007, no investments were held by the Commission.

NOTE 3 INVENTORIES

Inventories consist of the following at December 31:

	2008	2007
Parts	\$ 1,146,951	\$ 1,014,020
Fuel and bulk supplies	108,839	97,882
	<u>\$ 1,255,790</u>	<u>\$ 1,111,902</u>

PUBLIC UTILITIES COMMISSION
City of Hibbing, Minnesota

NOTES TO FINANCIAL STATEMENTS
December 31, 2008 and 2007

NOTE 4 PROPERTY, PLANT AND EQUIPMENT

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

	2008	2007
Buildings and grounds	\$ 8,003,919	\$ 7,423,300
Production equipment	42,493,984	42,084,975
Transmission and distribution system	44,273,272	43,518,908
Furniture and equipment	2,955,600	3,067,153
Construction in progress	819,728	711,237
	<u>98,546,503</u>	<u>96,805,573</u>
Less - Accumulated depreciation	64,132,593	62,964,490
	<u>\$ 34,413,910</u>	<u>\$ 33,841,083</u>
Depreciation for year	<u>\$ 2,613,766</u>	<u>\$ 2,515,679</u>

A summary of changes in capital assets during 2008 is as follows:

	Balance Jan. 1, 2008	Additions	Deletions	Balance Dec. 31, 2008
Buildings and grounds	\$ 7,423,300	\$ 1,119,908	\$ 539,289	\$ 8,003,919
Production equipment	42,084,975	715,962	306,953	42,493,984
Transmission and distribution system	43,518,908	1,110,975	356,611	44,273,272
Furniture and equipment	3,067,153	131,257	242,810	2,955,600
Construction in progress	711,237	108,491	-	819,728
	<u>96,805,573</u>	<u>3,186,593</u>	<u>1,445,663</u>	<u>98,546,503</u>
Less - Accumulated depreciation	62,964,490	2,613,766	1,445,663	64,132,593
	<u>\$ 33,841,083</u>	<u>\$ 572,827</u>	<u>\$ -</u>	<u>\$ 34,413,910</u>

A summary of changes in capital assets during 2007 is as follows:

	Balance Jan. 1, 2007	Additions	Deletions	Balance Dec. 31, 2007
Buildings and grounds	\$ 6,044,042	\$ 1,388,071	\$ 8,813	\$ 7,423,300
Production equipment	41,311,667	773,308	-	42,084,975
Transmission and distribution system	42,390,090	1,128,818	-	43,518,908
Furniture and equipment	2,742,167	577,085	252,099	3,067,153
Construction in progress	759,379	(48,142)	-	711,237
	<u>93,247,345</u>	<u>3,819,140</u>	<u>260,912</u>	<u>96,805,573</u>
Less - Accumulated depreciation	60,668,323	2,515,679	219,512	62,964,490
	<u>\$ 32,579,022</u>	<u>\$ 1,303,461</u>	<u>\$ 41,400</u>	<u>\$ 33,841,083</u>

PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

NOTES TO FINANCIAL STATEMENTS

December 31, 2008 and 2007

NOTE 5 NOTE PAYABLE

During 2007 the Commission entered into various short term loan agreements for operating cash flow purposes. The notes matured in 2008 and were subsequently renewed and mature by March, 2009. As of December 31, 2008 the notes carried interest rates of 3.25% and were secured by accounts receivable. The Commission expensed \$74,927 and \$80,089 of interest on the notes for 2008 and 2007, respectively.

Activity is as follows:

	January 1	Additions	Retirements	December 31
2007	\$ -	\$ 3,500,000	\$ 2,000,000	\$ 1,500,000
2008	1,500,000	1,500,000	1,500,000	1,500,000

NOTE 6 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, 2008 and 2007, the liability for sick leave, which represents one-half of the accumulated sick leave, was \$1,033,623 and \$986,137, 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, 2008 and 2007, the Commission's liability for vacation pay was \$395,403 and \$418,889, respectively.

NOTE 7 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, 2008 and 2007, the Commission owed the City of Hibbing \$361,586 and \$337,415, respectively for such charges.

