

PUBLIC UTILITIES COMMISSION
City of Hibbing, Minnesota

FINANCIAL STATEMENTS
For the Years Ended
December 31, 2007 and 2006

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
Independent Auditor's Report on Supplemental Information	22
Schedules of Departmental Revenues and Expenses	23
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>	24



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, 2007 and 2006, 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, 2007 and 2006, 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 23, 2008, 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 23, 2008

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, 2007. Please read it in conjunction with the financial statements, which follow in this report.

FINANCIAL HIGHLIGHTS

- The Utility's Net Assets decreased by \$2,326,441.
- Total Operating Revenues increased 7.8% from 2006 while Total Operating Expenses increased 7.9% from 2006.
- Net Property, Plant and Equipment increased by \$1,262,061.
- Unrestricted Cash and Certificates of Deposit decreased by \$2,567,439.
- Investment in Laurentian Energy Authority decreased by \$856,434.

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 2007 and 2006.

BALANCE SHEETS

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 12/31/07 and 12/31/06.

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 12/31/07</u>
<u>ASSETS</u>		
Cash & Certificates of Deposit	\$3,661	\$1,279
Other Current Assets	\$5,327	\$8,839
Investment in LEA	\$9,082	\$8,225
Capital and Other Assets	\$32,579	\$33,841
Total Assets	\$50,649	\$52,184
<u>LIABILITIES</u>		
Current Liabilities	\$3,968	\$8,320
Long Term Bonds and Notes	\$6,800	\$6,283
Other Long Term Liabilities	\$960	\$986
Total Liabilities	\$11,728	\$15,589
<u>NET ASSETS</u>		
Invested In Capital Assets, Net of Debt	\$31,432	\$32,761
Restricted	\$467	\$647
Unrestricted	\$7,022	\$3,187
Total Net Assets	\$38,921	\$36,595

Long Term Bonds have decreased by \$517.

Total Net Assets has decreased by \$2,326.

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 2006 and 2007).

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>2006</u>	<u>2007</u>
<u>OPERATING</u>		
Revenue	\$20,901	\$22,524
Expense	\$(22,418)	\$(24,190)
Operating Income (Loss)	\$(1,517)	\$(1,666)
<u>NON-OPERATING</u>		
Revenue	\$2,534	\$547
Expense	\$(138)	\$(1,207)
Non-Operating Income	\$2,396	\$(660)
INCREASE (DECREASE) IN NET ASSETS	\$879	\$(2,326)

Revenues from operations have increased 7.8% over 2006.

Expenses from operations have increased 7.9% over 2006.

The total decrease in Net Assets for 2007 is \$2,326 which represents a recovery of a negative 9.6% of Operating Expense compared to a positive 3.9% for 2006.

CAPITAL ASSETS AND DEBT

Capital Assets

2007 major completed projects included (in thousands):	
Ash System Upgrade	\$ 268
Leetonia Water Main Replacement	\$ 146
Gas Main Relocation	\$ 183
# 5 T/G 5-year Inspection	\$ 467
Ash System Installation	\$ 209
Plant Capital Improvements	\$ 378
Scranton Well Repair	\$ 49
Replace Condensate Lines	\$ 95
Booster Pumps	\$ 40
New Gas Services	\$ 99
New Control Room	\$ 43

Debt

At year end the Utility had \$6.7 million in outstanding debt compared to \$7.1 million as of 12/31/06 – a decrease of 5.7% - See Table 3 below.

