

STILLWATER UTILITIES AUTHORITY

Financial Statements

Fiscal Year ended June 30, 2008

CITY OF
stillwater

STILLWATER UTILITIES AUTHORITY
FINANCIAL STATEMENTS AND REPORTS
OF INDEPENDENT ACCOUNTANTS
JUNE 30, 2008

Prepared by:
Department of Finance

Marcy Alexander
Director of Finance

STILLWATER UTILITIES AUTHORITY
A Component Unit of the City of Stillwater, Oklahoma

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INDEPENDENT AUDITOR'S REPORT

To the Board of Trustees
Stillwater Utilities Authority

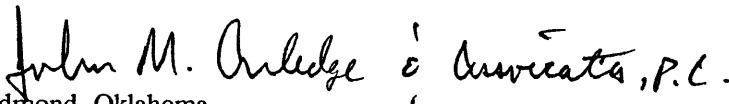
We have audited the accompanying statement of net assets of the Stillwater Utilities Authority (the "Authority"), a component unit of the City of Stillwater, Oklahoma, as of June 30, 2008, and the related statements of revenues, expenses and changes in net assets, and cash flows for the year then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Stillwater Utility Authority as of June 30, 2008, and the changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 21, 2008, on our consideration of the Authority's internal control over financial reporting and on our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis as listed in the Table of Contents is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.


Edmond, Oklahoma
October 21, 2008

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of Stillwater Utilities Authority's (the "Authority") financial performance provides an overview of the Authority's financial activities for the fiscal year ended June 30, 2008.

FINANCIAL HIGHLIGHTS

Net Assets: The Authority's net assets increased by \$5.2 million or 5.6%. This increase indicates a level of activity is being maintained that is currently adequate to replace depreciating assets as needed.

Unrestricted Net Assets: Unrestricted net assets of the Authority increased by \$0.7 million or 3.3%.

Revenues: The Authority's operating revenues increased by \$1.2 million or 2.3%. Net non-operating revenues decreased by \$0.2 million dollars. A rate increase for all utility services along with an increased customer count in all utility services contributed to the operating revenue increase. A decrease in interest rates impacted investment income and resulted in the net non-operating revenue decrease.

Expenses: The Authority's operating expenses decreased by \$1.4 million or 3.1% from the previous year. Decreased cost of purchased power primarily contributed to the decrease in operating expenses.

Transfers Out: The Authority transferred \$1.2 million more to other funds in the current year or an increase of 10.8%.

USING THIS ANNUAL REPORT

Statement of Net Assets and Statement of Revenues, Expenses and Change in Net Assets

The Statement of Net Assets and the Statement of Revenues, Expenses and Change in Net Assets includes all assets and liabilities of the Authority using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when the cash is received or paid. These statements provide information about whether the entity is better or worse off as a result of the year's activities.

Net assets are the difference between the Authority's assets and liabilities. Over time, increases or decreases in the Authority's net assets provide one indicator of the financial health of the Authority.

FINANCIAL ANALYSIS

Net Assets

A comparative overview of the major components of the Statement of Net Assets as of June 30 is shown below.

| (in millions) | <u>2007</u> | <u>2008</u> | Percentage Change <u>2007 to 2008</u> |
|--|--------------|--------------|--|
| Current and other assets | 29.9 | 37.8 | 26.4% |
| Capital assets | 99.7 | 99.8 | 0.1% |
| Total assets | 129.6 | 137.6 | 6.2% |
| Total current liabilities | 8.4 | 9.5 | 13.1% |
| Total noncurrent liabilities | 28.7 | 30.4 | 5.9% |
| Total liabilities | 37.1 | 39.9 | 7.5% |
| Net assets - | | | |
| Invested in capital assets, net of related debt | 68.6 | 72.7 | 6.0% |
| Restricted for debt service | 1.9 | 2.2 | 15.8% |
| Restricted for capital projects, | - | 0.1 | |
| Unrestricted | 22.0 | 22.7 | 3.2% |
| Total net assets | 92.5 | 97.7 | 5.6% |

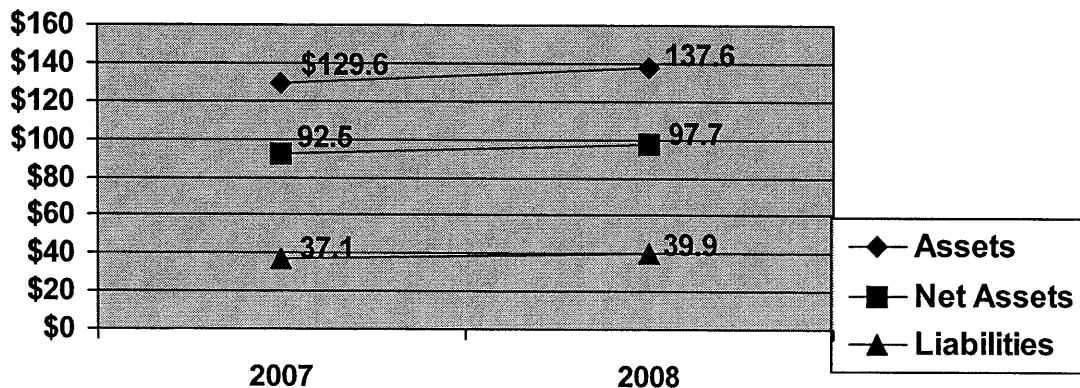
Net assets may serve over time as a useful indicator of an entities financial position. The Authority's assets exceeded liabilities by \$97.7 million at the close of 2008.

The largest portion of the Authority's net assets (74.4%) reflects its investment in capital assets (e.g. land, buildings, improvements other than buildings, machinery and equipment, and infrastructure), plus unspent bond proceeds, less any related debt used to acquire those assets that is still outstanding. The SUA uses these capital assets to provide services to citizens; therefore, these assets are not available for future spending. Although the Authority's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay debt must be provided from other sources, since capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the Authority's net assets (2.4%) represents resources that are subject to restrictions as to how they may be used. The remaining balance (23.2%) is unrestricted.

At the end of the current and previous fiscal year, the Authority is able to report positive balances in each of its net asset classifications.

