



LOBO ENERGY, INCORPORATED
(A Component Unit of the University of New Mexico)

Financial Statements

June 30, 2014 and 2013

(With Independent Auditors' Report Thereon)

LOBO ENERGY, INCORPORATED
(A Component Unit of the University of New Mexico)

Table of Contents

	Page
Official Roster	1
Independent Auditors' Report	2
Management's Discussion and Analysis	4
Financial Statements:	
Balance Sheets	8
Statements of Revenues, Expenses, and Changes in Net Position	9
Statements of Cash Flows	10
Notes to Financial Statements	11
Independent Auditors' Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	19
Supplementary Information	
Schedule of Findings and Responses	21
Exit Conference	22

LOBO ENERGY, INCORPORATED
(A Component Unit of the University of New Mexico)

Official Roster

June 30, 2014

OFFICERS

Mary S. Vosevich
Jewel M. Glavey

MEMBERS

J. E. "Gene" Gallegos
Conrad D. James
Robert G. Frank
David W. Harris
Stephen W. McKernan
Geraldine Forbes-Isais
Jon Word
Thomas J. Ruiz
Bruno E. Carrara



KPMG LLP
Two Park Square, Suite 700
6565 Americas Parkway, N.E.
Albuquerque, NM 87110-8179

Independent Auditors' Report

The Board of Directors
Lobo Energy, Incorporated
and
Mr. Hector Balderas, New Mexico State Auditor:

Report on the Financial Statements

We have audited the accompanying financial statements of Lobo Energy, Incorporated, a component unit of the University of New Mexico (Lobo Energy), which comprise the balance sheet as of June 30, 2014 and 2013, and the related statements of revenues, expenses, and changes in net position and cash flows for the years then ended and the related notes to the financial statements, which collectively comprise Lobo Energy's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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



Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of Lobo Energy, Incorporated as of June 30, 2014 and 2013, and the changes in its net position and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that management's discussion and analysis on pages 4 through 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 17, 2014, on our consideration of Lobo Energy'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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Lobo Energy's internal control over financial reporting and compliance.

KPMG LLP

Albuquerque, New Mexico
October 17, 2014

LOBO ENERGY, INCORPORATED
(A Component Unit of the University of New Mexico)

Management's Discussion and Analysis

June 30, 2014 and 2013

The following discussion and analysis provides an overview of the financial position and activities of Lobo Energy, Incorporated (Lobo Energy) as of and for the fiscal years ended June 30, 2014, 2013, and 2012. This discussion should be read in conjunction with the accompanying financial statements and notes. Management has prepared the basic financial statements and the related note disclosures along with this discussion and analysis. As such, the financial statements, notes, and this discussion are the responsibility of Lobo Energy's management.

Financial Highlights

- Lobo Energy's net position increased \$1,539,950 from \$2,641,851 in 2013 to \$4,181,801 in fiscal year 2014, primarily due to an increase in operating revenue and a decrease in expenses. Lobo Energy's net position increased \$2,027,620 from \$614,231 in 2012 to \$2,641,851 in fiscal year 2013, primarily due to an increase in funding from the University of New Mexico (UNM) and a decrease in expenses due to the conclusion of a consulting contract.
- During fiscal year 2014, Lobo Energy's operating revenue increased by \$378,211 and operating expenses decreased by \$463,495, resulting in net operating income of \$2,106,574 in fiscal year 2014, compared to net operating income of \$1,264,868 in fiscal year 2013. During fiscal year 2013, Lobo Energy's operating revenue decreased by \$5,082 and operating expenses decreased by \$1,047,938, resulting in net operating income of \$1,264,868 in fiscal year 2013, compared to net operating income of \$222,012 in fiscal year 2012.
- Cash decreased in fiscal year 2014 by \$3,111,883 resulting in cash on deposit with fiscal agent and cash on hand at the close of fiscal year 2014 of \$1,307,269. The decrease during fiscal year 2014 is primarily due to the depletion of the escrow account from which the expenses were paid in connection with the installation of the second co-generation unit in Ford Utilities Center on UNM's main campus. Cash increased in fiscal year 2013 by \$3,642,318 resulting in cash on deposit with fiscal agent and escrow agent and cash on hand at the close of fiscal year 2013 of \$4,419,152. The increase during fiscal year 2013 is primarily due to the \$10,000,000 loan to purchase and install the second co-generation unit in Ford Utilities Center on UNM's main campus.

Using this Annual Report

This annual report consists of a series of financial statements. The balance sheets; statements of revenues, expenses, and changes in net position; and statements of cash flows provide information about the activities of Lobo Energy.

