

**CITY OF NORTH LITTLE ROCK ELECTRIC DEPARTMENT**

**FINANCIAL STATEMENTS**

**DECEMBER 31, 2013 and 2012**

(With independent auditor's report thereon.)

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## Independent Auditor's Report

To the City Council  
City of North Little Rock, Arkansas

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the City of North Little Rock Electric Department (the "Department"), a component unit of the City of North Little Rock, Arkansas, which comprise the statement of net position as of December 31, 2013 and 2012, and the related statements of revenues, expenses and changes in net position and cash flows for the years then ended, and the related notes to the financial statements.

### **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. 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.

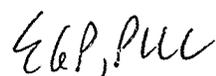
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Department as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

**Other Matters***Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison schedule on pages 3 through 9 and 22 be presented to supplement the basic financial statements. Such 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. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.



May 28, 2014

Certified Public Accountants &amp; Consultants

**CITY OF NORTH LITTLE ROCK ELECTRIC DEPARTMENT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE YEAR ENDED DECEMBER 31, 2013**

This section presents management's analysis of the City of North Little Rock Electric Department's (NLRED) financial condition and activities for the year. This information should be read in conjunction with the financial statements.

**Overview**

Management's Discussion and Analysis (MD&A) serves as an introduction to, and should be read in conjunction with, the basic financial statements and supplementary information. The MD&A represents management's examination and analysis of the utility's financial condition and performance.

The financial statements report information about the NLRED using full accrual accounting methods as utilized by similar business activities in the private sector. The financial statements include a statement of net position, statement of revenues, expenses and changes in net position, statement of cash flows, notes to the financial statements and other supporting schedules.

The statement of net position presents the financial position of the NLRED on a full accrual historical cost basis. This statement presents information on all of the assets and liabilities with the difference reported as net position. Over time, increases and decreases in net assets are an indicator of whether the financial position of the NLRED is improving or deteriorating.

While the statement of net position provides information about the nature and amount of resources and obligations at year-end, the statement of revenues, expenses, and changes in net position presents the results of the business activities over the course of the fiscal year and information as to how the net position changed during the year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the cash flows.

The statement of cash flows present's changes in cash and cash equivalents, resulting from operational, financing, and investing activities, this statement presents cash receipts and disbursement information only.

The notes to the financial statements and supplementary information are provided to disclose information that is essential to a full understanding of the material data provided in the statements.

The financial statements were prepared by NLRED staff from its detailed transactions for the years ending December 31, 2013 and 2012. The financial statements were audited and adjusted, if material, during the independent external audit process.

**Financial Analysis**

The financial statements on pages 10 through 12 provide information about the financial activities of NLRED. The following information is an analysis of the year presented.

**CITY OF NORTH LITTLE ROCK ELECTRIC DEPARTMENT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE YEAR ENDED DECEMBER 31, 2013**

**Statement of Net Position**

Total assets as of December 31, 2013 were \$170,363,308 and exceeded liabilities, which were \$74,999,901. Of the total net position, \$85,303,744 was invested in capital assets; \$5,709,061 (\$3,787,763 + \$1,921,298) was restricted for debt service and capital improvements; \$10,035,857 was restricted for working capital, and (\$3,715,052) were unrestricted. Please note that the restricted working capital of \$10,035,857 can be made unrestricted at any time and effectively the (\$3,715,052) deficit netted with the \$10,035,857 would result in a potential unrestricted amount of \$6,320,805.

	<u>2013</u>	<u>2012</u>
Current Assets	\$ 44,369,767	\$ 49,527,203
Total Property, Plant & Equipment	125,993,541	121,686,675
Deferred Outflows of Resources	1,970,203	3,313,567
Current Liabilities	9,209,901	11,534,384
Non-current Liabilities	65,790,000	68,845,000
Net position		
Net investment in capital assets	85,303,744	79,405,242
Restricted for debt service	3,787,763	3,881,923
Restricted for working capital	10,035,857	10,003,453
Restricted for capital improvements	1,921,298	5,255,745
Unrestricted net position	(3,715,052)	(4,398,302)

The current ratio is an indication of short-term liquidity and is calculated by dividing current assets by current liabilities. A resulting number greater than one indicates current assets in excess of current needs that can be applied in future periods. The current ratio for NLRED was 4.82 for 2013, compared 4.29 for 2012. Another ratio that is computed from this statement is the debt utilization ratio, which indicates what percentage the total debt is to total assets. This ratio is calculated by dividing total debt by total assets. The debt utilization ratio for the years ending December 31, 2013 and 2012 was 44% and 46% respectively.

The following were capital improvements, additions or replacements for 2013 (the figures are approximate):

Murray Hydro Electric Generation Plant	\$ 393,000
Distribution System (poles, wire, transformers, conductors, etc.)	3,684,000
AMI (advanced meter infrastructure – Smart Meters)	4,290,000
Office furniture & fixtures and computer & communication equipment	398,000
Transportation, tools and power equipment	484,000
CWIP – Smart Meters, Seal System for Hydro and Galloway Substation	<u>3,015,000</u>
Total Capital Improvements	<u>\$ 12,264,000</u>

**CITY OF NORTH LITTLE ROCK ELECTRIC DEPARTMENT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE YEAR ENDED DECEMBER 31, 2013**

**Statement of Revenues, Expenses, and Changes in Net Position**

For the year-ending December 31, 2013, operating revenues were \$93,373,975 and operating expenses were \$75,748,019. Non-operating revenues were \$2,440,306 and non-operating expenses were \$4,880,713. Transfers to the City were \$12,000,000. The results were an increase in net position in the amount of \$3,185,549.