Assets, Liabilities, and Net Assets at June 30 (in millions)



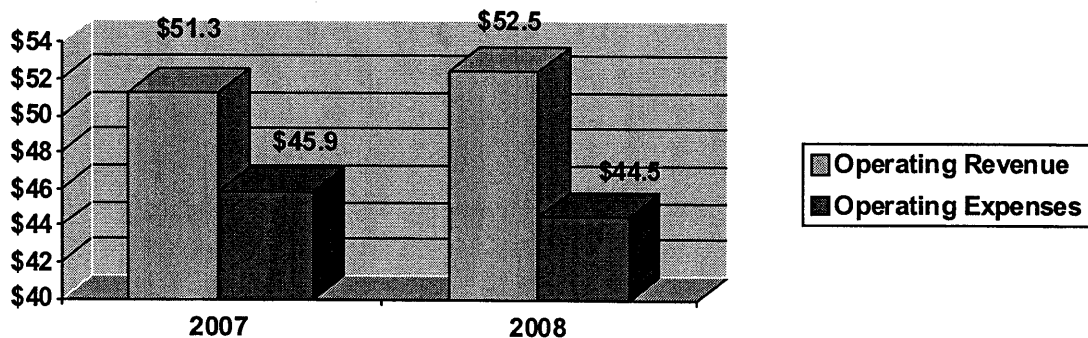
Changes in Net Assets

A comparative overview of the major components of the Statement of Revenues, Expenses, and Change in Net Assets for each of the years ended June 30 is shown below.

| (in millions) | <u>2007</u> | <u>2008</u> | <u>Percentage Change</u> <u>2007 to 2008</u> |
|--|---------------|---------------|---|
| Operating revenues | \$ 51.3 | \$ 52.5 | 2.3% |
| Operating expenses | <u>45.9</u> | <u>44.5</u> | -3.1% |
| Operating income | 5.4 | 8.0 | 48.1% |
| Non-operating revenues (expenses) | <u>0.5</u> | <u>0.3</u> | -40.0% |
| Net income before contributions and transfers | 5.9 | 8.3 | 40.7% |
| Capital contributions | 2.0 | 1.9 | -5.0% |
| Transfers in | 6.1 | 7.3 | 19.7% |
| Transfers out | <u>(11.1)</u> | <u>(12.3)</u> | 10.8% |
| Increase (decrease) in net assets | <u>\$ 2.9</u> | <u>\$ 5.2</u> | 79.3% |

Transfers in increased by \$1.2 million due to one half of the one half cent Transportation Sales Tax being transferred to the Authority to meet debt obligations of the 2007 Revenue Note issued in December 2007. Transfers out increased by 10.8% due to more supplemental funds needed by the primary government in fiscal year 2008 as compared to fiscal year 2007.

Operating Revenues and Expenses Comparison (in millions)



CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

Capital Assets, Net of Accumulated Depreciation – (in millions)

| | <u>2007</u> | <u>2008</u> |
|-------------------------------|----------------|----------------|
| Land | \$ 0.7 | \$ 0.7 |
| Water plant | 32.3 | 31.0 |
| Electric plant | 32.3 | 33.0 |
| Wastewater plant | 29.7 | 29.2 |
| Construction work in progress | 4.4 | 5.1 |
| General plant | 0.3 | 0.8 |
| Totals | <u>\$ 99.7</u> | <u>\$ 99.8</u> |

Debt Administration

At June 30, 2008, the Authority had \$33.5 million in bonds, notes, and long-term leases outstanding versus \$31.5 million last year, an increase of 6.3%. The increase is due to a \$6 million debt issue in December 2007.

Outstanding Debt, at fiscal year end - (in millions)

| | <u>2007</u> | <u>2008</u> |
|---|----------------|----------------|
| 2002 revenue bonds | 4.6 | 2.8 |
| 2005 revenue bonds | 12.0 | 11.1 |
| 2007 revenue note | - | 6.0 |
| 2002A&B notes-water treatment plant | 2.5 | 2.3 |
| 2002C note - wastewater treatment plant | 3.8 | 3.5 |
| 2005 OWRB fixed rate note | 7.0 | 6.8 |
| Long-term equipment leases | 1.6 | 1.0 |
| Totals | <u>\$ 31.5</u> | <u>\$ 33.5</u> |

ECONOMIC FACTORS AND NEXT YEAR'S ESTIMATES AND RATES

The customer base has increased for the Stillwater Utilities Authority. Since June 30, 2007, the number of electric customers has increased 6.9% and the number of water customers has increased 6%. Housing starts, commercial construction, and industrial expansions would indicate the continuation of this trend into fiscal year 2009.

Budgeting for the Authority is done in conjunction with budgeting for the City of Stillwater as a whole. Trends in rising operational costs led to the adoption of resolutions to increase all utility rates effective July 1, 2007. The resolutions also provided for subsequent annual rate increases effective January 1 of each year equal to 3% or the most recent annual consumer price index for the south urban region as determined by the U.S. Bureau of Labor Statistics, whichever is less. Effective January 1, 2008, all utility rates were increased by 2.9%.

CONTACTING THE STILLWATER UTILITIES AUTHORITY MANAGEMENT

This financial report is designed to provide our citizens, customers, taxpayers, bondholders and creditors with a general overview of the Authority's finances and to show accountability for the money it receives. Financial information for the Authority is also presented in the Comprehensive Annual Financial Report (CAFR) of the primary government, the City of Stillwater, Oklahoma. If you have questions about this report or need additional financial information, contact the Finance Department of the City of Stillwater, 723 S. Lewis St., P.O. Box 1449, Stillwater, Oklahoma 74076.

