

SOUTHEAST ALASKA POWER AGENCY

Financial Statements and Supplementary Information

For the Years Ended
June 30, 2011 and 2010

(With Independent Auditor's Report Thereon)

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SOUTHEAST ALASKA POWER AGENCY

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Independent Auditors' Report

The Board of Directors
Southeast Alaska Power Agency

We have audited the accompanying basic financial statements of the Southeast Alaska Power Agency as of and for the years ended June 30, 2011 and 2010, as listed in the table of contents. These financial statements are the responsibility of the Southeast Alaska Power Agency's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides 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 Southeast Alaska Power Agency as of June 30, 2011 and 2010, and the changes in its financial position and its 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 also issued our report on our consideration of the Southeast Alaska Power Agency's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Board of Directors
Southeast Alaska Power Agency

The Management's Discussion and Analysis on pages 4 through 6 is not a required part of the basic financial statements but is 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.

Mikunda, Cottrell & Co.

Anchorage, Alaska
December 7, 2011

MANAGEMENT'S DISCUSSION AND ANALYSIS

SOUTHEAST ALASKA POWER AGENCY

Management's Discussion and Analysis

June 30, 2011 and 2010

This presentation and analysis is intended to serve as an introduction to and a discussion of the June 30, 2011 and 2010 financial statements of Southeast Alaska Power Agency (Agency).

Financial Highlights

The Agency's assets exceeded liabilities at June 30, 2011 and June 30, 2010 by \$141.2 million and \$141.5 million, respectively. This represents a decrease of \$0.3 million for the year ended June 30, 2011 and an increase of \$12.8 million for the year ended June 30, 2010.

Financial Position

Total assets, total liabilities and total net assets at June 30, 2011, 2010 and 2009 follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Assets:			
Current assets	\$ 19,605,084	18,435,879	29,343,244
Capital assets	138,148,449	140,226,712	124,518,343
Noncurrent assets	<u>1,079,801</u>	<u>1,142,042</u>	<u>1,155,060</u>
Total assets	<u>158,833,334</u>	<u>159,804,633</u>	<u>155,016,647</u>
Liabilities:			
Current liabilities	2,999,730	2,992,277	10,324,560
Noncurrent liabilities	<u>14,646,102</u>	<u>15,300,124</u>	<u>15,939,228</u>
Total liabilities	<u>17,645,832</u>	<u>18,292,401</u>	<u>26,263,788</u>
Net assets:			
Invested in capital assets, net of related debt	122,847,347	124,291,588	108,149,115
Restricted for debt service	1,355,513	1,354,563	5,233,939
Restricted under agreements with external parties	552,177	477,111	2,020,815
Restricted for project improvements	-	8,581	9,050,583
Unrestricted	<u>16,432,465</u>	<u>15,380,389</u>	<u>4,298,407</u>
Total net assets	<u>141,187,502</u>	<u>141,512,232</u>	<u>128,752,859</u>
Total liabilities and net assets	\$ <u>158,833,334</u>	<u>159,804,633</u>	<u>155,016,647</u>

SOUTHEAST ALASKA POWER AGENCY

Management's Discussion and Analysis, continued

Discussion of Financial Position

2011 Compared to 2010

Total net assets at June 30, 2011 were slightly lower (\$0.33 million) compared to June 30, 2010. Two contributing factors were an increase in depreciation expense of \$1.20 million compared to the year ended June 30, 2010 and an increase in the rate rebate to the member utilities. The rate rebate was \$1.65 million for year ended June 30, 2011 compared to \$0.718 million for year ended June 30, 2010.

Total assets were nearly \$1 million lower at June 30, 2011 compared to June 30, 2010. Noncurrent liabilities were \$14.6 million at June 30, 2011 compared to \$15.3 million at June 30, 2010. Agency unrestricted funds were slightly higher at June 30, 2011 compared to June 30, 2010.

