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{ Teaming Up } 2002 Annual Report



## A word cloud graphic featuring the phrase "Teaming Up" repeated multiple times. The text is rendered in various sizes, with the largest instance being the most prominent in the center. The colors range from a light, pale yellow to a vibrant, saturated orange. The words are arranged in a somewhat chaotic but balanced manner, creating a sense of movement and emphasis on the concept of collaboration.



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# RPU: Teaming Up

## Letter from the Management

When the world changes, we must adapt. So we've all been reminded over the past two years. At RPU, this is not a novel concept, as we've been adapting to our changing marketplace for several years. We continue to learn. While the pace of change may seem slow, new electric generation, customer expectations and technology are significant drivers for change and challenge us to bring our great service to a higher level. We're teaming up, you might say.



2002 Utility Board (from left): Richard Landwehr, John Hunziker, RPU General Manager Larry Koshire, Roger Toulouse, Paul Bourgeois, Mark Utz



Board President Landwehr and then-Mayor Chuck Canfield observe the new combustion turbine at the Cascade Creek facility.

### EXPANSION

The growing demand in Rochester challenged us to keep pace and meet customer expectations for power and water quality and reliability. Building permits issued in Rochester in 2002 totaled 4,026 (an increase of nearly 9% over permits issued in 2001). 2002 also had the highest annual capital expenditures since 1969, when the fourth generating unit at Silver Lake Power Plant went online. These expenditures included the completion of a major transmission line upgrade to 161 kilovolts (kV), the commissioning of Cascade Creek Gas Turbine #2, and the planned upgrade and expansion of our distribution infrastructure. The transmission upgrade was the final step in a 14-year program. The project was completed ahead of schedule and under budget.

Cascade Creek Gas Turbine #2 went online in April of 2002, and was dedicated in a ceremony involving

community leaders and RPU employees. This 49.9-megawatt (MW) turbine is located adjacent to an existing unit. Both units are fueled by natural gas or oil providing RPU with capacity to meet peak power needs during the summer cooling season. We were also able to sell excess capacity that was not needed to serve Rochester's load.

Well 36 and the adjacent booster station also went online this past year. In addition, the renovation of the St. Mary's water tower was completed. This tower stands as a historical marker in our community.

In response to continued strong growth in Rochester's population, we've invested in large infrastructure projects to ensure our ability to provide high-quality power and water in a reliable manner. Upgrades, improvements, and replacements throughout the rest of the system were also completed to maintain system integrity.

### ELECTRIC AND WATER DIVISION PERFORMANCE

RPU sold over 1.17 billion kilowatt-hours (kWh) to 42,495 electric customers this past year. This is an increase of 3.67% in sales over 2001, and an increase of 2.8% in customers. The peak electric demand was set on July 31 at 254.4 MW.

Water sales amounted to 4.3 billion gallons, which is a decrease of 4.27% from 2001. Water customers numbered 31,629 in 2002, a 3.7% increase over the previous year. Peak water pumpage, set on July 17, was 27.6 million gallons. Maximum pumping capacity in a 24-hour period is 31.4 million gallons.

### BOND ISSUANCE

RPU accessed the bond market for the second time in its history in 2002 to obtain funding to support the electric capital budget. Rapid expansion of the community in recent years strained financial resources, which resulted in the need to rebuild our cash reserves. Issuing electric revenue bonds helped us maintain appropriate financial reserves while

smoothing revenue requirements. The bonds, worth \$11.275 million, received an "Aa3" rating from Moody's Investors Service and a rating of "A+" from Fitch, Inc. The ratings, maintained from the 2000 bond series, illustrate the agencies' confidence in RPU and Rochester's economy.

## LEGISLATIVE

Although it appears that retail customer choice (one form of deregulation) has slowed considerably, regulatory forces continue to impact the electric supply business. In response to anticipated changes in transmission markets, the RPU Board authorized joining TRANSLink Development Company, LLC, a midwestern transmission organization currently in the start-up phase. TRANSLink will represent the participating utilities' transmission interests as an independent "for-profit" transmission company. TRANSLink is expected to begin operations late in 2003.

## SECURITY CONCERNS

With concerns of power and water supply safety weighing on our minds after September 11, 2001, we embarked on an aggressive review of security procedures at RPU. Various security procedures and policies were implemented that are consistent with industry practice and enable the utility to respond to the published terrorism threat levels that are posted by national, state, and local authorities. We are confident that your utility is delivering an effective safety and security program for RPU's facilities and products.

## UTILITY BOARD

Roger Toulouse, who served on the Utility Board since 1977, completed his last year of service in 2002. Mr. Toulouse, a professional engineer, Vice President for TSP, specialized in the operations and administration of the Board. He served as its president for twelve years. During his tenure, Mr. Toulouse participated in Board decisions that led to RPU joining the Southern Minnesota Municipal Power Agency (SMMPA) and the Mid-Continent Area Power Pool (MAPP), supplying its own power

above 216 MW (above RPU's contract with wholesale provider SMMPA), and issuing electric revenue bonds in 2000 and 2002 that made possible construction of our 49.9-MW, natural-gas-fired combustion turbine. Mr. Toulouse retired when he reached his term limit.

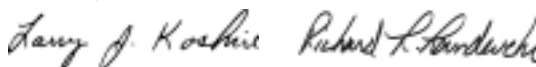
Appointed to the board to fill the vacancy was Mr. John "Jack" Jibben, Vice Chair of Project Coordination and Campus Planning for the Mayo Clinic, who is a mechanical engineer by training. Mr. Jibben's first term will run through 2006.

## LOOKING AHEAD

The future is bright for RPU as we explore ways to bring more value to our customers and determine creative solutions for energy-related issues, such as "Teaming Up" with Austin Utilities and Owatonna Public Utilities. This marketing partnership was launched in early 2002 as a way to optimize conservation monies (new legislation required municipals to spend 1.5% of gross electric revenue on conservation activities). The alliance also offers an opportunity to bring cost savings to the participating utilities, and ultimately, to the consumers. As we work to bring more value and make concerted effort to brand public power, we are certain we will have a strong presence in customer minds as competition brings more choices for the consumer's energy dollar.

RPU has provided utility service to the city of Rochester for more than 100 years, and plans to do so for many more. RPU's level of customer service will remain high, though the utility industry does not look today as it did ten years ago, and it will not look the same in another ten years. Our customers will be the guides to help us determine the best way to serve them, as we team up this year and into the future.