STILLWATER UTILITIES AUTHORITY
A Component Unit of the City of Stillwater, Oklahoma
Statement of Net Assets
June 30, 2008

ASSETS

Current assets:

| | | |
|--|----|------------|
| Cash and cash equivalents | \$ | 14,503,146 |
| Cash and cash equivalents - internally designated | | 4,154,725 |
| Restricted cash and cash equivalents | | 2,783,963 |
| Accounts receivable, net of allowance for uncollectible accounts of \$234,945 | | 7,940,069 |
| Due from City of Stillwater | | 110,401 |
| Inventories | | 1,017,763 |
| Total current assets | | 30,510,067 |

Noncurrent assets:

| | | |
|--------------------------------------|--|--------------|
| Restricted cash and cash equivalents | | 6,901,562 |
| Unamortized bond expense | | 345,156 |
| Capital assets: non depreciable | | |
| Land | | 669,169 |
| Construction work in progress | | 5,121,501 |
| Capital assets: depreciable | | |
| Water plant | | 68,829,322 |
| Electric plant | | 72,141,840 |
| Sewer plant | | 44,023,894 |
| General plant assets | | 2,756,790 |
| Less-accumulated depreciation | | (93,719,621) |
| Total noncurrent assets | | 107,069,613 |
| Total assets | | 137,579,680 |

LIABILITIES

Current liabilities:

| | | |
|--|--|-----------|
| Accounts payable | | 3,810,303 |
| Accrued liabilities | | 245,380 |
| Current portion of compensated absences | | 17,984 |
| Accrued interest payable | | 321,420 |
| Current portion of customer deposits payable | | 575,445 |
| Current portion of long-term debt obligations, net | | 4,495,955 |
| Total current liabilities | | 9,466,487 |

Noncurrent liabilities:

| | | |
|---|--|------------|
| Noncurrent portion of compensated absences | | 580,668 |
| Noncurrent portion of customer deposits payable | | 849,154 |
| Noncurrent portion of long-term debt obligations, net | | 28,966,073 |
| Total noncurrent liabilities | | 30,395,895 |
| Total liabilities | | 39,862,382 |

NET ASSETS

| | | |
|---|----|------------|
| Invested in capital assets, net of related debt | | 72,716,023 |
| Restricted for debt service | | 2,208,517 |
| Restricted for capital projects | | 54,756 |
| Unrestricted | | 22,738,002 |
| Total net assets | \$ | 97,717,298 |

See Notes to Financial Statements

STILLWATER UTILITIES AUTHORITY
A Component Unit of the City of Stillwater, Oklahoma
Statement of Revenues, Expenses and Change in Net Assets
For the Year Ended June 30, 2008

| | |
|---|-----------------------------|
| Operating revenues - pledged as security for revenue bonds: | |
| Charges for services, net of bad debt expense | \$ 51,350,293 |
| Other | 1,166,729 |
| Total operating revenues | <u>52,517,022</u> |
| Operating expenses: | |
| Operations and maintenance | 38,848,759 |
| Depreciation | 5,670,149 |
| Total operating expenses | <u>44,518,908</u> |
| Operating income | <u>7,998,114</u> |
| Nonoperating revenues (expenses): | |
| Investment income | 843,998 |
| Miscellaneous | 599,887 |
| Bond issuance costs | (88,676) |
| Interest expense and fiscal charges | (1,044,046) |
| Total nonoperating revenues (expenses) | <u>311,163</u> |
| Income before contributions and transfers | 8,309,277 |
| Capital contributions | 1,866,638 |
| Transfers in | 7,340,698 |
| Transfers out | (12,291,539) |
| Change in net assets | <u>5,225,074</u> |
| Total net assets, beginning of year | 92,492,224 |
| Total net assets, end of year | <u><u>\$ 97,717,298</u></u> |

See Notes to Financial Statements

STILLWATER UTILITIES AUTHORITY
A Component Unit of the City of Stillwater, Oklahoma
Statement of Cash Flows
For the Year Ended June 30, 2008

CASH FLOWS FROM OPERATING ACTIVITIES

| | |
|---|---------------|
| Receipts from customers | \$ 50,563,726 |
| Payments to suppliers | (27,921,839) |
| Payments to employees | (8,893,582) |
| Internal activity-payments to other funds | (1,462,638) |
| Other receipts (payments) | 1,163,794 |
| Net cash provided by operating activities | 13,449,461 |

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

| | |
|--|--------------|
| Operating subsidies and transfers to other funds | (12,190,218) |
| Net cash used in noncapital financing activities | (12,190,218) |

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES

| | |
|---|-------------|
| Proceeds from capital debt | 6,010,000 |
| Capital contributions | 127,856 |
| Proceeds from sale of capital assets | 8,258 |
| Transfers in related to capital financing | 7,340,698 |
| Purchases of capital assets | (4,218,226) |
| Bond issue costs paid | (67,100) |
| Principal paid on capital debt | (3,473,714) |
| Interest paid on capital debt | (943,950) |
| Net cash used in capital and related financing activities | 4,783,822 |

CASH FLOWS FROM INVESTING ACTIVITIES

| | |
|---|---------|
| Investment income | 843,998 |
| Net cash provided by investing activities | 843,998 |

| | |
|--|---------------|
| Net increase in cash and cash equivalents | 6,887,063 |
| Cash and cash equivalents, beginning of year | 21,456,333 |
| Cash and cash equivalents, end of year | \$ 28,343,396 |

Reconciliation of operating income to net cash provided by operating activities:

| | |
|---|---------------|
| Operating income | \$ 7,998,114 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | |
| Depreciation | 5,670,149 |
| Gain on disposal of assets | (2,935) |
| Changes in assets and liabilities: | |
| Receivables, net | (913,171) |
| Inventories | (6,990) |
| Accounts and other payables | 662,979 |
| Accrued liabilities | 41,315 |
| Net cash provided by operating activities | \$ 13,449,461 |

Noncash investing, capital and financing activities:

| | |
|---|-----------|
| Capital assets contributed to the Authority | 1,738,782 |
|---|-----------|

See Notes to Financial Statements

STILLWATER UTILITIES AUTHORITY
A Component Unit of the City of Stillwater, Oklahoma
Notes to Financial Statements
June 30, 2008

(1) NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations and Reporting Entity

The Stillwater Utilities Authority (the "Authority") is a public trust operating under a Trust Indenture dated April 1, 1979, which was created by an ordinance of the City of Stillwater, Oklahoma (the "City"). The City is the beneficiary of the trust. The Authority was created to operate and maintain a utilities system that provides electric, water and wastewater services to residents, businesses and industries located in the Stillwater area. Operations of the Authority commenced July 1, 1979. The City's five councilors who serve as trustees govern the Authority. The Authority is a component unit of the City's reporting entity and is reported as an enterprise fund in the City's Comprehensive Annual Financial Report.