NOTE 8 LONG-TERM DEBT

Bonds payable consist of the following at December 31:

	2008	2007
\$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 percent.	1,011,000	1,080,000
\$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.	1,830,000	1,900,000
\$4,000,000 Promissory Note to the State of Minnesota dated July, 2005. Interest rate of 3.5 percent. Interest payments deferred until 2010. Quarterly payments of \$66,667 through 2009 with anticipated quarterly payments of \$94,753 from 2010 through 2021.	3,466,667	3,733,333
\$400,000 Real estate mortgage payable to local bank dated December 29, 2008. Variable rate note of 0.5 percent above prime, due in 60 monthly payments of \$7,330, subject to change every twelve months, matures December 31, 2013.	400,000	-

PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

NOTES TO FINANCIAL STATEMENTS

December 31, 2008 and 2007

NOTE 8 LONG-TERM DEBT (Continued)

\$2,820,000 Public Utilities Revenue Note Series 2008A, due in semi-annual installments of \$115,000 to \$170,000 through December, 2017, interest rate is variable based on provisions of the \$50,000,000 Midwest Consortium of Municipal Utilities Revenue Bonds which provides the funding for the Note but the interest rate cannot exceed 11 percent.

	2,585,000	-
	9,292,667	6,713,333
Less - Unamortized bond discounts	23,585	24,979
	9,269,082	6,688,354
Less - Current maturities	652,667	405,667
Total Long-Term Debt - Bonds and notes payable	\$ 8,616,415	\$ 6,282,687

The terms of the Revenue Note Series 2008A called for the proceeds of the note to be placed in an escrow account. As funds were expended, the Commission submitted requests to the escrow agent to draw down on the account. As of December 31, 2008, the escrow account held on the Commission's behalf had a balance of \$1,215,083 and has been reported in the accompanying statements of net assets as a restricted asset.

A summary of changes in long-term debt during 2008 is as follows:

	Balance Jan. 1, 2008	Additions	Reductions	Balance Dec. 31, 2008
G.O. Public Utilities Revenue Bond	\$ 1,080,000	\$ -	\$ 69,000	\$ 1,011,000
Public Utilities Revenue Note 2005A	1,900,000	-	70,000	1,830,000
State of Minnesota Promissory Note	3,733,333	-	266,666	3,466,667
Real estate mortgage	-	400,000	-	400,000
Public Utilities Revenue Note 2008A	-	2,820,000	235,000	2,585,000
Unamortized bond discounts	(24,979)	-	(1,394)	(23,585)
	6,688,354	3,220,000	639,272	9,269,082
Compensated absences	986,137	47,486	-	1,033,623
Accrued post employment benefits	-	2,801,176	-	2,801,176
	\$ 7,674,491	\$ 6,068,662	\$ 639,272	\$ 13,103,881

A summary of changes in long-term debt during 2007 is as follows:

	Balance Jan. 1, 2007	Additions	Reductions	Balance Dec. 31, 2007
G.O. Public Utilities Revenue Bond	1,147,000	-	67,000	1,080,000
Public Utilities Revenue Note 2005A	1,970,000	-	70,000	1,900,000
State of Minnesota Promissory Note	4,000,000	-	266,667	3,733,333
Unamortized bond discounts	(26,373)	-	(1,394)	(24,979)
	7,090,627	-	402,273	6,688,354
Compensated absences	960,100	26,037	-	986,137
	\$ 8,050,727	\$ 26,037	\$ 402,273	\$ 7,674,491

PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

NOTES TO FINANCIAL STATEMENTS

December 31, 2008 and 2007

NOTE 8 LONG-TERM DEBT (Continued)

The annual requirements to amortize all long-term debt outstanding as of December 31, 2008, including interest payments of \$3,055,169 are as follows:

Year ending December 31,	Principal	Interest	Total
2009	\$ 726,915	\$ 239,724	\$ 966,639
2010	485,063	600,173	1,085,236
2011	513,728	566,834	1,080,562
2012	787,079	289,419	1,076,498
2013	821,263	258,736	1,079,999
2014 - 2018	3,758,698	837,520	4,596,218
2019 - 2023	1,899,921	241,405	2,141,326
2024 - 2025	300,000	21,358	321,358
	<u>\$ 9,292,667</u>	<u>\$ 3,055,169</u>	<u>\$ 12,347,836</u>

NOTE 9 RISK MANAGEMENT

Risk of Loss

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.

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, 2008 and 2007, is as follows:

	2008	2007
January 1 liability	\$ 12,049	\$ 2,484
Current year claims	347,224	318,929
Claims paid during the year	(343,134)	(309,364)
December 31 liability	<u>\$ 16,139</u>	<u>\$ 12,049</u>

PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

NOTES TO FINANCIAL STATEMENTS

December 31, 2008 and 2007

NOTE 10 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 in the past 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 11 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.

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 Plan 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 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.

PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

NOTES TO FINANCIAL STATEMENTS

December 31, 2008 and 2007

NOTE 11 DEFINED BENEFIT PENSION PLAN - STATEWIDE (continued)

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, 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 9.1% and 6.0%, respectively, of their annual covered salary in 2008. The Commission is required to contribute the following percentages of annual covered payroll: 11.78% for Basic Plan PERF members, 6.5% for Coordinated Plan members. Employer contribution rates for the Coordinated plan will increase to 6.75% effective January 1, 2009.

The Commission's contributions to the Public Employees Retirement Fund for the years ending December 31, 2008, 2007, and 2006 were \$318,216, \$283,111 and \$266,428, respectively. The Commission's contributions were equal to the contractually required contributions for each year as set by state statute.

NOTE 12 OTHER POST EMPLOYMENT BENEFITS

Plan Description

The Commission provides health care and dental insurance benefits for retired Commission employees. Commission employees become eligible for such benefits upon retirement. During the years ended December 31, 2008 and 2007, the Commission expended \$471,118, and \$485,597, respectively for benefits for approximately 38 retirees in 2008 and 38 retirees in 2007.

Annual OPEB Cost and Net OPEB Obligation

The Commission's annual other postemployment benefit (OPEB) cost is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years. The following table shows the components of the Commission's annual OPEB cost for 2008, the amount actually contributed to the plan, and changes in the Commission's net OPEB obligation:

ARC	\$ 2,801,176
Interest on net OPEB obligation	-
Adjustment to ARC	-
Annual OPEB cost	2,801,176
Contributions during the year	-
Increase in net OPEB obligation	2,801,176
Net OPEB beginning of the year	-
Net OPEB, end of year	\$ 2,801,176

PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

NOTES TO FINANCIAL STATEMENTS

December 31, 2008 and 2007

NOTE 12 OTHER POST EMPLOYMENT BENEFITS (continued)

The Commission's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2008 were as follows:

Fiscal Year Ended	Annual OPEB Cost	Employer Contribution	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
December 31, 2008	\$ 2,801,176	\$ -	-	\$ 2,801,176

Funding Status and Funding Progress

The actuarial accrued liability for benefits at December 31, 2008 is \$30,281,516. The Commission currently has no assets that have been irrevocably deposited in a trust for future health benefits, thus the entire amount is unfunded. The covered payroll (annual payroll of active employees covered by the plan) is \$4,932,098. The ratio of the unfunded actuarially accrued liabilities (UAAL) to covered payroll is 613.97 percent.

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and healthcare cost trends. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, present multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation. The actuarial methods and assumptions used include techniques that are designed to reduce the effect of short-term volatility in actuarial accrued liabilities, consistent with the long-term perspective of the calculations.

In the December 31, 2008, actuarial valuation, the projected unit credit actuarial cost method was used. The actuarial assumptions included a 4.5 percent discount rate, which is based on the estimated long-term investment yield on the general assets of the Commission. The annual healthcare cost trend rate is 7.9 percent for medical and 5.84 for dental initially, reduced incrementally to an ultimate rate of 4.3 percent for medical and 4.0 for dental. The unfunded actuarial accrued liability is being amortized as a level dollar amount over 30 years.

PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

NOTES TO FINANCIAL STATEMENTS

December 31, 2008 and 2007

NOTE 13 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.

In 2006, the authority was a development stage organization. As of December 31, 2006, biomass fueled steam and electricity production had not yet started. The Authority began production in early 2007.

The Commission has entered into various agreements with the Authority including agreements for the purchase of steam as well as operation and lease agreements. The steam agreement calls for the purchases of minimum quantities of steam based on an escalating fee structure. The operating agreement calls for the Authority to pay the Commission fees based on the operating costs of the Commission's facility up to specified maximum amounts. In addition, the Authority is required to pay the Commission an annual rental fee of \$25,000.

As of December 31, 2008 and 2007, respectively, the Commission has reported on its balance sheet an investment of \$7,831,289 and \$8,225,335, 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 had pledged \$387,353 of deposits to secure a letter of credit for the Authority as of 2007. The deposits are reflected as a restricted asset on the accompanying Commission statement of net assets as of December 31, 2007.

PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

NOTES TO FINANCIAL STATEMENTS

December 31, 2008 and 2007

NOTE 13 JOINT VENTURE (continued)

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:

	2008	2007
Current assets	\$ 4,834,741	\$ 5,064,810
Non-current restricted assets	7,227,148	5,936,994
Other assets	3,995,287	4,452,496
Capital assets	62,827,310	65,064,064
Total assets	78,884,486	80,518,364
Current liabilities	9,602,832	8,882,440
Non-current liabilities	53,886,452	55,452,630
Total liabilities	63,489,284	64,335,070
Net assets	15,395,202	16,183,294
Total operating revenues	27,918,390	24,908,291
Operating expenses	26,152,433	24,163,765
Change in net assets	(788,092)	(1,712,867)

NOTE 14 STATEMENT PRESENTATION

Certain 2007 operating expenses have been reclassified between expense categories from their original presentation in the prior year financial statements. The reclassifications had no effect on the decrease in net assets for the year.

PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

**SCHEDULE OF FUNDING PROGRESS -
OTHER POST EMPLOYMENT BENEFITS PLAN**

For the Years Ended December 31, 2008 and 2007

<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Assets</u>	<u>Actuarial Accrued Liability</u>	<u>Unfunded Actuarial Accrued Liability (UAAL)</u>	<u>Funded Ratio</u>	<u>Covered Payroll</u>	<u>UAAL as a Percentage of Covered Payroll</u>
December 31, 2008	\$ -	\$ 30,281,516	\$ 30,281,516	0.00%	\$ 4,932,098	613.97%

Note:

The Commission implemented GASB Statement No. 45 for the fiscal year ended December 31, 2008. Accordingly, information for prior years is not available

The Commission has no assets that have been irrevocably deposited into a trust for future health benefits. Accordingly, the actuarial value of assets is zero.



**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, 2008 and 2007, 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 22, 2009

PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

SCHEDULES OF DEPARTMENTAL REVENUES AND EXPENSES

For the Years Ended December 31, 2008 and 2007

2008	Electric	Steam	Gas	Water	Total
Operating Revenues					
Sales and services	\$ 12,168,761	\$ 3,528,765	\$ 8,174,407	\$ 1,963,784	\$ 25,835,717
Other	35,177	-	-	-	35,177
Total Operating Revenues	12,203,938	3,528,765	8,174,407	1,963,784	25,870,894
Operating Expenses					
Operation costs	11,246,783	2,691,913	6,595,299	546,370	21,080,365
Maintenance expense	-	100,089	16,431	36,437	152,957
Distribution expense	1,292,028	678,537	523,672	835,371	3,329,608
General overhead	1,115,493	195,200	585,598	892,339	2,788,630
Post employment benefits	1,120,470	196,082	588,247	896,377	2,801,176
Total Operating Expenses	14,774,774	3,861,821	8,309,247	3,206,894	30,152,736
Operating Loss	\$ (2,570,836)	\$ (333,056)	\$ (134,840)	\$ (1,243,110)	\$ (4,281,842)
2007	Electric	Steam	Gas	Water	Total
Operating Revenues					
Sales and services	\$ 10,493,530	\$ 3,128,311	\$ 7,018,870	\$ 1,879,996	\$ 22,520,707
Other	2,921	-	-	-	2,921
Total Operating Revenues	10,496,451	3,128,311	7,018,870	1,879,996	22,523,628
Operating Expenses					
Operation costs	8,725,058	2,845,187	6,002,961	916,457	18,489,663
Maintenance expense	-	97,110	15,759	28,113	140,982
Distribution expense	1,106,974	660,418	558,225	689,299	3,014,916
General overhead	992,595	174,027	545,044	832,381	2,544,047
Total Operating Expenses	10,824,627	3,776,742	7,121,989	2,466,250	24,189,608
Operating Loss	\$ (328,176)	\$ (648,431)	\$ (103,119)	\$ (586,254)	\$ (1,665,980)



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, 2008, which comprise the Commission's basic financial statements and have issued our report, thereon dated June 22, 2009. 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 below to be significant deficiencies 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. In addition, one individual has complete control over the maintenance of the general ledger and can propose and post adjustments to the financial statements without additional approval.

Audit entries were proposed that were deemed significant in nature to the financial statements. Although all entries were discussed with and approved by management for correction, the adjustments resulted in financial statements that varied materially from the unaudited statements.

Commission's Response – The Commission acknowledges the lack of segregation of duties and will continue to monitor the issue as it deems necessary. The audit entries were the result of accounting and billing issues as they relate to the Commission's relationship with its joint venture and the recording of its OPEB liability. The Commission believes that the issues have been properly identified and rectified.

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 deficiencies described above are material weaknesses.

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 22, 2009.

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 laws governing the operations of the Commission require that a bond reserve be established and that the reserve should be equal to not less than the maximum principal and interest to become due in any year of the outstanding debt. The Commission did not have adequate cash balances to fully meet the required reserve.

Statutes require that a vendor be paid interest on any bills not paid in a timely manner. We noted that there were several instances during the year in which vendors were not paid interest on bills that were paid past their normal due date.

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.

Steele & Co., Ltd

June 22, 2009