Sincerely,



Larry J. Koshire  
General Manager

Richard L. Landwehr  
Board President

# with Customers

## RPU: Teaming Up

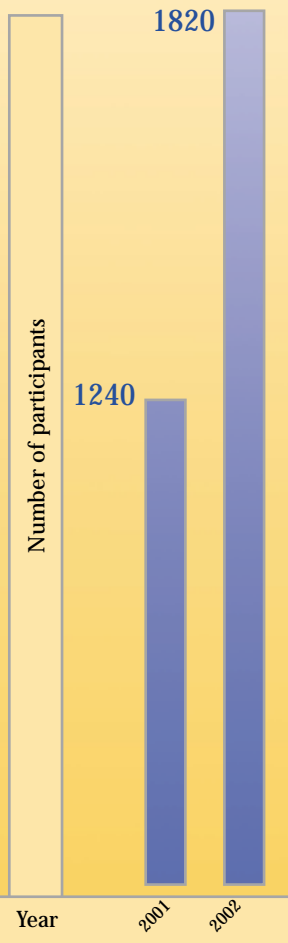
Efforts to interact with customers ramped up this year at RPU. We worked to bring more value to our customers and move to “the other side of the meter.”

### CONSERVE & SAVE

Teaming up with customers is exactly what happened when RPU, and Austin and Owatonna Utilities launched “Conserve & Save,” an incentive and education program for energy- and water-efficient appliances and equipment in late summer 2002.

### CONSERVE & SAVE

#### Rebate Participation



RPU experienced increased awareness and participation in incentives programs this year. “Conserve & Save” expanded rebates we offered in the past, including many not previously offered, so that alone brought in participants. For the rebates previously offered—central air conditioners, geothermal heat pumps, and compact fluorescent light bulbs (CFLs)—participation in 2002 (1820) jumped 46% from 2001 figures (1240). Total rebates in 2002, including all items now eligible, totaled 2242.

Trade allies, including appliance dealers and heating/cooling equipment contractors, have played a big part in the success of “Conserve & Save.” We supply dealers in the three cities with rebate applications and other promotional material, as well as train them in the program. They offer our incentives in conjunction with their products to make a sale.

Our commercial and industrial customers also realized the benefits of “teaming up” in the past year. These customers often require specialized knowledge and expertise in the areas of energy management and conservation. RPU worked with customers in these segments, ranging from the largest industrial to the smallest commercial customer, to develop creative energy solutions. RPU Energy Solutions, the energy services arm of RPU, partnered with customers over the course of the year to improve their operations, which often helped reduce load for the utility. Kilowatt savings for the year totaled 1,672, and kWh totaled 5,805,087. Consulting services, provided by RPU, and the physical work done, contracted through a third party, resulted in successful teaming up with commercial and industrial customers.

All customer classes teamed together to save a total of 7,124,986 kWh. This translates into seven million pounds of coal not burned to supply electricity to our community.

### VALUE-ADDED PRODUCTS AND SERVICES

Our customers, in order to realize value from their utility services, desire help with conservation as well as other value-added products and services. Through surveys and discussions on the street, our customers have also let us know they want piece of mind when it comes to their utility service and more investment in and access to renewable energy.

Peace of mind can come from something called Service Assured<sup>SM</sup>. Service Assured<sup>SM</sup>, an assurance program protecting underground water and electric service, is available to all customers on a monthly subscription basis for a nominal fee. In the event of a service break, RPU will repair or replace the service at no charge to the customer. In the past year, 727 customers signed up for Service Assured<sup>SM</sup>, bringing total participation to 3,815. While that is only nine percent of customers eligible, it brought in

## RPU: Timeline

1997  
Annual Report

*In order to improve our services and monitor our electric and water operations more precisely, a \$1 million project was initiated to replace the utilities/ supervisory control and data acquisition (SCADA) system.*





\$59,232 for RPU, after expenses. The 2003 promotion of Service Assured<sup>SM</sup> promises to be much more aggressive. The added push will bring more customers to the program and develop a credible revenue source for the utility, while providing our customers with piece of mind and protecting them from costly repair bills.

Partners, our residential load management program, saves customers money on their summer electric bills while curbing load (or conserving energy) for the utility. Participants in Partners receive a credit for having their central air conditioner compressor or electric water heater cycled for no more than a specified number of minutes per hour during peak periods. After reviewing the program's performance, RPU decided in 2002 to lower the credits offered per month, and promoted the environmental benefits of becoming a Partner. Credits paid out for the program decreased for the year while participants increased, showing that it is not only the credit that entices people to Partner with RPU.

Wind Power, RPU's offering that gives customers the opportunity to invest in wind energy, gained customers this year as more people becoming more excited and knowledgeable about green energy. The excitement is building in Rochester as RPU is studying with the Minnesota Department of Commerce (DOC) the possibility of producing wind energy in Rochester.

In the spring, RPU secured a \$5,000 grant from the DOC to purchase equipment for constructing a temporary tower and anemometer to test the wind on the Assisi Heights campus. Both RPU and the DOC provided in-kind work to install the tower and monitor study results. The anemometer went into service in August 2002, and will remain up for one year collecting data on wind speed, velocity and frequency. At the end of the study year, the data will be analyzed and a business case prepared for the

possibility of constructing a wind turbine on that site in Rochester.

RPU also has keen interest in two wind turbines that were in the construction phase at the end of the year. These turbines near Fairmont, Minn. will be owned and operated by SMMMPA, our wholesale power agency. SMMMPA, of which Fairmont Utilities is also a member, completed a siting study, purchased land, and began construction of two 950-kW units, which is one of the 18 SMMMPA members. Scheduled to begin operation in April 2003, the turbines will be a welcome addition to RPU's selection of conservation and renewable offerings.

### ENERGY SOLUTIONS

Teaming up with our largest customers is a task we take very seriously. For nearly two years, we've provided turnkey energy services under the Energy Solutions umbrella. From lighting retrofits to process analysis, RPU helps commercial and industrial customers in Rochester achieve greater profitability by reducing energy consumption.

In the research and development area, we reached an agreement with the University of Minnesota-Rochester to study hydrogen fuel cells. Near the end of 2002, we laid out the scope of the study, began the process of ordering the fuel cell, and set project assignments for both RPU and UMR.

*RPU promotes investment in green energy by offering a wind power program for customers.*



*-Bill Seidl,  
Holiday Inn City Center*

*"They're great to work with. They understand business owners' needs. We already see reductions and the project isn't finished. Our energy savings will pay for our projects."*



*-Bill McCollom,  
Rochester Marriott*

*"For RPU to come in saying, 'We can save you money and it won't cost you a thing [since projects are billed on utility bills and the savings covers the cost]' is phenomenal. Every promise they've made, they've come through on."*

1998  
"Building  
Relationships"

*Early in the year we unveiled a new logo and motto. The logo, the RPU acronym, and the sun rising over the horizon symbolize a new focus on customer service: opportunities for working together.*



*Crews began construction of a 161,000-volt transmission line to provide second feed to Northern Hills Substation.*



# with Our Community

## RPU: Teaming Up

Serving our community with electric- and water-related products and services is what we do, but teaming up with our community is much more than that. It's ensuring RPU will serve the community now and into the future. It's reaching out to educate and inform our community. It's also working as an organization and as individuals to make our community a better place. We are growing with the community. During the past year, RPU has done all of the above with enthusiasm and dedication.