	<u>2013</u>	<u>2012</u>
Operating Revenues	\$ 93,373,975	\$ 91,842,679
Operating Expenses	75,748,019	74,220,865
Non-operating Revenues	2,440,306	1,595,954
Non-operating Expenses	4,880,713	4,918,592
Transfers to the City	12,000,000	12,000,000
Increase (Decrease) in Net Position	3,185,549	2,299,176

The NLRED operating revenues were about 2 percent higher than reported in 2012. The majority of NLRED operating revenue is derived from residential and commercial customers. In 2013, the NLRED had an average of 33,393 residential customers, 4,807 commercial customers, and 173 large users.

Operating expenses, not including depreciation expense, increased 1.8 percent in 2013. Depreciation expense increased 4.5 percent in 2013.

Non-operating revenues increased 53 percent in 2013 and non-operating expenses decreased 0.8 percent in 2013.

**Budget-to-Actual Comparison**

The budget is prepared internally by NLRED based on the prior year's activity. The previous year amounts are adjusted to reflect anticipated activity for the current year. As with any budget, there are differences between anticipated and actual results.

Actual operating revenues were more than budgeted operating revenues by approximately \$1,900,000. Operating expenses, not including depreciation, were approximately \$1,200,000 less than the amount budgeted. Increase in Net Position was approximately \$2,700,000 more than the amount budgeted.

See "Budgetary Comparison Schedule" on page 22.

**CITY OF NORTH LITTLE ROCK ELECTRIC DEPARTMENT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE YEAR ENDED DECEMBER 31, 2013**

**NLRED: Year in Review: 2013**

**INTRO**

The North Little Rock Electric Department (NLRED) has been a consumer owned utility for over 100 years. Currently, NLRED is Arkansas' largest municipal electric utility, providing reliable service to residential, commercial and industrial customers in the cities of North Little Rock, Sherwood and Pulaski County. NLRED remains committed to providing safe and reliable services in an efficient, cost effective, and prompt manner.

<b>Number of Customers</b>	<b>Services Territory</b>	<b>Revenues</b>
38,373	60 square miles	\$93,373,975
<b>SAIDI (Avg. outage in mins.)</b>	<b>System Usage (lowest since 1997)</b>	<b>Peak Demand</b>
39 min	954,005,791 kwh	238,601 kwd

NLRED started 2013 with many challenges and opportunities. We responded by delivering strong results which strengthened our operational processes and taking significant steps that will lead our customers into a new energy era. Our major accomplishments are discussed below in greater detail.

**I. MURRAY HYDRO**

Over twenty years ago, our community made an enormous investment in renewable energy by constructing the Murray Hydroelectric Plant ("Murray Hydro"). In January of 2013, the future of Murray Hydro was uncertain. Unit 2 was not operational. Contaminated oil had severely damaged internal components. The draft tube was scarred and pitted. The costs of repair were unknown. After exploring various alternatives, Unit 2 was sufficiently repaired to return to service and competitive bids were sought for major overhaul. This strategy proved more successful than anticipated.

Restructured debt and favorable water flow combined for the first profitable year of Murray Hydro ownership. At less than five million dollars, the major overhaul of Unit 2 was cost effective *and* manageable within cash reserves. The work is slated for 2014. Also, the new seal systems that were completed in 2013 will save approximately \$500,000 in annual routine maintenance costs.

High debt payments and maintenance costs have caused many to question the wisdom of the Murray Hydro project. This year marked the turning point in that debate. Our community began to enjoy real economic value for the millions of invested dollars – and see the clear path to greater economic value in the future. Properly maintained, Murray Hydro will provide inexpensive renewable energy to this community for generations.

**CITY OF NORTH LITTLE ROCK ELECTRIC DEPARTMENT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE YEAR ENDED DECEMBER 31, 2013**

**NLRED: Year in Review: 2013**

**II. SMART METERS**

Our department began installing advanced meters in June 2012. By January 2013, we had installed 4,400 meters, but installation had slowed. We worked with our contractor to improve performance. We ended the year with over 27,000 meters installed and anticipate that all residential meters will be installed in 2014. Our smart meter program will soon provide enhanced information to our customers and allow for more responsive and efficient business operations.

**III. EMERGENCY RESPONSE**

In the North Little Rock Electric Department, the year began with storm recovery. Our city was struck by an unforeseen ten-year storm while electric workers were away for the Christmas holiday. Almost half of our customers (18,750) lost power. Despite these challenges, over 99% of customers had power restored within five days.

After the Christmas Storm, Mayor Joe Smith conducted a city-wide evaluation and pressed leaders to improve emergency response. The Electric Department revised emergency response plans across the board, conducted rehearsals, and established a work station at the City's new Emergency Operation Centers. Today, the Electric Department is more prepared than ever for an emergency.

**IV. RELIABILITY AUDIT**

In preparation of the new reliability standards imposed by the federal government, NLRED conducted a mock audit to assess whether NLRED is compliant with the applicable reliability standards. The mock audit proved successful in that no violations were found and team members were able to address open items to further prepare for the SERC audit scheduled for December of 2014.

**V. BAYOU METO PROJECT**

The Bayou Meto Water Management District ("Bayou Meto") is involved in a joint project with the federal and state government to use water from the Arkansas River for crop irrigation and waterfowl management. Bayou Meto requested the City to serve as the electric provider for the Marion Berry Pump Station, a major project facility. After lengthy analysis, our engineers developed a solution that would save millions in construction costs and allow the project to maintain its development schedule. In an eight (8) month window, the City annexed the pump station, entered an agreement to acquire the service territory, designed the project, bid the work, contracted with the Corps of Engineers to perform the necessary work, and executed subcontracts for work to proceed. The project is now underway.

