

**NEW MEXICO MUNICIPAL
ENERGY ACQUISITION AUTHORITY
Year Ended June 30, 2010**

INTRODUCTORY SECTION

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**NEW MEXICO MUNICIPAL
ENERGY ACQUISITION AUTHORITY
List of Principal Officials
June 30, 2010**

<u>Name</u>	<u>Title</u>
Lance Allgood	Chairperson
Jorge Garcia	Vice Chairperson
Gerald Herrera	Secretary
Maude Grantham-Richards.....	Member
Jay Burnham	Member
John Arrowsmith	Member
Susan Nipper	Financial Analyst

FINANCIAL SECTION

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INDEPENDENT AUDITOR'S REPORT

State Auditor and the Board Members
New Mexico Municipal Energy Acquisition Authority
Farmington, New Mexico

We have audited the accompanying financial statements of the business-type activities of New Mexico Municipal Energy Acquisition Authority (NMMEAA) as of and for the year ended June 30, 2010, as listed in the table of contents. These financial statements are the responsibility of NMMEAA'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 NMMEAA as of June 30, 2010, and the respective changes in financial position and cash flows 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 January 11, 2011 on our consideration of NMMEAA's internal control over financial reporting and on our tests of its 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.

Management's discussion and analysis, on pages vii through x, is not a required part of the basic financial statements but is supplementary information required by the Government Accounting Standards Board. We have applied certain limited procedures, which consisted primarily 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.

A handwritten signature in black ink that reads "David Berry, CPA, PC". The signature is written in a cursive style with a large initial 'D' and 'B'.

Farmington, New Mexico
January 11, 2011

Management's Discussion and Analysis

Management's Discussion and Analysis of the New Mexico Municipal Energy Acquisition Authority (NMMEAA) financial performance provides an overview of NMMEAA's financial activities for the year ended June 30, 2010. Please read this information in conjunction with the accompanying financial highlights, the basic financial statements and the accompanying notes to the financial statements.

NMMEAA was created June 19, 2008 through a Joint Powers Agreement organized pursuant to the laws of the State of New Mexico between the City of Las Cruces and the City of Gallup for the purpose of obtaining a reliable long-term supply of natural gas under favorable terms, conditions and prices to benefit government-owned utilities and their retail customers. The City of Farmington, the City of Las Cruces and the Incorporated County of Los Alamos have 30 year gas supply agreements with NMMEAA, with the gas furnished through a prepaid gas purchase and sale contract with Royal Bank of Canada (RBC).

On November 19, 2009 \$780,965,000 of New Mexico Municipal Energy Acquisition Authority Gas Supply Variable Rate Revenue Bonds, Series 2009 were issued to provide a lump sum payment to RBC for the prepaid gas contract. A total quantity of 171,322,165 MMBtu of natural gas will be delivered at designated delivery points and specified daily quantities over a period of 30 years to NMMEAA under the terms of the prepaid agreement.

Financial Analysis

The following condensed financial statements summarize NMMEAA's financial position and operating results for the period ended June 30, 2010.

New Mexico Municipal Energy Acquisition Authority Net Assets

	FY2010
Current assets	\$ 53,994,896
Noncurrent assets	850,634,312
Total assets	<u>904,629,208</u>
Current liabilities	9,911,844
Noncurrent liabilities	894,612,927
Total liabilities	<u>904,524,771</u>
Unrestricted net assets	<u>104,437</u>
Total net assets	<u>\$ 104,437</u>

Condensed Statement of Revenues, Expenses and Changes in Net Assets
Year ended June 30, 2010

Operating revenues	\$	18,034,835
Operating expenses		19,589,088
Operating income		(1,554,253)
Nonoperating revenues (expenses)		
Investment earnings		5,633
Net costs to be recovered in future periods		18,000,000
Commodity swap		317,849
Interest rate swaps		(15,285,370)
Interest expense bondholders		(1,258,103)
Amortization expense		(121,319)
Total nonoperating revenues (expenses)		1,658,690
Change in net assets		104,437
Total net assets-beginning		-
Total net assets-ending	\$	104,437

2010 Financial Highlights

Statement of Net Assets:

Total assets and liabilities result from the issuance of revenue bonds and the purchase of a prepaid gas contract. Derivative financial instruments necessary to make the transaction possible are shown at their fair value as of June 30, 2010. Since the derivatives effectively reduced the risk of a decrease in cash flow the annual changes in fair values were deferred.

Operating Revenues:

Operating revenues result from gas deliveries beginning in October 2009. These revenues are based on a specified index less a discount from such price, plus a premium. The discount is allowed only if the bond indenture required primary rate stabilization reserve is met each month.