2002 outpaced last year by almost nine percent with 4,026 city permits issued. The permits totaled approximately \$322.7 million, and included 946 single-family homes among other construction projects, including commercial projects.

The most important way we are teaming up with customers is by providing them with electric and water service. RPU sold over 1.17 billion kilowatt-hours (kWh) to 42,495 electric customers this past year. That equates to an increase of 3.67% in sales over 2001, and an increase of 2.8% in customers. The peak electric demand was set on July 31 at 254.4 megawatts (MW).

Water sales amounted to 4.3 billion gallons, which is a decrease of 4.27% from 2001. Cooler-than-normal weather and a decrease in industrial water demand played a part in this water sales decrease. Water customers numbered 31,629 in 2002, a 3.7% increase over the previous year. Peak water pumpage, set on July 17, was 27.6 million gallons. Pumping capacity in a 24-hour period is 31.4 million gallons.

### OUTREACH AND EDUCATION

The value of a flourishing community is immeasurable, and RPU strives to be an active member of the community and a responsible citizen. RPU employees are also active community volunteers. Some activities our employees have participated in over the last year include Meals on Wheels, PossAbilities of Southern Minnesota, school and community electrical safety demonstrations, a Public Power Week open house, service clubs, local mentoring programs, and the Rochester Area Builders.

Once again, we participated in Olmsted County's United Way Campaign, as a department of the City of Rochester. RPU employees pledged \$16,500 this year, with nearly half of our employees participating. This money will go to work right here in our



*RPU employees visit Rochester third-grade classrooms to promote electrical safety.*

Teaming up with our community means ensuring we are able to provide an economically sound, environmentally feasible power supply plan, now and into the future. The installation of RPU's second

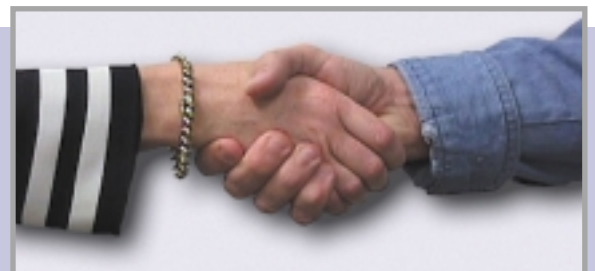
combustion turbine at the Cascade Creek Substation was completed this year and dedicated in May. Community and business leaders and employees celebrated the dedication on May 23 with a breakfast, a luncheon, and tours of the new facility. The new combustion turbine, similar to a jet engine, runs on natural gas or #2 fuel oil. On summer peak days, of which there were several, it allowed RPU to provide its own power over 216 MW, which is the contracted rate of delivery with our wholesale supplier. The summer peak of 2002 was 254.4 MW. On days when demand remained under 216 MW, we were able to fire up the turbine and sell capacity that was not required to serve our native load, so the turbine also serves as a source of revenue for RPU.

The new power supply source will be effective in serving our growing community. Construction in

## RPU: Timeline

1999  
"Keeping  
Our Pledge"

- We pledged to:*
1. Add value to our service,
  2. Listen to our customers,
  3. Get involved in our community,
  4. Protect the environment, and
  5. Continue delivering future value to our customers.





community, which makes our participation that much more exciting.

### NEIGHBORHOOD PROJECTS

A major project this year was completed that illustrates our commitment to being a responsible citizen of Rochester. We renovated the St. Marys water tower, which is no longer in service, but stands near the St. Marys Hospital campus as a historical landmark for our city. It required extensive exterior renovation, and the project included moving all contracted wireless communications equipment to the roof from a lower landing to improve tower aesthetics.

RPU also played a part in the beginning stages of Rochester's Cascade Lake project. The City of Rochester plans to expand Cascade Lake in northwest Rochester, and RPU relocated its 161 kV transmission lines out of the new lake footprint to provide better usage and nicer landscape for the development project. We worked with Public Works and the City Council to determine the most aesthetic alternative for re-routing the lines, while still keeping the project economical. The project was completed during the summer of 2002, and the area is now ready for the City to continue with the lake's expansion.

Work continued on our Wellhead Protection Program, which is an effort to protect the wells in Rochester so the drinking water remains clean and safe. By May of 2002, we had completed ground water modeling and identified the Drinking Water Supply Management Areas, which are both requirements of Phase 1 of this Minnesota Department of Health (MDH)-sponsored project. Phase 2 will pick up in 2003.



**2000**  
"Fueling a Dynamic  
Economy"

*We continued to  
improve the value of our  
services for customers. In  
2000, we made available  
the value-added services  
of Wind Power and  
Emergency Beacon.*

"My Emergency Beacon worked like a charm. I lived in a town home and had to call 911 for medical assistance. The police said seeing the flashing light cut about 5 minutes off their response time. It also attracted the Neighborhood Watch volunteers."

Frank Dapron, Rochester, MN



# with Industry Partners

## RPU: Teaming Up

*Jerry McCarthy, Austin Utilities General Manager*

*"The partnership of Austin, Owatonna, and Rochester has created an opportunity to use the talents and combined resources of each community to better serve our consumer-owners. Each community has brought something to the table that enhances the value of offerings while avoiding redundant planning and development cost associated with program development. As a result of this partnership, I believe we will be more creative and forward thinking as we jointly search for ways to serve our communities in the future."*

*-Tom Kuntz, Owatonna Public Utilities General Manager*

*"This association brought together three of the four largest electric municipal utilities in the State of Minnesota. One of the benefits is it allows us to unify our Conservation Improvement Programs (CIP) for all customers in Austin, Owatonna and Rochester. Forming the partnership allows the three municipalities to use and combine the marketing and technical expertise from all three utilities to increase the energy conservation benefits to all our customers."*

Customers in our Southeastern Minnesota community are like those across the country and around the world—they want products and services faster, better, and at a better price. Through customer surveys and interaction, our customers have told us they want more than a utility delivered to their business or home. They want help managing their energy and water—how to conserve or use wisely, and how to get the best value from it.

### UTILITY PARTNERSHIP

Not prompted by the slowing economy, but definitely as a testament to creative customer solutions during a difficult time, RPU joined together with two other municipal utilities to form a marketing partnership. Austin (Minn.) Utilities, Owatonna (Minn.) Public Utilities, and Rochester Public Utilities launched this partnership in February 2001. We will have a name for our partnership and begin building brand equity. For this year, we've focused on bringing value to the expanded customer base through products and services we offer, such as energy-efficiency incentives.