**CITY OF NORTH LITTLE ROCK ELECTRIC DEPARTMENT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE YEAR ENDED DECEMBER 31, 2013**

**NLRED: Year in Review: 2013**

**VI. SHERWOOD FRANCHISE**

A substantial portion of the North Little Rock Electric service territory is located within the municipal border of Sherwood. At times, the relationship between the two cities has been rocky. Nevertheless, near the end of 2012, the City Councils of North Little Rock and Sherwood agreed to enter a twenty-two (22) year franchise agreement for the provision of electric service. Unfortunately, this successful negotiation was short-lived. A group of dissatisfied Sherwood citizens circulated petitions to refer the franchise agreement to a public vote.

North Little Rock benefitted from the efforts of several Sherwood citizens who campaigned on the value of our municipal partnership. The Electric Department used direct mail, advertisement, and a telephone-based town hall meeting to share a message of reliability, declining rates, and fair partnership between the two cities. In May, the Sherwood voters chose North Little Rock Electric by a 2-1 margin. The new franchise agreement now serves as a foundation for ever-improving relationships between North Little Rock and Sherwood.

**VII. MISO INTEGRATION**

The past year ushered in a new era for the entire electric industry in Arkansas. The Midcontinent Independent System Operator ("MISO") assumed control of the transmission system in December and launched markets for real-time and day-ahead power purchases. The North Little Rock Electric Department spent months preparing for MISO integration. The new wholesale power contract was drafted in contemplation of new opportunities and risks in the MISO markets. North Little Rock will monitor and participate in the market to ensure power costs are stable and affordable for many years.

**VIII. WHOLESALE POWER CONTRACT**

NLRED's approach to power contracting in 2013 matured from a full requirements contract to an energy-only contract in order to capitalize on the cost-effective delivery of power from the MISO market. NLRED has sought to responsibly navigate this marketplace with a balanced approach to cost and risk. Under the new contract, NLRED will begin managing the output of its generation resources in the market. When generation resources produce excess energy, that energy will be sold into the market at the current market price. When those resources produce insufficient energy, the City will purchase replacement energy from the market at the current market price. This approach is intended to reduce costs and allow NLRED to experience market participation while minimizing exposure to price volatility.

**IX. TREE TRIMMING**

Since the ice storm in 2000, NLRED has worked to mitigate outages caused by storm-damaged trees. Last year marked the first year in which our entire system had been cut. In 2013, NLRED began exploring cost-reduction strategies to efficiently maintain our electric rights-of-way. Through continued commitment and reduced cost, NLRED will be less susceptible to storm damage in the future.

**CITY OF NORTH LITTLE ROCK ELECTRIC DEPARTMENT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE YEAR ENDED DECEMBER 31, 2013**

**NLRED: Year in Review: 2013**

**X. THE ROAD AHEAD**

The utility industry is evolving, and NLRED must be prepared to respond to the changing needs of its customers, its employees and its other constituencies. We will continue to focus on developing strategies to deliver superior service to our customers, provide a collaborative rewarding work environment for our employees, and to manage City resources in an open, responsible, and environmentally sound manner.

**Contacting the Management**

The financial report is designed to provide our customers, citizens, creditors, news media, City Council and management with a general overview of NLRED finances and to show the accountability for the money it receives. If you have any questions about this report or need further financial information, contact our office at P. O Box 159, North Little Rock, AR 72115 or phone (501) 992-4041.

**City of North Little Rock Electric Department**  
**Statement of Net Position**  
**December 31, 2013 and 2012**  
(See independent auditor's report.)

Assets

	<b>2013</b>	<b>2012</b>
<b>Current Assets</b>		
Cash and cash equivalents	\$ 15,959,455	15,965,472
Restricted cash	15,744,917	19,141,121
Accounts receivable, net of allowance of \$512,595 and \$588,530, respectively	3,977,392	4,247,123
Other receivables	130,685	76,566
Unbilled revenue	4,379,000	4,124,000
Materials and supplies	2,475,990	3,543,072
Prepaid expenses	1,702,328	2,429,849
<b>Total Current Assets</b>	44,369,767	49,527,203
<b>Property, Plant and Equipment</b>	247,840,709	238,501,515
Less accumulated depreciation	(121,847,168)	(116,814,840)
<b>Total Property, Plant and Equipment</b>	125,993,541	121,686,675
<b>Total Assets</b>	170,363,308	171,213,878
<b>Deferred Outflows of Resources</b>		
Deferred amount from refunding of bonds	1,970,203	3,313,567
<b>Total Assets and Deferred Outflows of Resources</b>	\$ 172,333,511	174,527,445

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

**Liabilities and Net Position**

	<u>2013</u>	<u>2012</u>
<b>Current Liabilities</b>		
Accounts payable	\$ 3,621,721	5,894,230
Accrued expenses and other liabilities	1,635,719	1,658,041
Bonds payable - current portion	3,055,000	2,935,000
Accrued interest payable	897,461	1,047,113
<b>Total Current Liabilities</b>	<u>9,209,901</u>	<u>11,534,384</u>
<b>Non-current Liabilities</b>		
Bonds payable, net of current portion	65,790,000	68,845,000
<b>Total Non-current Liabilities</b>	<u>65,790,000</u>	<u>68,845,000</u>
<b>Total Liabilities</b>	<u>74,999,901</u>	<u>80,379,384</u>
<b>Net Position</b>		
Net investment in capital assets	85,303,744	79,405,242
Restricted for debt service	3,787,763	3,881,923
Restricted for working capital	10,035,857	10,003,453
Restricted for capital improvements	1,921,298	5,255,745
Unrestricted net position	(3,715,052)	(4,398,302)
<b>Total Net Position</b>	<u>97,333,610</u>	<u>94,148,061</u>
<b>Total Liabilities and Net Position</b>	<u>\$ 172,333,511</u>	<u>174,527,445</u>