The Trust Indenture that established the Authority provides for transfers of surplus funds to the City at the sole discretion of the trustees. Surplus revenues generated by the one cent transferred sales tax (see Note 8) may be used only for purchasing or redeeming bonds or other indebtedness of the City or the Authority prior to maturity, or any other lawful purpose of the Authority; however, proceeds from the one cent transferred sales tax cannot be returned to the City's General Fund.

The Trust Indenture limits the amount of bonds or notes that the Authority may issue in any fiscal year to 10% of its gross revenues (as defined) recorded in the preceding year. Per the trust indenture, the 10% limitation can be exceeded only upon approval by a majority of the City's qualified voters, voting on such question. However, no election is required for the issuance of:

- a. Indebtedness incurred to refund all or part of the Authority's outstanding indebtedness.
- b. Project completion bonds or notes authorized to be issued pursuant to the provisions of any indenture or other instrument securing the initial indebtedness to fund such project.
- c. Indebtedness incurred which is necessary to ensure the timely payment of outstanding Authority indebtedness and to operate in accordance with good utility practice as may be required by any indenture or other instrument securing any indebtedness of the Authority.

Proprietary Accounting Methodology

The Authority has implemented Governmental Accounting Standards Board (GASB) Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting". The Authority has elected to apply all applicable GASB pronouncements as well as 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.

Accounts Receivable

Substantially all accounts receivable relate to electric, water, and wastewater services provided to residents, businesses and industries located in the Stillwater area. Unbilled, but earned, revenues are accrued as accounts receivable and recognized as revenue at year end.

Inventories

Inventories of materials and supplies are valued at the lower of average cost or market.

Utility Plant

The cost of utility plant includes direct material, labor and indirect costs such as engineering fees. Assets are recorded at historical cost except for donated assets which are recorded at fair market value at the time of donation. Assets transferred to the Authority at its inception in 1979 were recorded at estimated historical cost of \$12,999,188. The cost of routine maintenance and repairs to property is expensed. For depreciation purposes, the Authority uses the composite method for certain types of assets, principally meters, wire, poles and electrical transformers. All other fixed assets are depreciated over their estimated useful lives (ranging from 3 to 50 years) using the straight-line method. Gains and losses are included in operations in the period the asset is retired or removed from service.

Capitalized Interest

The Authority capitalizes net interest costs during the construction period on funds borrowed to finance the construction of significant property, plant and equipment projects. Total interest expense incurred by the Authority during the year ended June 30, 2008 was \$1,044,046. This amount related to projects that were completed in prior years. No interest was capitalized for the year ended June 30, 2008.

Unamortized Bond Discount, Premium and Issue Costs

Bond discount, premium and issue costs are amortized using the straight-line method over the life of the applicable bonds. Bond discount and premium amortized are reported as a component of interest expense, while amortized bond issue costs are reported separately as non-operating expense.

Unamortized Loss Due to Bond Refunding

A non-cash gain or loss resulting from the refunding of bonds is amortized using the straight-line method over the original life of the defeased bonds. Loss on defeasance is reported as a component of interest expense.

Operating and Nonoperating Revenues

Operating revenues are those that result from providing services to customers. All revenues not meeting this definition are reported as nonoperating revenues.

Transfers

Permanent transfers of funds between the Authority and the City or between the Authority and other Authorities of the City are recorded as transfers.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, demand deposits and money market accounts with brokers.

Assets Internally Designated

Assets internally designated consist of cash and cash equivalents set aside by the Board of Trustees in anticipation of future potential operating cost increases and/or future substantial capital expenditure requirements (rate stabilization assets) and at the Board's discretion may subsequently be used for other purposes. As of June 30, 2008, cash and cash equivalents in the amount of \$4,154,725 have been internally designated by the Authority for this purpose.

Restricted Assets

Proceeds from debt and related sinking fund accounts are classified as restricted assets, since their use is restricted by applicable bond indentures. Customer utility deposits held by the Authority are also classified as restricted assets.

Compensated Absences

Full-time employees of the Authority accumulate vacation and sick leave benefits each pay period at various rates depending upon tenure with the Authority. Employees may accumulate and carry over to subsequent years up to 25 days of vacation. Upon termination, employees are paid for unused vacation. Employees may accrue up to a maximum of 1,000 hours of sick leave. An employee with five or more years of service who retires or resigns receives 10% of the accumulated unused sick leave to be computed at the rate of pay being received by the employee at retirement or resignation date. Employees with ten to thirty years of service receive a percentage payment of their unused sick leave ranging from 12.5% to 30%. The liability for these compensated absences is recorded as noncurrent liabilities. The current portion of this liability is estimated based on historical trends using the amounts that would be payable if termination occurred at the end of the fiscal year.

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 certain reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period; accordingly, actual results could differ from those estimates.

Equity Classifications

Equity is classified as net assets and is displayed in three components:

- Invested in capital assets, net of related debt – This component consists of capital assets including restricted assets, net of accumulated depreciation and reduced by the outstanding balance of bonds, notes, or long-term leases or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- Restricted net assets – This component consists of net assets with constraints placed on their use either by 1) external groups such as creditors, grantors, contributors, or laws or regulations of other governments, or 2) law through resolution or other enabling legislation.
- Unrestricted net assets – This component consists of all other net assets that do not meet the definitions of either “invested in capital assets, net of related debt” or “restricted”.

When both restricted and unrestricted resources are available for use, it is generally the Authority's policy to use restricted resources first.

(2) DEPOSITS AND INVESTMENTS

It is the Authority's policy to use state statutes (as they relate to municipal deposits and investments) as the Authority's deposit and investment guide. Therefore, the Authority collateralizes 100% of all deposit amounts, including interest, not covered by federal deposit insurance. Obligations that may be pledged as collateral include U.S. government issues, U.S. government insured securities, State of Oklahoma bonds, and bonds of any Oklahoma county or school district. The Authority prefers and requests U.S. government securities as collateral.