Operations

Components of the Agency's operating revenues, operating expenses, and non-operating revenues/expenses for the years ended June 30, 2011, 2010, and 2009 are as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Operating revenues - revenue from power sales	\$ 11,099,706	10,615,895	16,552,240
Rate rebate	<u>(1,650,000)</u>	<u>(717,760)</u>	<u>-</u>
Net operating revenues	<u>9,449,706</u>	<u>9,898,135</u>	<u>16,522,240</u>
Operating expenses:			
Operating and maintenance	3,301,870	2,962,678	5,124,148
General and administrative	1,923,624	2,010,780	2,270,840
Depreciation expense	<u>3,827,841</u>	<u>2,611,262</u>	<u>2,464,495</u>
Total operating expenses	<u>9,053,335</u>	<u>7,584,720</u>	<u>9,859,483</u>
Operating income	<u>396,371</u>	<u>2,313,415</u>	<u>6,692,757</u>

SOUTHEAST ALASKA POWER AGENCY

Management's Discussion and Analysis, continued

Discussion of Operations

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Non-operating revenues (expenses):			
Investment income	\$ 167,022	138,321	527,788
Interest expense	(807,911)	(739,244)	(2,299,138)
Amortization of loan fees	(80,212)	(95,657)	(91,174)
Capital grant revenue	<u>-</u>	<u>5,580,600</u>	<u>35,268,383</u>
Net non-operating revenues (expenses)	<u>(721,101)</u>	<u>4,884,020</u>	<u>33,405,859</u>
 Income (loss) before special item	 (324,730)	 7,197,435	 40,098,616
Special item:			
Restructure (2009)	-	(237,336)	(20,974,940)
ILF Intertie Credit AEA (2010)	<u>-</u>	<u>5,799,274</u>	<u>-</u>
Total special items	<u>-</u>	<u>5,561,938</u>	<u>(20,974,940)</u>
 Change in net assets	 (324,730)	 12,759,373	 19,123,676
 Net assets - beginning of year	 <u>141,512,232</u>	 <u>128,752,859</u>	 <u>109,629,183</u>
 Net assets - end of year	 <u>\$ 141,187,502</u>	 <u>141,512,232</u>	 <u>128,752,859</u>

2011 Compared to 2010

Revenue from power sales, before the rate rebate, were nearly \$.5 million higher for the year ended June 30, 2011 compared to the year ended June 30, 2010. This was primarily due to higher utilization of the Tyee Lake facility. Operating expenses were nearly \$1.5 million higher for the year ended June 30, 2011 compared to year ended June 30, 2010. This was primarily due to increased depreciation expense which was about \$1.2 million higher in the year ended June 30, 2011 compared to for the year ended June 30, 2010.

In summary, the change in net assets for the year ended June 30, 2011 was approximately \$0.3 million lower than for the year ended June 30, 2010. Total net assets at June 30, 2011 were \$141,187,502 compared to \$141,512,232 at June 30, 2010.