**City of North Little Rock Electric Department**  
**Statement of Revenues, Expenses, and Changes in Net Position**  
**For the Years Ended December 31, 2013 and 2012**  
(See independent auditor's report)

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	2013	2012
<b>Operating Revenues</b>		
Sale of electricity, net of uncollectible accounts	\$ 93,373,975	91,842,679
<b>Operating Expenses</b>		
Purchased electricity	53,138,237	52,418,202
Depreciation	6,338,189	6,064,394
Other distribution expenses	3,041,916	2,927,249
General and administrative	2,635,218	2,399,377
Customer records and collection expense	2,620,253	2,586,029
Distribution system maintenance	2,461,248	2,593,897
Generation plant maintenance	1,637,728	1,087,877
Operating expenses	1,071,500	1,174,208
Franchise tax	956,093	1,068,026
Other generation plant expenses	475,992	447,684
Conservation	410,974	533,623
Property and liability insurance	395,272	360,238
General plant maintenance	323,206	376,688
Regulatory fees	242,193	183,373
<b>Total Operating Expenses</b>	75,748,019	74,220,865
<b>Operating Income</b>	17,625,956	17,621,814
<b>Non-Operating Revenues (Expenses)</b>		
Interest and investment income	89,108	497,824
Interest expense	(3,628,433)	(3,832,098)
Trustee fees	(10,280)	(93,104)
Penalty income	938,412	950,407
Bond issuance costs	-	(993,390)
Miscellaneous	1,412,786	147,723
Loss on disposal of equipment	(1,242,000)	-
<b>Total Non-Operating Revenues (Expenses)</b>	(2,440,407)	(3,322,638)
Income before transfers out	15,185,549	14,299,176
Transfers out	12,000,000	12,000,000
<b>Increase (Decrease) in Net Position</b>	3,185,549	2,299,176
Net position - beginning of period	94,148,061	91,848,885
<b>Net Position - End of Period</b>	\$ 97,333,610	94,148,061

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

**City of North Little Rock Electric Department**  
**Statement of Cash Flows**  
**For the Years Ended December 31, 2013 and 2012**  
(See independent auditor's report.)

	<b>2013</b>	<b>2012</b>
<b>Cash Flows From Operating Activities:</b>		
Cash received from:		
Customers	\$ 93,334,587	\$ 91,299,701
Cash payments for:		
Cash paid to vendors for goods and services	(9,544,493)	(7,912,179)
Cash paid for purchase of electricity	(53,138,237)	(52,418,202)
Cash paid for taxes	(905,948)	(1,031,276)
Cash paid to employees	(5,942,755)	(5,604,272)
<b>Net Cash Provided by Operating Activities</b>	<b>23,803,154</b>	<b>24,333,772</b>
 <b>Cash Flows From Noncapital and Financing Activities:</b>		
Transfers to other departments	(12,000,000)	(12,000,000)
Penalty income	938,412	950,407
<b>Net Cash Required by Operating Activities</b>	<b>(11,061,588)</b>	<b>(11,049,593)</b>
 <b>Cash Flows From Capital and Related Financing Activities:</b>		
Repayment of long-term debt and bonds payable	(2,935,000)	-
Purchase of property, plant and equipment	(12,265,680)	(14,816,776)
Refunding of 1992, 1997 and 2009 bonds	-	(9,783,639)
Interest paid	(2,434,721)	(3,818,383)
Other receipts	1,402,506	54,620
<b>Net Cash Required by Capital and Related Financing Activities</b>	<b>(16,232,895)</b>	<b>(28,364,178)</b>
 <b>Cash Flows From Investing Activities:</b>		
Proceeds from maturities of investment securities	-	22,415,951
Interest on investments	89,108	820,049
<b>Net Cash Provided by Investing Activities</b>	<b>89,108</b>	<b>23,236,000</b>
 <b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>(3,402,221)</b>	<b>8,156,001</b>
Cash and cash equivalents at beginning of year	35,106,593	26,950,592
<b>Cash and Cash Equivalents at End of Year</b>	<b>\$ 31,704,372</b>	<b>35,106,593</b>

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

	<u>2013</u>	<u>2012</u>
<b>Reconciliation of Operating Income to Net Cash Provided by Operating Activities:</b>		
Operating income	\$ 17,625,956	\$ 17,621,814
Adjustments to reconcile operating income to cash provided by operating activities:		
Depreciation expense	6,716,814	6,385,685
(Increase) decrease in assets:		
Accounts receivable	269,731	(678,062)
Other receivables	(54,119)	(10,916)
Unbilled revenues	(255,000)	146,000
Prepaid expenses	727,521	91,983
Materials and supplies	1,067,082	(1,239,618)
Increase (decrease) in liabilities:		
Accounts payable	(2,272,509)	1,756,103
Accrued expenses	(22,322)	260,783
<b>Net Cash Provided by Operating Activities</b>	<u>\$ 23,803,154</u>	<u>24,333,772</u>
 <b>Supplemental Disclosure of Noncash Transactions Investing and Financing Activities:</b>		
Amortization deferred on bond refunding, included in interest expense	<u>\$ 1,343,364</u>	<u>671,682</u>

**City of North Little Rock Electric Department**  
**Notes to Financial Statements**  
**December 31, 2013 and 2012**

**1. Summary of Significant Accounting Policies**

Principles of Operation

The City of North Little Rock Electric Department (the "Department") generates and provides electrical power to residents and businesses of the City of North Little Rock, Arkansas, and other communities in Pulaski County, Arkansas. The Department extends credit to customers on an unsecured basis. The financial statements present only the Department, an enterprise fund, and are not intended to present the financial position of the City of North Little Rock, Arkansas. The Department has adopted Government Accounting Standards Board ("GASB") Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which incorporates Financial Accounting Standards Board ("FASB") pronouncements and Accounting Principles Board ("APB") opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements, in which case, GASB prevails. Preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires the use of management's estimates. Actual results may differ from estimates.