The three cities are located approximately 45 miles from each other in the southeast corner of Minnesota, allowing for in-person collaboration with minimal challenges. As the marketing staffs worked together to become a cohesive team, the individual account representatives formed sub-teams to handle accounts in all three cities. This sharing of personnel, expertise, and time was driven by the desire to provide more for our customers—the customers are able to receive more from their relationship with the utility, while the utilities maintain the same amount of staff.

Sharing personnel and being able to offer better customer service is only one benefit of this partnership for RPU. We also realize cost savings, in part due to sharing personnel, and also in some joint purchasing of items like promotional premiums and printing services.

A main driver behind the formation of this partnership was to leverage our Conservation Improvement Program (CIP) budget, which is mandated by the state. All municipalities in the state are required to spend 1.5% of gross electric revenue on conservation initiatives in their communities. At RPU, that amounted to \$1.2 million in 2002. Combined with Austin and Owatonna Utilities, approximately \$2 million in conservation money flowed back into our communities. By having three utilities sharing resources to get this money back into the hands of customers to help them conserve energy, we were able to successfully promote energy efficiency through offering incentives on ENERGY STAR® appliances. These cost-saving measures will help place downward pressure on rates into the future, which will help our customers prosper in their business- and home-life endeavors.

### INDUSTRY INTERACTION

As the industry continues to change, the RPU Board took positive action to be part of change here in our region. Late in 2002, an agreement was approved by the Board to join TRANSLink in the development of a new transmission company. This agreement will allow RPU to place its transmission system into the TRANSLink network and participate in the wholesale transmission business. Start-up of TRANSLink is planned for late 2003.

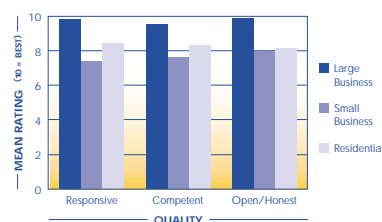
One of the most important teams at RPU is the one within our organization, the team of employees including management and staff. Throughout the past year, we've worked together to learn new problem solving techniques and realize the value of teamwork—which is especially important in our changing industry.

## RPU: Timeline

2001  
"Prepared to Serve"

*RPU Energy Solutions debuted in 2001. The partnership allows us to provide turnkey energy-efficient offerings to key account customers to help the conserve energy and remain prosperous. All customer classes reported high overall satisfaction with RPU, as determined by our most recent customer survey.*

CUSTOMER EVALUATION OF EMPLOYEE CONTACT





# with Employees

## RPU: Teaming Up

Teaming Up } 2002 Annual Report

RPU management has been working towards becoming more team oriented over the past year, which has challenged all employees, including managers, directors, and our general manager to think differently about how we do business at RPU. As we move toward customer choice, some characteristics historically inherent to municipal utilities, such as hierarchical communication and "regular" business hours, will not serve our customers to the level they are coming to expect.

Managers and various staff are regarded as leaders and experts in their areas or on a certain project. This dismantles the hierarchical order that is often inherent to municipal utilities. Employees at RPU have struggled with, challenged, and tested this new way of thinking. Processes are becoming smoother and more transparent to the customer while we work to make decisions closer to the customers and serve them more effectively and efficiently.

Moving to "the other side of the meter" is a main goal of our change. When we can make decisions closer to the customer, we will establish better communication and faster decision-making with better results. This results in those value-added services and our ability to be a customer's energy partner, which are requests customers have made of us through a recent customer survey.

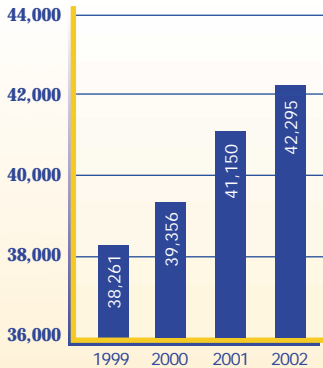
*General Manager Larry Koshire (left) celebrates the May 2002 dedication of Cascade Creek Gas Turbine #2 with Mark Elre, Burns and McDonnell; then-Mayor Chuck Canfield, and Utility Board President Richard Landwehr.*



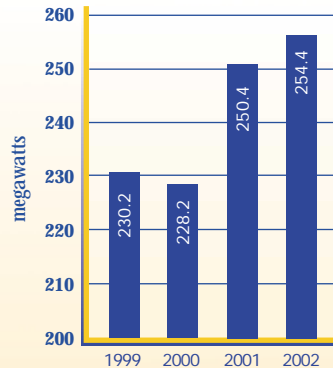
# 2002 Financial Statements

## Financial Highlights

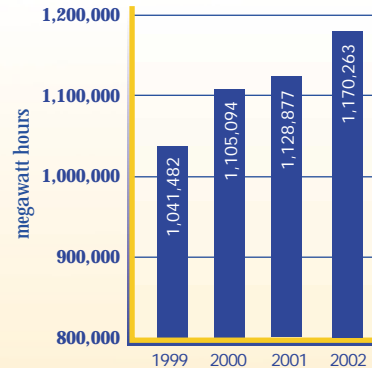
**Number of  
Electric Customers**



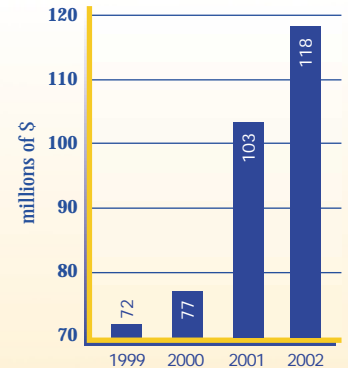
**Electric Peaks**



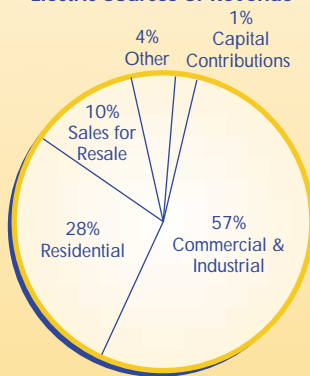
**Electric Sales**



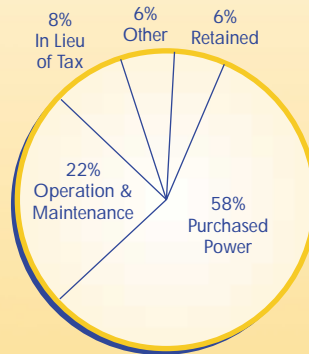
**Net Plant & Property  
Investment Electric Utility**



