



**Junkermier • Clark
Campanella • Stevens • P.C.**

501 Park Drive South
P. O. Box 989
Great Falls, MT 59403
Phone (406) 761-2820
FAX (406) 761-2825
www.jccsca.com

Certified Public Accountants and Business Advisors

**INDEPENDENT ACCOUNTANT'S REPORT
ON APPLYING AGREED-UPON PROCEDURES**

December 11, 2008

To the Audit Committee, Honorable Mayor, City Commissioners,
City Manager, and Electric City Power Board of Directors
City of Great Falls, Montana

We have performed the procedures enumerated below, which were agreed to by the City Manager, solely to assist you with testing and verifying specific concerns regarding the Electric Utility Fund. The City's management is responsible for the City's accounting records. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of those parties specified in the report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose. Our procedures consisted of the following:

1. Review the procedures regarding the cash deficit in the Electric Utility Fund. Ensure this fund is being treated the same as other funds with cash deficits, including timing and approval of any transfers or interfund loans.
2. Review the process for charging interest on deficit cash balances to ensure consistent treatment between this fund and others which have a deficit cash balance.
3. Review current electricity customer contracts to substantiate those contracts include scheduled price increases.
4. Review electricity customer contracts for any provisions regarding bankruptcy or default on the customers' payments. If the contracts contain no specific provisions regarding bad debts, provide the City with the requirements surrounding setting up a bad debt reserve on their accounts receivable.
5. The City is considering passing a measure that would blend their purchased electricity rate with other Southern Montana Electric member co-ops. We will report on any action taken by the City Commission.
6. Review the prepaid, payables, and construction in progress accounts to ensure the June 30, 2008, balances are reasonable and valid.
7. Conduct testing on the accounting for the water credit to determine it is being calculated and accrued in accordance with the City's contracts.
8. Review a sample of travel expenditures for proper treatment, approval, and accounting.
9. Test the calculation of internal service charges from the Electric Utility Fund for consistent treatment between this fund and others which have internal service charges.
10. Review the City's procedures to ensure they are in accordance with the Ordinances governing the Electric Utility Fund.

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The remainder of this letter summarizes the results of the previously listed procedures. It does not affect our report dated December 11, 2008, on the financial statements of the City of Great Falls, Montana. The attached appendices A, B and C are provided as additional information.

1. We reviewed the procedures regarding the cash deficit in the Electric Utility Fund. We discussed these procedures with Melissa Kinzler, Budget Officer/Assistant Director Fiscal Services Department. The Governmental Accounting Standards Board (GASB) prohibits funds from showing a deficit cash balance at fiscal year-end (GASB 31, paragraph 22). Therefore, City management reclassifies any unrestricted deposits to cash and borrows from various funds, including the general fund, any balance required to cover the deficit balance. This same process is followed for all other funds with a deficit cash balance at fiscal year-end.
2. We reviewed the process for charging interest on deficit cash balances to ensure consistent treatment between the Electric Utility Fund and others which have a deficit cash balance. We reviewed the process to calculate interest with Melissa Kinzler and Cheryl Lucas, staff accountant. We also obtained the calculation for June 2008 and tested it for proper calculations and matched the calculations with the general ledger detail in the Electric Utility Fund. We found the interest calculation to be consistent between the Electric Utility Fund and others which have a deficit cash balance.
3. We reviewed the current electricity customer contracts in order to substantiate those contracts include scheduled price increases. Based on our review of contracts currently in place, the total of customer contracts with Electric City Power are scheduled for approximately a 10.5% increase for fiscal year 2009, with approximately 2.0% increases for fiscal years 2010 and 2011. Transmission charges increased 21.5% effective for March 2008-2009 consumption.
4. We reviewed the electricity customer contracts for any provisions regarding bankruptcy or default on the customers' payments. The contracts with all but two entities specify in section 4.2 that "Payment shall be due and payable on or before the 15th day after the date of the monthly billing statement. If Customer's invoice has not been paid within fifteen (15) days of the date of the billing statement, Electric City may demand immediate payment by providing notice to Customer. Subject to Section 4.4, if Customer's invoice is not paid in full within ten (10) days of such notice (the "*Delinquency Date*"), the account will be deemed delinquent and the provisions of Section 6.1 will apply." Section 4.4 of the contract instructs customers how to handle disputed amounts. Section 6.1 of the contract specifies "upon the occurrence of an event of default, Electric City may (i) immediately suspend all service under this Agreement by written notice to Customer and (ii) terminate this Agreement by an additional written notice to Customer fixing a termination date which shall be no earlier than thirty (30) days after the date of the notice of termination. At the time Electric City provides such additional notice of termination to Customer, Electric City may also inform the distribution utility of the effective date of such contract termination." The contracts also require a customer to provide security in the form of cash, an irrevocable letter of credit, an irrevocably guaranty, a surety bond, or otherwise agreed-upon form of security equal to "reasonably anticipated supply costs for two months of service" unless the customer can otherwise establish its creditworthiness to the satisfaction of Electric City. According to Martha Cappis, Operations Supervisor Fiscal Services Department, the City has experienced no delinquent payments since Electric City Power, Inc. operations began.