The balance sheets provide information about Lobo Energy's overall financial status. The statements of revenues, expenses, and changes in net position provide information about the operating revenues and expenses and the nonoperating revenues and expenses of Lobo Energy. The statements of cash flows provide information related to the cash inflows and outflows of Lobo Energy.

LOBO ENERGY, INCORPORATED
(A Component Unit of the University of New Mexico)

Management's Discussion and Analysis

June 30, 2014 and 2013

Financial Information

Lobo Energy's condensed financial information as of and for the fiscal years ended June 30, 2014, 2013, and 2012 is provided in the following table:

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Current assets	\$ 1,502,661	4,424,819	796,234
Other assets	15,030	30	30
Capital assets	<u>11,030,097</u>	<u>7,908,104</u>	<u>—</u>
Total assets	<u>\$ 12,547,788</u>	<u>12,332,953</u>	<u>796,264</u>
Current liabilities	\$ 1,015,242	1,408,969	182,033
Long-term liabilities	7,350,745	8,282,133	—
Net position	<u>4,181,801</u>	<u>2,641,851</u>	<u>614,231</u>
Total liabilities and net position	<u>\$ 12,547,788</u>	<u>12,332,953</u>	<u>796,264</u>
Operating revenue	\$ 3,290,454	2,912,243	2,917,325
Operating expenses	<u>1,183,880</u>	<u>1,647,375</u>	<u>2,695,313</u>
Operating income	2,106,574	1,264,868	222,012
Nonoperating revenue	14,724	1,006,272	4,860
Nonoperating expenses	<u>581,348</u>	<u>243,520</u>	<u>—</u>
Change in net position	1,539,950	2,027,620	226,872
Net position, beginning of year	<u>2,641,851</u>	<u>614,231</u>	<u>387,359</u>
Net position, end of year	<u>\$ 4,181,801</u>	<u>2,641,851</u>	<u>614,231</u>

Financial Position

As of June 30, 2014 and 2013, Lobo Energy has cash in the amount of \$1,307,269 and \$4,419,152, respectively, of which \$1,299,617 and \$1,679,759, respectively, is held by Lobo Energy's fiscal agent, UNM, and \$7,652 and \$10,593, respectively, is held in an operating bank account at a financial institution.

All of the June 30, 2014 and 2013 net assets are held as equity in the form of unrestricted net position of \$1,433,837 and \$1,837,376, respectively. Additionally, at June 30, 2014 and 2013, Lobo Energy has \$2,747,964 and \$804,475 shown as net investment in capital assets.

Capital Assets and Debt Administration

Lobo Energy's investment in capital assets as of June 30, 2014 and 2013 was \$11,030,097 and \$7,908,104, respectively. This investment in capital assets includes a co-generation project in construction and internally generated software. Additional information concerning Lobo Energy's capital assets may be found in note 5 in notes to the financial statements.

LOBO ENERGY, INCORPORATED
(A Component Unit of the University of New Mexico)

Management's Discussion and Analysis

June 30, 2014 and 2013

At the end of the current fiscal year, Lobo Energy had total debt outstanding of \$8,282,133. This debt was incurred when Lobo Energy borrowed \$10,000,000 during FY 2012–13 for the purchase of the co-generation project described above. Additional information concerning Lobo Energy's long-term debt may be found in note 5 to the financial statements.

Statements of Revenues, Expenses, and Changes in Net Position

Revenues – Under the current Management Services Agreement (MSA), total revenue earned during fiscal years 2014 and 2013 for utility project management services and other project management services was \$3,290,454 and \$2,912,243, respectively, and includes \$480,000 in both fiscal years for utilities management services. Other management services for fiscal years 2014 and 2013 were \$2,789,428 and \$2,404,800, respectively. In addition, Lobo Energy provided other management services on the Mesa del Sol campus for an outside company beginning April 15, 2012. Other project management services revenue realized from this project was \$21,026 in 2014 and \$27,443 in 2013.

Expenses – Total operating expenses decreased \$463,495 during the fiscal year ended June 30, 2014 due to a decrease of \$660,481 in project expenses due to the completion of the Shimizu NA solar project at Mesa del Sol and a decrease of \$15,412 in administrative expenses offset by an increase in depreciation expenses of \$212,398 due to the installation of the second Co-generation unit on the UNM campus. Total operating expenses decreased \$1,047,938 during the fiscal year ended June 30, 2013 due to a decrease of \$1,082,992 in project expenses due to the conclusion of a consulting contract offset by an increase of \$35,054 in administrative expenses. This change is due to the fact that there was a decrease in project expenses. UNM is the fiscal agent of Lobo Energy. UNM holds the majority of Lobo Energy's assets and invests the holdings in a commingled account with UNM's other investments. The pro rata interest earnings are credited to Lobo Energy's account monthly. Lobo Energy transfers funds to its checking account as needed.