Operating Expenses:

Operating expenses consist primarily of the amortization of the prepaid gas supply. Various administrative expenses account for the remainder of FY2010 operating expenses.

Nonoperating Revenues and Expenses:

Income from the commodity swap contract and interest on investments comprise the nonoperating revenue. Interest expense from an interest rate swap accounts for most of the nonoperating expense. Other nonoperating expenses include a net cost to be recovered in future periods. Under SFAS 71, certain income and expense items are deferred and not included in the determination of net income until such costs are recoverable.

General Trends and Significant Events

Recent changes in U.S. Treasury regulations and U.S. Tax code has allowed government-owned utilities to issue tax-exempt bonds to pre-pay for natural gas supplies to secure stable, lower priced natural gas for use by retail customers or for the generation of electricity which is then sold to retail customers. In 2008 negative economic events began to occur in the U.S. which hurt the financial standing of large financial institutions. This was followed by a drop in natural gas prices in 2009, which had been at record highs. Long term pre-paid gas contracts reduce the volatility of the natural gas market.

In November, 2009 NMMEAA issued tax exempt bonds to purchase a 30 year prepaid supply of natural gas. In connection with the purchase of the gas supply, NMMEAA entered into a commodity swap agreement to convert the floating, market-referenced revenues received from gas supply agreements to a fixed revenue stream for the entire gas supply delivered under the prepaid gas agreement. The commodity swap counterparty during fiscal year 2010 was BP Corporation North America (BPCNA). The term of the commodity swap agreement is the same term as the prepaid gas agreement and covers the same period and gas delivery points. The commodity swap counterparty had to maintain a credit rating of at least A1 by Moody's or post collateral according to the trust indenture. Due to a downgrade by Moody's of BPCNA to Baa1 from Aa3 on June 18, 2010 caused by the impact from the oil spill in the Gulf of New Mexico, BP had to post collateral with NMMEAA. Since the credit rating did not meet the required minimum of the indenture, effective July 1, 2010 BPCNA was replaced by J.P. Morgan Chase Bank NA as the commodity swap counterparty.

NMMEAA also entered into an interest rate swap agreement covering two transactions with RBC to hedge interest rate fluctuations on the bonds and to more closely match payment obligations on the bonds with revenues from the supply agreements and the commodity swap agreement.

Summary of the Financial Statements

The financial statements, related notes and management's discussion and analysis provide information about NMMEAA's financial position and activities as of June 30, 2010. The statement of net assets presents assets, liabilities and net assets; the statement of revenues, expenses and changes in net assets present operating results and change in net assets; and the statement of cash flows shows sources and uses of cash during the year. The notes to the financial statements provide additional disclosures and information essential to a full understanding of the data provided in the statements.

Report of Management

NMMEAA has prepared and is responsible for the financial statements and related information included in this report. Management believes that its policies and procedures provide guidance and reasonable assurance that NMMEAA's operations are conducted according to management's intentions within an ethical framework. In management's opinion, the financial statements present fairly, in all material respects, the financial position, results of operations and cash flows of NMMEAA in conformity with accounting principles generally accepted in the United States of America. Questions regarding this report or for additional information should be addressed to the manager of NMMEAA, the City of Farmington, at the address shown below.

The City of Farmington
101 N. Browning Parkway
Farmington, NM 87401-7995
505-599-8311

BASIC FINANCIAL STATEMENTS

New Mexico Municipal Energy Acquisition Authority
Statement of Net Assets
June 30, 2010

ASSETS:

Current assets:

Cash and cash equivalents	\$ 4,956,068
Receivables	2,522,782
Restricted cash and cash equivalents	16,505,426
Prepaid gas supply, current	24,696,348
Derivative financial instruments maturing within one year	5,314,272
Total current assets	53,994,896

Noncurrent assets:

Prepaid gas supply, long-term	711,228,535
Deferred bond issue costs	7,157,850
Costs recoverable from future billings	18,000,000
Derivative financial instruments, long-term	114,247,927
Total noncurrent assets	850,634,312
Total assets	\$ 904,629,208

LIABILITIES:

Current liabilities:

Accounts payable	\$ 198,931
Accrued interest payable	2,998,641
Current maturities of long-term debt	600,000
Collateral	800,000
Deferred inflows - derivatives maturing within one year	5,314,272
Total current liabilities	9,911,844

Noncurrent liabilities:

Deferred inflows - derivative financial instruments	114,247,927
Long-term debt, net of current maturities	780,365,000
Total noncurrent liabilities	894,612,927
Total liabilities	904,524,771

NET ASSETS:

Unrestricted net assets	104,437
Total net assets	\$ 104,437

See notes to financial statements.

