



INTERIOR ALASKA NATURAL GAS UTILITY
(A DEVELOPMENT STAGE COMPANY)

FINANCIAL STATEMENTS WITH SUPPLEMENTARY INFORMATION

YEAR ENDED JUNE 30, 2014

and

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

INTERIOR ALASKA NATURAL GAS UTILITY
(A DEVELOPMENT STAGE COMPANY)

FINANCIAL STATEMENTS WITH SUPPLEMENTARY INFORMATION

Year Ended June 30, 2014

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Report of Independent Certified Public Accountants

The Board of Directors
Interior Alaska Natural Gas Utility

Report on the Financial Statements

We have audited the accompanying statement of net position of the Interior Alaska Natural Gas Utility (IGU) (a development stage company), a component unit of the Fairbanks North Star Borough, as of and for the year ended June 30, 2014, and the related statements of revenues, expenses and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements, which collectively comprise IGU's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the net position of Interior Alaska Natural Gas Utility as of June 30, 2014, and its revenues, expenses and changes in net position and its cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Management has omitted management's discussion and analysis that accounting principles generally accepted in the United State of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise IGU's basic financial statements. The supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated November 13, 2014, on our consideration of IGU's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering IGU's internal control over financial reporting and compliance.

Cook + Haugeberg LLC

November 13, 2014

FINANCIAL STATEMENTS

INTERIOR ALASKA NATURAL GAS UTILITY
(A DEVELOPMENT STAGE COMPANY)

STATEMENT OF NET POSITION

June 30, 2014

<u>ASSETS</u>	<u>2014</u>
Intangible plant	
Certificate of public convenience and necessity	\$ 729,676
Current assets	
Cash	<u>354,956</u>
Total current assets	<u>354,956</u>
Other assets	
Capitalized engineering and feasibility charges	<u>301,865</u>
Total assets	<u><u>\$ 1,386,497</u></u>
 <u>LIABILITIES AND NET POSITION</u>	
Current liabilities	
AIDEA line of credit	\$ 15,000
Accounts payable	290,602
Unearned contract revenue	<u>39,780</u>
Total current liabilities	<u>345,382</u>
Net position	
Net investment in capital assets	1,031,541
Unrestricted	<u>9,574</u>
Total net position	<u>1,041,115</u>
Total liabilities and net position	<u><u>\$ 1,386,497</u></u>

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

INTERIOR ALASKA NATURAL GAS UTILITY
(A DEVELOPMENT STAGE COMPANY)

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

Year Ended June 30, 2014

	<u>2014</u>
Operating revenues	
Contract revenue	\$ 1,304,556
Donations	<u>9,500</u>
Total operating revenue	<u>1,314,056</u>
Operating expenses	
Advertising	5,015
Contract services	375,615
Legal fees	2,574
Office expenses	3,624
Travel expenses	<u>4,292</u>
Total operating expenses	<u>391,120</u>
Operating income	<u>922,936</u>
Increase in net position	922,936
Net position - beginning	<u>118,179</u>
Net position - ending	<u><u>\$ 1,041,115</u></u>

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

INTERIOR ALASKA NATURAL GAS UTILITY
(A DEVELOPMENT STAGE COMPANY)

STATEMENT OF CASH FLOWS

Year Ended June 30, 2014

	2014
Cash flows from operating activities	
Cash received from customers	\$ 639,950
Cash paid to suppliers and consultants	(121,066)
Net cash provided by operating activities	518,884
Cash flows from capital and related financing activities	
Acquisition of plant and facilities	(1,010,903)
Net cash used for capital and related financing activities	(1,010,903)
Net decrease in cash	(492,019)
Cash balance at beginning of year	846,975
Cash balance at end of year	\$ 354,956
Reconciliation of Operating Income to Net Cash Provided by Operating Activities	
Operating income	\$ 922,936
Adjustments to reconcile operating income to net cash provided by operating activities	
(Increase) decrease in assets	
Accounts receivable	314
Increase (decrease) in liabilities	
Accounts payable	270,054
Unearned contract revenue	(674,420)
Total adjustments	(404,052)
Net cash provided by operating activities	\$ 518,884
Non-cash activities	
AIDEA line of credit fees and charges	\$ 15,000

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

INTERIOR ALASKA NATURAL GAS UTILITY
(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS

ORGANIZATION

The Interior Alaska Natural Gas Utility, doing business as the Interior Gas Utility (IGU), was formed in 2012 by the Fairbanks North Star Borough (Borough) in cooperation with the City of Fairbanks and the City of North Pole. The goal of the organization is to lower energy costs for the Borough area by bringing natural gas to Interior Alaska. IGU is governed by a seven-member board initially appointed by the Borough, the City of Fairbanks and the City of North Pole serving staggered terms. Initial appointments were for 2, 3 and 4 year terms. Following the initial terms all seats have 3-year terms and four seats on the board are elected while three seats on the board remain appointed, one by each of the three municipalities. The organization will have a small management team and subcontract the operations of the gas utility.