FINANCIAL STATEMENTS

SOUTHEAST ALASKA POWER AGENCY

Statements of Net Assets

June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
<u>Assets</u>		
Current assets:		
Cash and investments, including restricted cash and investments of \$1,497,761 and \$1,432,068 at June 30, 2011 and 2010, respectively	\$ 18,532,331	11,680,439
Grants receivable	-	35,827
Accounts receivable	894,805	822,990
Accrued interest receivable	47,030	-
ILF credit receivable	-	5,799,274
Prepaid expenses and other assets	130,918	97,349
Total current assets	<u>19,605,084</u>	<u>18,435,879</u>
Noncurrent assets:		
Restricted cash and investments	700,320	682,349
Bond and loan issuance costs, net	379,481	459,693
Capital assets, net	138,148,449	140,226,712
Total noncurrent assets	<u>139,228,250</u>	<u>141,368,754</u>
Total assets	<u>\$ 158,833,334</u>	<u>159,804,633</u>
<u>Liabilities and Net Assets</u>		
Liabilities:		
Current liabilities:		
Accounts payable and accrued expenses	\$ 636,368	1,639,517
Rebate payable to members	1,650,000	717,760
Accrued interest payable	58,362	-
Current portion of long-term debt	655,000	635,000
Total current liabilities	<u>2,999,730</u>	<u>2,992,277</u>
Noncurrent liabilities:		
Long-term debt, net of current portion	14,775,000	15,430,000
Bond issue premium (discount), net	(128,898)	(129,876)
Total noncurrent liabilities	<u>14,646,102</u>	<u>15,300,124</u>
Total liabilities	<u>17,645,832</u>	<u>18,292,401</u>
Net assets:		
Invested in capital assets, net of related debt	122,847,347	124,291,588
Restricted for debt service	1,355,513	1,354,563
Restricted by agreements with external parties	552,177	477,111
Restricted for project improvements	-	8,581
Unrestricted	16,432,465	15,380,389
Total net assets	<u>141,187,502</u>	<u>141,512,232</u>
Total liabilities and net assets	<u>\$ 158,833,334</u>	<u>159,804,633</u>

See accompanying notes to financial statements.

SOUTHEAST ALASKA POWER AGENCY
Statements of Revenues, Expenses, and Changes in Net Assets
Years Ended June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Operating revenues:		
Revenue from power sales	\$ 11,099,706	10,615,895
Rate rebate	<u>(1,650,000)</u>	<u>(717,760)</u>
Net operating revenues	<u>9,449,706</u>	<u>9,898,135</u>
Operating expenses:		
Operating and maintenance	3,301,870	2,962,678
General and administrative	1,923,624	2,010,780
Depreciation expense	<u>3,827,841</u>	<u>2,611,262</u>
Total operating expenses	<u>9,053,335</u>	<u>7,584,720</u>
Operating income	396,371	2,313,415
Nonoperating revenues (expenses):		
Investment income	167,022	138,321
Interest expense	(807,911)	(739,244)
Amortization of bond issuance and other costs	(80,212)	(95,657)
Capital grant revenue	<u>-</u>	<u>5,580,600</u>
Net nonoperating revenues (expenses)	<u>(721,101)</u>	<u>4,884,020</u>
Income (loss) before special items	(324,730)	7,197,435
Special items:		
Restructure	-	(237,336)
ILF credit from Alaska Energy Authority	<u>-</u>	<u>5,799,274</u>
Total special items	<u>-</u>	<u>5,561,938</u>
Change in net assets	(324,730)	12,759,373
Net assets - beginning of year	<u>141,512,232</u>	<u>128,752,859</u>
Net assets - end of year	\$ <u>141,187,502</u>	<u>141,512,232</u>

See accompanying notes to financial statements.

SOUTHEAST ALASKA POWER AGENCY

Statements of Cash Flows

Years Ended June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash flows from operating activities:		
Receipts from customers and users	\$ 11,027,891	10,659,768
Payment of rate rebate	(717,760)	-
Payments to suppliers and employees	(6,233,708)	(4,363,197)
Net cash flows from operating activities	<u>4,076,423</u>	<u>6,296,571</u>
Cash flows from capital and related financing activities:		
Interest payments on long-term debt	(777,075)	(959,716)
Principal payments on long-term debt	(635,000)	(430,000)
Receipt of intertie loan fund credit	5,799,274	-
Other payments related to restructure	-	(237,336)
Proceeds from capital grants	35,827	8,489,253
Purchase of capital assets	(1,749,578)	(26,975,951)
Net cash flows from capital and related financing activities	<u>2,673,448</u>	<u>(20,113,750)</u>
Cash flows from investing activities - investment income received	<u>119,992</u>	<u>138,321</u>
Net increase (decrease) in cash and cash equivalents	6,869,863	(13,678,858)
Cash and investments at beginning of year	<u>12,362,788</u>	<u>26,041,646</u>
Cash and investments at end of year	\$ <u>19,232,651</u>	<u>12,362,788</u>
Reconciliation of operating income to net cash provided (used) by operating activities:		
Operating income	\$ 396,371	2,313,415
Adjustments to reconcile operating income to net cash flows from operating activities:		
Depreciation	3,827,841	2,611,262
Changes in assets and liabilities:		
(Increase) decrease in assets:		
Prepaid expenses and other assets	(5,065)	21,121
Accounts receivable	(71,815)	43,873
Increase (decrease) in liabilities:		
Rebate payable to members	932,240	717,760
Accounts payable and accrued expenses	(1,003,149)	589,140
Net cash flows from operating activities	\$ <u>4,076,423</u>	<u>6,296,571</u>