Table 3
OUTSTANDING BONDS AND NOTES
(In Thousands)

	<u>As of 12/31/06</u>	<u>As of 12/31/07</u>
G.O. Public Utilities Revenue Bond	\$1,147	\$1,080
2005 Public Utility Revenue Note	\$1,970	\$1,900
State of Minnesota Note	\$4,000	\$3,733
Total Debt	<u>\$7,117</u>	<u>\$6,713</u>
Less: Unamortized Bond Discounts	<u>\$(26)</u>	<u>\$(25)</u>
Total Bonds and Notes on Statement of Net Assets	\$7,091	\$6,688

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The 2008 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 17.7% for Electric, 8.4% for Steam, and 13.8% for Water and maintaining the same rate as 2007 for the Gas Utility. All to be effective January 1, 2008. These rate adjustments resulted in the following levels of budgeted expense recovery for 2008:

Electric	4.0%
Steam	4.0%
Gas	4.7%
Water	4.0%
Total from Operations	4.2%

Total capital expenditures are budgeted at \$3,319,500 a level consistent with previous years.

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, 2007 and 2006

<i>ASSETS</i>		
	2007	2006
Current Assets		
Cash	\$ 61,477	\$ 628,916
Certificates of deposit	-	2,000,000
Accounts receivable - Customers, net of allowance for doubtful accounts of \$76,490 and \$66,000 for 2007 and 2006	1,698,608	1,779,432
Accounts receivable - Joint venture	3,554,254	-
Interest receivable	-	5,726
Unbilled revenues	2,080,505	2,177,500
Inventories	1,111,902	925,738
Prepaid expense	393,047	439,229
Total Current Assets	8,899,793	7,956,541
Restricted Assets		
Cash held for fuel assistance recipients	25,946	17,378
Cash held for customer deposits	157,741	171,335
Cash held for bond reserve account	646,744	466,762
Cash held to secure letter of credit	387,353	376,323
Total Restricted Assets	1,217,784	1,031,798
Property, Plant and Equipment	33,841,083	32,579,022
Other Assets		
Equity in joint venture	8,225,335	9,081,769
Total Other Assets	8,225,335	9,081,769
TOTAL ASSETS	\$ 52,183,995	\$ 50,649,130

(Continued)

PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

STATEMENTS OF NET ASSETS

December 31, 2007 and 2006

	2007	2006
<i>LIABILITIES AND NET ASSETS</i>		
Current Liabilities (Payable from current assets)		
Accounts payable	\$ 4,880,445	\$ 2,340,483
Note payable	1,500,000	-
Accrued expense	291,263	284,772
Due to City of Hibbing	337,415	319,678
Compensated absences payable	418,889	412,372
	<u>7,428,012</u>	<u>3,357,305</u>
Current Liabilities (Payable from restricted assets)		
Current portion of general obligation revenue bonds payable	405,667	291,269
Accrued interest payable	302,829	130,968
Third party advances for fuel assistance	25,946	17,378
Customer deposits payable	157,741	171,335
	<u>892,183</u>	<u>610,950</u>
Total Current Liabilities	8,320,195	3,968,255
Long-Term Liabilities		
General obligation revenue bonds	6,282,687	6,799,358
Compensated absences payable	986,137	960,100
	<u>7,268,824</u>	<u>7,759,458</u>
Total Liabilities	15,589,019	11,727,713
Net Assets		
Invested in capital assets, net of related debt	32,761,083	31,432,022
Restricted for debt service	646,744	466,762
Unrestricted	3,187,149	7,022,633
	<u>36,594,976</u>	<u>38,921,417</u>
Total Net Assets	36,594,976	38,921,417
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 52,183,995</u>	<u>\$ 50,649,130</u>

