

# **American Public Energy Agency**

Accountants' Report and Financial Statements

March 31, 2011 and 2010



# American Public Energy Agency

March 31, 2011 and 2010

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## Independent Accountants' Report on Financial Statements and Supplementary Information

Board of Directors  
American Public Energy Agency  
Lincoln, Nebraska

We have audited the accompanying balance sheets of American Public Energy Agency as of March 31, 2011 and 2010, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of American Public Energy Agency'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. 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 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 American Public Energy Agency as of March 31, 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.

As discussed in Note 7, in 2011 American Public Energy Agency changed its method of accounting for derivative instruments as required by Governmental Accounting Standards Board (GASB) Statement No. 53, *Accounting, and Financial Reporting for Derivative Instruments*, by retroactively restating prior year financial statements.

The accompanying management's discussion and analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. 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.

*BKD, LLP*

June 13, 2011

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis of American Public Energy Agency's (APEA) financial performance provides an overview of APEA's financial activities for the years ended March 31, 2011, 2010 and 2009. Please read this information in conjunction with the accompanying financial highlights, the basic financial statements and the accompanying notes to the financial statements.

### **Financial Analysis**

The following comparative condensed financial statements summarize APEA's financial position and operating results for the years ended March 31, 2011, 2010 and 2009.

### **Condensed Balance Sheets**

	<b>March 31,</b>			<b>Change 2011 to 2010</b>	<b>Change 2010 to 2009</b>
	<b>2011</b>	<b>2010</b>	<b>2009</b>		
<b>Assets</b>					
Current assets	\$117,496,673	\$ 91,720,928	\$ 64,480,416	\$ 25,775,745	\$ 27,240,512
Prepaid gas supply, long-term	250,183,120	342,002,387	413,889,274	(91,819,267)	(71,886,887)
Capital assets, net	4,343	7,944	9,969	(3,601)	(2,025)
Deferred costs to be recovered in future periods	59,714,996	61,772,046	54,588,600	(2,057,050)	7,183,446
Fair value of derivative instruments	42,740,284	22,801,737	3,315,561	19,938,547	19,486,176
Deferred outflow from derivative instruments	21,418,109	55,312,501	93,605,174	(33,894,392)	(38,292,673)
Other long-term assets	35,233,110	25,520,351	23,080,991	9,712,759	2,439,360
<b>Total assets</b>	<b>\$526,790,635</b>	<b>\$599,137,894</b>	<b>\$ 652,969,985</b>	<b>\$ (72,347,259)</b>	<b>\$ (53,832,091)</b>
<b>Liabilities and Net Assets</b>					
Current liabilities	\$ 97,328,486	\$ 60,914,388	\$ 37,281,061	\$ 36,414,098	\$ 23,633,327
Long-term debt	360,740,728	455,955,717	514,536,707	(95,214,989)	(58,580,990)
Fair value of derivative instruments	21,418,109	55,312,501	93,605,174	(33,894,392)	(38,292,673)
Deferred inflow from derivative instruments	42,740,284	22,801,737	3,315,561	19,938,547	19,486,176
<b>Total liabilities</b>	<b>522,227,607</b>	<b>594,984,343</b>	<b>648,738,503</b>	<b>(72,756,736)</b>	<b>(53,754,160)</b>
Invested in capital assets	4,343	7,944	9,969	(3,601)	(2,025)
Unrestricted	4,558,685	4,145,607	4,221,513	413,078	(75,906)
<b>Total net assets</b>	<b>4,563,028</b>	<b>4,153,551</b>	<b>4,231,482</b>	<b>409,477</b>	<b>(77,931)</b>
<b>Total liabilities and net assets</b>	<b>\$526,790,635</b>	<b>\$599,137,894</b>	<b>\$ 652,969,985</b>	<b>\$ (72,347,259)</b>	<b>\$ (53,832,091)</b>

### **2011 Financial Highlights**

- The increase in current assets is primarily due to the current portion of the prepaid gas commodity.
- Prepaid gas supply decreased due to the deliveries of natural gas.
- In 2011, APEA implemented GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which required APEA to record a noncurrent asset or liability for the fair value of derivative instruments and an offsetting deferred inflow or outflow on the Balance Sheets. The implementation of this standard had no impact on the change in net assets.

## **2010 Financial Highlights**

- The increase in current assets is primarily due to the current portion of the prepaid gas commodity.
- Prepaid gas supply decreased due to the deliveries of natural gas.

## ***Condensed Statements of Revenues, Expenses and Changes in Net Assets***

	<u>March 31,</u>			<u>Change</u>	<u>Change</u>
	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2011 to 2010</u>	<u>2010 to 2009</u>
Operating revenues	\$ 94,227,868	\$ 62,907,790	\$ 52,027,334	\$ 31,320,078	\$ 10,880,456
Operating expenses	<u>(72,682,249)</u>	<u>(49,293,576)</u>	<u>(41,332,623)</u>	<u>(23,388,673)</u>	<u>(7,960,953)</u>
Operating income	<u>21,545,619</u>	<u>13,614,214</u>	<u>10,694,711</u>	<u>7,931,405</u>	<u>2,919,503</u>
Net nonoperating expenses	(21,046,142)	(13,692,145)	(9,357,393)	(7,353,997)	(4,334,752)
Distribution to members	<u>(90,000)</u>	<u>-</u>	<u>(200,000)</u>	<u>(90,000)</u>	<u>200,000</u>
Increase (decrease) in net assets	<u>\$ 409,477</u>	<u>\$ (77,931)</u>	<u>\$ 1,137,318</u>	<u>\$ 487,408</u>	<u>\$ (1,215,249)</u>

## **2011 Financial Highlights**

### ***Operating Revenues and Expenses***

Operating revenues and expenses increased during the year based on the prepay gas transactions and the price of gas.