Factors Impacting Future Periods

When Lobo Energy was tasked with implementing an energy conservation program on the UNM campus, Lobo Energy entered into a contract with Energy Education, Inc. (EEI) in December 2007. An implementation plan was presented to Lobo Energy Incorporated/UNM by EEI at the kickoff meeting on December 17, 2007. There was a strategic planning period through February 2008. The training and implementation period, referred to as the fast track, was planned from March through September 2008. Due to the fact that the energy conservation specialists were not hired until April 2008, the fast track did not begin until April. The contract reads that the savings would be determined during four performance years that would not begin until the fast track was over. The first performance year began October 1, 2008. Performance year four of the energy-conservation contract ended on September 30, 2012. After that date, Lobo Energy made no more payments to EEI, although the contract reads that Lobo Energy may continue the program with support from EEI for an indefinite period.

Early in fiscal year 2013, Lobo Energy purchased a second co-generation unit and contracted to have it installed in Ford Utilities Center on the UNM campus (note 5 for a detailed explanation of this project). This project was completed during FY 2014.

A Lobo Energy employee has developed a software package for use by UNM that can also be used by other facilities managers (note 5 for a detailed explanation of this project).

LOBO ENERGY, INCORPORATED
(A Component Unit of the University of New Mexico)

Management's Discussion and Analysis

June 30, 2014 and 2013

Lobo Energy will not continue to provide services in connection with the solar energy project on the Mesa del Sol campus for which it is compensated by Shimizu NA.

Contacting Lobo Energy's Financial Management

This report is meant to accurately describe the financial condition and position of Lobo Energy.

If you have questions about this report or need additional financial information, contact Lobo Energy, Incorporated at 800 Bradbury Drive SE, Suite 216, Albuquerque, New Mexico 87106-4310.

LOBO ENERGY, INCORPORATED
(A Component Unit of the University of New Mexico)

Balance Sheets

June 30, 2014 and 2013

Assets	2014	2013
Current assets:		
Cash on deposit with fiscal agent	\$ 1,299,617	1,679,759
Cash on deposit with BBVA Compass Bank	7,652	10,593
Cash on deposit with Bank of Albuquerque	—	2,728,800
Accounts receivable	189,844	5,667
Prepaid Expenses	5,548	—
Total current assets	1,502,661	4,424,819
Capital assets:		
Construction in progress	622,579	7,908,104
Property, plant, and equipment	10,619,916	—
Less accumulated depreciation and amortization	(212,398)	—
Net capital assets	11,030,097	7,908,104
Noncurrent assets:		
Other assets	30	30
Equity method investment	15,000	—
Total assets	\$ 12,547,788	12,332,953
Liabilities and Net Position		
Current liabilities:		
Accounts payable	\$ 83,854	501,850
Current portion of long-term debt	931,388	907,119
Total current liabilities	1,015,242	1,408,969
Long-term debt, excluding current installments	7,350,745	8,282,133
Total liabilities	8,365,987	9,691,102
Net position:		
Net investment in capital assets	2,747,964	804,475
Unrestricted	1,433,837	1,837,376
Total net position	4,181,801	2,641,851
Total liabilities and net position	\$ 12,547,788	12,332,953

See accompanying notes to financial statements.

LOBO ENERGY, INCORPORATED
(A Component Unit of the University of New Mexico)

Statements of Revenues, Expenses, and Changes in Net Position

Years ended June 30, 2014 and 2013

	2014	2013
Operating revenue:		
Utilities management services	\$ 480,000	480,000
Other management services	2,810,454	2,432,243
Total operating revenue	3,290,454	2,912,243
Operating expenses:		
Administrative expenses	158,383	173,795
Depreciation expenses	212,398	—
Project expenses	813,099	1,473,580
Total operating expenses	1,183,880	1,647,375
Operating gain	2,106,574	1,264,868
Nonoperating revenue:		
Capital funds received from UNM	—	1,000,000
Interest income	14,724	6,272
Nonoperating expense:		
Loss on equity method investment	350,077	—
Interest expense	231,271	243,520
Change in net position	1,539,950	2,027,620
Net position, beginning of year	2,641,851	614,231
Net position, end of year	\$ 4,181,801	2,641,851

See accompanying notes to financial statements.