The Statements of the Governmental Accounting Standards Board (GASBS) 20 *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, states "in the absence of an applicable GASB pronouncement, business-type accounting and financial reporting for state and local governmental entities has generally been defined by

pronouncements of the Financial Accounting Standards Board (FASB), Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARBs) of the Committee on Accounting Procedure." We reviewed Statement of Federal Financial Accounting Standards (SFFAS) 1 *Accounting for Selected Assets and Liabilities*, issued by the FASB, for the rules governing recording an allowance for uncollectible receivables. SFFAS 1 states "An allowance for estimated uncollectible amounts should be recognized to reduce the gross amount of receivables to its net realizable value." Therefore, if City management believes a portion of the recorded accounts receivable may not be collectible, an appropriate allowance should be set up.

5. As of December 3, 2008, the City Commissioners have not passed any measures related to the blended electricity rate.
6. We reviewed the prepaids, construction in progress, and payables accounts to ensure the June 30, 2008, balances are reasonable and valid. The prepaids consist of expenses incurred through contract agreements related to a debt issuance the City was going to issue, but never did. Under the Interpretations of the Governmental Accounting Standards Board (GASBI) 6, these costs are accumulated until the debt issuance, when they are amortized over the life of the debt. Since this debt will no longer be issued, most of the prepaid costs are no longer valid assets and have been expensed in 2008. The construction in progress account was for costs (i.e. engineering, design, water rights) associated with the potential construction of the HGS. The construction in progress balance is reasonable and a valid asset. The payables consist of debt issuance costs still required to be paid by the City, the water credit due to Southern, June electricity costs payable to Southern, and interfund liabilities. The payables are all reasonable and valid.
7. We conducted testing on the accounting for the water credit to determine it is calculated and accrued in accordance with the City's contracts. The water credit is determined based on both the original contract with Southern Montana Electric and the net amount of electricity purchased or resold on the imbalance market from the original 5 megawatt hour (MwH) block of power purchased. At the end of each month, the City is sent a bill from Southern. This bill takes the 5 megawatt hours multiplied by the price per megawatt hour (\$41.70 for block 1) multiplied by the number of hours in the month. This amount, plus the transmission charges for the month, is the total amount due to Southern. This amount is further broken down into the water credit (\$5.70 per megawatt hour) and the cash portion due (\$36.00 per megawatt hour). The cash portion, plus administration and general charges and less board fees, is paid to Southern by the middle of the month (i.e. January's bill is paid by February 19th). When the City and Southern are notified by Northwestern Energy about the net dollar amount of energy from the 5 megawatts traded on the open market, the imbalance is posted back against the water credit. We tested three months of the calculation in the current fiscal year and found the calculation to be accounted for in compliance with the Southern contract and consistently within each of these three months.
8. We reviewed a sample of travel expenditures for proper treatment, approval, and accounting. All travel expenditures were supported with receipts or other documentation, were properly approved, and were properly accounted for in the Electric Utility Fund.
9. We tested the June 30, 2008, calculation of internal service charges from the Electric Utility Fund for consistent treatment between this fund and others which have internal service charges. We found this calculation to be consistent for the Electric Utility Fund and other funds which have internal service charges.

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10. We reviewed the City's procedures to ensure they are in accordance with the Ordinances governing the Electric Utility Fund. We reviewed Ordinances 2861 "An Ordinance Amending Title 5, OCCGF, to include Chapter 20 Authorizing the City of Great Falls to Establish and Operate an Electric Utility and to Market Electric Power Service to Consumers Within the City of Great Falls"; 2925 "An Ordinance Amending Title 5, Chapter 20, OCCGF, Authorizing and Approving the Creation of Electric City Power, Inc. Pursuant to the Montana Nonprofit Corporation Act in Order to Secure and Provide Reliable and Economic Supplies of Electricity for the City of Great Falls, its Residents and Other Consumers"; and 2972 "An Ordinance Amending OCCGF 13 Chapter 2 Section 070(C) Pertaining to the Utility Service Area." Section 5.20.070 of Ordinance 2925 states the rates and charges of ECP "shall be designed to enable the Corporation to operate on a self-sufficient and self-sustaining basis and to produce revenues at all times sufficient to pay all operating, maintenance, debt service, repair and replacement costs of the Corporation and to provide reserves necessary or desirable for working capital, capital improvements and replacements and rate stabilization purposes." The City is not in compliance with this section of the Ordinance. According to the City, as stated in the June 30, 2008, Comprehensive Annual Financial Report (CAFR), "increased rates paid by customers along with proposed rate decreases offered by Southern, pending commission approval, will cause the deficit balance to decline and be eliminated over time." We found the City to be in compliance with the remaining Ordinances as they relate to the accounting and monitoring of the Electric Utility Fund.