### ***Net Nonoperating Expenses***

Pursuant to the termination agreement between APEA, Municipal Energy Agency of Nebraska (MEAN) and National Public Gas Agency (NPGA), distributions to MEAN and NPGA totaled \$308,978 and \$339,592 during 2011 and 2010, respectively.

## **2010 Financial Highlights**

### ***Operating Revenues and Expenses***

Operating revenues and expenses increased during the year based on the prepay gas transactions and the price of gas.

### ***Net Nonoperating Expenses***

Pursuant to the termination agreement between APEA, Municipal Energy Agency of Nebraska (MEAN) and National Public Gas Agency (NPGA), distributions to MEAN and NPGA totaled \$339,592 and \$537,312 during 2010 and 2009, respectively.

### ***General Trends and Significant Events***

#### **Status of the Energy Sector:**

Conditions in U.S. financial markets, interest rate spreads in particular, are challenging APEA's prepayment business model. APEA has been examining alternate legal and financial structures in order to carry out its mission of supplying discounted natural gas to public gas systems.

The rapid development of the natural gas production from shale formations throughout the U.S. over the past two years has increased natural gas supplies and decreased not only current price volatility but also the natural gas future price curve. There has been a fundamental shift in focus and thought process concerning the use of natural gas for electric generation fuel for gas turbines and transportation fuel for vehicles and equipment. There appears to be a stronger market developing for use of natural gas in the U.S. considering the positive aspects associated with the environmental impact and desire to reduce dependency on foreign oil.

#### **Significant Events:**

In June 2010, APEA received notices from Moody's Investors Service (Moody's) and Standard and Poor's Ratings Services (S&P) of a downgrade of the credit rating of the Series 2003 A and B Gas Supply Variable Rate Revenue Bonds (the "2003 Bonds") and the Series 2005 Variable Rate Gas Supply Variable Rate Revenue Bonds (the "2005 Bonds"). The APEA downgrades were a result of a downgrade of BP Corporation North America Inc. (BPNA) ratings following the April 2010 explosion and oil spill in the Gulf of Mexico. BPNA is the guarantor of the obligation of the gas supplier for the APEA revenue bonds as well as the liquidity provider under a Standby Bond Purchase Agreement for the short-term debt. Moody's lowered the rating on the APEA bonds to Baa1/VMIG3 from Aa3/VMIG1 and S&P lowered the rating from A/A-1 to AA-/A-1+. The APEA ratings carry the same rating as BPNA.

Metropolitan Utilities District in Omaha (MUD) informed APEA that it was exercising its option under the terms of the gas purchase contract for the 2005 bonds to remarket the remaining gas to APEA, beginning November 1, 2010. APEA is remarketing gas purchased with proceeds of the 2003 Bonds and 2005 Bonds and is selling all of the volumes to qualified public purchasers according to the terms and conditions of the gas purchase agreements.

#### **Looking into the Future:**

APEA anticipates completing three separate natural gas prepay transactions when the financial markets and the interest rate spreads improve and return to historical levels. Final documentation on these transactions is virtually complete.

APEA has also reviewed other financing structures that would allow entry into other energy related transactions. APEA will continue to think creatively and focus on the development of all viable financing opportunities. Participation in other energy and natural gas related projects would enhance and further the mission, goals, and objectives as set by the APEA Board of Directors.

### ***Summary of the Financial Statements***

The financial statements, related notes and management's discussion and analysis provide information about APEA's financial position and activities. The balance sheets present APEA's assets, liabilities and net assets as of March 31, 2011 and 2010. The statements of revenues, expenses and changes in net assets present APEA's operating results and changes in net assets for the years ended March 31, 2011 and 2010. The statements of cash flows provide information about the flow of cash within APEA by activities for the years ended March 31, 2011 and 2010. The notes to the financial statements provide additional disclosures and information that is essential to a full understanding of the data provided in the statements.

### ***Report of Management***

APEA has prepared and is responsible for the financial statements and related information included in this report. Management believes that its policies and procedures provide guidance and reasonable assurance that APEA's operations are conducted according to management's intentions and to a high standard of business ethics. In management's opinion, the financial statements present fairly, in all material respects, the financial position, results of operations and cash flows of APEA in conformity with accounting principles generally accepted in the United States of America. This Annual Financial Report is also available via the Internet at [www.apea.org](http://www.apea.org).