New Mexico Municipal Energy Acquisition Authority
Statement of Revenues, Expenses and Changes in Net Assets
For the Year Ended June 30, 2010

Operating revenues:	
Gas supply agreement income	<u>\$ 18,034,835</u>
Operating expenses:	
Cost of gas sold	18,919,976
Gas service administration expense	12,673
Trustee expense	15,619
Rating agency expense	6,500
Liquid facility expense	246,128
Remarketing agency expense	383,992
Management fee expense	4,200
Total operating expenses	<u>19,589,088</u>
Operating income (loss)	<u>(1,554,253)</u>
Nonoperating revenues(expenses):	
Investment income	5,633
Net costs to be recovered in future periods	18,000,000
Commodity swap	317,849
Interest rate swaps:	
Transaction I swap-fixed 4.1871%	(20,164,868)
Transaction I swap-actual variable rate	1,258,103
Transaction II swap-80% 1 mth LIBOR+80.74bp	3,621,395
Total interest rate swap expense	<u>(15,285,370)</u>
Interest expense to bondholders	(1,258,103)
Amortization of debt issue costs	(121,319)
Total nonoperating expenses	<u>1,658,690</u>
Change in net assets	<u>104,437</u>
Net assets-beginning	-
Net assets-ending	<u>\$ 104,437</u>

See notes to financial statements.

New Mexico Municipal Energy Acquisition Authority
Statement of Cash Flows
For the Year Ended June 30, 2010

Cash flows from operating activities

Receipts from customers/users	\$ 17,442,513
Payments to other suppliers of goods and services	(470,180)
Payment to gas supplier	<u>(754,844,860)</u>
Net cash provided (used) by operating activities	<u><u>(737,872,527)</u></u>

Cash flows from noncapital financing activities

Proceeds from issuance long-term debt	780,965,000
Payment of bond issue costs	(7,279,169)
Interest paid	<u>(14,242,580)</u>
Net cash provided (used) by noncapital financing activities	<u>759,443,251</u>

Cash flows from investing activities

Investment income	5,633
Purchases of investments	<u>(114,863)</u>
Net cash provided (used) by investing activities	<u>(109,230)</u>

Net increase in cash and cash equivalents 21,461,494

Cash and cash equivalents, July 1, 2009 -

Cash and cash equivalents, June 30, 2010 \$ 21,461,494

Reconciliation of operating income to net cash provided (used) by operating activities

Operating income (loss)	\$ (1,554,253)
Changes in operating assets and liabilities	
Receivables - gas supply agreement	(1,392,322)
Collateral received	800,000
Prepaid gas supply	(735,924,883)
Accounts payable	198,931
Net cash provided (used) by operating activities	<u><u>\$ (737,872,527)</u></u>

See notes to financial statements.

New Mexico Municipal Energy Acquisition Authority
Notes to Financial Statements
June 30, 2010

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

Nature of Operations

New Mexico Municipal Energy Acquisition Authority (NMMEAA) was established in 2008 through a joint powers agreement to acquire long-term energy supplies by the City of Las Cruces, NM and the City of Gallup, NM. Both cities are New Mexico charter municipalities with municipal home-rule powers created and existing pursuant to the Constitution and laws of the State of New Mexico. NMMEAA was formed to:

- Purchase natural gas to be furnished to retail gas customers within the gas service area of the City of Las Cruces for purposes other than electric generation, or for sale to another municipal or governmentally-owned utility to be furnished to retail gas customers within such utility's natural gas service area for purpose other than electric generation;
- Purchase natural gas to be used to produce electricity to be furnished to retail customers with the electricity service area of the City of Gallup, or for sale to another municipal or governmentally-owned utility to be used to produce electricity to be furnished to retail customers within such utility's electric service area for such use;
- Purchase electricity for distribution and sale of electricity for distribution and sale of electricity by the City of Gallup to its retail customers and to other municipal or governmentally-owned electric utilities for such use; and
- Finance the cost of purchasing natural gas or electricity through the issuance of revenue bonds secured by natural gas supply and related contracts and/or electricity supply and related contracts ("Supply contracts) and revenues received pursuant to such Supply Contracts and other contracts.

Beginning in October 2009, NMMEAA began selling natural gas to the City of Farmington, NM, and in November 2009 to the City of Las Cruces, NM and the Incorporated County of Los Alamos, NM through long-term gas supply contracts. Proceeds received from issuing New Mexico Municipal Energy Acquisition Authority Gas Supply Variable Rate Revenue Bonds, Series 2009 were used to purchase a long-term prepaid gas supply for these contracts.