Deposits

Custodial credit risk for deposits is the risk that in the event of a bank failure, a government's deposits may not be returned to it. The Authority's deposit policy for custodial credit risk requires compliance with the provisions of state law. At June 30, 2008, the Authority was not exposed to custodial credit risk.

Investments

Oklahoma Statutes authorize municipalities to invest in obligations of the United States government, its agencies and instrumentalities; collateralized or insured certificates of deposits and other evidences of deposits at banks, savings banks, savings and loan associations and credit unions located in this state, or fully insured certificates of deposits at banks, savings banks, savings and loan associations and credit unions located out of state; negotiable certificates of deposit issued by a nationally or state-chartered bank, a savings bank, a savings and loan association or a state-licensed branch of a foreign bank; prime banker's acceptances which are eligible for purchase by the Federal Reserve System and which do not exceed 270 days' maturity; prime commercial paper which shall not have a maturity that exceeds 180 days nor represent more than 10% of the outstanding paper of an issuing corporation; repurchase agreements that have underlying collateral consisting of those items specified above; and money market funds regulated by the Securities and Exchange Commission and which investments consist of those items noted above.

As of June 30, 2008, the Authority had the following investments and maturities:

| <u>Type</u> | <u>Fair Value</u> | <u>Less than 1</u> | <u>1-5</u> | <u>6-10</u> | <u>More than 10</u> |
|---------------------------|-------------------|--------------------|------------|-------------|---------------------|
| Money market mutual funds | \$ 26,606,671 | \$ 26,606,671 | \$ - | \$ - | \$ - |

Interest Rate Risk – As a means of limiting its exposure to fair value losses arising from rising interest rates, the Authority's investment policy is to comply with the Oklahoma statutes listed above. Money market mutual funds are presented as an investment with a maturity of less than one year, because they are redeemable in full immediately.

Credit Risk – Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. As of June 30, 2008, the Authority's money market mutual funds were rated AAA by Standard & Poors. The Authority's investment policy does not address credit risk.

Concentration of Credit Risk – The Authority places no limit on the amount that may be invested in any one issuer.

Custodial Credit Risk for Investments – For an investment, custodial credit risk is the risk that in the event of the failure of the counterparty, the Authority will not be able to recover the value of its investments of collateral securities that are in the possession of an outside party. The Authority's investment policy does not address custodial credit risk. As of June 30, 2008, the Authority's investments were not exposed to custodial credit risk as all of the Authority's investments were registered in the name of the Authority and held by a counterparty.

Deposits and investments presented in the statement of net assets are as follows:

| | |
|------------------|----------------------|
| Carrying amount: | |
| Deposits | \$ 1,736,725 |
| Investments | 26,606,671 |
| | <u>\$ 28,343,396</u> |

| | |
|----------------------------------|----------------------|
| Statement of Net Assets amounts: | |
| Cash and cash equivalents: | |
| Unrestricted | \$ 14,503,146 |
| Internally designated | \$ 4,154,725 |
| Restricted-current | 2,783,963 |
| Restricted-noncurrent | 6,901,562 |
| | <u>\$ 28,343,396</u> |

(3) LONG-TERM LIABILITIES

As of June 30, 2008, the Authority's outstanding debt consisted of the following:

Notes Payable

| | |
|--|---------------------|
| 2002 Oklahoma Water Resources Board (OWRB) SRF Note Payable dated February 28, 2002, original amount of \$3,413,483, secured by utility revenues, no interest plus an administrative fee of 0.5%, semiannual installments of principal commencing March 15, 2002 through September 15, 2021. | \$ 2,304,101 |
| 2002 OWRB SRF Note Payable dated December 19, 2002, original amount of \$4,876,086, secured by utility revenues, no interest plus an administrative fee of 0.5%, semiannual installments of principal commencing March 15, 2003 through September 15, 2022. | 3,535,162 |
| 2005 OWRB Fixed Rate Note Payable dated June 29, 2005, original amount of \$7,620,000, secured by utility revenues, 2.6% interest plus an administrative fee of 0.5%, semiannual installments of principal and interest commencing September 15, 2005 through March 15, 2025 | 6,757,201 |
| 2007 Revenue Note dated December 5, 2007, original amount of \$6,010,000, secured by dedicated ½ cent sales tax revenues, interest rate is 3.68%, semiannual installments of principal and interest commencing December 1, 2008 through December 1, 2016 | <u>6,010,000</u> |
| Total Notes Payable | <u>\$18,606,464</u> |
| Current portion | \$ 1,215,681 |
| Non-current portion | <u>17,390,783</u> |
| Total Notes Payable | <u>\$18,606,464</u> |

Revenue Bonds

| | |
|--|---------------------|
| 2002 Refunding Series bonds dated September 16, 2002, original issue amount of \$11,825,000, secured by utility revenues, interest rates range from 2.1% to 3.2%, semiannual interest and annual principal installments commencing December 1, 2002 through December 1, 2009 | \$ 2,835,000 |
| Less: Unamortized discount | (242) |
| Unamortized loss on defeasance | <u>(112,871)</u> |
| Net 2002 Revenue Bonds Payable | <u>2,721,887</u> |
| 2005 Refunding Series bonds dated May 11, 2005, original issue amount of \$12,965,000, secured by utility revenues, interest rates range from 3.25% to 5.0%, semiannual interest and annual principal installments commencing October 1, 2005 through October 1, 2012. | 10,755,000 |
| Plus: Unamortized premium | 415,217 |
| Less: Unamortized loss on defeasance | <u>(67,353)</u> |
| Net 2005 Revenue Bonds Payable | <u>11,102,864</u> |
| Total Revenue Bonds Payable | <u>\$13,824,751</u> |

| | |
|-----------------------------|---------------------|
| Current portion | \$ 2,857,522 |
| Non-current portion | <u>10,967,229</u> |
| Total Revenue Bonds Payable | <u>\$13,824,751</u> |

Capital Lease Obligations

Borrowings have been advanced pursuant to a credit agreement with Banc of America Leasing and Capital LLC that provides, until March 14, 2009, for the purchase of equipment. The maximum purchase price for equipment under the agreement is the lower of \$7 million or the fair market value of the equipment with fixed interest rate calculations based on the term of the lease as well as the U.S. Treasury Bond Obligation rate in effect at the time of funding.