Roger W. Mock  
President and  
Chief Executive Officer

# American Public Energy Agency

## Balance Sheets

March 31, 2011 and 2010

<b>Assets</b>	<b>2011</b>	<b>2010 (Restated - Note 7)</b>
<b>Current Assets</b>		
Cash and cash equivalents	\$ 11,178,113	\$ 8,403,431
Short-term investments	2,790,000	3,050,000
Accounts receivable	11,561,966	8,257,222
Accrued interest receivable	96,276	70,771
Prepaid expenses	51,060	52,614
Prepaid gas supply, current	91,819,258	71,886,890
Total current assets	117,496,673	91,720,928
<b>Noncurrent Assets</b>		
Restricted investments	34,748,737	24,901,853
Prepaid gas supply, long-term	250,183,120	342,002,387
Capital assets, net	4,343	7,944
Deferred bond issue costs	484,373	618,498
Deferred costs to be recovered in future periods	59,714,996	61,772,046
Fair value of derivative instruments	42,740,284	22,801,737
Deferred outflow from derivative instruments	21,418,109	55,312,501
Total noncurrent assets	409,293,962	507,416,966
Total assets	<u>\$ 526,790,635</u>	<u>\$ 599,137,894</u>
<b>Liabilities and Net Assets</b>		
<b>Current Liabilities</b>		
Current maturities of long-term debt	\$ 95,580,000	\$ 58,945,000
Accounts payable	335,880	376,945
Accrued interest payable	1,412,606	1,592,443
Total current liabilities	97,328,486	60,914,388
<b>Noncurrent Liabilities</b>		
Long-term Debt	360,740,728	455,955,717
Fair value of derivative instruments	21,418,109	55,312,501
Deferred inflow from derivative instruments	42,740,284	22,801,737
Total noncurrent liabilities	424,899,121	534,069,955
<b>Net Assets</b>		
Invested in capital assets	4,343	7,944
Unrestricted	4,558,685	4,145,607
Total net assets	4,563,028	4,153,551
Total liabilities and net assets	<u>\$ 526,790,635</u>	<u>\$ 599,137,894</u>

**American Public Energy Agency**  
**Statements of Revenues, Expenses and**  
**Changes in Net Assets**  
**Years Ended March 31, 2011 and 2010**

	<u>2011</u>	<u>2010</u>
<b>Operating Revenues</b>		
Gas supply	\$ 93,959,431	\$ 62,814,227
Other	268,437	93,563
	<u>94,227,868</u>	<u>62,907,790</u>
Total operating revenues		
<b>Operating Expenses</b>		
Cost of gas sold	71,886,900	48,497,442
Administrative and general	795,349	796,134
	<u>72,682,249</u>	<u>49,293,576</u>
Total operating expenses		
<b>Operating Income</b>	<u>21,545,619</u>	<u>13,614,214</u>
<b>Nonoperating Revenues (Expenses)</b>		
Investment income	1,249,593	927,492
Net costs (revenue) to be recovered in future periods	(2,057,049)	7,183,446
Interest expense	(17,709,797)	(19,368,714)
Amortization of debt issuance costs	(134,125)	(134,125)
Arbitrage rebates and bond fees	(2,085,786)	(1,960,652)
Distributions under contract	(308,978)	(339,592)
	<u>(21,046,142)</u>	<u>(13,692,145)</u>
Net nonoperating expenses		
<b>Income (Loss) Before Distributions to Members</b>	499,477	(77,931)
<b>Distributions to Members</b>	<u>(90,000)</u>	<u>-</u>
<b>Increase (Decrease) in Net Assets</b>	409,477	(77,931)
<b>Net Assets, Beginning of Year</b>	<u>4,153,551</u>	<u>4,231,482</u>
<b>Net Assets, End of Year</b>	<u>\$ 4,563,028</u>	<u>\$ 4,153,551</u>

**American Public Energy Agency**  
**Statements of Cash Flows**  
**Years Ended March 31, 2011 and 2010**

	<u>2011</u>	<u>2010</u>
<b>Operating Activities</b>		
Cash received from customers	\$ 67,096,309	\$ 50,961,529
Cash received from swap provider and others	23,787,945	9,936,652
Cash paid to suppliers and employees	<u>(792,390)</u>	<u>(793,146)</u>
Net cash provided by operating activities	<u>90,091,864</u>	<u>60,105,035</u>
<b>Capital and Related Financing Activities</b>		
Purchase of capital assets	<u>-</u>	<u>(963)</u>
Net cash used in capital and related financing activities	<u>-</u>	<u>(963)</u>
<b>Noncapital Financing Activities</b>		
Principal payments on long-term debt	(58,945,000)	(35,305,000)
Distributions to members and others	(398,978)	(339,592)
Fiscal payments	(2,085,785)	(1,960,652)
Interest paid	<u>(17,524,623)</u>	<u>(19,112,367)</u>
Net cash used in noncapital financing activities	<u>(78,954,386)</u>	<u>(56,717,611)</u>
<b>Investing Activities</b>		
Interest received on investment securities	1,224,088	893,904
Proceeds from sales and maturities of investment securities	1,060,000	1,550,000
Purchases of investment securities	<u>(10,646,884)</u>	<u>(5,868,485)</u>
Net cash used in investing activities	<u>(8,362,796)</u>	<u>(3,424,581)</u>
<b>Increase (Decrease) in Cash and Cash Equivalents</b>	2,774,682	(38,120)
<b>Cash and Cash Equivalents, Beginning of Year</b>	<u>8,403,431</u>	<u>8,441,551</u>
<b>Cash and Cash Equivalents, End of Year</b>	<u>\$ 11,178,113</u>	<u>\$ 8,403,431</u>
<b>Reconciliation of Operating Income to Net Cash Provided by Operating Activities</b>		
Operating income	\$ 21,545,619	\$ 13,614,214
Amortization of prepaid gas supply	71,886,899	48,497,442
Depreciation	3,601	2,988
Changes in operating assets and liabilities		
Accounts receivable	(3,304,744)	(2,113,084)
Prepaid expenses	1,554	2,485
Accounts payable	<u>(41,065)</u>	<u>100,990</u>
<b>Net Cash Provided by Operating Activities</b>	<u>\$ 90,091,864</u>	<u>\$ 60,105,035</u>