Reporting Entity

In evaluating how to define a governmental entity, for financial reporting purposes, management must consider all potential component units for which financial accountability may exist. The determination of financial accountability pursuant to Governmental Accounting Standards Board (GASB 14, *The Financial Reporting Entity* and GASB No. 39,

Determining Whether Certain Organizations are Component Units includes consideration of a number of criteria, including: (1) the ability to appoint a voting majority of another entity's governing body and to impose its will on that entity, (2) the potential for that entity to provide specific financial benefits to or impose specific financial burdens on others, and (3) the entity's fiscal dependency on others. NMMEAA has determined that it has no reportable component units.

Accounting Method

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

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

Use of Estimates

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

Cash and Cash Equivalents

NMMEAA considers all highly liquid investments with original maturities of three months or less at the time of purchase to be cash and cash equivalents. At June 30, 2010, cash and cash equivalents consisted of money market mutual funds invested in government securities and US Treasury Bills.

Investments

Interest rate swaps with financial services companies are carried at contract value. Investment income consists of interest income. Investments for NMMEAA are reported at fair value.

Receivables

Receivables are stated at the amount billed to customers and interest receivable. Receivables billed to customers are due within 10 days after issuance of the invoice, or by the 20th of the month or the business day immediate preceding such day if the 20th is not a business day. Management does not believe an allowance for doubtful accounts is necessary at June 30, 2010.

Deferred Bond Issue Costs

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

Prepaid Gas Supply

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

Costs Recoverable from Future Billings

The Natural Gas Supply Agreements for the project establish a pricing mechanism outlining the methods for billing customers for the natural gas supply. Expenses in excess of amounts currently billable to customers under the pricing mechanism will be recovered from future billings to customers and are classified as a deferred debit. These amounts are principally related to long-term supply and include interest expense, amortization, and other project costs that are realized at different times than they are billed to customers.

NMMEAA's derivative financial instruments are accounted for in accordance with GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. In connection with this Statement, the fair value of NMMEAA's derivative financial instruments is recorded on the Balance Sheet, with an offsetting deferred asset or liability. At June 30, 2010, the positive fair value of NMMEAA's derivative instruments is offset by a deferred credit.

Net Asset Classification

Restricted net assets have externally imposed constraints imposed by creditors (such as debt covenants), contributors, law or regulations of other governments. NMMEAA has no restricted net assets, nor does it have any net assets invested in capital assets, net of related debt. The only net assets of NMMEAA are unrestricted net assets.

Classification of Revenues

NMMEAA has classified its revenues as either operating or nonoperating revenues according to the following criteria:

- Operating revenues are derived from delivery of gas supplies to customers.

- Nonoperating revenues are derived from capital and related financing, noncapital financing and investing activities such as net costs to be recovered in future periods and investment income.

Derivative Instruments

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

Income Taxes

NMMEAA operates as a governmental entity under a joint powers agreement in the State of New Mexico and is exempt from federal and state income taxes.

Note 2: Cash and Investments

As of June 30, 2010 NMMEAA had the following cash and investments which are held in trust by Wells Fargo Bank, National Association, as Trustee.

	<u>Trust</u>
Cash held in trust	\$ 1,916,975
Wells Fargo Advantage 100% Treasury Money Market Fund #008	17,591,773
US Treasury Bill; 7/29/2010; #912795074	1,952,746
Total Cash and Cash Equivalents	<u>\$ 21,461,494</u>
	<u><u>Financial Statements</u></u>
Cash and cash equivalents	\$ 4,956,068
Restricted cash and cash equivalents	16,505,426
Total Cash and Cash Equivalents	<u>\$ 21,461,494</u>

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. NMMEAA's may only invest in direct obligations of the United States or obligations guaranteed as to full and timely payment both as to principal and interest by the United States; and in investments in a money market fund secured by obligations of the United States. The money market funds are presented as cash and cash equivalents with a maturity of less than one year because they are redeemable in full immediately.

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The trust indenture requires counterparties to have a credit rating by Moody's of at least A1.

Custodial Credit Risk

Custodial credit risk is the risk that in the event of a bank failure NMMEAA's deposits with the Trustee may not be returned to it. All moneys held under the Indenture by the Trustee are to be held in such manner as required by applicable Federal or State laws and regulations of the state in which the Trustee is located and shall be either continuously or fully insured by the Federal Deposit Insurance Corporation (FDIC), or if not continuously and fully insured by FDIC, by lodging with the Trustee, as custodian, as collateral security, qualified investments having a market value (exclusive of accrued interest) not less than the amount of such moneys. At June 30, 2010, NMMEAA's did not have any bank deposits and there was no collateral pledged by the Trustee.

Concentration of Credit Risk

NMMEAA and the trust indenture place no limit on the amount that may be invested in any one issuer.