Operating Revenues and Expenses

The Department recognizes revenue and expenses using the accrual method of accounting. The Department distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services in connection with the principal ongoing operations of the Department. Operating expenses for the proprietary funds include the cost of personnel, supplies, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Department considers certificates of deposits and all highly liquid cash investments with original maturities of less than three months to be cash equivalents.

Accounts Receivable

Accounts receivable are stated at the amount billed to customers. The Department utilizes the allowance method of accounting for uncollectible accounts receivable. The Department reviews their customer accounts on a monthly basis and records a reserve for specific amounts that management determines may not be collected, which generally will include accounts that are more than 90 days past due. In addition, the Department has established a general reserve for potential uncollectible accounts based on historical bad debts. Amounts are written off at the point when collection attempts have been exhausted, which is usually nine months after the account is past due. Management uses significant judgment in estimating uncollectible amounts. In estimating uncollectible amounts, management considers factors such as current overall economic conditions, industry-specific economic conditions, historical customer performance and anticipated customer performance. While management believes the Department's processes effectively address its exposure to doubtful accounts, changes in economic, industry or specific customer conditions may require adjustment to the allowance recorded by the Department. Accounts receivable are net of an allowance for doubtful accounts of \$512,595 and \$588,530 at both December 31, 2013 and 2012.

**City of North Little Rock Electric Department**  
**Notes to Financial Statements**  
**December 31, 2013 and 2012**

**1. Summary of Significant Accounting Policies (continued)**

Debt Issuance Expenses

Debt issuance expenses are recorded as expense in the year that they are incurred.

Investments

Investment income includes interest income, realized gains and losses on investments carried at other than fair value and the net change for the year in the fair value of investments carried at fair value. Investment income is included in unrestricted net assets and is reflected as nonoperating revenue in the statements of revenues, expenses and changes in net position.

Inventory

Inventory consists of materials and supplies valued at the lower of cost or market, using the average cost method.

Property, Plant and Equipment

Property, plant and equipment are stated at cost unless otherwise noted. Depreciation is provided by the straight-line method over the estimated useful lives of the related assets ranging from five to fifty years. The cost of additions to property, plant and equipment include contractual work, direct labor, materials and allocable overhead. Costs of repairs and maintenance that do not improve or extend the assets lives are charged to expense as incurred.

Restricted Assets

The Department's bond agreements restrict certain assets for the payment of debt service, capital improvements, and repairs and maintenance.

Compensated Absences

The Department policies permit most employees to accumulate vacation and sick leave benefits that may be realized as paid time off, or in limited circumstances, as a cash payment. The Department has accrued a liability for vacation and sick leave pay, which has been earned but not taken by employees.

Transfers to General Fund

The Department transfers funds to the General Fund of the City of North Little Rock, Arkansas based on amounts directed and authorized by the City Council in the annual budget. These transfers are accounted for as operating transfers. The amounts of these transfers were \$12,000,000 for each of the years ended December 31, 2013 and 2012.

Reclassification

Certain reclassifications have been made to 2012 financial statements to conform to the current presentation.

**2. Description of Funds**

The Department complies with all state and local laws and regulations as well as the provisions of certain contracts requiring the use of separate funds. The required funds used by the Department include the following:

**City of North Little Rock Electric Department**  
**Notes to Financial Statements**  
**December 31, 2013 and 2012**

**2. Description of Funds (continued)**

Operation and Maintenance Fund

The Operating and Maintenance Fund is used to pay the reasonable and necessary monthly expenses of operation, and repair and maintenance of the electric system. The fund is maintained by required monthly transfers from the Revenue Fund.

Revenue Bond Fund

On the next to last business day of each month, there shall be paid to this fund a sum equal to one-sixth of the next installment of interest, one-twelfth of the next installment of principal, and the estimated fees for the trustee for the current month until such time as there is accumulated in the fund an amount equal to the maximum annual debt service on all bonds outstanding.

Surplus Fund

Any surplus in the Revenue Fund after making all disbursements and making all required deposits described above including the correction of any deficiencies may be used for any lawful municipal purpose including early redemption of outstanding bonds or for the construction of extensions, betterments, and improvements to the electric system.

**3. Deposits, Investments and Investment Income**

Investment return includes dividend, interest, and other investment income, realized and unrealized gains and losses on investments carried at fair value, and realized gains and losses on other investments. Investment return is included in unrestricted net assets.

Interest rate risk – The Department has no formal policy to limit its exposure to fair value losses due to rising interest rates.

Credit risk – Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. Provisions of debt agreements require the investments by the Department be rated no less than Aa by Moody's Investors Service and AA by Standard and Poor's Investor Service. There were no such investments at December 31, 2013 or 2012.

Custodial credit risk – For an investment, custodial credit risk is the risk that, in the event of a failure of the counterparty, the Department will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. There were no such investments at December 31, 2013 or 2012.

Concentration of credit risk – The Department places no limit on the amount that may be invested in any one issuer. The Department had amounts deposited in common trust and money market funds totaling \$6,429,122 and \$9,018,598 which are included in cash and restricted cash at December 31, 2013 and 2012, respectively. During part of the year in 2012 the Company held investments in U.S. Treasury obligations, U.S. agencies obligations, and other investments that produced investment income.