# American Public Energy Agency

## Notes to Financial Statements

March 31, 2011 and 2010

### Note 1: Nature of Operations and Summary of Significant Accounting Policies

#### ***Nature of Operations***

American Public Energy Agency (APEA) is an interlocal agency, being a body corporate and politic organized under the laws of the State of Nebraska. APEA is governed by its members and provides energy acquisition programs and related services to public agencies in any state. Energy acquisitions are accomplished primarily through long-term special obligation financing transactions.

#### ***Reporting Entity***

In evaluating how to define a governmental entity, for financial reporting purposes, management must consider all potential component units for which financial accountability may exist. The determination of financial accountability pursuant to Governmental Accounting Standards Board (GASB) No. 14, *The Financial Reporting Entity* and GASB No. 39, *Determining Whether Certain Organizations are Component Units* includes consideration of a number of criteria, including: (1) the ability to appoint a voting majority of another entity's governing body and to impose its will on that entity, (2) the potential for that entity to provide specific financial benefits to or impose specific financial burdens on others, and (3) the entity's fiscal dependency on others. APEA has determined that it has no reportable component units.

#### ***Accounting Method***

APEA's funds are accounted for on the accrual basis of accounting. APEA's accounting records are maintained in accordance with accounting principles generally accepted in the United States of America for regulated utilities and generally follow the Uniform System of Accounts for Public Utilities and License prescribed by the Federal Energy Regulatory Commission (FERC). APEA prepares its financial statements as a business-type activity in conformity with applicable pronouncements of the GASB. Pursuant to GASB Statement No. 20, APEA has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) that were issued on or before November 30, 1989, to the extent they do not conflict with or contradict GASB pronouncements.

Under the provisions of FASB Accounting Standards Codification (ASC) 980, *Regulated Operations*, APEA prescribes rate making recovery for certain transactions. This method includes the standard that debt service requirements, as opposed to interest expense and amortization, are a cost for rate making purposes.

# American Public Energy Agency

## Notes to Financial Statements

March 31, 2011 and 2010

### Note 1: Nature of Operations and Summary of Significant Accounting Policies - Continued

#### ***Use of Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

#### ***Cash Equivalents***

APEA considers all highly liquid investments with original maturities of three months or less at the time of purchase to be cash equivalents. At March 31, 2011 and 2010, cash equivalents consisted of money market mutual funds invested in government securities.

#### ***Investments***

Investments in money market mutual funds are carried at fair value and investment contracts with insurance and other financial services companies are carried at contract value.

Investment income consists of interest income and the net change for the year in the fair value of investments.

#### ***Accounts Receivable***

Accounts receivable are stated at the amount billed to customers. Accounts receivable are ordinarily due 30 days after the issuance of the invoice. Accounts past due more than 120 days are considered delinquent after best efforts in collection. Delinquent receivables are charged off as they are deemed uncollectible. Management does not believe an allowance for doubtful accounts is necessary at March 31, 2011 and 2010.

#### ***Deferred Bond Issue Costs***

Bond issue costs incurred on the revenue bond issues have been deferred and are being amortized over the life of the bonds using the effective interest method.

#### ***Prepaid Gas Supply***

APEA prepays for deliveries of natural gas supplies with the proceeds from revenue bonds. Prepaid gas supplies are stated at average cost, as determined by each prepay contract.

# American Public Energy Agency

## Notes to Financial Statements

March 31, 2011 and 2010

### Note 1: Nature of Operations and Summary of Significant Accounting Policies - Continued

#### **Capital Assets**

Capital assets are recorded at cost at date of acquisition. Furniture and equipment are depreciated over the estimated useful life of each asset. Leasehold improvements are depreciated over the shorter of the lease term or the estimated useful lives of the improvements. Annual depreciation is computed using the straight-line method.

#### **Deferred Costs to be Recovered in Future Periods**

Rates for natural gas billings are designed to provide, over the life of each project, full recovery of all project costs as defined in the respective bond resolutions and as prescribed by the Board of Directors. In accordance with accounting standards on *Regulated Operations*, certain income and expense items which would be recognized during the current period are deferred and not included in the determination of net income until such costs are recoverable. The costs to be recovered consist primarily of the difference between amortization of prepaid gas supplies and debt service requirements included in rates. As of March 31, 2011 and 2010, this difference in timing has resulted in an amount of \$59,714,996 and \$61,772,046 respectively, recorded as costs to be recovered in future periods in the accompanying balance sheets.

#### **Net Asset Classification**

Net assets are required to be classified into three components - invested in capital assets; restricted; and unrestricted. These classifications are defined as follows:

**Invested in capital assets** - This component of net assets consists of capital assets, net of accumulated depreciation. There is no debt related to capital assets.