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, 2007 and 2006

	2007	2006
Operating Revenues		
Charges for services	\$ 22,520,707	\$ 20,880,017
Other	2,921	20,827
Total Operating Revenues	<u>22,523,628</u>	<u>20,900,844</u>
Operating Expenses		
Operation costs	17,097,010	16,668,989
Maintenance expense	140,982	601,049
Distribution expense	3,014,916	2,846,779
General overhead	3,936,700	2,301,517
Total Operating Expenses	<u>24,189,608</u>	<u>22,418,334</u>
Operating Loss	(1,665,980)	(1,517,490)
Nonoperating Revenues (Expenses)		
Interest income	102,727	166,113
Late payment penalties	181,614	166,801
Other income	262,106	193,146
Interest expense	(350,475)	(138,000)
Equity interest in joint venture increase (decrease) in net assets	(856,433)	1,422,318
Capital contribution from joint venture	-	586,025
Total Nonoperating Revenues (Expenses)	<u>(660,461)</u>	<u>2,396,403</u>
Increase (Decrease) in Net Assets	<u>\$ (2,326,441)</u>	<u>\$ 878,913</u>
Net Assets - Beginning of Year	\$ 38,921,417	\$ 38,042,504
Increase (Decrease) in Net Assets	(2,326,441)	878,913
Net Assets - End of Year	<u>\$ 36,594,976</u>	<u>\$ 38,921,417</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, 2007 and 2006

	2007	2006
Cash Flows From Operating Activities		
Receipts from customers	\$ 22,696,421	\$ 21,592,021
Payments to suppliers	(18,111,933)	(15,338,682)
Payments to employees	(4,658,094)	(4,644,924)
Other receipts	443,720	359,947
Net Cash Provided by Operating Activities	370,114	1,968,362
Cash Flows From Capital and Related Financing Activities		
Principal payments of general obligation revenue bonds	(403,667)	(125,000)
Proceeds from long term borrowing	-	2,000,000
Proceeds from short term borrowing	3,500,000	-
Payments on short term borrowing	(2,000,000)	-
Payments for additions to property, plant and equipment	(3,777,739)	(3,675,411)
Interest paid	(178,614)	(138,578)
Net Cash Used in Capital and Related Financing Activities	(2,860,020)	(1,938,989)
Cash Flows From Investing Activities		
Purchases of certificates of deposit	-	(2,000,000)
Proceeds from maturities of certificates of deposit	2,000,000	1,000,000
Investment in joint venture	-	(2,462,281)
Interest income received	108,453	162,919
Net Cash Provided by (Used in) Investing Activities	2,108,453	(3,299,362)
NET DECREASE IN CASH	(381,453)	(3,269,989)
Cash - Beginning of Year	1,660,714	4,930,703
Cash - End of Year	\$ 1,279,261	\$ 1,660,714

(Continued)

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, 2007 and 2006

	2007	2006
Reconciliation of operating income to net cash provided by operating activities:		
Operating loss	\$ (1,665,980)	\$ (1,517,490)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation	2,515,679	2,429,025
Amortization	1,394	1,394
Receipt of late payment penalties	181,614	166,801
Receipt of other income	262,106	193,146
Decrease in accounts receivable	80,824	123,897
Increase in receivable from joint venture	(3,554,254)	-
Decrease in unbilled revenue	96,995	567,280
Increase in inventories	(186,164)	(70,987)
Increase (decrease) in prepaid expenses	46,182	(41,647)
Increase in accounts payable	2,539,962	64,304
Increase in compensated absences payable	32,554	22,028
Increase in accrued expenses	6,491	11,723
Increase in due to City of Hibbing	17,737	23,146
Increase (decrease) in third party advances for fuel assistance	8,568	(4,877)
Increase (decrease) in customer deposits payable	(13,594)	619
Net Cash Provided by Operating Activities	\$ 370,114	\$ 1,968,362
Cash is presented on the balance sheet as follows:		
Cash	61,477	628,916
Restricted assets	1,217,784	1,031,798
	\$ 1,279,261	\$ 1,660,714
Supplemental Disclosure:		
Noncash capital and related financing transaction:		
Equipment constructed by joint venture and transferred to Commission	\$ -	\$ 586,025

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

PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

NOTES TO FINANCIAL STATEMENTS

December 31, 2007 and 2006

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, 2007 and 2006

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 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.

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, 2007 and 2006

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 (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, 2007 and 2006, the carrying amount of the Commission's deposits were \$1,271,261 and \$1,652,714 and the bank balances were \$2,370,775 and \$2,684,293 respectively. As of December 31, 2007 and 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.