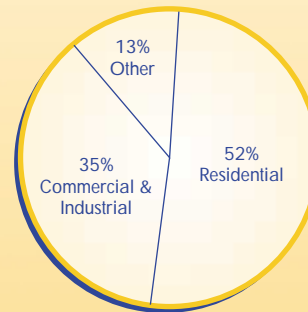
**Electric Sources of Revenue**



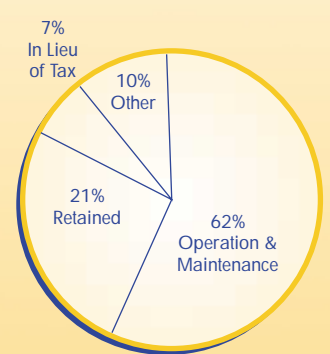
**Electric Uses of Revenue**



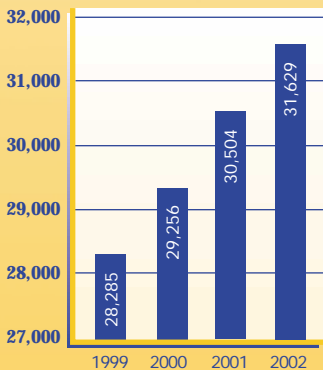
**Water Sources of Revenue**



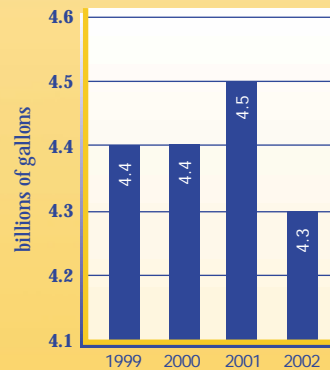
**Water Uses of Revenue**



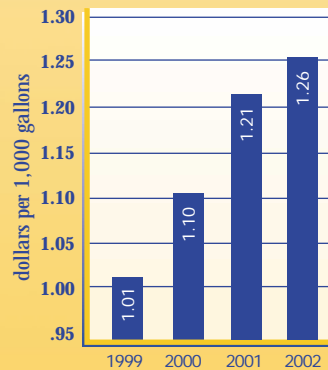
**Number of  
Water Customers**



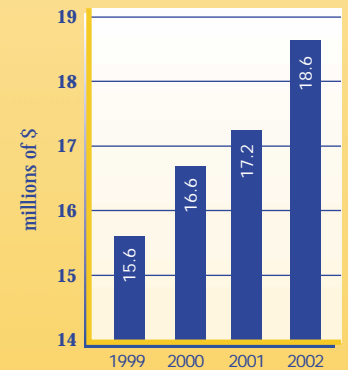
**Water Sales**



**Average Billing Rate  
per 1,000 gallons**



**Net Plant & Property  
Investment Water Utility**



# 2002 Financial Statements

## Consolidated Statements of Revenues, Expenses, and Changes in Net Assets

	Years Ended December 31	
	2002	2001
<b>Operating Revenues:</b>		
Electric	\$90,633,880	\$90,193,498
Water	5,707,107	5,701,579
Total Operating Revenues	96,340,987	95,895,077
<b>Operating Expenses:</b>		
Purchased Power	53,403,133	53,282,171
Operations and Maintenance	24,803,254	26,590,189
Depreciation	4,782,095	4,337,252
Total Operating Expenses	82,988,482	84,209,612
<b>Operating Income</b>	13,352,505	11,685,465
<b>Nonoperating Revenues (Expenses):</b>		
Investment Income	843,131	2,359,484
Interest Expense	(1,183,146)	(1,437,761)
Miscellaneous, Net	(673,191)	58,922
Total Nonoperating Revenues (Expenses)	(1,013,206)	980,645
<b>Income Before Transfers/Capital Contributions:</b>	12,339,299	12,666,110
Transfers Out	(6,998,633)	(6,836,990)
Capital Contributions	1,339,950	1,705,652
<b>Change in Net Assets</b>	6,680,616	7,534,772
Net Assets, Beginning of Year	112,072,949	104,538,177
Net Assets, End of Year	\$118,753,565	\$112,072,949

See Notes to Consolidated Financial Statements found on pages 15-19.



# 2002 Financial Statements

## Income by Segments of Business

<b>2002</b>	Electric	Water	Total
Operating Revenues	<b>\$90,633,880</b>	<b>\$5,707,107</b>	<b>\$96,340,987</b>
Operating Expenses	<b>78,725,261</b>	<b>4,263,221</b>	<b>82,988,482</b>
Operating Income	<b>11,908,619</b>	<b>1,443,886</b>	<b>13,352,505</b>
Nonoperating Income	<b>(1,094,290)</b>	<b>81,084</b>	<b>(1,013,206)</b>
Income Before Transfers/ Capital Contributions	<b>10,814,329</b>	<b>1,524,970</b>	<b>12,339,299</b>
Transfers Out	<b>(6,693,125)</b>	<b>(305,508)</b>	<b>(6,998,633)</b>
Capital Contributions	<b>1,339,950</b>		<b>1,339,950</b>
Change in Net Assets	<b>\$5,461,154</b>	<b>\$1,219,462</b>	<b>\$6,680,616</b>

<b>2001</b>	Electric	Water	Total
Operating Revenues	\$90,193,498	\$5,701,579	\$95,895,077
Operating Expenses	80,302,072	3,907,540	84,209,612
Operating Income	9,891,426	1,794,039	11,685,465
Nonoperating Income	898,728	81,917	980,645
Income Before Transfers/ Capital Contributions	10,790,154	1,875,956	12,666,110
Transfers Out	(6,515,743)	(321,247)	(6,836,990)
Capital Contributions	1,705,652		1,705,652
Change in Net Assets	\$5,980,063	\$1,554,709	\$7,534,772

See Notes to Consolidated Financial Statements found on pages 15-19.