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements

June 30, 2011 and 2010

(1) **Organization and Operations**

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

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

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

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

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

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

Basis of Accounting

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

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Summary of Significant Accounting Policies, continued

GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, provides two options for reporting proprietary fund activities. The Agency has elected to apply all applicable GASB pronouncements and all FASB Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins including those issued subsequent to November 30, 1989, unless they conflict with or contradict GASB pronouncements.

Cash and Investments

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

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

Restricted Assets

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

Capital Assets

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

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

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

Revenue Recognition

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

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Summary of Significant Accounting Policies, continued

Revenue Recognition, continued

The member cities and utilities purchase power from SEAPA pursuant to conditions of the new Power Sales Agreement adopted at the close of Restructuring on February 24, 2009. The SEAPA Board of Directors sets the wholesale power rate annually. The estimated wholesale power rate for the years ended June 30, 2011 and 2010 was set at 6.8 cents per Kwh. The member utilities only pay for the amount of power used.

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

	<u>2011</u>	<u>2010</u>
Ketchikan Public Utilities	54.0%	57.0%
Wrangell Municipal Light and Power	20.0	18.0
Petersburg Municipal Light and Power	<u>26.0</u>	<u>25.0</u>
	<u>100.0%</u>	<u>100.0%</u>

Operating Revenues and Expenses

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

Employee Benefits

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

Risk Management

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

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Summary of Significant Accounting Policies, continued

Environmental Issues

The Agency's policy relating to environmental issues is to record a liability when the likelihood of responsibility for clean up is probable and the costs are reasonably estimable. At June 30, 2011 and 2010, there were no environmental issues that met both of these criteria, and, accordingly, no provision has been made in the accompanying financial statements for any potential liability.

Income Taxes

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

Estimates

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

Grants

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

(3) **Cash and Investments**

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

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

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Cash and Investments, continued

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

The Bond Fund, consisting of the Interest Account, the Principal Account and the Series 2009 Bonds Cost of Issuance Account, is held by the Trustee. The Bond Reserve Fund is also held by the Trustee and is required to be maintained at all times at not less than the Bond Reserve Requirement.

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

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

	<u>Cash and Cash</u>	<u>Investments</u>	<u>Total</u>
	<u>Equivalents</u>		
Unrestricted - current:			
Internal renewal and replacement fund	\$ 5,479,518	-	5,479,518
Revenue fund	1,501,207	-	1,501,207
Commercial checking account	56,910	-	56,910
Subordinate debt	309	-	309
Investment fund	<u>31,805</u>	<u>506,839</u>	<u>538,644</u>
Total unrestricted	<u>7,069,749</u>	<u>506,839</u>	<u>7,576,588</u>
Unrestricted - noncurrent -			
Investment fund	<u>-</u>	<u>9,457,982</u>	<u>9,457,982</u>
Restricted - current:			
Insurance escrow fund	1	-	1
Reclamation contingency fund	552,177	-	552,177
2009 Trust series bond interest	116,896	-	116,896
2009 Trust series bond principal	109,462	-	109,462
2009 Trust series bond reserve	11,205	686,450	697,655
STI CD	<u>21,570</u>	<u>-</u>	<u>21,570</u>
Total restricted - current	<u>811,311</u>	<u>686,450</u>	<u>1,497,761</u>
Restricted - noncurrent -			
2009 Trust series bond reserve	<u>-</u>	<u>700,320</u>	<u>700,320</u>
Total cash and investments	<u>\$ 7,881,060</u>	<u>11,351,591</u>	<u>19,232,651</u>