In 2012 IGU received a contract from the Borough to build the framework from which the utility will operate, including securing funding, developing a capital program for build-out of the necessary infrastructure, and establishing a public outreach protocol to assist homeowners in converting to natural gas. IGU has contracted with MWH Americas, Inc. to provide project management services for the startup of IGU. IGU also initiated engineering studies for the project. From inception through April 3, 2014 IGU performed services under the Borough contract. After April 3, 2014 IGU funded operations through the contract with the Borough and funded the design, right-of-way, permitting, management services and other contractual services provided to advance construction of the project using accumulated operating income, accounts payable and a line of credit provided by the Alaska Industrial Development and Export Authority

On December 20, 2013 IGU was awarded a Certificate of Public Convenience and Necessity (CPCN) by the Regulatory Commission of Alaska determining a service area within the Borough. IGU has a goal to deliver gas to the customers' meter for approximately \$15/thousand cubic feet (mcf) by fall of 2016.

IGU has secured sources of funding for 2014 operations and preconstruction activities from the Borough and AIDEA. In May 2014, IGU secured a line of credit up to \$7,500,000 from the Borough to serve as bridge loan funding for the project. In April 2014 AIDEA authorized an \$8,100,000 line of credit from the Sustainable Energy Transmission and Supply (SETS) Loans, available through Senate Bill (SB) 23.

These financial statements include all the activities of IGU, a component unit and an integral part of the reporting entity of the Fairbanks North Star Borough, the primary government. Complete financial statements of the Borough can be obtained from the Borough Clerk's Office at 809 Pioneer Road, PO Box 71267, Fairbanks, Alaska 99707-1267; phone number 907-459-1000 or on the web at co.fairbanks.ak.us/FinancialServices/DefaultDocuments.htm.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Presentation and Basis of Accounting - IGU applies all applicable provisions of the Governmental Accounting Standards Board (GASB) which has authority for setting accounting standards for governmental entities. The accounting policies of IGU conform to the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission (FERC).

The financial statements of IGU are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recognized when they are earned and become measureable and expenses are recognized in the period incurred, if measureable. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with IGU's principal ongoing operations.

INTERIOR ALASKA NATURAL GAS UTILITY
(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS
(Continued)

Regulated Operations - IGU meets the criteria, and accordingly, follows the accounting and reporting requirements applicable to regulated operations. IGU is subject to the regulatory authority of the Regulatory Commission of Alaska (RCA) and, as a result, revenues intended to recover certain costs are provided either before or after the costs are incurred, resulting in regulatory assets or liabilities.

Development Stage Company - Financial Accounting Standards Board (FASB) ASC 915-10-20, Development Stage Entities, defines a development stage company as one that is "devoting substantially all of its efforts to establishing a new business where either of the following conditions exists: a) Planned principal operations have not commenced. b) Planned principal operations have commenced, but there has been no significant revenue therefrom." The IGU is a development stage company because it has not commenced planned principal operations as of June 30, 2014.

Use of Estimates - In preparing financial statements in conformity with generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the 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 could differ from those estimates.

Intangible Assets - Intangible assets of IGU are capitalized at historic cost. Intangible assets with an indefinite life are not amortized, but are tested annually for impairment or change in circumstances that could effect the nature of the asset. Other capitalized intangible assets will be amortized over the useful life of those assets.

Cash equivalents - For purposes of reporting cash flows, IGU considers all cash accounts which are not subject to withdrawal restrictions or penalties to be cash or cash equivalents.

Contract receivables - Contract receivables are recorded when invoices are issued and are presented in the balance sheet, net of allowance for doubtful accounts, if any.

Net Position - The implementation of GASB Statement No. 63 requires IGU to categorize its net position. IGU's net position is categorized as net investments in capital assets and unrestricted.