| | |
|--|---------------------|
| Total cost of capital assets financed by capital lease obligations | \$ 2,027,034 |
| Less: accumulated depreciation | <u>(743,934)</u> |
| Net capital assets financed by leases | <u>\$ 1,283,100</u> |

| | |
|--|--------|
| \$400,880 capital lease with Banc of America for equipment, fixed interest rate of 2.804%, semiannual installments commencing September 8, 2004 through March 8, 2009. | 84,702 |
|--|--------|

| | |
|--|--------|
| \$102,148 capital lease with Banc of America for equipment fixed interest rate of 3.116%, semiannual installments commencing June 10, 2005 through December 10, 2009 | 32,319 |
|--|--------|

| | |
|--|---------|
| \$212,061 capital lease with Banc of America for equipment fixed interest rate of 3.454%, semiannual installments commencing March 9, 2006 through September 9, 2010 | 110,567 |
|--|---------|

| | |
|---|---------|
| \$184,633 capital lease with Banc of America for equipment fixed interest rate of 4.0%, semiannual installments commencing November 12, 2006 through May 12, 2011 | 115,135 |
|---|---------|

| | |
|---|---------|
| \$553,307 capital lease with Banc of America for equipment fixed interest rate of 4.09%, semiannual installments commencing December 15, 2006 through June 15, 2014 | 431,302 |
|---|---------|

| | |
|---|--------|
| \$104,420 capital lease with Banc of America for equipment fixed interest rate of 3.9803%, semiannual installments commencing February 24, 2007 through August 24, 2011 | 75,225 |
|---|--------|

| | |
|--|--------|
| \$57,950 capital lease with Banc of America for equipment fixed interest rate of 3.9535%, semiannual installments commencing September 2, 2007 through March 2, 2011 | 44,302 |
|--|--------|

| | |
|--|----------------|
| \$411,635 capital lease with Dell Government Leasing for equipment fixed interest rate of 7.522%, annual installments commencing July 1, 2007 through June 1, 2009 | <u>137,261</u> |
|--|----------------|

| | |
|----------------------|---------------------|
| Total Capital Leases | <u>\$ 1,030,813</u> |
|----------------------|---------------------|

| | |
|----------------------|---------------------|
| Current portion | \$ 422,752 |
| Non-current portion | <u>608,061</u> |
| Total Capital Leases | <u>\$ 1,030,813</u> |

Accrued Compensated Absences

| | |
|------------------------------------|-------------------|
| Current portion | \$ 17,984 |
| Non-current portion | <u>580,668</u> |
| Total Accrued Compensated Absences | <u>\$ 598,652</u> |

Deposits Subject to Refund

| | |
|----------------------------------|---------------------|
| Current portion | \$ 575,445 |
| Non-current portion | <u>849,154</u> |
| Total Deposits Subject to Refund | <u>\$ 1,424,599</u> |

Changes in Long-Term Liabilities

The following is a summary of changes in the Authority's long-term liabilities for the year ended June 30, 2008:

| | Balance at July 1, 2007 | Additions | Reductions | Balance at June 30, 2008 | Amounts Due Within One Year |
|----------------------------------|----------------------------|---------------------|---------------------|-----------------------------|-----------------------------------|
| Notes Payable | \$13,307,167 | \$ 6,010,000 | \$ 710,703 | \$ 18,606,464 | \$1,215,681 |
| Revenue Bonds Payable, net | 16,557,497 | - | 2,732,746 | 13,824,751 | 2,857,522 |
| Capital Lease Obligations | 1,663,711 | - | 632,898 | 1,030,813 | 422,752 |
| Total Long-Term Debt Obligations | 31,528,375 | 6,010,000 | 4,076,347 | 33,462,028 | 4,495,955 |
| Accrued Compensated Absences | 580,667 | 64,684 | 46,699 | 598,652 | 17,984 |
| Deposits Subject to Refund | 1,297,995 | 702,049 | 575,445 | 1,424,599 | 575,445 |
| Total Long-Term Liabilities | <u>\$33,407,037</u> | <u>\$ 6,776,733</u> | <u>\$ 4,698,491</u> | <u>\$ 35,485,279</u> | <u>\$ 5,089,384</u> |

Applicability of Federal Arbitrage Regulations

Certain debt issuances of the Authority issued after the Tax Reform Act of 1986 are subject to the federal arbitrage regulations. The arbitrage rebate regulations require that all earnings from the investment of gross proceeds of an issue in excess of the amount that could have been earned had the yield on the investment been equal to the yield on the bonds be remitted to the federal government. These carry strict penalties for noncompliance including taxability of interest retroactive to the date of the issue. The Authority's management believes it is in compliance with these rules and regulations.

Maturities of Long-term Debt

The debt service maturities for the Authority's long-term indebtedness for the coming years are as follows:

| Year ending June 30, | 2002 Revenue Bonds | | 2005 Revenue Bonds | |
|-------------------------|---------------------|------------------|----------------------|---------------------|
| | Principal | Interest | Principal | Interest |
| 2009 | 1,985,000 | 57,471 | 870,000 | 477,187 |
| 2010 | 850,000 | 13,600 | 2,080,000 | 426,650 |
| 2011 | - | - | 3,030,000 | 314,500 |
| 2012 | - | - | 3,190,000 | 159,000 |
| 2013 | - | - | 1,585,000 | 39,625 |
| Total | <u>\$ 2,835,000</u> | <u>\$ 71,071</u> | <u>\$ 10,755,000</u> | <u>\$ 1,416,962</u> |

| Year ending June 30, | Notes Payable | | Capital Leases | |
|-------------------------|----------------------|---------------------|---------------------|------------------|
| | Principal | Interest | Principal | Interest |
| 2009 | 1,215,681 | 565,000 | 422,752 | 42,396 |
| 2010 | 1,375,380 | 424,372 | 197,406 | 22,194 |
| 2011 | 1,410,387 | 388,344 | 170,531 | 14,687 |
| 2012 | 1,445,225 | 351,534 | 84,571 | 8,841 |
| 2013 | 1,486,347 | 312,398 | 76,202 | 5,591 |
| 2014-2018 | 6,758,296 | 955,805 | 79,351 | 2,442 |
| 2019-2023 | 3,922,136 | 373,491 | - | - |
| 2024-2028 | 993,012 | 39,449 | - | - |
| Total | <u>\$ 18,606,464</u> | <u>\$ 3,410,393</u> | <u>\$ 1,030,813</u> | <u>\$ 96,151</u> |

(4) RESTRICTED ASSETS

Certain assets of the Authority are restricted in their use by bond and note indentures. Cash and cash equivalents, classified as current, in the amount of \$2,208,517 at June 30, 2008 have been restricted in use to the service of debt.