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Cash and Investments, continued

The cash and investments were held in trust accounts for the following activities as of June 30, 2010:

	<u>Cash and Cash</u> <u>Equivalents</u>	<u>Investments</u>	<u>Total</u>
Unrestricted - current:			
Internal renewal and replacement fund	\$ 3,189,864	-	3,189,864
Revenue fund	6,985,607	-	6,985,607
Commercial checking account	72,592	-	75,592
Subordinate debt	308	-	308
Total unrestricted	<u>10,248,371</u>	<u>-</u>	<u>10,248,371</u>
Restricted - current:			
Insurance escrow fund	2	-	2
Reclamation contingency fund	477,111	-	477,111
STI AEA account	5	-	5
STI Project account	8,576	-	8,576
2009 Trust series bond interest	119,973	-	119,973
2009 Trust series bond principal	105,903	-	105,903
2009 Trust series bond reserve	16,119	682,849	698,968
Swan Lake intertie CD	21,530	-	21,530
Total restricted - current	<u>749,219</u>	<u>682,849</u>	<u>1,432,068</u>
Restricted - noncurrent -			
2009 Trust series bond reserve	<u>-</u>	<u>682,349</u>	<u>682,349</u>
Total cash and investments	<u>\$ 10,997,590</u>	<u>1,365,198</u>	<u>12,362,788</u>

Investment Securities

General – Investment Policies, Portfolio Information and Restrictions

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

1. Obligations of, or obligations insured or guaranteed by, the United States;
2. Obligations of United States agencies or instrumentalities;
3. Corporate debt securities with a minimum rating of "A" or the equivalent by a nationally recognized rating organization;

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Cash and Investments, continued

Investment Securities, continued

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

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

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

1. Obligations of the United States or of an agency or instrumentality of the United States;
2. Repurchase and reverse repurchase agreements secured by the Treasury of the United States or obligations of an agency or instrumentality of the United States; certificates of deposit, bankers' acceptances, and other similar obligations of a bank domiciled in the United States that has on the date of purchase:
 - Outstanding debt rated Aa or AA or higher by at least one of the nationally recognized rating services, including dollar-denominated obligations issued by a United States branch of a foreign bank if the debt of the parent is rated A or higher; and
 - A combined capital and surplus aggregating at least \$500,000,000;
3. Commercial paper and other short-term taxable instruments that maintain the highest rating by at least two nationally recognized rating services on the date of purchase;

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Cash and Investments, continued

Investment Securities, continued

4. Obligations of a corporation domiciled in the United States or obligations of a municipality if the obligations are rated on the date of purchase Aa or AA or higher by at least two nationally recognized rating services;
5. Certificates of deposit that are issued by a state or federally chartered financial institution that is a commercial or mutual bank, savings and loan association, or credit union, but only if and to the extent the institution's accounts are insured through the appropriate federal insuring agency of the United States;
6. Money market funds in which the securities of the fund consist of obligations listed above; and
7. Any other investment permitted under the Issuer's investment policy, as amended from time to time in writing, which will not adversely affect the ratings of the Outstanding Bonds.

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

At June 30, 2011 and 2010, the Agency had the following cash and investments:

	<u>2011</u>	<u>2010</u>
Money market	\$ 821,544	719,106
Demand deposits	7,037,946	10,256,955
U.S. government agency	6,239,479	1,365,197
U.S. government bonds	3,025,028	-
Corporate bonds	2,087,084	-
Certificates of deposit	<u>21,570</u>	<u>21,530</u>
	<u>\$ 19,232,651</u>	<u>12,362,788</u>

Interest Rate

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

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Cash and Investments, continued