Income Taxes - IGU is a wholly owned, legally separate component unit of the Fairbanks North Star Borough and does not pay Federal or Alaska income tax.

Subsequent Events - IGU has evaluated events and transactions for potential recognition or disclosure through November 13, 2014, the date on which the financial statements were available to be issued.

PRELIMINARY ENGINEERING AND FEASIBILITY CHARGES

In 2014 IGU provided contract services to the Borough for preliminary survey and investigation charges. IGU has capitalized work performed that was not included in the Borough contract. In 2015 it is anticipated additional engineering and feasibility work will be performed by IGU and for the benefit of IGU. Such 2015 expenditures, including costs incurred to build the framework of operating, securing funding, developing a capital program to build the necessary infrastructure, and establishing public outreach protocol to assist homeowners in converting to natural gas, will be capitalized.

INTERIOR ALASKA NATURAL GAS UTILITY
(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS
(Continued)

PLANT

Certificate of Public Convenience and Necessity

Costs incurred related to obtaining a Certificate of Public Convenience and Necessity (CPCN) permit from the Regulatory Commission of Alaska have been capitalized by IGU at a cost of \$729,674.

Long term considerations

IGU has a commitment from AIDEA to provide financing of the distribution system. Construction costs for the 2015 summer season are projected to be \$27,000,000, inclusive of design and project management. Based on the terms of the line of credit between AIDEA and IGU, the terms and conditions of the long-term note are to be designed to allow IGU to reach or approach the target price of the Interior Energy Project - nominally, \$15/mcf. If those terms are not reached payment on the line of credit is not required, and AIDEA would be provided the work products of IGU for design, permitting, and right-of-way.

LINE OF CREDIT

IGU received a \$8,100,000 line of credit with AIDEA dated June 30, 2014. The per annum interest rate for advances under the line of credit is zero percent (0%) until December 31, 2017. Amounts drawn under this line of credit are anticipated to be converted into a long-term note prior to December 31, 2017. Security is the engineering and feasibility studies. In the event the project is deemed uneconomical, the engineering and feasibility studies will revert to AIDEA and the loan will be forgiven. The balance outstanding at June 30, 2014 was \$15,000.

IGU received a \$7,500,000 line of credit with the Borough dated May 15, 2014, and expiring June 30, 2021, with final payment on outstanding amounts due June 30, 2024. The per annum interest rate for advances under the line of credit is equal to the Federal Funds Rate at the time of the advance, adjusted annually to the Federal Funds Rate as of January 1. There was no balance outstanding at June 30, 2014.

CONCENTRATION OF CREDIT RISK

IGU maintains its cash in the bank deposit account which, at times, may exceed federally insured limits. IGU believes it is not exposed to any significant credit risk on cash and cash equivalents. IGU has no investment policy that would limit this type of credit risk.

INTERIOR ALASKA NATURAL GAS UTILITY
(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS
(Continued)

RELATED PARTY TRANSACTIONS

IGU is wholly owned by the Fairbanks North Star Borough but is legally separate. IGU has received a services contract from the Borough. A summary of contract activity follows:

	Phase I	Phase II			
	¹ Task 1 and 2	Task 3	Task 4	Task 5	Totals
Contract Budget	\$ 319,000	\$ 1,101,635	\$ 735,200	\$ 288,500	\$ 2,444,335
Contract costs in fiscal year 2013	(31,417)	(314)	(5,638)	(5,638)	(43,007)
Contract costs in fiscal year 2014	(23,776)	(551,771)	(724,038)	(102,188)	(1,401,773)
Subtotal	(55,193)	(552,085)	(729,676)	(107,826)	(1,444,780)
Task 1 and 2 operating costs	(153,116)				(153,116)
Total task costs incurred	(208,309)	(552,085)	(729,676)	(107,826)	(1,597,896)
Allocated to future operating expenses	(110,691)		(5,524)	(180,674)	(296,889)
Subtotal	(319,000)	(552,085)	(735,200)	(288,500)	(1,894,785)
Remaining on contract at June 30, 2014	<u>\$</u>	<u>\$ 549,550</u>	<u>\$</u>	<u>\$</u>	<u>\$ 549,550</u>

¹ Tasks 1 and 2 are part of Phase 1 of the contract with the Borough. The contract does not include an allocation of contract amounts between Task 1 and Task 2.