	<u>Portfolio Composition</u>
Wells Fargo Advantage 100% Treasury Money Market Fund #008	\$ 17,591,773
US Treasury Bill; 7/29/2010; #912795074	1,952,746
Total Investments in Cash and Cash Equivalents	<u>\$ 19,544,519</u>

Note 3: Restricted Assets

The following is a summary of restricted assets as of June 30, 2010.

Restricted assets

Debt service required reserve	\$ 13,752,469
Primary rate stabilization requirement	1,952,957
Collateral held	800,000
Total restricted assets	<u>\$ 16,505,426</u>

Note 4: Long-term Debt

Long-term debt at June 30, 2010 consisted of the following:

Revenue Bonds:	<u>2010</u>
2009 Series A (Fixed Rate), Gas Project Revenue Bonds (Project No.1), 4.1871%, due 2011 to 2039	\$ 780,965,000
Less current maturities of long-term debt	<u>(600,000)</u>
Long-term debt	<u>\$ 780,365,000</u>

Changes in Long-term Liabilities

During the year ended June 30, 2010, the following changes occurred in long-term liabilities:

	Balance <u>June 30, 2009</u>	<u>Additions</u>	<u>Reductions</u>	Balance <u>June 30, 2010</u>	Due Within <u>One Year</u>
Revenue Bonds:					
Series 2009	\$ -	\$ 780,965,000	\$ -	\$ 780,965,000	\$ 600,000
	-	-	-	-	-
Total Revenue Bonds	<u>\$ -</u>	<u>\$ 780,965,000</u>	<u>\$ -</u>	<u>\$ 780,965,000</u>	<u>\$ 600,000</u>

Future principal and interest payments required to be made in accordance to the interest rate swap counterparty under Transaction I (fixed interest rate of 4.1871%) are as follows:

Year Ending June 30,	Principal	Fixed @ 4.1871% Interest	Total
2011	\$ 600,000	\$ 32,695,598	\$ 33,295,598
2012	2,225,000	32,646,365	34,871,365
2013	3,925,000	32,519,775	36,444,775
2014	5,380,000	32,330,832	37,710,832
2015	6,910,000	32,078,559	38,988,559
2016-2021	73,570,000	183,607,196	257,177,196
2022-2027	131,680,000	158,116,969	289,796,969
2028-2033	212,380,000	115,751,054	328,131,054
2034-2040	344,295,000	52,129,360	396,424,360
	<u>\$ 780,965,000</u>	<u>\$ 671,875,709</u>	<u>\$ 1,452,840,709</u>

Note 5: Related Party Transactions

NMMEAA's natural gas sales to members (City of Las Cruces) were \$997,055 during the year ended June 30, 2010. At June 30, 2010, receivables of \$30,997 are due from members (City of Las Cruces).

Note 6: Gas Purchase and Sales Agreements

NMMEAA has entered into long-term gas purchase and supply contracts for which prepayments have been made and amounts remaining of \$24,696,348 and \$711,228,535 are reflected in both current and noncurrent asset categories at June 30, 2010. Long-term sales agreements also exist with customers, to take delivery of the natural gas over a period continuing through 2039. The sale price to the customer for these contracts is at specified index prices less a discount. As discussed in Note 7, swap agreements are used to convert these variable index prices to fixed prices sufficient to meet debt service requirements.

Gas Project Revenue Bonds, Series 2009

In October 2009, NMMEAA issued \$780,965,000 of gas supply revenue bonds to fund the prepayment of 171,322,165 Mmbtus of gas from BP Corporation North America with deliveries beginning November 2009 and ending October 2039. The City of Farmington, NM, and the City of Las Cruces, NM and the Incorporated County of Los Alamos, NM will purchase the scheduled monthly gas at a specified index less a discount from such index

price for the entire term of November 2009 through October 2039. The revenue bonds are secured by a pledge of the gas supply revenues derived from the prepay transaction.

NMMEAA entered into an interest rate swap with Royal Bank of Canada in connection with the Series 2009, Gas Project Revenue Bonds. Under the swap agreement, NMMEAA receives a payment from the interest rate counterparty equal to the variable interest amount payable to bondholders. Under Transaction II NMMEAA then pays the swap counterparty the interest amount payable to bondholders and receives back an interest rate equal to 80% of the LIBOR rate plus 80.74 basis points paid on the outstanding debt. The synthetic rate for FY2010 for the interest rate swap was 3.4672%.