Investment Securities, continued

Investment maturities at June 30 are as follows:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Investment Maturities (in Years)</u>	
		<u>Less Than 1</u>	<u>1-5</u>
2011:			
U.S. government agencies	\$ 6,239,479	1,193,289	5,046,190
U.S. government bonds	3,025,028	-	3,025,028
Corporate bonds	<u>2,087,084</u>	<u>-</u>	<u>2,087,084</u>
Total	\$ <u>11,351,591</u>	<u>1,193,289</u>	<u>10,158,302</u>
2010:			
U.S. government agencies	\$ <u>1,365,198</u>	<u>682,849</u>	<u>682,349</u>

Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The credit quality ratings of the Agency's investments as of June 30, 2011 and 2010, as described by nationally recognized statistical rating organizations, are shown below (using Standard & Poor's Corporation rating scale unless otherwise noted):

<u>Investment Type</u>	<u>Rating</u>	<u>Percent of Total</u>	
		<u>2011</u>	<u>2010</u>
U.S. government agency	AAA	54.9%	98.3%
U.S. government bonds	AAA	18.4	-
Corporate bonds	AAA	26.6	-
Certificates of deposit	AAA	<u>0.2</u>	<u>21.7</u>
		<u>100.0%</u>	<u>100.0%</u>

Custodial Credit Risk

Custodial credit risk is the risk that deposits may not be returned in the event of a bank failure. The Agency has not established a formal custodial credit risk policy for its investments. However, the Agency has a custodial agreement in place with their primary banking institution. At June 30, 2011 and 2010, \$518,301 and \$469,107 of bank deposits were uninsured and uncollateralized.

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Cash and Investments, continued

Investment Securities, continued

Concentration Risk

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

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

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

At June 30, 2010, the Agency's investments included the following concentrations greater than 5%:

<u>Investment Type</u>	<u>Investment at Fair Value</u>	<u>Percentage of Total Portfolio</u>
Federal Home Loan Mortgage Association Discount Note	\$ 1,365,198	11.0%

(4) **Capital Assets**

The components of the Agency's capital assets at June 30, 2011 and 2010 are as follows:

	<u>2011</u>	<u>2010</u>
Tyee Lake	\$ 25,920,629	24,700,793
Swan Lake	15,882,352	15,805,757
Swan-Tyee Intertie	112,341,261	111,915,680
Leasehold improvements	<u>52,566</u>	<u>25,000</u>
	154,196,808	152,447,230
Less accumulated depreciation	<u>(16,048,359)</u>	<u>(12,220,518)</u>
Total capital assets, net of accumulated depreciation	<u>\$ 138,148,449</u>	<u>140,226,712</u>

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Capital Assets, continued

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

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

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Capital Assets, continued

Capital asset activity for the Agency for the year ended June 30, 2010 follows:

	Balance at June 30, <u>2009</u>	<u>Additions</u>	<u>Transfers and Deletions</u>	Balance at June 30, <u>2010</u>
Capital assets not being depreciated:				
Swan-Tyee intertie	\$ 95,872,516	15,472,713	111,345,229	-
Swan Lake construction in process	-	246,421	204,818	41,603
Swan-Tyee construction in progress	-	570,451	-	570,451
Tyee Lake construction in progress	<u>628,221</u>	<u>2,005,046</u>	<u>1,531,403</u>	<u>1,101,864</u>
Total capital assets not being depreciated	<u>96,500,737</u>	<u>18,294,631</u>	<u>113,081,450</u>	<u>1,713,918</u>
Capital assets being depreciated:				
Structures	11,338,528	-	-	11,338,528
Infrastructure	1,668,030	-	-	1,668,030
Generation and distribution	24,265,580	113,077,470	-	137,343,050
Furniture, fixtures and other	354,724	3,980	-	358,704
Leasehold improvements	<u>-</u>	<u>25,000</u>	<u>-</u>	<u>25,000</u>
Total capital assets being depreciated	<u>37,626,862</u>	<u>113,106,450</u>	<u>-</u>	<u>150,733,312</u>
Less accumulated depreciation:				
Structures	(2,415,795)	(360,041)	-	(2,775,836)
Infrastructure	(511,227)	(72,607)	-	(583,834)
Generation and distribution	(6,428,831)	(2,143,924)	-	(8,572,755)
Furniture, fixtures and other	<u>(253,403)</u>	<u>(34,690)</u>	<u>-</u>	<u>(288,093)</u>
Total accumulated depreciation	<u>(9,609,256)</u>	<u>(2,611,262)</u>	<u>-</u>	<u>(12,220,518)</u>
Capital assets being depreciated, net	<u>28,017,606</u>	<u>110,495,188</u>	<u>-</u>	<u>138,512,794</u>
Total capital assets, net	\$ <u>124,518,343</u>	<u>128,789,819</u>	<u>113,081,450</u>	<u>140,226,712</u>