Certain cash and cash equivalents of the Authority are restricted by agreement for the purpose of acquiring necessary easements related to water line upgrades for an area of service purchased from a rural water district. As of June 30, 2008 cash and cash equivalents, classified as non-current, in the amount of \$54,756 were restricted for this purpose.

Proceeds received from the 2007 Revenue Note issue are restricted in their use to finance transportation improvement projects identified in the 2006 Transportation Sales Tax Ordinance. As of June 30, 2008 cash and cash equivalents, classified as noncurrent, in the amount of \$5,997,652 were restricted for this purpose.

Customer deposits received for water or electric service are restricted in their use toward the customer's final bill. As of June 30, 2008 cash and cash equivalents in the amount of \$1,424,599, of which \$575,445 is classified as current and \$849,154 is classified as non-current, have been restricted for customer deposits.

(5) CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2008 was as follows:

| | Balance at July 1, 2007 | Additions, Net of Transfers | Deletions, Net of Transfers | Balance at June 30, 2008 |
|---|------------------------------------|--|--|-------------------------------------|
| Capital assets not being depreciated: | | | | |
| Land | \$ 669,169 | \$ - | \$ - | \$ 669,169 |
| Construction work in progress | 4,421,179 | 3,763,766 | 3,063,444 | 5,121,501 |
| Total capital assets not being depreciated | <u>5,090,348</u> | <u>3,763,766</u> | <u>3,063,444</u> | <u>5,790,670</u> |
| Other capital assets: | | | | |
| Buildings | 2,670,422 | 2,206,340 | - | 4,876,762 |
| Improvements other than buildings | 162,081,554 | 2,877,268 | 516,547 | 164,442,275 |
| Machinery and equipment | 18,357,209 | 939,806 | 864,206 | 18,432,809 |
| Total other capital assets at historical cost | <u>183,109,185</u> | <u>6,023,414</u> | <u>1,380,753</u> | <u>187,751,846</u> |
| Less accumulated depreciation for: | | | | |
| Buildings | 1,106,491 | 184,928 | - | 1,291,419 |
| Improvements other than buildings | 74,768,657 | 4,650,424 | 8,609 | 79,410,472 |
| Machinery and equipment | 12,592,527 | 962,857 | 537,654 | 13,017,730 |
| Total accumulated depreciation | <u>88,467,675</u> | <u>5,798,209</u> | <u>546,263</u> | <u>93,719,621</u> |
| Other capital assets, net | <u>94,641,510</u> | <u>225,205</u> | <u>834,490</u> | <u>94,032,224</u> |
| Total capital assets, net | <u>\$ 99,731,858</u> | <u>\$ 3,988,971</u> | <u>\$ 3,897,934</u> | <u>\$ 99,822,895</u> |

Contributed Capital Assets

For the year ended June 30, 2008, the Authority accepted and received water and sewer lines that were installed by developers amounting to \$1,713,845.

(6) PENSION PLAN

All full time City employees are provided pension benefits through a defined contribution plan administered by the Oklahoma Municipal Retirement Fund. The employee begins participation at the date of employment. Employees contribute a minimum of 3% of their salary with an optional maximum of up to 14% of their salary. The City Commission determines the City's contribution each year. The City's contributions for each employee begin vesting after 5 years and are fully vested after 10 years. If an employee terminates before becoming fully vested, the part of the employer's contributions that are forfeited may be used to reduce the City's current-period contributions requirement. The Authority reimburses the City for all related costs of the pension plan.

The Authority's total payroll in fiscal year 2008 was \$7,263,088. Covered payroll (for employees covered under the plan) was \$7,085,845. The employees' contributions amounted to \$425,111 or 6.00% of covered payroll in fiscal year 2008. The City made contributions of \$415,736 in 2008, which was 5.87% of the fiscal year covered payroll resulting in total contributions of \$840,847 for the year ended June 30, 2008.

(7) RELATED PARTY TRANSACTIONS

The Authority provides utility services to the City without charge, and the Authority is not assessed property taxes.

The Authority leases the electric, water and sewer systems from the City under a 50-year lease agreement which expires in 2029, with an option to renew the lease until all Authority bond obligations are redeemed or a provision for redemption of the obligations has been made. The annual lease rental is a nominal amount. The leased utility plant is included in the Authority's financial statements, as it is the City's intent under the lease agreement for the Authority to operate the utilities indefinitely.

All personnel of the Authority are employees of the City. Payroll and related costs are reimbursed by the Authority to the City and are reflected as expenses of the Authority.

Administrative and general expenses incurred by the City benefiting the Authority in the amount of \$1,462,638 for the year ended June 30, 2008 have been proportionately allocated and reflected in the Authority's financial statements as expenses.

(8) TRANSFERS IN

One cent of the City's three cent general-use sales tax is designated for the Authority. The sales tax transfer is received by the City monthly from the State of Oklahoma and is appropriated and transferred to the Authority. The Authority uses the sales tax transfer to meet the debt service requirements of the 2005 and 2002 revenue bonds. The sales tax may also be used, at the Authority's discretion, for capital expenditures, operating and maintenance expenses or any other lawful purpose of the Authority including the purchase or redemption of bonds or other indebtedness of the Authority prior to maturity. It may also be transferred to the City's sinking fund for the repayment of general obligation debt of the City. For the year ended June 30, 2008 the transfers to the Authority related to this sales tax were \$6,412,136.