# 2002 Financial Statements

## Consolidated Statements of Net Assets

	December 31	
	2002	2001
<b>ASSETS:</b>		
<b>Current Assets:</b>		
Cash and Cash Equivalents (Note 4)	\$13,119,843	\$12,071,058
Accounts Receivable and Accrued Utility Revenues	8,870,244	9,614,726
Fossil Fuel Inventory	1,417,664	3,067,697
Materials and Supplies Inventory	3,703,972	3,034,414
Other Current Assets	219,660	169,313
Total Current Assets	27,331,383	27,957,208
<b>Non-Current Assets:</b>		
<b>Restricted Cash and Cash Equivalents (Note 5)</b>		
Cash and Cash Equivalents	12,392,111	13,786,532
Amounts Held in Escrow	286,658	825,198
Total Restricted Cash and Cash Equivalents	12,678,769	14,611,730
<b>Deferred Charges</b>		
Unamortized Bond Issuance Costs (Note 6)	583,763	454,026
Other	45,375	38,440
Total Deferred Charges	629,138	492,466
<b>Capital Assets</b>		
Construction Work in Progress	10,922,549	34,053,685
Depreciable Assets, Net (Note 7)		
Electric	110,191,605	72,091,223
Water	16,714,424	15,065,747
Net Capital Assets	137,828,578	121,210,655
Total Non-Current Assets	151,136,485	136,314,851
Total Assets	\$178,467,868	\$164,272,059
<b>LIABILITIES:</b>		
<b>Current Liabilities:</b>		
Accounts Payable	\$6,498,773	\$9,047,485
Due to Other Funds	1,344,889	1,956,703
Accrued Compensated Absences	1,732,647	1,175,166
Customer Deposits	261,017	270,133
Interest Payable	337,191	165,219
Current Maturities of Long-Term Debt (Note 6)	1,275,000	800,000
Construction Advance (Note 11)		841,745
Deferred Credits	247,386	100,287
Total Current Liabilities	11,696,903	14,356,738
<b>Non-Current Liabilities:</b>		
Accrued Compensated Absences	819,400	627,716
Accrued Claims	190,000	222,000
Notes Payable (Note 6)		200,000
Revenue Bonds Payable		
(net of unamortized discount) (Note 6)	46,014,845	35,763,081
Unearned Lease Revenues	993,155	1,029,575
Total Non-Current Liabilities	48,017,400	37,842,372
Commitments and Contingencies (Note 11)		
Total Liabilities	\$59,714,303	\$52,199,110
<b>NET ASSETS:</b>		
Invested in Capital Assets, Net of Related Debt	\$102,930,846	\$98,234,108
Restricted (Note 5)	286,658	825,198
Unrestricted Net Assets	15,536,061	13,013,643
Total Net Assets	\$118,753,565	\$112,072,949

See Notes to Consolidated Financial Statements found on pages 15-19.

# 2002 Financial Statements

## Consolidated Statements of Cash Flows

	Years Ended December 31	
	2002	2001
<b>Cash Flows From Operating Activities:</b>		
Cash Received from Customers	\$92,321,244	\$92,492,013
Cash Paid to Suppliers and Employees	(76,473,431)	(82,735,498)
Internal Activity-Payments from Other Funds	3,632,489	3,448,362
Net Cash Provided By Operating Activities	19,480,302	13,204,877
<b>Cash Flows from Noncapital Financing Activities:</b>		
Operating Transfers to Other Funds	(7,032,180)	(6,859,673)
<b>Cash Flows from Capital and Related Financing Activities:</b>		
Proceeds from Issuance of Revenue Bonds	11,194,853	
Capital Contributions	1,339,950	1,705,652
Additions to Utility Plant and Other Assets	(23,437,626)	(27,743,134)
Facilities and Service Territory Acquisition	(512,634)	(369,218)
Payments on Bonds and Notes Payable Obligations	(2,578,835)	(2,763,901)
Issuance Costs of Revenue Bonds	(129,737)	25,275
Net Cash (Used In) Capital and Related Financing Activities	(14,124,029)	(29,145,326)
<b>Cash Flows From Investing Activities:</b>		
Interest Received	791,732	2,265,832
Service Territory Escrow Payments	(256,121)	(691,566)
Funds Released From Service Territory Escrow	794,660	902,736
Net Cash Provided By Investing Activities	1,330,271	2,477,002
Net (Decrease) in Cash and Cash Equivalents	(345,636)	(20,323,120)
<b>Cash and Cash Equivalents, Beginning of Year</b>	<b>25,857,590</b>	<b>46,180,710</b>
<b>Cash and Cash Equivalents, End of Year</b>	<b>\$25,511,954</b>	<b>\$25,857,590</b>
<b>Classified As:</b>		
Current Assets	\$13,119,843	\$12,071,058
Restricted Assets	12,392,111	13,786,532
<b>Total Cash and Cash Equivalents, End of Year</b>	<b>\$25,511,954</b>	<b>\$25,857,590</b>
<b>Reconciliation of Operating Income to Net Cash Provided by Operating Activities</b>		
Operating Income	\$13,352,505	\$11,685,465
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities		
Depreciation	4,782,095	4,337,252
Other	268,916	593,159
(Increase) Decrease in:		
Accounts Receivable and Accrued Utility Revenues	244,138	1,054,223
Inventories	980,475	(2,554,278)
Prepaid and Other Current Assets	(3,140)	(12,407)
Increase (Decrease) in:		
Accrued Liabilities and Accounts Payable	595,495	(2,708,043)
Customer Deposits	(9,116)	14,370
Unearned Lease Revenues	(36,420)	(36,420)
Other	(694,646)	831,556
<b>Net Cash Provided by Operating Activities</b>	<b>\$19,480,302</b>	<b>\$13,204,877</b>

See Notes to Consolidated Financial Statements found on pages 15-19.

# 2002 Financial Statements

## Notes to Consolidated Financial Statements

### NOTE 1: ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Organization and Accounting Method

Rochester Public Utilities is comprised of two proprietary funds, the Electric and Water Enterprise Funds of the City of Rochester, Minnesota. Activities are accounted for using the flow of economic resources measurement focus and the accrual basis of accounting. The utility prepares its fund-basis financial statements as a business-type activity in conformity with the applicable pronouncements of the Governmental Accounting Standards Board (GASB). Pursuant to GASB Statement No. 20, the utility has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) that were issued on or before November 30, 1989, to the extent they do not conflict with or contradict GASB pronouncements. Interfund transactions are not eliminated for purposes of the consolidated financial statements.

#### Revenues

Meters are read through a series of monthly cycles. Accounts are billed based on a combination of fixed charges and charges for actual usage. Utility tariffs for electric service include a purchased power adjustment, under which electric rates charged to customers are adjusted to reflect changes in purchased power costs. Other activities are billed according to contractual arrangements and fees, or fees for services provided. Utility revenues are recognized on the accrual basis of accounting and include estimated amounts for service rendered but not billed.

#### Accounts Receivable

The utility provides an allowance for losses on receivables, as needed, for accounts considered uncollectible.

#### Property, Depreciation and Amortization

Electric and water property is recorded at original cost. Additions to utility plant and significant replacements are recorded at cost. Cost includes components of labor, materials and overhead. Depreciation expense is recorded using the straight-line method over the expected useful life of the property, which ranges from five years to seventy-five years. Purchased service territory rights are amortized over a forty-year period on a straight-line basis.

#### Contributions in Lieu of Taxes

Contributions in Lieu of Taxes are paid by the utility to the General Fund of the City of Rochester based upon the monthly commodity sales billed by the electric and water utilities, and are reported as Transfers Out in the Statement of Revenues, Expenses and Changes in Net Assets.

#### Inventories

Inventories consist of materials, supplies, and fossil fuels used in utility operations. Materials and supplies inventory is valued at a moving average cost or market. Fossil fuel inventory is valued at cost, using the last-in, first-out method.

#### Compensated Absence Benefits

Vacation pay, which is payable upon termination, is accrued as it is earned by employees.