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

(5) **Short-Term Borrowings**

The Agency has a line of credit available of \$10,000,000 bearing interest at prime plus 0.25% (5.0% at June 30, 2011), with a maturity date of May 2012, and secured by the Agency's assets. Interest is payable monthly with the outstanding balance payable on demand. At June 30, 2011 and 2010, there was no outstanding balance on the line.

(6) **Long-Term Debt**

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

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

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

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

The 2004 bonds were defeased by placing a portion of the proceeds of the new bonds in irrevocable trusts to provide for all future debt service payments on the old bonds. Accordingly, trust accounts are not included in these financial statements. At June 30, 2011, the amount of the bonds considered defeased was \$23,995,000.

The following tables reflect the changes in long-term debt for the years ended June 30, 2011 and 2010, respectively:

	Balance at June 30, <u>2010</u>	<u>Additions</u>	<u>Deletions</u>	Balance at June 30, <u>2011</u>	Due Within <u>One Year</u>
Series 2009 Bonds	\$ <u>16,065,000</u>	<u>-</u>	<u>635,000</u>	<u>15,430,000</u>	<u>655,000</u>
	Balance at June 30, <u>2009</u>	<u>Additions</u>	<u>Deletions</u>	Balance at June 30, <u>2010</u>	Due Within <u>One Year</u>
Series 2009 Bonds	\$ <u>16,495,000</u>	<u>-</u>	<u>430,000</u>	<u>16,065,000</u>	<u>635,000</u>

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Long-Term Debt, continued

The minimum payments of the outstanding bonds for the years subsequent to June 30, 2011 based on scheduled maturities are as follows:

<u>Fiscal Year</u> <u>Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 655,000	700,513	1,355,513
2013	675,000	680,863	1,355,863
2014	700,000	658,925	1,358,925
2015	725,000	634,425	1,359,425
2016	745,000	612,675	1,357,675
2017-2021	4,175,000	2,613,920	6,788,920
2022-2026	5,245,000	1,533,902	6,778,902
2027-2028	<u>2,510,000</u>	<u>204,251</u>	<u>2,714,251</u>
	<u>\$ 15,430,000</u>	<u>7,639,474</u>	<u>23,069,474</u>

(7) **Commitments and Contingencies**

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

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

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

Commitments and Contingencies, continued

SEAPA has taken the lead role in the PFMA Analysis studies, as well as the follow-up projects that were required to be completed as a result of the analysis. Two projects were identified as a result of the studies; the testing and installation of anchor bolts in penstock thrust blocks and the installation of a Low Level Outlet Works (LLOW). As of November 15, 2011, the installation of the anchor bolt project is 100% complete and the LLOW is approximately 95% complete. SEAPA believes the total financial impact to complete the Solomon Gulch PFMA issues should not exceed one million dollars. SEAPA's share of this cost would then be limited to approximately \$460,000. These expenses should all occur in FY12.