COMMITMENTS

IGU has retained the following companies to provide engineering and related utility build-out planning under services contracts. Contract phases, amounts and period completed are as follows:

	Contract	2014 Activity
MWH Americas, Inc., Task Orders Authorized	\$ 1,679,288	\$ 511,093
PDC, INC. Engineers, Phase 1 Design	1,189,985	
Michael Baker, Jr. Corporation, Phase 2 Design	975,616	
ENSTAR Natural Gas Company, Hydraulic Modelling	72,000	
	<u>\$ 3,916,889</u>	<u>\$ 511,093</u>

INTERIOR ALASKA NATURAL GAS UTILITY
(A DEVELOPMENT STAGE COMPANY)

NOTES TO FINANCIAL STATEMENTS
(Continued)

CONTINGENCIES

IGU's build-out program and financing are contingent on financing from AIDEA. Concurrently, the amount and type of funding that AIDEA will have available to assist IGU is dependent on the final costs of the liquefied natural gas (LNG) facility on the North Slope of Alaska. After financing for the LNG facility is determined, AIDEA will look to the remaining tools available in the Interior Energy Project (IEP) financing legislation (SB23 and the State of Alaska's 2013 capital budget) to finance the distribution system. To the extent that the grant funding and low cost financing provided by SB23 and the 2013 capital budget is fully utilized to finance the LNG facility, low cost financing will not be available for distribution.

IGU's build-out financing, conversion strategy, and ability to demonstrate payback on long-term financing is contingent on achieving IEP target pricing of delivered natural gas approaching \$15 per mcf. Thus, much of the potential success of IGU and the IEP is dependent on AIDEA achieving success financing the LNG facility using as little of the authorized low cost financing as possible.

SUBSEQUENT EVENTS

Amendment 3 to the services contract between the Borough and IGU was signed on August 8, 2014. In that amendment the contract amount for task 3 was increased by \$301,635.

A significant number of contractual commitments were entered into in July through October 2014. See the note titled Commitments.

In November 2014 IGU provided preliminary estimates to the Borough Assembly indicating pricing of delivered natural gas in the range of \$18 to \$26 per mcf at the customers' meter based on AIDEA and Interior Energy Project progress to date.

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SUPPLEMENTARY INFORMATION

INTERIOR ALASKA NATURAL GAS UTILITY
(A DEVELOPMENT STAGE COMPANY)

SCHEDULE I - CAPITALIZED ENGINEERING AND FEASIBILITY CHARGES

Year Ended June 30, 2014

	<u>2014</u>
AIDEA line of credit fees	\$ 15,000
Subcontractor expense by task	
Task 3 utility support	<u>286,865</u>
	<u>\$ 301,865</u>

See accompanying notes to the financial statements
and independent accounts' auditor report.

INTERIOR ALASKA NATURAL GAS UTILITY
(A DEVELOPMENT STAGE COMPANY)

SCHEDULE II - OPERATING EXPENSES AND CAPITAL OUTLAY (BY TASK)

Year Ended June 30, 2014

	<u>2014</u>
Expenses paid by private donations	
Office expenses	\$ <u>250</u>
Subcontractor expenses by task	
Task 2 community plan for distribution	23,776
Task 3 utility support	264,906
Task 5 financial analysis and business plan	<u>102,188</u>
Subtotal subcontractor expenses by task	<u>390,870</u>
Total operating expenses	<u>391,120</u>
Capital outlay by task	
Task 4 CPCN support	724,038
Task 3 utility support	<u>286,865</u>
Subtotal capital outlay by task	<u>1,010,903</u>
Total operating expenses and capital outlay	<u>\$ <u>1,402,023</u></u>

See accompanying notes to the financial statements
and independent accounts' auditor report.

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SUPPLEMENTAL REPORT REQUIRED BY
GOVERNMENT AUDITING STANDARDS

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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
Interior Alaska Natural Gas Utility

We have audited, in accordance with the 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, the statement of net position of the Interior Alaska Natural Gas Utility (IGU) (a development stage company), a component unit of the Fairbanks North Star Borough, and the related statements of revenues, expenses and changes in net position, and cash flows as of and for the year ended June 30, 2014, and the related notes to the financial statements, and have issued our report thereon dated November 13, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered IGU's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of IGU's internal control. Accordingly, we do not express an opinion on the effectiveness of IGU's internal control.

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 a 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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether IGU's financial statements are free from 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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of IGU's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering IGU's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Cook + Haugeberg LLC

Certified Public Accountants

November 13, 2014
Fairbanks, Alaska