The utility's sick leave liability is estimated based on the utility's past experience of making termination payments for sick leave. Employees are compensated upon termination for one-third of their unused sick leave, after meeting certain qualifications.

#### Amortization of Bond Issuance Costs and Bond Discount

Bond issuance costs, bond discount and bond premium are amortized over the terms of the related bond issues using the interest method.

#### Taxes

In accordance with certain provisions of the United States Internal Revenue Code and related federal and state governing laws and regulations, the utility is exempt from federal and state income taxes and local property taxes.

#### Use of Estimates

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the period. Actual results could differ from the estimates.

### **Reclassifications**

Certain reclassifications have been made to the 2001 financial statements to conform to the 2002 presentation.

### **Concentration of Credit Risk**

Financial instruments that expose the utility to a concentration of credit risk consist primarily of cash equivalents and accounts receivable.

Cash equivalents are primarily comprised of the utility's equity in the City of Rochester cash and investment pool. Credit risk factors associated with the cash and investment pool are disclosed in Note 4.

The utility's accounts receivable are generally due from a large number of residential and business retail customers who are concentrated geographically in or near the City of Rochester.

### **NOTE 2: ADOPTION OF NEW ACCOUNTING STANDARD**

In 1999, GASB issued Statement No. 34, Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments, as subsequently amended or affected by GASB Statements No. 37 and 38. The utility adopted the new standard in 2002 by retroactively restating the prior year financial statements. While not changing previously reported net assets, the adoption of these new standards resulted in changes in the form and content of the financial statements.

### **NOTE 3: REVENUES**

Revenue, consisting primarily of billings to customers for utility services, includes accrued utility revenue amounts of \$3,164,507 and \$3,936,118 for the years ended December 31, 2002 and 2001, respectively.

Sales to the utility's single largest customer were \$9,005,637 and \$8,279,778 in 2002 and 2001, respectively. During the year ended December 31, 2002, no other customer accounted for more than 10% of operating revenues. Sales to other funds of the City of Rochester were \$2,883,406 and \$2,756,436 for the years ended December 31, 2002 and 2001, respectively.

### **NOTE 4: CASH AND CASH EQUIVALENTS**

The utility considers all temporary cash investments, including the utility's equity in the City of Rochester investment pool, to be cash and cash equivalents. Generally, cash equivalents are highly liquid investments. The majority of the utility's cash and cash equivalents are held in the City of Rochester cash and investment pool.

All deposits are insured or collateralized by securities held by the City of Rochester or its agents in the City's name.

The utility's equity in the City of Rochester cash and investment pool is based on actual cash receipts and disbursements and a monthly allocation of investment earnings on a pro-rata basis.

Investments held in the investment pool are disclosed in the notes to the City of Rochester's basic financial statements included in the City's 2002 Comprehensive Annual Financial Statement by credit risk category, which gives an indication of the level of credit risk assumed by the City of Rochester.

### **NOTE 5: RESTRICTED ASSETS**

#### **Restricted Cash and Cash Equivalents**

In 2002, the electric utility issued revenue bonds to fund improvements of the distribution system, and in 2000, the electric utility issued revenue bonds to fund the construction of a new gas turbine generator and improvements to the electric utility's transmission and distribution system. Provisions of the revenue bonds require that the electric utility fund a debt service account in an amount equal to the following year's bond principal and interest payments at least by the date the debt service payments are due each year. In addition to the debt service account, bond provisions require that \$3,517,468 of the bond proceeds be deposited in a reserve account to be used to pay bond principal and interest payments if funds in the debt service account are insufficient.

Under the terms of the revenue bonds, the bond proceeds, net of accrued interest, bond discount, and the reserve requirement, were deposited into a Construction Account to pay all construction-related costs. Any funds remaining after the payment of these costs must be transferred to the debt service account.



Restricted Cash and Cash Equivalents are summarized as follows:

	<u>2002</u>	<u>2001</u>
Debt Service Account	\$ 127,148	\$
Reserve Account	3,517,468	2,471,688
Construction Account	8,747,495	11,314,844
Total	<u>\$ 12,392,111</u>	<u>\$ 13,786,532</u>

#### Restricted Amounts Held in Escrow

In accordance with a territorial rights agreement with People's Cooperative Services, the utility deposits funds in an escrow account managed by a fiscal agent upon annexation of areas in service territories assigned to People's Cooperative Services. Upon agreement of compensation for the transfer of the service territory rights to the utility, the funds in escrow are returned to the utility. The service territory escrow fund totaled \$286,658 and \$825,198 at December 31, 2002 and 2001, respectively.

#### NOTE 6: LONG-TERM DEBT

At December 31, 2002 and 2001, long-term debt consisted of the following:

	<u>2002</u>	<u>2001</u>
Revenue Bonds, Series 2002A, 3.00% - 4.50%, due December 1, 2003 to 2017	\$ 11,275,000	
Revenue Bonds, Series 2000A, 4.75% - 5.25%, due December 1, 2001 to 2030	36,115,000	\$ 36,715,000
Less: Unamortized premium	446,139	430,172
Plus: Unamortized premium	145,984	78,253
Note payable, due in annual installments of \$200,000 plus interest at 5.56% through July, 2003	200,000	400,000
Less: Current Maturities	1,275,000	800,000
TOTAL	<u>\$ 46,014,845</u>	<u>\$ 35,963,081</u>

The revenue bonds are secured by all funds and revenues of the utility derived from the ownership and operation of its electric utility system. The bond issuance costs, bond discount and bond premium are amortized over the terms of the bond issues.

The annual requirements to amortize all debt outstanding as of December 31, 2002, including interest payments of \$37,127,707 are as follows:

	<u>Revenue Bonds</u>	<u>Notes Payable</u>
2003	\$ 3,488,746	\$ 211,120
2004	3,492,219	
2005	3,487,719	
2006	3,491,344	
2007	3,487,706	
Thereafter	67,058,853	
Total	<u>\$ 84,506,587</u>	<u>\$ 211,120</u>

#### NOTE 7: CAPITAL ASSETS

Major classes of property and total accumulated depreciation as of December 31, 2002 and 2001 are as follows:

	<u>2002</u>	<u>2001</u>
Intangible Plant Assets	\$ 5,596,560	\$ 5,066,940
Land and Land Rights	1,994,774	1,994,774
Buildings, Structures, and Improvements	19,047,461	17,874,976
Installations, Equipment, & Fixtures	178,491,080	141,427,494
Total Depreciable Assets	205,129,875	166,364,184
Less: Accumulated Depreciation	78,223,846	79,207,214
Net Depreciable Assets	<u>\$ 126,906,029</u>	<u>\$ 87,156,970</u>

#### NOTE 8: SOUTHERN MINNESOTA MUNICIPAL POWER AGENCY

The utility is a voting member of the Southern Minnesota Municipal Power Agency (SMMPA). The utility has entered into a power purchase contract with SMMPA, whereby SMMPA will provide all utility power requirements up to 216 megawatts, the contract rate of delivery. This contract expires in the year 2030. In 1999, the utility and SMMPA agreed to a contract rate of delivery (CROD) that began in 2000. The CROD caps the amount of power SMMPA must supply to the utility under the power purchase contract. The utility is responsible for acquiring its power needs above the CROD. The utility purchased 1,178,592,804 and 1,150,363,413 kilowatt hours, totaling \$54,405,121 and \$53,824,961 from SMMPA during the years ended December 31, 2002 and 2001, respectively.