We were not engaged to, and did not, conduct an audit or a review, the objectives of which would be the expression of an opinion or limited assurance on the Electric Utility Fund. Accordingly, we do not express such an opinion or limited assurance.

We have already discussed this letter with various City personnel, and we will be pleased to discuss it in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

This report is intended solely for the information and use of the City of Great Falls management, Audit Committee, Honorable Mayor, City Commissioners, City Manager, and Electric City Power Board of Directors and is not intended to be and should not be used by anyone other than those specified parties.

Junkermier, Clark, Campanella, Stevens, P.C.
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APPENDIX A

Background Information

On October 7, 2003, the City of Great Falls passed Ordinance 2861 which allowed the City of Great Falls "(1) to construct, operate, or maintain an electric utility to be known as "Electric City Power"; and, (2) to market and provide electric services to customers within and/or outside the boundaries of the City of Great Falls." The Electric Utility Fund is used to account for the newly formed Electric City Power, which is considered a blended component unit of the City of Great Falls (the City). On November 1, 2005, the City passed Ordinance 2925 which created Electric City Power, Inc., a non-profit designed to own, operate, and take all other actions necessary or desirable in connection with the municipal electric utility of the City. See Appendix A for a listing of all contracts, ordinances, and resolutions concerning Electric City Power, the Electric Utility Fund, and Southern Montana Electric Generation & Transmission Cooperative, Inc.

On August 29, 2003, the City invested \$500 to become a member of Southern Montana Electric Generation & Transmission Cooperative, Inc. (Southern). This membership allows the City to purchase electricity for resale from Southern. Effective on October 2, 2007, the City and Southern entered into a wholesale power contract which expires December 31, 2048. The contract does not require the City or Electric City Power, Inc. (ECP) to participate as owners in the Highwood Generating Station (HGS). However, it specifies the City's "desire to be an equity participant in the HGS if it can secure financing satisfactory to the Rural Utilities Service (RUS) and in such time as to not delay Southern's financing and construction of HGS." If ECP becomes an equity participant in the HGS and provides 15% of total equity financing, ECP is entitled to 15% of the net output from HGS. Under this contract, the City did not pledge "any of its revenues or assets to performance of its obligations...other than revenues, rights and assets of the City which are held solely for the purpose of operating its electric supply business." The contract requires the City to "develop and implement a conservation and renewable energy program." This program is to be developed in a timely fashion and approved by any government agency requiring the program. If Southern incurs any monetary cost should the conservation and renewable energy program not be approved, those costs will pass through to the City. Also as part of this contract, the City paid for some initial costs of the HGS. The City obtained a loan from First Interstate Bank to pay for these initial costs. The City also incurred debt issuance costs that will need to be paid in the future.

Since the passing of these Ordinances, ECP has added contract addendums to the wholesale power contract to purchase multiple blocks of electricity through Southern at specified rates per block, plus transmission and administration charges. The addendums have various expiration dates through September 30, 2011. ECP sells this electricity to selected businesses, governmental units, and individuals. ECP has established contracts with these customers, agreeing to provide electricity at specified rates, plus transmission and administration charges.

The first block of power is for 5 megawatts, which the City purchases at a price of \$41.70 per megawatt hour (MwH) through December 31, 2008. The price consists of a \$36 cash payment and a \$5.70 water credit, explained below. The second block of power is for 8-10 megawatts at \$44.15 per MwH (through September 30, 2011). The third block of power is for 7 megawatts (through December 31, 2008) and 12 megawatts (from January 1, 2009 through March 31, 2011) at \$52.80 per MwH through December 31, 2008 and \$47.45 per MwH from January 1, 2009 through March 31, 2011.

On behalf of the City, Southern is able to resell on the open market any electricity it does not use out of the original purchased blocks. The City also has to purchase electricity on the open market if their customers use more than the purchased blocks. The City receives a credit for any power resold and a debit for an additional power purchased. The combined result of the additional purchases and sales is referred to as net imbalances. Depending on which block of power was affected, the net debit or credit will go against cash (for blocks 2 and 3) or against the water credit (for block 1). However, the imbalance transactions cannot be calculated timely and the City is not informed until several months after the month in which the electricity was sold. Therefore, the City records the full month's electricity purchase and then records the net imbalances when they are informed of the net value purchased or amounts resold.