One half of the City's one-half cent transportation sales tax is transferred to the Authority. The sales tax transfer is received by the City monthly from the State of Oklahoma and is appropriated and transferred to the Authority. The Authority uses the sales tax transfer to meet the debt service requirements of the 2007 revenue note. For the year ended June 30, 2008 the transfers to the Authority related to this sales tax were \$928,562.

(9) TRANSFERS OUT

City General Fund

The Authority annually transfers surplus funds in an amount determined by the Authority trustees to the City's General Fund as provided for in the Authority's Trust Indenture. For the year ended June 30, 2008, the transfer amount was \$12,134,964.

Stillwater Public Golf Authority

During the year ended June 30, 2008, the Authority transferred \$156,575 to the Stillwater Public Golf Authority. This transfer arose as the result of the payment of vendor and payroll claims made on behalf of the Stillwater Public Golf Authority, a component unit of the City of Stillwater.

(10) RISK MANAGEMENT

The Authority, as a component unit of the City, is covered under the City's self-insurance policy for group medical, general liability, workers compensation, unemployment, and property damage. The City has a reinsurance policy which limits the City's liability for major medical to \$100,000 per individual per year. The City purchases conventional insurance for excess losses, general liability and property damage. Settlement amounts have not exceeded insurance coverage for the current year or the three prior years.

(11) REVENUES PLEDGED

The Authority has pledged future sales tax revenues to repay a \$6,010,000 note issued in December 2007 to finance transportation improvement projects identified in the 2006 Transportation Sales Tax Ordinance. The note is payable solely from sales tax revenue equal to one half of the one-half cent transportation sales tax collected by the City and transferred to the Authority by way of the Sales Tax Agreement. Sales taxes are projected to produce 100 percent of the debt service requirements over the life of the note. Total principal and interest remaining on the note is \$7,185,327, payable semiannually commencing December 2008 and concluding December 2016. For the current year, total sales tax revenues were \$928,562.

The Authority has pledged future sales tax revenues and future utility revenues, net of operating and maintenance expenses, to repay debt obligations. Proceeds from the debt issues financed the refunding of prior debt obligations of the Authority and the Stillwater Public Golf Authority and refinanced outstanding balances of notes to the OWRB. The debt obligations are payable from the one cent sales tax revenue dedicated to the Authority by City Ordinance No. 1835 and from net revenues derived from the existence and operation of the utility system to the extent sales tax revenue fails to cover the debt obligations. Pledged revenues are projected to produce 125 percent of the debt service requirements over the life of the debt. For the current year, sales tax revenues were \$6,412,136 and net revenues were \$14,491,788. The following is a summary of the debt issues included in this pledge of revenues:

| Debt Issue | Issue Amount | Issue Date | Maturity Date | Remaining Principal and Interest | Current Year Principal and Interest |
|-----------------------------|---------------|------------|---------------|----------------------------------|-------------------------------------|
| 2005 Refunding Series Bonds | \$ 12,965,000 | May 2005 | Oct 2012 | \$ 12,171,962 | \$ 1,304,325 |
| 2002 Refunding Series Bonds | \$ 11,825,000 | Sept 2002 | Dec 2009 | \$ 2,906,071 | \$ 2,044,280 |
| 2002 OWRB SRF Note | \$ 3,413,483 | Feb 2002 | Sept 2021 | \$ 2,385,932 | \$ 183,039 |
| 2002 OWRB SRF Note | \$ 4,876,086 | Dec 2002 | Sept 2022 | \$ 3,669,681 | \$ 262,706 |
| 2005 OWRB Fixed Rate Note | \$ 7,620,000 | Jun 2005 | Mar 2025 | \$ 8,775,917 | \$ 516,230 |

(12)COMMITMENTS

Included in the purchase of Rural Water Corporation No. 3, the Authority has agreed to consolidate the two water distribution systems over the next five years. This consolidation will include making improvements and upgrades to pump stations and adding additional water lines to specified areas within the system.

(13) LITIGATION

Dedrickson vs. City, et al, Case No. CJ-2008-97, District Court of Payne County. This taxpayer suit against the City and the Authority alleges unlawful diversion of earmarked tax revenues into the City's general fund. If this suit is successful, it would require the City to return \$43 million dollars to the Authority. At the present time, no trial date is set and discovery is ongoing. A verdict in favor of the plaintiff would result in "all or nothing" damages. Management believes this suit results from a misunderstanding of the facts and intends to vigorously defend this action.

(14)RECENTLY ISSUED ACCOUNTING STANDARDS

Statement No. 45, "Accounting and Financial Reporting by Employers for Post Employment Benefits Other than Pensions" – This statement establishes accounting and financial reporting for post employment health care and other benefits if provided separately from a pension plan. This statement will become effective for the Authority in the fiscal year ending June 30, 2009. Management has not yet determined the impact of this statement on the Authority's financial statements.

OTHER REPORTS

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 Trustees of
Stillwater Utilities Authority

We have audited the financial statements of the Stillwater Utilities Authority (the "Authority") as of and for the year ended June 30, 2008, and have issued our report thereon dated October 21, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Authority's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Authority's financial statements that is more than inconsequential will not be prevented or detected by the Authority's internal control. We consider the following to be a significant deficiency in internal control over financial reporting.

Distribution of signed accounts payable checks are currently the responsibility of the accounts payable department. We recommend that checks, once signed, not be returned to accounts payable and that alternative procedures be developed for distribution of those checks.

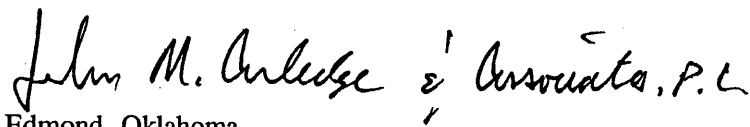
A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material misstatement of the financial statements will not be prevented or detected by the Authority's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies or material weaknesses. However, we believe that the significant deficiency described above is not a material weakness.

Compliance and Other Matters

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

This report is intended solely for the information and use of the governing body and management and is not intended to be and should not be used by anyone other than these specified parties.


Edmond, Oklahoma
October 21, 2008