**Restricted** - This component of net assets consists of constraints placed on net assets use through external constraints imposed by creditors (such as through debt covenants), contributors, or law or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation. There are no restricted net assets at March 31, 2011 and 2010.

**Unrestricted net assets** - This component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets".

#### **Classification of Revenues**

Operating revenues include revenues resulting from delivery of gas supplies to customers. Nonoperating revenues include those derived from capital and related financing, noncapital financing and investing activities.

# American Public Energy Agency

## Notes to Financial Statements

March 31, 2011 and 2010

### Note 1: Nature of Operations and Summary of Significant Accounting Policies - Continued

#### *Derivative Instruments*

Derivative instruments are utilized by APEA to manage market risk and reduce its exposure resulting from fluctuations in prices of natural gas. These instruments include commodity swap agreements which convert index-priced natural gas revenues to fixed prices for servicing outstanding debt obligations and interest rate swap agreements which effectively change APEA's variable interest rate to a synthetic fixed rate. Gas supply revenues in each operating period include the netting adjustments of the commodity swap agreements. Interest expense in each operating period include the netting adjustments of the interest rate swap agreement.

APEA's derivative financial instruments are accounted for in accordance with GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. In connection with this Statement, the fair value of APEA's derivative financial instruments is recorded on the Balance Sheets, with an offsetting deferred asset or liability.

#### *Income Taxes*

In accordance with certain provisions of the Interlocal Cooperation Act of Nebraska and related governing laws and regulations, APEA is exempt from federal and state income taxes.

### Note 2: Deposits, Investments and Investment Return

#### *Deposits*

Custodial credit risk is the risk that in the event of a bank failure, a government's deposits may not be returned to it. APEA's deposit policy for custodial credit risk requires compliance with the provisions of state law. State law requires collateralization of all deposits with federal depository insurance or bonds and other obligations of the U.S. Treasury or U.S. agencies.

#### *Investments*

APEA's investing is performed in accordance with the investment policy adopted by its Board of Directors and applicable state statutes. APEA may invest in U.S. Treasury and U.S. agency securities, certificates of deposit, time deposits, and banker's acceptances, commercial paper, money market funds, repurchase agreements, municipal bonds, and investment contracts. APEA has specific investments in guaranteed investment contracts with an insurance company as provided in bond documents. In the event that secured investment opportunities arise, other than those specified above, investment consent is required through the approval of the Board of Directors.

**American Public Energy Agency**  
**Notes to Financial Statements**  
**March 31, 2011 and 2010**

**Note 2: Deposits, Investments and Investment Return - Continued**

At March 31, 2011 and 2010, APEA had the following investments, maturities and credit ratings:

	Fair Value	Maturities in Years		Credit Rating Moody's S/P
		Less Than 1	1 - 5	
<b>March 31, 2011</b>				
Money market mutual funds -				
US agencies	\$ 10,993,517	\$10,993,517	\$ -	Aaa/AAAm
Investment contracts	34,748,737	-	34,748,737	Not rated
	<u>\$ 45,742,254</u>	<u>\$10,993,517</u>	<u>\$ 34,748,737</u>	
Cash held at trustee	\$ 97,790	\$ 97,790	\$ -	N/A
Money market mutual funds -				
US agencies	8,240,968	8,240,968	-	Aaa/AAAm
Investment contracts	24,901,853	-	24,901,853	Not rated
	<u>\$ 33,240,611</u>	<u>\$ 8,338,758</u>	<u>\$ 24,901,853</u>	

**Interest Rate Risk**

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. APEA's investment policy does not place a limit on the amount that may be invested in any one maturity category. The money market mutual funds are presented as an investment with a maturity of less than one year because they are redeemable in full immediately. While maturities of the investment contracts are reflected consistent with the contract maturity, the funds are available for specific uses as identified in the bond indentures.

**Credit Risk**

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. APEA's investment policy establishes requirements for certain investment securities or issuers of securities to be rated at certain rates or higher. The following investment types must be rated at the minimum rates by Moody's and S&P as noted below:

U.S. agency securities	Aaa/AAA
Commercial paper	P-1/A-1
Municipal bonds	AA

# American Public Energy Agency

## Notes to Financial Statements

March 31, 2011 and 2010

### Note 2: Deposits, Investments and Investment Return - Continued

#### **Custodial Credit Risk**

For an investment, custodial credit risk is the risk that, in the event of a failure of the counterparty, APEA would not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. All of the underlying securities for APEA's investment contracts at March 31, 2011 and 2010, are held by the counterparties in other than APEA's name.

#### **Concentration of Credit Risk**

APEA places no limit on the amount that may be invested in any one issuer.

	<b>Portfolio Composition</b>	
	<b>March 31,</b>	
	<b>2011</b>	<b>2010</b>
Investment contracts		
Transamerica Occidental Life Insurance Company	30.99 %	40.29 %
Transamerica Life Insurance and Annuity Company	44.97	34.63

#### **Summary of Carrying Values**

The carrying values of deposits and investments shown above are included in the balance sheets at March 31, 2011 and 2010 as follows:

	<b>2011</b>	<b>2010</b>
Carrying Value		
Deposits	\$ 2,974,596	\$ 3,114,673
Investments	45,742,254	33,240,611
	<u>\$ 48,716,850</u>	<u>\$ 36,355,284</u>

Included in the following balance sheet captions:

	<b>2011</b>	<b>2010</b>
Current Assets		
Cash and cash equivalents	\$ 11,178,113	\$ 8,403,431
Short-term investments	2,790,000	3,050,000
Noncurrent Assets		
Restricted investments	34,748,737	24,901,853
	<u>\$ 48,716,850</u>	<u>\$ 36,355,284</u>

Of the cash and cash equivalents amounts shown above, \$10,667,448 and \$7,873,099 were restricted for debt service at March 31, 2011 and 2010, respectively.