APPENDIX A

Background Information (Continued)

As part of ECP's contract with Southern, a portion of ECP's payment will be in the form of a water credit. The water credit pays for \$5.70 per MWh of the first block of power, plus or minus any amount of imbalance. This water credit will accrue until the contract expires on December 31, 2008. During construction and operation of HGS, it will require use of water provided by the City. The accrued water credit will be used to pay for the use of the City's water. Once the credit is used up, the HGS will pay cash for any use of the City's water. If HGS does not commence operation, the City will need to pay Southern for the unused water credit. It has not been established how the City would pay this back if the HGS is not constructed.

ECP received monies from other City funds which use the electricity provided by ECP. This is recognized in the form of a loan from the individual funds to the Electric Utility Fund and has been used on an ongoing basis to cover any cash deficit in the Electric Utility Fund. The loans totaled \$1.4 million and are included in advance from other funds in the Electric Utility Fund's trial balance.

ECP uses some of the City's resources and employee's time. Therefore, the City charges the Electric Utility Fund an internal service fee, calculated based on the percentage of time and expenses the Electric Utility Fund uses.

APPENDIX B

Summarized Trial Balance

The summarized trial balance of the Electric Utility Fund at June 30, 2008, consists of the following items:

ASSETS

Cash and cash equivalents	\$ 796	
Restricted cash and investments	100,000	Certificate of Deposit required by the Public Service Commission. Restricted as security for pilot program to sell electricity to individuals.
Accounts receivable	952,648	Amounts due from ECP customers.
Prepaid items	157,282	Debt issuance preparation costs.
Prepaid items	1,145,162	Deferred energy imbalances.
Capital assets	1,773,897	Costs associated with preparing for the construction of the HGS.
Other investments	<u>514,997</u>	Investment in Southern.

TOTAL ASSETS \$ 4,644,782

LIABILITIES

Current debt	\$ 46,066	General obligation note from First Interstate Bank for preparation for the construction of the HGS (Approved in Resolution 9534).
Long-term debt	1,431,752	General obligation note from First Interstate Bank for preparation for the construction of the HGS (Approved in Resolution 9534).
Accrued payables	280,426	Accounts payable for debt issuance preparation costs.
Accrued payables	857,368	June electricity costs payable to Southern.
Accrued payables	3,147	Accrued investment interest payable.
Other liabilities	1,083,914	Water credit due to Southern.
Due to other City funds	541,731	Due to general fund to cover cash deficit balance at fiscal year-end.
Advance from other funds	1,400,000	Provided by other funds and used on an ongoing basis to cover cash flow needs.
Advance from other funds	<u>100,000</u>	Provided by general fund to meet restricted cash requirements.

TOTAL LIABILITIES 5,744,404

NET ASSETS

Unrestricted	(1,495,701)	
Restricted for financial assurance	100,000	Corresponds to reserved cash balance above.
Investments in capital assets, net of related debt.	<u>296,079</u>	Corresponds to capital assets, net of related debt, above.

TOTAL NET ASSETS \$ (1,099,622)

APPENDIX C

Ordinances, Resolutions and Contracts Listing

<u>Ordinances & Resolutions</u>	<u>Commission approval date</u>
Ordinance 2861: Enabling ordinance	October 7, 2003
Ordinance 2925: Amends Title 5, Chapter 20, OCCGF. Authorizes creation of ECPI	November 1, 2005
Resolution 9537: Intent to participate in HGS	December 6, 2005
Ordinance 2972: City services ordinance	September 18, 2007
<u>Agreements Between City/Southern/ECP</u>	<u>Agreement date</u>
Wholesale Power Agreement/Contracts Agreement (water credit)	September 21, 2004
Wholesale power purchase contract	September 29, 2004
Power purchase agreement - addendum 1	October 18, 2005
Power purchase agreement - addendum 2	November 8, 2006
Wholesale power contract (supercedes 9/29/04)	October 2, 2007
<u>City Services Agreements</u>	
Water service agreement (raw water)	March 15, 2005
Potable water service agreement	June 5, 2007
Reservation of wastewater treatment capacity agreement	June 5, 2007
Fire protection and emergency services agreement	June 17, 2008
<u>Other Agreements</u>	
Agreement regarding security for power purchases	July 17, 2007
Assignment & assumption between City and ECP	October 2, 2007
<u>Electric City Power Corporate Documents</u>	<u>Commission approval date</u>
Resolution 9529: ECP Articles of Incorporation	November 15, 2005
Resolution 9530: ECP Bylaws	November 15, 2005
IRS SS-4 Application for employer identification number	February 1, 2007
IRS Employer identification number assigned to ECP	February 27, 2007
MT DOR Non-profit tax-exempt status granted MCA 15-31-102(1)	February 23, 2007
Business entity annual report filing for 2008	February 5, 2008