**City of North Little Rock Electric Department  
Notes to Financial Statements  
December 31, 2013 and 2012**

**3. Deposits, Investments and Investment Income (continued)**

Total investment return for the years ended December 31, 2013 and 2012 is comprised of the following:

	<u>2013</u>	<u>2012</u>
Interest and investment income	\$ 89,108	497,824
Net unrealized gains (losses) reported at fair value	-	-
	<u>\$ 89,108</u>	<u>497,824</u>

**4. Property, Plant and Equipment**

Property, plant and equipment consisted of the following at December 31, 2013:

	<u>2012</u>	<u>Additions</u>	<u>Transfers</u>	<u>Disposals</u>	<u>2013</u>
Land	\$ 2,032,960	-	-	-	2,032,960
Plant and equipment	226,201,674	533,329	8,716,846	(2,926,486)	232,525,363
Construction in process	10,266,881	11,732,351	(8,716,846)	-	13,282,386
	238,501,515	12,265,680	-	(2,926,486)	247,840,709
Less accumulated depreciation	(116,814,840)	(6,716,814)	-	1,684,486	(121,847,168)
	<u>\$121,686,675</u>	<u>5,548,866</u>	<u>-</u>	<u>(1,242,000)</u>	<u>125,993,541</u>

Property, plant and equipment consisted of the following at December 31, 2012:

	<u>2011</u>	<u>Additions</u>	<u>Transfers</u>	<u>Disposals</u>	<u>2012</u>
Land	\$ 2,032,960	-	-	-	2,032,960
Plant and equipment	213,562,564	736,258	12,328,553	(425,701)	226,201,674
Construction in process	8,514,916	14,080,518	(12,328,553)	-	10,266,881
	224,110,440	14,816,776	-	(425,701)	238,501,515
Less accumulated depreciation	(110,854,856)	(6,385,685)	-	425,701	(116,814,840)
	<u>\$113,255,584</u>	<u>8,431,091</u>	<u>-</u>	<u>-</u>	<u>121,686,675</u>

The Department allocates a portion of total depreciation expense across a couple of operating expense accounts. The amount of depreciation expense that was allocated as of December 31, 2013 and 2012 was \$378,625 and \$321,291, respectively.

**5. Long-Term Debt**

The City of North Little Rock Electric Department issued \$158,400,000 bonds on June 1, 1992 for capital improvements. The interest rate on the Series 1992 revenue bonds ranged from 6.1% to 6.5%. Annual sinking fund payments are made sufficient to redeem principal plus interest at rates ranging from 3.70% to 6.50% were required. These bonds were part of the advance bond refunding.

**City of North Little Rock Electric Department**  
**Notes to Financial Statements**  
**December 31, 2013 and 2012**

**5. Long-Term Debt (continued)**

The Department issued \$15,350,000 bonds on December 30, 1997 for capital improvements. Annual sinking fund payments sufficient to redeem principal plus interest at rates from 4.45% to 5.20% are required; redeemable at the City of North Little Rock, Arkansas' option, as a whole or in part, as 102% of the principal amount beginning January 1, 2008, at declining percentages thereafter. These bonds were part of the prior year bond refunding.

On July 15, 2009, the Department issued \$5,000,000 working capital bonds. The interest rate on the 2009A working capital bonds is 5.5%. Annual sinking fund payments sufficient to redeem principal plus interest are required; redeemable at the City of North Little Rock, Arkansas' option, as a whole or in part, at 100% of the principal plus accrued interest at any date on 15 days' notice. These bonds were part of the prior year bond refunding.

On December 15, 2009, the Department issued \$10,000,000 working capital bonds. The interest rate on the 2009B working capital bonds is 5.5%. Annual sinking fund payments sufficient to redeem principal plus interest at rates of 5.5% are required; redeemable at the City of North Little Rock, Arkansas' option, as a whole or in part, at 100% of the principal amount plus accrued interest at any date on 15 days' notice. These bonds were part of the prior year bond refunding.

On May 1, 2011, the Department issued \$16,000,000 revenue bonds. The interest rate on the Series 2011 Revenue bonds is 5.1%. Annual sinking fund payments sufficient to redeem principal plus interest at rates ranging from 2.3% to 5.1% are required; redeemable at the City of North Little Rock, Arkansas' option, as a whole or in part, at 100% of the principal amount plus accrued interest at any date on 45 days' notice.

On June 1, 2012, the Department issued bonds totaling \$55,780,000. The interest rates on the Series 2012A, 2012B and 2012C Revenue bonds range between 3.0% and 5.0%. Annual sinking fund payments sufficient to redeem principal plus interest at rates ranging from 2.6% to 5.0% are required; redeemable at the City of North Little Rock, Arkansas' option, as a whole or in part, at 100% of the principal amount plus accrued interest at any date on 30 days' notice. The 2012A and 2012B bonds were issued for the refunding of the 1992, 1997 and 2009 Series bonds and to provide \$7,000,000 for capital improvements. The 2012C bonds were issued to finance working capital of \$10,185,000 for the Department.

As a result of this refunding, \$3,985,249 of deferred bond issuance costs will be amortized over the remaining life of the old bonds. As of December 31, 2013, \$1,970,203 in remaining deferred bond costs is reported as a reduction from the bond liability.