Investments

As of December 31, 2006 the Commission invested \$2,000,000 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:

	2007	2006
Parts	\$ 1,014,020	\$ 866,300
Fuel and bulk supplies	97,882	59,438
	<u>\$ 1,111,902</u>	<u>\$ 925,738</u>

PUBLIC UTILITIES COMMISSION
City of Hibbing, Minnesota

NOTES TO FINANCIAL STATEMENTS
December 31, 2007 and 2006

NOTE 4 PROPERTY, PLANT AND EQUIPMENT

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

	2007	2006
Buildings and grounds	\$ 7,423,300	\$ 6,044,042
Production equipment	42,084,975	41,311,667
Transmission and distribution system	43,518,908	42,390,090
Furniture and equipment	3,067,153	2,742,171
Construction in progress	711,237	759,379
	<u>96,805,573</u>	<u>93,247,349</u>
Less - Accumulated depreciation	62,964,490	60,668,327
	<u>\$ 33,841,083</u>	<u>\$ 32,579,022</u>
Depreciation for year	<u>\$ 2,515,679</u>	<u>\$ 2,429,025</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>

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>

NOTE 5 NOTE PAYABLE

During 2007 the Commission entered into various short term loan agreements for operating cash flow purposes. As of December 31, 2007, the notes carried interest rates of 6.25%, were secured by accounts receivable and mature by April, 2008. Interest expensed during 2007 was \$80,089.

PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

NOTES TO FINANCIAL STATEMENTS

December 31, 2007 and 2006

NOTE 5 NOTE PAYABLE (Continued)

Activity is as follows:

	January 1	Additions	Retirements	December 31
2006	\$ -	\$ -	\$ -	\$ -
2007	-	3,500,000	2,000,000	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, 2007 and 2006, the liability for sick leave, which represents one-half of the accumulated sick leave, was \$986,137 and \$960,100, 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, 2007 and 2006, the Commission's liability for vacation pay was \$418,889 and \$412,372, 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, 2007 and 2006, the Commission owed the City of Hibbing \$337,415 and \$319,678, respectively for such charges.

NOTE 8 LONG-TERM DEBT - BONDS

Bonds payable consist of the following at December 31:

	2007	2006
\$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.	1,080,000	1,147,000
\$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.	1,900,000	1,970,000
\$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.	3,733,333	4,000,000
	6,713,333	7,117,000
Less - Unamortized bond discounts	24,979	26,373
	6,688,354	7,090,627
Less - Current maturities	405,667	291,269
Total Long-Term Debt - Bonds	\$ 6,282,687	\$ 6,799,358

PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

NOTES TO FINANCIAL STATEMENTS

December 31, 2007 and 2006

NOTE 8 LONG-TERM DEBT - BONDS (Continued)

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)
	<u>7,090,627</u>		<u>402,273</u>	<u>6,688,354</u>
Compensated absences	960,100	26,037	-	986,137
	<u>\$ 8,050,727</u>	<u>\$ 26,037</u>	<u>\$ 402,273</u>	<u>\$ 7,674,491</u>

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
Unamortized bond discounts	(27,767)	-	(1,394)	(26,373)
	<u>5,214,233</u>	<u>2,000,000</u>	<u>123,606</u>	<u>7,090,627</u>
Compensated absences	953,062	7,038	-	960,100
	<u>\$ 6,167,295</u>	<u>\$ 2,007,038</u>	<u>\$ 123,606</u>	<u>\$ 8,050,727</u>

The annual requirements to amortize all long-term debt outstanding as of December 31, 2007, including interest payments of \$2,609,056 are as follows:

Year ending December 31,	Principal	Interest	Total
2008	\$ 405,667	\$ 128,225	\$ 533,892
2009	407,667	122,536	530,203
2010	153,000	495,796	648,796
2011	168,725	475,846	644,571
2012	429,023	212,299	641,322
2013 - 2017	2,412,281	806,106	3,218,387
2018 - 2022	2,296,970	325,527	2,622,497
2023 - 2025	440,000	42,721	482,721
	<u>\$ 6,713,333</u>	<u>\$ 2,609,056</u>	<u>\$ 9,322,389</u>

NOTE 9 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, 2007 and 2006

NOTE 9 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, 2007 and 2006, is as follows:

	2007	2006
January 1 liability	\$ 2,484	\$ 8,461
Current year claims	318,929	141,524
Claims paid during the year	(309,364)	(147,501)
December 31 liability	<u>\$ 12,049</u>	<u>\$ 2,484</u>

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 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 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.

PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

NOTES TO FINANCIAL STATEMENTS

December 31, 2007 and 2006

NOTE 11 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 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.

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 9.10% and 5.75%, respectively, of their annual covered salary in 2007. Contribution rates in the Coordinated Plan will increase in 2008 to 6.0%. The Commission is required to contribute the following percentages of annual covered payroll: 11.78% for Basic Plan PERF members and 6.25% for Coordinated Plan members. Employer contribution rates for the Coordinated plan will increase to 6.5% effective January 1, 2008. The Commission's contributions to the Public Employees Retirement Fund for the years ending December 31, 2007, 2006, and 2005 were \$283,111, \$266,428 and \$230,386, 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, 2007 and 2006

NOTE 12 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, 2007 and 2006, the Commission expended \$485,597, and \$496,282, respectively, in benefits for approximately 38 retirees in 2007 and 42 retirees in 2006.

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, 2007 and 2006, respectively, the Commission has reported on its balance sheet an investment of \$8,225,335 and \$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 \$387,353 and \$376,323 of deposits to secure a letter of credit for the Authority as of December 31, 2007 and 2006, respectively. The deposits are reflected as restricted assets on the accompanying Commission statement of net assets.

PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

NOTES TO FINANCIAL STATEMENTS

December 31, 2007 and 2006

NOTE 13 EQUITY IN 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:

	2007	2006
Current assets	\$ 5,064,810	\$ 5,051,566
Non-current restricted assets	5,936,994	10,236,430
Other assets	4,452,496	4,518,631
Capital assets	65,064,064	60,013,753
Total assets	80,518,364	79,820,380
Current liabilities	8,882,440	5,640,413
Non-current liabilities	55,452,630	56,490,000
Total liabilities	64,335,070	61,924,219
Net assets	16,183,294	17,896,161
Total operating revenues	24,908,291	-
Operating expenses	24,163,765	855,409
Change in net assets	(1,712,867)	7,738,193



**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, 2007 and 2006, 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 23, 2008

PUBLIC UTILITIES COMMISSION

City of Hibbing, Minnesota

SCHEDULES OF DEPARTMENTAL REVENUES AND EXPENSES

For the Years Ended December 31, 2007 and 2006

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	8,167,997	2,747,701	5,710,504	470,808	17,097,010
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	1,549,656	271,513	837,501	1,278,030	3,936,700
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)
2006	Electric	Steam	Gas	Water	Total
Operating Revenues					
Sales and services	\$ 10,061,819	\$ 3,050,820	\$ 6,008,420	\$ 1,758,958	\$ 20,880,017
Other	20,827	-	-	-	20,827
Total Operating Revenues	10,082,646	3,050,820	6,008,420	1,758,958	20,900,844
Operating Expenses					
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
Total Operating Expenses	10,573,613	3,662,355	6,387,377	1,794,989	22,418,334
Operating Loss	\$ (490,967)	\$ (611,535)	\$ (378,957)	\$ (36,031)	\$ (1,517,490)



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, 2007, which comprise the Commission's basic financial statements and have issued our report, thereon dated June 23, 2008. 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. 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 23, 2008.

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. Statutes also require that the documentation for the quotes be kept on file for one year. We noted instances for which required documentation was not readily available for purchases requiring quotes.

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). We were not able to document that all required forms were received during the year.

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.

Stulz & Co., Ltd

June 23, 2008