Note 7: Derivative Instruments

Derivative instruments are utilized by NMMEAA to manage market risk and reduce its exposure resulting from fluctuations in prices of natural gas in order to meet debt service requirements. These instruments include a commodity swap agreement which converts index-priced natural gas revenues to fixed prices for servicing outstanding debt obligations and an interest rate swap with two transactions which effectively convert NMMEAA's variable interest rate to a synthetic fixed rate. Effective with fiscal years beginning after June 15, 2009, GASB Statement No. 53 requires that the fair value of financial arrangements called "derivatives" or "derivative instruments" be reported in the financial statements of state and local governments. If a derivative effectively hedges, or significantly reduces the risk of rising or falling cash flows or fair values, then its annual fair value changes are deferred until the hedged transaction occurs or the derivative ceases to be effective. According to GASB 53, a derivative is defined as a financial arrangement with values or cash payments that are based on what happens in separate transactions, agreements, or rates and have these characteristics:

- The financial arrangements are leveraged. There is minimal or no initial investment, but the arrangement achieves changes in fair value that would have required a far larger investment.
- The financial arrangement can be settled early with a cash payment or the transfer of an equivalent asset.

Even though governments enter into a derivative to minimize an identified risk, the derivative itself can expose the government to the following risks:

- Credit risk is the chance the counterparty to a swap agreement will not make good on its promise to pay the government.
- Interest rate risk refers to the idea that the longer a derivative is in place the greater the potential is that changes in interest rates could reduce the value of the transaction to the government.
- Termination risk refers to a derivative ending earlier than planned, thereby depriving a government of risk protection and potentially requiring a significant termination payment. This can happen if the credit rating of either the government or the counterparty falls below the agreed upon level.

- Basis risk is the idea that in some derivatives the amount received by the government from the counterparty is based on one market rate, and the amount it pays to bondholders is based on another index. An example of this is one payment being based on the Securities Industry and Financial Markets Association (SIFMA) index and the other payment based on the London Interbank Offered Rate (LIBOR). If the rate on which the bondholder payments going out increases more than the rate determining the receipts to the government, less money will be received than payments going out.
- Rollover risk happens when the derivative does not last as long as the associated debt is outstanding. This would happen if the interest rate swap was for 15 years, but the variable rate debt was for 30 years. At the end of the 15 years, the government may not be able to get another interest rate swap derivative and would no longer be protected from rising interest rates.
- Market-access risk is the chance a government will not be able to issue debt, or in doing so it would become more expensive.
- Foreign currency risk is the chance that changes in foreign exchange rates will adversely affect the value of the derivative if it is denominated in a foreign currency.

As of June 30, 2010 NMMEA had the following derivative instruments:

Item	Type	Objective	Notional Amount	Effective Date	Maturity Date	Terms	Fair Value
A	Natural gas commodity swap	To enable NMMEA to receive a fixed revenue stream with respect to the sale of the entire gas supply delivered under the prepaid gas agreement.	171,322,165 MMBtu	October 1, 2009	September 30, 2039	Receive fixed price, pays Inside FERC El Paso SJ index	\$ 187,737,271
B	Pay-fixed interest rate swap (Transaction I)	Hedge exposure to interest rate fluctuations on bonds and match with expected revenues from supply agreements and the commodity swap.	\$ 780,965,000	November 19, 2009	November 1, 2039	Pay 4.1871% fixed, receive periodic floating bond rate determined by Remarketing Agent (RBC).	\$ (115,534,516)
C	Pay periodic floating bond rate determined by Remarketing agent (Item B above) Transaction II	Same as Transaction I	\$ 780,965,000	November 19, 2009	November 1, 2039	Pay floating bond rate determined by Remarketing Agent and receive 80% of USD-LIBOR-BBA one month +80.74bp	\$ 47,359,444

The fair value of the commodity swap was provided by the commodity swap counterparty, BP Corporation North America (BPCNA). The fair value of Transaction I and Transaction II interest rate swaps were provided by the interest rate swap counterparty, Royal Bank of Canada (RBC).

Item	Type	Changes in Fair Value		Fair Value at June 30, 2010		Notional Amount
		Classification	Amount	Classification	Amount	
A	Natural gas commodity swap	Deferred inflow	\$ 187,737,271	Derivative Instruments	\$ 187,737,271	171,322,165 MMBtu
B	Pay-fixed interest rate swap (Transaction I)	Deferred outflow	\$ (115,534,516)	Derivative Instruments	\$ (115,534,516)	\$ 780,965,000
C	Pay periodic floating bond rate determined by Remarketing agent (Item B)	Deferred inflow	\$ 47,359,444	Derivative Instruments	\$ 47,359,444	\$ 780,965,000
		Total Deferred Inflow	\$ 119,562,199	Total Derivative Instruments	\$ 119,562,199	
		Deferred inflows - derivatives current	\$ 5,314,272	Derivative instruments current	\$ 5,314,272	
		Deferred inflows - derivatives noncurrent	\$ 114,247,927	Derivative instruments noncurrent	\$ 114,247,927	

NMMEAA evaluated the effectiveness of its derivative instruments using the consistent critical terms method. Following are tables showing the three derivative instruments and critical terms of the hedging instrument and the item that it is hedging. Since the critical terms are the same it is assumed the three instruments are effective, and any changes in the fair value are deferred in FY 2010.