(8) **Operating Lease**

The Agency entered into a five-year lease agreement for office space in Ketchikan, Alaska in January 2010, with the right to renew for two consecutive five-year periods. Under the terms of the lease, the Agency will pay the following amounts in future years:

<u>Year Ending</u> <u>June 30:</u>	<u>Amount</u>
2012	\$ 31,596
2013	32,838
2014	34,074
2015	17,346

During 2011 and 2010, the Agency expensed \$42,513 and \$53,834, respectively, under non-cancelable lease obligations.

(9) **Special Item - Restructure**

The restructuring of the Four Dam Pool Power Agency (FDPPA) successfully closed on February 24, 2009. Under this transaction, Kodiak Electric Association paid \$38,000,000 for the Terror Lake Project and the Solomon Gulch Project was transferred to Copper Valley Electric Association along with \$15,000,000. The Four Dam Pool Power Agency was renamed Southeast Alaska Power Agency (SEAPA) and retained ownership of the Swan Lake and Tye Lake projects in Southeast Alaska. The existing long-term debt of the pre-closing Agency (FDPPA) was either retired or defeased. Finally, SEAPA sold \$16,495,000 of its own bonds as part of the existing debt retirement/defeasance and to also prefund the R&R account as well as other accounts. An additional \$237,336 was paid to Kodiak Electric Association as a result of final adjustments and reconciliations related to the restructure and is reported in the financial statements in fiscal year 2010 as a special item.

SOUTHEAST ALASKA POWER AGENCY

Notes to Financial Statements, continued

(10) **Special Item – Intertie Loan Fund (ILF) Credit**

On January 31, 2002, the FDPPA purchased the Four Dam Pool Initial Project from the Alaska Energy Authority (AEA) for \$68,000,000. The original purchase price for the projects was established at \$73 million. The purchase price was reduced by a \$5 million credit granted by AEA which would be repaid to AEA if the Agency (i) abandons efforts to complete the Swan-Tyee Intertie project, (ii) prior to April 11, 2005 has not entered into an approved financing plan or (iii) has not commenced construction of the Swan-Tyee Intertie prior to April 2010. The Agency accrued a liability to AEA and increased the basis of the project by \$5 million since condition (ii) above was not met as of June 30, 2005. The Agency remitted the \$5 million to AEA during the year ended June 30, 2006. Subsequently, the funds were placed in an AEA-held escrow with the condition that these funds will be released to the Agency upon completion of the Swan-Tyee Intertie and the satisfaction of certain other conditions. The Swan-Tyee Intertie project was completed and became operational on January 1, 2010.

The conditions for the release of the funds held in the AEA escrow were satisfied and AEA released the \$5 million plus \$799,274 accrued interest on October 6, 2010. The total amount of the Intertie Loan Fund Credit of \$5,799,274 was recorded as a receivable at June 30, 2010.

GOVERNMENT AUDITING STANDARDS

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

The Board of Directors
Southeast Alaska Power Agency

We have audited the financial statements of Southeast Alaska Power Agency as of and for the year ended June 30, 2011 and have issued our report thereon dated December 7, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

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

The Board of Directors
Southeast Alaska Power Agency

Compliance and Other Matters

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

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

Mikunda, Cottrell & Co.

Anchorage, Alaska
December 7, 2011

SOUTHEAST ALASKA POWER AGENCY

Schedule of Findings and Questioned Costs

Year Ended June 30, 2011

I. Summary of Auditor's Results

Financial Statements

Type of auditor's report issued

Unqualified

Internal control over financial reporting:

- Material weakness(es) identified?
- Significant deficiency(ies) identified?
- Noncompliance material to financial statements noted?

_____	yes	<u> X </u>	no
_____	yes	<u> X </u>	no
_____	yes	<u> X </u>	no

II. Financial Statement Findings

None noted.

SOUTHEAST ALASKA POWER AGENCY

Summary Schedule of Prior Year Audit Findings

Year Ended June 30, 2011

Financial Statement Findings

There were no prior year audit findings.

SOUTHEAST ALASKA POWER AGENCY

Corrective Action Plan

Year Ended June 30, 2011

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