**City of North Little Rock Electric Department**  
**Notes to Financial Statements**  
**December 31, 2013 and 2012**

**5. Long-Term Debt (continued)**

The following is a summary of the bonds payable activity for the years ended December 31, 2013 and 2012, respectively:

	<u>2012</u>	<u>Additions</u>	<u>Retirements</u>	<u>2013</u>
Bonds payable	\$ 71,780,000	-	(2,935,000)	68,845,000
	<u>2011</u>	<u>Additions</u>	<u>Retirements</u>	<u>2012</u>
Bonds payable	\$ 76,585,000	55,780,000	(60,585,000)	71,780,000

Aggregate payments of the bonds outstanding are as follows for the years ending December 31:

	<u>Series 2011</u>	<u>Series 2012</u>	<u>Total</u>
Principal:			
2014	-	3,055,000	3,055,000
2015	685,000	4,990,000	5,675,000
2016	705,000	5,095,000	5,800,000
2017	725,000	5,205,000	5,930,000
2018	745,000	5,340,000	6,085,000
2019-2023	4,185,000	25,305,000	29,490,000
2024-2028	5,185,000	3,855,000	9,040,000
2029-2033	3,770,000	-	3,770,000
	<u>\$ 16,000,000</u>	<u>52,845,000</u>	<u>68,845,000</u>
Interest:			
2014	675,902	1,569,622	2,245,524
2015	668,024	1,532,999	2,201,023
2016	650,893	1,432,951	2,083,844
2017	690,765	1,317,749	2,008,514
2018	607,598	1,185,908	1,793,506
2019-2023	2,588,246	3,018,224	5,606,470
2024-2028	1,584,328	598,652	2,182,980
2029-2033	292,300	-	292,300
	<u>\$ 7,758,056</u>	<u>10,656,105</u>	<u>18,414,161</u>

**City of North Little Rock Electric Department**  
**Notes to Financial Statements**  
**December 31, 2013 and 2012**

**5. Long-Term Debt (continued)**

The City of North Little Rock, Arkansas will maintain rates sufficient to produce net revenues equal to at least 125% of the annual debt service. Net revenues are defined as all revenues derived from operations of the electric system, including profits from all funds maintained under bond indenture except the project fund, less extraordinary income items and after reduction for normal operating expenses (exclusive of depreciation and noncash items and interest expense). For the years ended December 31, 2013 and 2012, the Department was in compliance with this covenant.

All revenues derived from the operation of the Department shall be deposited in the Revenue Bond Fund. Revenues deposited shall be expended into the following funds in the following order of priorities: Operation and Maintenance Fund, Revenue Bond Fund and Surplus Fund.

**6. Non-uniformed Employees Retirement Plan**

All full-time employees of the Department are participants of "The Retirement System of the City of North Little Rock" (Non-uniformed Plan) defined benefit plan. The provisions of the plan call for employee contributions of 4% of gross earnings to be paid through payroll withholdings. Each month, the Department contributes 6% of each employee's monthly compensation. Employer contributions reflected in the financial statements for the years ended December 31, 2013 and 2012 was \$310,035 and \$298,911, respectively, and was included in operating expenses. Employee contributions to the plan were \$206,691 and \$199,274 for the years ended December 31, 2013 and 2012.

For more information regarding funding status and composition of the pension benefit obligation, see the 2012 City of North Little Rock, Arkansas, Comprehensive Annual Financial Report.

**7. Related Party Transactions**

The Utilities Accounting Department of the City of North Little Rock, Arkansas, under the direction of the Department of Finance of the City, performs customer billing, collection services and accounts receivable recordkeeping for the Department. The Utilities Accounting Department charges the Department for this service based on the number of bills rendered. Charges for services totaled approximately \$2,100,000 each year for the years ended December 31, 2013 and 2012. Service deposits for Department customers are collected and maintained by the Utilities Accounting Department. Interest earnings on deposit funds invested are recorded by the Department and reflected in these financial statements.

Charges by the Department to the North Little Rock Street Department for the electricity usage amounted to approximately \$120,000 for the years ended December 31, 2013 and 2012. Amounts billed by the Department for service to the Street Department are determined by the City Council.

**City of North Little Rock Electric Department**  
**Notes to Financial Statements**  
**December 31, 2013 and 2012**

**8. Litigation**

In the normal course of business, the Department is, from time to time, subject to allegations that may or do result in litigation. The Department evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of legal counsel, management records an estimate of the amount of ultimate expected loss, if any. Based on management's evaluation, no amounts were accrued for expected losses as of December 31, 2013 and 2012. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

**9. Other Post-Employment Benefit Plan**

Department employees participate in an other post-employment benefit plan (the "OPEB Plan") sponsored by the City of North Little Rock, Arkansas. GASB Statement 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions* ("GASB 45"). GASB 45 requires that employers providing post-employment benefits other than pensions record and disclose annual other post-employment benefit ("OPEB") cost and a net OPEB obligation in their financial statements and disclose other information about their OPEB plans, including the unfunded actuarial liability ("UAAL").

The OPEB Plan allows employees to continue health insurance coverage beyond retirement. Although retirees are required to pay 100% of the group premium for continued coverage, the higher cost of covering retirees results in a subsidy to those retirees, which is reflected in the recorded OPEB cost.

The effect of adopting GASB 45 was not material to the financial statements of the Department. Based on an actuarial valuation performed as of January 1, 2012, the Department recorded OPEB cost of \$7,378 for 2013; \$34,568 for 2012; and \$26,530 for 2011. The net OPEB obligation was \$192,571, \$185,193 and \$150,625 as of December 31, 2013, December 31, 2012 and 2011, respectively. The Department's share of the UAAL, which is not recorded in the financial statements, was \$417,499 as of the actuarial date of January 1, 2013; \$400,000 as of the actuarial date January 1, 2012; and \$373,297 as of the actuarial date of January 1, 2011. The UAAL will be included in annual OPEB cost over an amortization period of 30 years. The OPEB obligation and UAAL were computed using a discount rate of 5.5% and healthcare cost inflation rate of 5%. Additional OPEB Plan disclosures, including required supplementary information, required by GASB 45 may be found in the 2013 Comprehensive Annual Financial Report for the City of North Little Rock, Arkansas.