Consistent Critical Terms	Commodity Swap NMMEAA and BP	Natural Gas Supply Agreements (COF,LA,LC with NMMEAA) - is Revenue in NMMEAA	Prepaid Natural Gas Purchase and Sale Agreement NMMEAA and RBC
Commodity	Natural Gas	Natural Gas	Natural Gas
Beginning Gas Delivery Date	October 1, 2009	October 1, 2009	October 1, 2009
Ending Gas Delivery Date	September 30, 2039	September 30, 2039	September 30, 2039
Notional Total Quantity Gas (MMBtu)	171,322,165	171,322,165	171,322,165
Natural Gas Spot Market Index	Inside FERC Gas Market Report El Paso San Juan Basin Index	Inside FERC Gas Market Report El Paso San Juan Basin Index	Inside FERC Gas Market Report El Paso San Juan Basin Index
Price	BP pays fixed price per Appendix A-1,2,3; NMMEAA pays at inside FERC; Amt is netted	Index-discount+premium	\$4.406 per MMBtu fixed
Delivery Point (#1) City of Farmington (COF) gas	The interconnection between Transwestern and Public Service Company of New Mexico with the Transwestern Blanco Hub	The interconnection between Transwestern and Public Service Company of New Mexico with the Transwestern Blanco Hub	The interconnection between Transwestern and Public Service Company of New Mexico with the Transwestern Blanco Hub
Delivery Point (#2) Las Cruces (LC) gas	El Paso Natural Gas Company's Blanco Pool, DRN 216748	El Paso Natural Gas Company's Blanco Pool, DRN 216748	El Paso Natural Gas Company's Blanco Pool, DRN 216748
Delivery Point (#3) Los Alamos (LA) gas	El Paso Natural Gas Company's Blanco Pool	El Paso Natural Gas Company's Blanco Pool	El Paso Natural Gas Company's Blanco Pool

Consistent Critical Terms	Interest Rate Swap Transaction I NMMEAA & RBC	Variable-Rate Bonds
Notional Amount	\$ 780,965,000	\$ 780,965,000
Effective Date	November 19, 2009	November 19, 2009
Termination Date	November 1, 2039	November 1, 2039
Variable interest rate	Bond interest rate (calculated by Remarketing Agent)	calculated by Remarketing Agent
Variable rate reset dates	Thursday	Thursday
Frequency of rate resets	Weekly	Weekly

Consistent Critical Terms	Interest Rate Swap Transaction II NMMEAA & RBC	Variable-Rate Bonds
Notional Amount	\$ 780,965,000	\$ 780,965,000
Effective Date	November 19, 2009	November 19, 2009
Termination Date	November 1, 2039	November 1, 2039
Variable interest rate (a)	Bond rate calculated by Remarketing Agent	Bond rate calculated by Remarketing Agent
Variable rate reset dates (a)	Thursday	Thursday
Frequency of rate resets (a)	Weekly	Weekly

Risks

Credit risk: NMMEAA's derivative instruments are held with two separate counterparties. Should the credit rating drop below A1 as issued by Moody's Investors Service, collateral must be posted. The credit ratings for each of the counterparties are shown below. BPCNA's rating dropped below the required minimum and as of June 30, 2010 \$800,000 in collateral was posted with NMMEAA. As of July 1, 2021, J.P. Morgan Chase Bank NA replaced BPCNA as the commodity swap counterparty.

Derivative Instrument	Type	Counterparty	Required Credit Rating of Counterparty (Moody's)	Actual Credit Rating of Counterparty (Moody's) on June 30, 2010	Counterparty Collateral Posted with NMMEAA
A	Natural gas commodity swap	BP Corporation North America (BPCNA)	A1	Baa1	\$ 800,000
B	Pay-fixed interest rate swap (Transaction I)	Royal Bank of Canada (RBC)	A1	A1	\$ -
C	Pay periodic floating bond rate determined by Remarketing agent (Item B above) Transaction II	Royal Bank of Canada (RBC)	A1	A1	\$ -

The aggregate fair value of hedging derivative instruments in asset positions at June 30, 2010 was \$119,562,199. This represents the maximum loss that would be recognized at the reporting date if all counterparties failed to perform as contracted. This is reduced by \$800,000 of collateral held, resulting in a net exposure risk of \$118,762,199.