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**Note 2: Deposits, Investments and Investment Return - Continued**

***Investment Return***

Investment return for the years ended March 31, 2011 and 2010 consisted of interest income of \$1,249,593 and \$927,492, respectively.

**Note 3: Long-term Debt**

Long-term debt at March 31, 2011 and 2010 consisted of the following:

	<u>2011</u>	<u>2010</u>
Revenue bonds		
Gas Supply Variable Rate Revenue Bonds, 2005 Series A, due June 1, 2006 to December 1, 2015	\$ 263,163,000	\$ 281,818,000
Gas Supply Variable Rate Revenue Bonds, 2003 Series A, due August 1, 2004 to February 1, 2014	97,205,000	117,350,000
Gas Supply Variable Rate Revenue Bonds, 2003 Series B, due August 1, 2004 to February 1, 2014	<u>97,205,000</u>	<u>117,350,000</u>
Total long-term debt	457,573,000	516,518,000
Less current maturities of long-term debt	(95,580,000)	(58,945,000)
Less unamortized discount	<u>(1,252,272)</u>	<u>(1,617,283)</u>
Long-term debt	<u><u>\$ 360,740,728</u></u>	<u><u>\$ 455,955,717</u></u>

APEA has issued revenue bonds to finance prepayments for natural gas supplies meeting a portion of the long-term gas requirements of various public agencies. The bonds are secured by a pledge of the gas supply revenues derived from the related prepay transactions. A summary description of each gas supply project financing transaction is as follows:

***Gas Supply Variable Rate Revenue Bonds, Series 2005A, Series 2003A and Series 2003B***

In August 2005, APEA issued \$349,783,000 of gas supply revenue bonds to fund the prepayment of 65,277,000 Mmbtus of gas from BP Canada Energy Marketing Corp. (BP) with deliveries beginning November 2005 and ending October 2015. In December 2003, APEA issued \$305,960,000 of gas supply revenue bonds to fund the prepayment of 83,246,000 Mmbtus of gas from BP with deliveries beginning January 2004 and ending December 2013.

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**Note 3: Long-term Debt - Continued**

***Debt Activity***

Long-term debt activity for 2011 and 2010 is summarized as follows:

	<b>Series 2005A</b>	<b>Series 2003A</b>	<b>Series 2003B</b>	<b>Total</b>
<b>Balance, March 31, 2009</b>	\$ 299,778,000	\$ 126,022,500	\$ 126,022,500	\$ 551,823,000
Less principal payments on bonds	<u>(17,960,000)</u>	<u>(8,672,500)</u>	<u>(8,672,500)</u>	<u>(35,305,000)</u>
<b>Balance, March 31, 2010</b>	281,818,000	117,350,000	117,350,000	516,518,000
Less principal payments on bonds	<u>(18,655,000)</u>	<u>(20,145,000)</u>	<u>(20,145,000)</u>	<u>(58,945,000)</u>
<b>Balance, March 31, 2011</b>	<u><u>\$ 263,163,000</u></u>	<u><u>\$ 97,205,000</u></u>	<u><u>\$ 97,205,000</u></u>	<u><u>\$ 457,573,000</u></u>

Future principal and interest payments required to be made in accordance with all of the long-term debt agreements at March 31, 2011, are as follows:

<b>Year Ending March 31,</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
2012	\$ 95,580,000	\$ 14,873,507	\$ 110,453,507
2013	122,360,000	10,913,722	133,273,722
2014	127,760,000	6,444,413	134,204,413
2015	54,360,000	2,893,206	57,253,206
2016	<u>57,513,000</u>	<u>820,937</u>	<u>58,333,937</u>
	<u><u>\$ 457,573,000</u></u>	<u><u>\$ 35,945,785</u></u>	<u><u>\$ 493,518,785</u></u>

The interest payments reflected in the table above for the Series 2005 and 2003 variable rate bonds, were calculated based on the interest rate swap agreements (See Note 7) which convert these issues to an effective fixed rate of approximately 3.65%.

**Note 4: Membership**

At March 31, 2011 and 2010, three municipalities, comprised the membership of APEA. In 2011, the Board of Directors approved a distribution of surplus net revenues to the existing members in the amount of \$90,000. In 2010, no distributions were made to members.

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## Notes to Financial Statements

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### Note 4: Membership - Continued

In February 2007, a termination and settlement agreement (“the “Termination Agreement”) was executed between APEA and two former members. The Termination Agreement set forth current distributions and provided for certain future contingent distributions to the former members. Distributions under this agreement were \$308,978 and \$339,592 during 2011 and 2010, respectively. Additional distributions to the former members may be payable pursuant to the Termination Agreement to the extent of excess cash flows from the remaining gas supply prepayment transactions. As these future distributions are contingent on excess cash flows, they will be recorded as a reduction to net assets on an annual basis when they are determinable.