The utility was reimbursed \$2,101,039 and \$2,131,594 for the years ended December 31, 2002 and 2001, respectively, for its share of previous SMMPA charges. These reimbursed charges are reported as offsets to purchased power costs.

The utility had an agreement with SMMPA through November 2014 for the use and availability of the utility's combustion turbine generating capacity. Under the terms of this agreement, the utility was paid a fixed fee for providing the availability of generating capacity and was reimbursed for the fuel-related costs of generating power. The agreement was terminated on the earliest termination date of April 1, 2001.

Activity under this agreement for the year ended December 31, 2001, was as follows:

	<u>2001</u>
kWh provided	1,186,000
Payments for availability	\$ 123,090
Reimbursed generation costs	\$ 367,085

The utility leases a portion of its electrical transmission system, known as the North Loop, to SMMPA under a non-cancelable operating lease through the year 2030. The utility is responsible for all operating and maintenance costs. The utility received a lump sum payment of \$1,500,000 in 1989 and lease revenues are being recognized ratably over the lease term.

#### **NOTE 9: PENSION PLANS**

The utility participates in a statewide retirement plan administered by the Public Employees Retirement Association (PERA) of Minnesota. PERA administers the Public Employees Retirement Fund (PERF), which is a cost sharing, multiple employer retirement plan. PERA provides retirement benefits as well as disability benefits to members and benefits to survivors, upon death of eligible members. Benefits and annual contributions are established by State statute. Total required contributions made during the year ended December 31, 2002, were \$1,195,235, of which \$623,707 were made by the utility and \$571,528 were made by the employees.

PERA does not make separate measurements of assets and pension benefit obligations for individual employers participating in the plan. PERA issues a publicly available financial report that includes financial statements and required supplementary information for PERF. The report may be obtained by writing to PERA, 60 Empire Dr. # 200, St. Paul, Minnesota 55103-2088 or by calling (651) 296-7460 or 1-800-652-9026.

The utility had maintained an unqualified supplemental pension plan. The plan was unfunded and discontinued in 1968. Funds have been deposited with a plan administrator to fund the estimated benefits due under the plan. The pension reserve deposit as of December 31, 2002 and 2001, was \$135,812 and \$145,631, respectively. Payments under the plan for 2002 and 2001 were \$19,520 and \$21,775, respectively.

#### **NOTE 10: LEGAL MATTERS**

The utility continues to pursue the acquisition of certain electric service rights from People's Cooperative Services, a rural utility system. At times this involves proceedings before the Minnesota Public Utilities Commission and the Minnesota courts, and negotiation of various settlement agreements with People's Cooperative Services.

#### **NOTE 11: COMMITMENTS AND CONTINGENCIES**

##### **Risk Management Program**

The City of Rochester has established a self-insurance program for group health coverage and workers' compensation. Rochester Public Utilities participates in this self-insurance program. The group health program is limited to losses of \$225,000 per claim with a variable annual aggregate, and the workers' compensation coverage is limited to \$700,000 per occurrence, both through the use of stop-loss policies. The City recognizes a liability on individual claims when a loss is probable, and the amount can be reasonably estimated. In addition, the City recognizes an estimated liability on unreported claims that are incurred but not yet reported. The utility recognized an estimated liability for workers' compensation claims of \$60,000 at December 31, 2002 and 2001. No actuarial studies have been performed by independent actuaries.

##### **Power Sales Agreement**

The utility has entered into an agreement with the Minnesota Municipal Power Agency (MMPA) to sell a maximum 100 megawatts of power annually from its Silver Lake Plant to MMPA at a fixed rate. Under the terms of the agreement, the utility is paid a fixed fee for providing the availability of generating capacity and is reimbursed for the fuel-related costs of generating power.

Activity under this agreement for the years ended December 31, 2002 and 2001, was as follows:

	<b>2002</b>	<b>2001</b>
kWh provided	64,537,000	252,673,000
Payments for availability	\$ 4,509,660	\$ 4,395,420
Reimbursed generation costs	\$ 1,902,273	\$ 7,068,708

### **Service Territory Settlements**

In connection with the acquisitions of certain electric service rights from People's Cooperative Services (PCS), the utility is required to make payments to PCS based upon the amount of electricity sold in specific territories over a ten-year term. The payment varies by each settlement agreement and ranges from 5.7 mills (tenths of a cent) per kWh to 14.5 mills per kWh. These commitments expire over periods from 2004 to 2012. Costs are recognized under these agreements as service is provided.

### **Construction Advance**

Under the requirements of a merger filing by Xcel Energy with the Federal Energy Regulatory Commission (FERC), the utility received \$1,870,000 during the year ended December 31, 2000, from Northern States Power (NSP), a wholly owned subsidiary of Xcel Energy. These funds were used to upgrade certain portions of the utility's transmission system. NSP was also responsible for 50% of any upgrade costs incurred by the utility in excess of the \$1,870,000. The utility deferred revenue recognition from this construction advance until related construction costs were incurred. Total revenue recognized was \$841,745 and \$1,028,255 for the years ended December 31, 2002 and 2001, respectively.

# Report of Independent Auditors

To the Public Utility Board  
City of Rochester, Minnesota

We have audited the consolidated statements of net assets of Rochester Public Utilities as of December 31, 2002 and 2001 and the related consolidated statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of Rochester Public Utilities' management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

As discussed more fully in Note 1, the consolidated financial statements present only the Electric and Water Funds and are not intended to present fairly the financial position of the City of Rochester and the results of its operations and the cash flows of its proprietary and similar trust fund types in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the fund-basis financial statements referred to above present fairly, in all material respects, the financial position of Rochester Public Utilities as of December 31, 2002 and 2001, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 2 to the fund-basis financial statements, the utility adopted the provisions of Governmental Accounting Standards Board Statement No. 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments, and Statement No. 37, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus, as of January 1, 2001. This results in a change in the format and content of the financial statements.

*Smith, Schafer and Associates, Ltd.*

Smith, Schafer and Associates, Ltd.  
Certified Public Accountants  
February 20, 2003  
Rochester, Minnesota

## Teaming Up





Teaming Up

Teaming Up