Interest rate risk: NMMEAA is exposed to interest rate risk on its interest rate swap. In Transaction I, NMMEAA pays a fixed interest rate and receives a variable rate equal to the bondholder rate. As interest rates increase, the net payment on the swap decreases but the interest expense to bondholders increases. In Transaction II, NMMEAA receives a variable

rate based on the LIBOR index which is netted against the variable rate of Transaction I, so as LIBOR increases the net payment on the swap decreases.

Basis risk: NMMEAA is exposed to basis risk on its pay-fixed interest rate swap because the variable rate payment received under Transaction II is based on the LIBOR index, while the payment made under Transaction II and the receipt under Transaction I are at the same rate as the variable rate debt. The weighted-average interest rate on NMMEAA's hedged variable-rate debt is .2637%, 80 percent of LIBOR + 80.74 basis points is .7590%. The fixed interest rate under Transaction I is 4.1871% and the synthetic blended rate is 3.4672%.

Termination risk: NMMEAA or its counterparties may terminate a derivative instrument if the other party fails to perform under the terms of the contract. Each party is only required to pay the other party the amounts owed under the contract.

Rollover risk: NMMEAA is not exposed to rollover risk because the hedging derivative instruments mature at the same time as the items they hedge.

Note 8: Significant Estimates and Concentrations

Generally accepted accounting principles require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Those matters include the following:

Major Suppliers

NMMEAA purchased all of its natural gas supply from one national gas supplier. There are a limited number of national gas suppliers in which NMMEAA could contract with under prepay gas transactions and any disruption of deliveries under the supply contracts could have an impact on NMMEAA's operations.

Current Economic Conditions

The current protracted economic decline continues to present energy companies with difficult circumstances and challenges, which in some cases have resulted in large declines in the fair value of financial instruments and other assets, declines in revenues, constraints on liquidity and difficulty obtaining financing. The financial statements have been prepared using values and information currently available to NMMEAA.

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COMPLIANCE SECTION

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**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**

State Auditor and the Board Members
New Mexico Municipal Energy Acquisition Authority
Farmington, New Mexico

We have audited the financial statements of the business-type activities of the New Mexico Municipal Energy Acquisition Authority (NMMEAA) as of and for the ended June 30, 2010, and have issued our report thereon dated January 11, 2011. 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 NMMEAA's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of NMMEAA's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of NMMEAA's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of NMMEAA's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we considered to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether NMMEAA'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*.

We noted one instance of noncompliance that is required to be reported under Section 12-6-5, NMSA 1978, which are described in the accompanying schedule of findings and responses as findings 2010-1.

This report is intended solely for the information and use of the Board, management and the Office of the State Auditor and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "David Beery, CPA, PC". The signature is written in a cursive style with a large, sweeping initial "D".

**Farmington, New Mexico
January 11, 2011**

NEW MEXICO MUNICIPAL ENERGY ACQUISITION AUTHORITY
SCHEDULE OF FINDINGS AND RESPONSES
Year Ended June 30, 2010

A. Summary of Audit Results

1. The auditor's report expresses an unqualified opinion on the basic financial statements of NMMEAA.
2. No material weaknesses were disclosed during the audit of the financial statements.
3. No instances of noncompliance material to the financial statements of NMMEAA were disclosed during the audit.
4. A single audit was not required.

B. Findings - Financial Statements Audit

Current Year Findings

2010-1 Failure to File Audit Report by Due Date

Condition

The New Mexico State Auditor requires the audit to be completed and submitted by December 1st following the entity's June 30th year end. The audited financial statements were submitted in January 2011.

Criteria

According to the State of New Mexico, Office of the State Auditor publication 2.2.2 NMAC – Requirements for Contracting and Conducting Audits of Agencies, Section 9.1, the filing date of the audit reports is December 1st following the end of the fiscal year.

Cause

NMMEAA's first year end was June 30, 2010 and it was not determined until November 2010 that an audit was required by the New Mexico State Auditor's Office.

Effect

According to the state source referred to above, "Failure to file the audit report by the due date set in Section 9.1 is considered non-compliance with 2.2.2 NMAC and shall be a current year finding." Each entity shall submit a statement to the State Auditor's Office providing an explanation for the delay in submission.

Recommendation

The audit should be completed by the required due date of the State Auditor.

Management Response

NMMEAA will contract with an auditor and schedule its audit on a timely basis in the future.

**NEW MEXICO MUNICIPAL ENERGY ACQUISITION AUTHORITY
EXIT CONFERENCE
Year Ended June 30, 2010**

An exit conference was held on January 19, 2011. In attendance were:

NMMEAA:

Board Member Maude Grantham-Richards
Financial Analyst..... Susan Nipper

David Berry, CPA, PC:

Auditor David Berry, CPA