**10. Commitments**

In 2007, the City of North Little Rock, Arkansas entered into a power purchase agreement with the Missouri Joint Municipal Electric Utility Commission ("MJMEUC"). Under the agreement, the Department is committed to acquire approximately 60 megawatts of generating capacity from the Plum Point Energy Stations, which was constructed near Osceola, Arkansas and began power generation in 2010. The agreement runs through December 31, 2050, but may end prior to that date if the plant is retired, if certain termination provisions apply or if otherwise agreed to by the parties. Under the agreement, the Department will pay its proportionate share of the fixed and variable costs of operating the plant and its share of MJMEUC's administrative and other costs associated with the contract.

**City of North Little Rock Electric Department**  
**Notes to Financial Statements**  
**December 31, 2013 and 2012**

**10. Commitments (continued)**

In 2010, the Department entered into a fixed rate wholesale purchase power contract with NRG Power Marketing, LLC for \$53.96 per megawatt hour for the period April 1, 2010 through December 31, 2013. Effective October 17, 2013, the Department entered into a new fixed rate wholesale purchase power contract with NRG Power Marketing, LLC for the period of January 1, 2014 to December 31, 2016 for \$41.86 per megawatt hour.

The City of North Little Rock, Arkansas has an agreement with Entergy whereby Entergy has interconnected its transmission facilities with the City's facilities to transmit the hydroelectric power and energy generated at Murray Hydroelectric Plant ("Plant") to the electric system. The agreement was effective when the Plant became operational in November 1988. The term of the agreement continues as long as the City is authorized to operate the Plant, unless terminated earlier by either party on not less than 60 months advance written notice. Rates are determined based upon agreed-upon formulas, with billings to be made on a monthly basis.

During 2012, the City of North Little Rock established an adjustable Energy Cost Recovery Rider ("ECR") as a component of its electric rate structure. The ECR is designed to generate increases or decreases in billings to customers depending on increases or decreases in the cost purchasing and providing power to its customers.

During 2013, the City entered into an energy-only contract in order to capitalize on the cost-effective delivery of power from the Midcontinent Independent System Operator ("MISO") market. Under the new contract, the City will begin managing the output of its generation resources in the market by selling excess energy into the market at the current market price. When those resources produce insufficient energy, the City will purchase replacement energy from the market at the current market price.

**11. Debt Refunding**

On June 1, 2012, the City of North Little Rock Electric Department issued \$55,780,000 in revenue refunding bonds with interest rates ranging between 3.0% and 5.0%. The Department issued the bonds to refund \$38,595,000 of the outstanding Series 1992, 1997, and 2009 bonds and to provide \$10,185,000 in working capital and \$7,000,000 for capital improvements.

The Department issued the 2012A bonds to advance refund \$39,500,000 of the outstanding Series 1992 Bonds with a 6.5% interest rate. The City used the net proceeds along with other resources to purchase U.S. government securities. These securities were deposited in an irrevocable trust to provide for all future debt service on the refunded portion of the Series 1992 bonds. As a result, that portion of the Series 1992 bonds is considered defeased, and the Department has removed the liability from its accounts. The outstanding principal of the defeased bonds is \$34,741,929 at December 31, 2012.

The advance refunding reduced debt service payments over the next 12 years by \$555,504. The result was an economic gain (difference between the present values of debt service payments on the old and new debt) of \$771,641 in the year ended December 31, 2012.

City of North Little Rock Electric Department  
 Budgetary Comparison Schedule  
 For the Year Ended December 31, 2013  
 (See independent auditor's report)

	<u>Budget</u>	<u>Actual</u>	<u>Actual Over (Under) Budget</u>
<b>Operating Revenues</b>			
Sale of electricity, net of uncollectible accounts	\$ 91,500,000	93,373,975	1,873,975
<b>Operating Expenses</b>			
Purchased electricity	54,057,000	53,138,237	(918,763)
Depreciation	6,064,395	6,338,189	273,794
Other distribution expenses	2,951,000	3,041,916	90,916
General and administrative	2,846,142	2,635,218	(210,924)
Customer records and collection expense	2,300,000	2,620,253	320,253
Distribution system maintenance	2,445,000	2,461,248	16,248
Generation plant maintenance	1,855,352	1,637,728	(217,624)
Operating expenses	792,200	1,071,500	279,300
Franchise tax	1,070,000	956,093	(113,907)
Other generation plant expenses	601,000	475,992	(125,008)
Conservation	493,500	410,974	(82,526)
Property and liability insurance	396,112	395,272	(840)
General plant maintenance	508,000	323,206	(184,794)
Regulatory fees	275,000	242,193	(32,807)
<b>Total Operating Expenses</b>	<u>76,654,701</u>	<u>75,748,019</u>	<u>(906,682)</u>
<b>Operating Income</b>	<u>14,845,299</u>	<u>17,625,956</u>	<u>2,780,657</u>
<b>Non-Operating Revenues (Expenses)</b>			
Interest and investment income	50,000	89,108	39,108
Interest expense	(3,628,433)	(3,628,433)	-
Other income	1,237,000	1,098,918	(138,082)
<b>Total Non-Operating Revenues (Expenses)</b>	<u>(2,341,433)</u>	<u>(2,440,407)</u>	<u>(98,974)</u>
Income before transfers out	<u>12,503,866</u>	<u>15,185,549</u>	<u>2,681,683</u>
Transfers out	<u>12,000,000</u>	<u>12,000,000</u>	<u>-</u>
<b>Increase (Decrease) in Net Position</b>	503,866	3,185,549	2,681,683
Net position - beginning of period	<u>94,148,061</u>	<u>94,148,061</u>	<u>-</u>
<b>Net Position - End of Period</b>	<u>\$ 94,651,927</u>	<u>97,333,610</u>	<u>2,681,683</u>