### Note 5: Risk Management

APEA is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions, injuries to employees and others; and natural disasters. APEA carries commercial insurance, subject to certain limits and deductibles, to reduce the financial impact for claims arising from such matters. Claims have not exceeded this commercial coverage in any of the three preceding years.

### Note 6: Gas Purchase and Sales Agreements

APEA has entered into long-term gas purchase and supply contracts for which prepayments have been made and amounts remaining of \$342,002,378 and \$413,889,277 are reflected in both current and noncurrent asset categories at March 31, 2011 and 2010, respectively. Under the original long-term sales agreements, deliveries of natural gas were scheduled for two customers over a period continuing through November 2015. Effective April 1, 2009 and October 31, 2010, both customers have given APEA notice to terminate deliveries under the applicable gas sales agreements. In accordance with the gas purchase contracts, APEA has the ability to remarket this natural gas to BP, who must accept delivery. All terminated gas deliveries to the original customers have been remarketed to BP.

### Note 7: Derivative Instruments

#### ***Implementation of New Accounting Principle***

In 2011, APEA implemented the provisions of GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. This statement is intended to improve how governmental entities report information about derivative instruments, financial arrangements used by governmental entities to manage specific risks or make investments, in their financial statements. The statement specifically requires governmental entities to measure most derivative instruments at fair value in their financial statements. The Balance Sheet as of March 31, 2010 has been

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**Note 7: Derivative Instruments - Continued**

***Implementation of New Accounting Principle – Continued***

restated to record the fair value and negative fair value of the derivative instruments of \$22,801,737 and \$55,312,501, respectively, as a noncurrent asset and liability and reflect a deferred cash inflow and outflow of the same amount. The adoption of GASB No. 53 had no impact on 2010 revenues, expenses or change in net assets.

***Composition of Derivative Instruments***

The fair values and notional amounts of derivative instruments outstanding as of March 31, 2011 and 2010, classified by type, and the changes in fair value of such derivative instruments for the year ended, as reported in the financial statements, are as follows:

<b>March 31, 2011</b>	<b>Notional Amount</b>	<b>Fair Value</b>	<b>Counterparty Credit Rating</b>
Cash flow hedges:			
Pay-variable, receive fixed commodity swap - Series 2005A	38,782,500 mmbtu	\$ 58,668,818	Aa2/A+
Pay-fixed, receive variable interest rate swap - Series 2005A	\$ 263,163,000	<u>(15,928,534)</u>	Aa2/A+
		<u>\$ 42,740,284</u>	
Pay-variable, receive fixed commodity swap - Series 2003A&B	40,060,000 mmbtu	\$ (12,268,804)	Aa2/A+
Pay-fixed, receive variable interest rate swap - Series 2003A&B	\$ 194,410,000	<u>(9,149,305)</u>	Aa2/A+
		<u>\$ (21,418,109)</u>	
<b>March 31, 2010</b>			
Cash flow hedges:			
Pay-variable, receive fixed commodity swap - Series 2005A	45,377,000 mmbtu	\$ 41,377,440	Aa2/A+
Pay-fixed, receive variable interest rate swap - Series 2005A	\$ 281,818,000	<u>(18,575,703)</u>	Aa2/A+
		<u>\$ 22,801,737</u>	
Pay-variable, receive fixed commodity swap - Series 2003A&B	50,783,000 mmbtu	\$ (44,126,303)	Aa2/A+
Pay-fixed, receive variable interest rate swap - Series 2003A&B	\$ 234,700,000	<u>(11,186,198)</u>	Aa2/A+
		<u>\$ (55,312,501)</u>	

All fair values are classified as derivative instruments on the Balance Sheets. The increases in fair value of these derivative instruments were \$53,832,939 and \$57,778,849 for 2011 and 2010, respectively. As these commodity swaps are considered hedging derivative instruments, the increase in fair value is reflected within deferred outflows and inflows on the Balance Sheets. The fair values of the commodity and interest rate swaps are netted for the Series 2005A and Series 2003A&B prepay transactions as the swaps were entered into with the same counterparty and the applicable swap agreements include provisions allowing for the netting of amounts related to the same prepay transaction.

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## Notes to Financial Statements

### March 31, 2011 and 2010

#### Note 7: Derivative Instruments - Continued

##### *Composition of Derivative Instruments - Continued*

The fair values of the commodity swaps are based on forward prices from established indexes for the applicable region and discounted using established interest rate indexes. The fair values of the interest rate swaps are based on the future yield curve for tax-exempt bonds and discounted using established interest rate indexes.

##### *Objective and Terms of Hedging Derivative Instruments*

The following table displays the objective and terms of APEA's hedging derivative instruments outstanding at March 31, 2011:

Type	Objective	Maturity Date	Terms
Pay-variable, receive fixed commodity swap - Series 2005A	APEA has entered into a fixed to floating commodity swap in connection with the related natural gas prepay transaction. The purpose of the commodity swap is to correlate gas sales revenue APEA receives based on floating natural gas indices to a fixed stream of payments necessary to make debt service payments on its Bonds.	12/1/2015	The commodity swap extends to the date of the final maturity of the related Natural Gas Supply Agreements. The commodity swaps requires monthly payments based on a notional quantity of natural gas that corresponds to the volume of natural gas purchased pursuant to the related gas purchase agreement. Payments under the commodity swap are based on published natural gas indices at the gas delivery points.
Pay-fixed, receive variable interest rate swap - Series 2005A	APEA entered into an interest rate swap in connection with its Series 2005 Bonds, effective on or before the date of the initial issuance of such bonds, to correlate the fixed payments it receives under the related commodity swaps with its variable rate debt service payment on these bonds.	11/24/2015	The interest rate swap extends to the date of the final maturity of these bonds and requires monthly payments based on a notional amount equal to the scheduled outstanding principal amount of these bonds. Under the interest rate swaps, APEA pays the counterparty a fixed payment of 3.705% on the notional amount and receives a variable payment equal to the rate actually borne by the 2005 Series Bonds.
Pay-variable, receive fixed commodity swap - Series 2003A&B	APEA has entered into a fixed to floating commodity swap in connection with the related natural gas prepay transaction. The purpose of the commodity swap is to correlate gas sales revenue APEA receives based on floating natural gas indices to a fixed stream of payments necessary to make debt service payments on its Bonds.	2/1/2014	The commodity swap extends to the date of the final maturity of the related Natural Gas Supply Agreements. The commodity swaps requires monthly payments based on a notional quantity of natural gas that corresponds to the volume of natural gas purchased pursuant to the related gas purchase agreement. Payments under the commodity swaps are based on published natural gas indices at the gas delivery points.
Pay-fixed, receive variable interest rate swap - Series 2003A&B	APEA entered into an interest rate swap in connection with its Series 2003 Bonds, effective on or before the date of the initial issuance of such bonds, to correlate the fixed payments it receives under the related commodity swaps with its variable rate debt service payment on these bonds.	1/25/2014	The interest rate swap extends to the date of the final maturity of these bonds and requires monthly payments based on a notional amount equal to the scheduled outstanding principal amount of these bonds. Under the interest rate swaps, APEA pays the counterparty a fixed payment of 3.540% on the notional amount and receives a variable payment equal to the rate actually borne by the Series 2003 Bonds.

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## Notes to Financial Statements

March 31, 2011 and 2010

### Note 7: Derivative Instruments – Continued

#### **Commodity Swap Risks**

**Termination Risk:** Each of the Commodity Swaps terminate in the event of a “triggering event” under the related gas purchase agreement, in the event of APEA or counterparty nonperformance, and in connection with other specified events. Under the Commodity Swap entered into in connection with the Series 2005A, 2003A and B Bonds, no payment, in the amount of the fair value or otherwise, is to be made by either party in connection with an early termination of such swap.

**Credit Risk:** Each of the Commodity Swaps is tied to a related gas prepay transaction and terminates in the event such transaction terminates. Therefore, the only credit risk associated with a Commodity Swap is for margins lost on future commodity deliveries associated with a termination of the related gas prepay transaction in the event of a counterparty’s inability to perform in accordance with the terms of the related Commodity Swap. If the Swap Counterparty is rated below “Aa3” by Moody’s Investors Service, Inc. or “AA-“ by Standard & Poor’s Rating Services, the Swap Counterparty must provide APEA adequate assurances of Swap Counterparty’s ability to continue performing under all Transactions, which adequate assurances must be satisfactory to APEA.

#### **Interest Rate Swap Risks**

**Termination Risk:** The Interest Rate Swaps terminate in the event of a “triggering event” under the related gas purchase agreement, in the event of APEA or counterparty nonperformance, and in connection with other specified events. Under the Interest Rate Swaps, no termination payment, in the amount of the fair value or otherwise, is to be made by either party in connection with an early termination of such swap.

**Credit risk:** The Interest Rate Swaps are tied to the natural gas prepay transactions associated with the Series 2005 Bonds and Series 2003 Bonds and terminate in the event such transaction terminates. At March 31, 2011 and 2010, APEA was not exposed to credit risk because the interest rate swaps had a negative fair value. However, should interest rates increase and the fair value of the interest rate swaps become positive, APEA would be exposed to credit risk on the swaps in the amount of their fair values. To mitigate this credit risk, the swap counterparty is required to maintain certain credit ratings under the interest rate swap agreements. If the Swap Counterparty is rated below “Aa3” by Moody’s Investors Service, Inc. or “AA-“ by Standard & Poor’s Rating Services, the Swap Counterparty must provide APEA adequate assurances of Swap Counterparty’s ability to continue performing under all Transactions, which adequate assurances must be satisfactory to APEA.

# American Public Energy Agency

## Notes to Financial Statements

March 31, 2011 and 2010

### **Note 8: Employee Benefit Plan**

APEA contributes to a defined contribution profit sharing plan covering all employees with 1,000 hours of service and having attained the age of 20 ½ years. Employees may contribute a minimum of six percent of their salary on a before income tax basis. APEA contributes 150 percent of each employee's contribution up to six percent of each employee's salary. Contributions actually made by plan members and APEA aggregated \$15,646 and \$23,469 during 2011 and \$15,250 and \$22,875 during 2010, respectively.

### **Note 9: Significant Estimates and Concentrations**

APEA has purchased all of its natural gas under prepaid supply contracts from BP. BP also acts as the liquidity facility provider. APEA bonds that are not remarketed must also be purchased by BP under related standby bond purchase agreements. At March 31, 2011, BP held approximately \$196,000,000 of APEA bonds purchased under the standby bond purchase agreements.