LOBO ENERGY, INCORPORATED
(A Component Unit of the University of New Mexico)

Statements of Cash Flows

Years ended June 30, 2014 and 2013

	2014	2013
Cash flows from operating activities:		
Receipts from customers	\$ 3,106,277	2,925,976
Payments to other suppliers of goods or services	(643,964)	(735,236)
Payments to employees for services	(751,062)	(592,322)
Net cash provided by operating activities	1,711,251	1,598,418
Cash flows from investing activities:		
Construction in progress	(3,334,392)	(7,908,104)
Payments made for equity method investment	(365,077)	—
Net cash used in investing activities	(3,699,469)	(7,908,104)
Cash flow from capital financing activities:		
Proceeds on long-term debt	—	10,000,000
Payments of long-term debt	(907,119)	(810,748)
Capital contribution from UNM	—	1,000,000
Interest earned	14,724	6,272
Interest expense	(231,271)	(243,520)
Net cash provided by financing activities	(1,123,666)	9,952,004
Net decrease in cash and cash equivalents	(3,111,884)	3,642,318
Cash and cash equivalents, beginning of year	4,419,152	776,834
Cash and cash equivalents, end of year	\$ 1,307,268	4,419,152
Reconciliation of operating gain to net cash provided by operating activities:		
Operating gain	\$ 2,106,574	1,264,868
Adjustments to reconcile operating income to net cash		
depreciation expense provided by (used in) operating activities:	212,398	—
Change in accounts receivable	(184,177)	13,733
Change in accounts payable	(417,996)	319,817
Change in prepaid expenses	(5,548)	—
Net cash provided by operating activities	\$ 1,711,251	1,598,418

See accompanying notes to financial statements.

LOBO ENERGY, INCORPORATED
(A Component Unit of the University of New Mexico)

Notes to Financial Statements

June 30, 2014 and 2013

(1) Description of Business

Lobo Energy, Incorporated (a component unit of the University of New Mexico) is owned, controlled, and was established by the University of New Mexico's (UNM) Board of Regents.

Lobo Energy, Incorporated (Lobo Energy) was incorporated in the state of New Mexico on July 15, 1998. It was organized under the amended state of New Mexico's University Research Park Act. The name of the Act has since been changed to the University Research Park and Economic Development Act.

Lobo Energy was established to provide UNM with services outlined in an Interim Services Agreement (ISA) that included procuring electricity and natural gas for UNM, installing an energy metering and management system, and developing a Master Utility Business Plan (plan) for the upgrade and improvement of the utility infrastructure. Lobo Energy completed the installation of a metering and monitoring system and developed and integrated energy procurement methods into UNM's procurement processes. Lobo Energy's board of directors approved the plan in June 2000. UNM implemented the business plan and financed and constructed the projects contemplated in the business plan.

In developing the plan, Lobo Energy employed several consultants to assist in assessing the utility infrastructure needs, defining a technical solution, and determining the financial parameters of that solution. The combined efforts resulted in a comprehensive plan that identified many utility improvement projects, their construction costs, and the financial impacts upon the utility services. The utility systems included in the plan were renewed through a series of construction projects over a period of several years.

Lobo Energy conducted its business under the terms of a November 2000–2005 Management Services Agreement (MSA) that replaced the original ISA. Under the MSA, with respect to existing and any and all new utility systems and equipment, UNM continued to own, finance, operate, maintain, and in all respects control the utility equipment and systems. Lobo Energy provided project management services and transition management services for the duration of the project. The utility upgrade project was completed during 2006.

Lobo Energy currently provides services to UNM under the terms of a revised MSA, which is effective November 2010–2015 (note 3). Under the revised MSA, Lobo Energy provides UNM with two types of management services: utility project management services and other management and planning services.

UNM requested that Lobo Energy implement an energy conservation program on the campus during fiscal year 2008. Lobo Energy entered into a contract with Energy Education, Inc. (EEI), a corporation that specializes in energy conservation. (EEI is now known as Cenergistic.) Lobo Energy hired six energy conservation specialists (ECSs). Contract payments began after the first six months the contract was in effect. The ongoing program continues to be very effective. UNM has experienced a dramatic decrease in its energy consumption, as well as a reduction in the size of its carbon footprint, since the onset of the project. The four-year contract with EEI expired on September 30, 2012. The energy conservation project continues on the campus.

During fiscal year 2009, Lobo Energy was asked by UNM to explore renewable energy applications that might be viable on the campus. Lobo Energy issued a Request for Information (RFI) regarding potential renewable energy projects for installation on the UNM campus when funding becomes available.

LOBO ENERGY, INCORPORATED
(A Component Unit of the University of New Mexico)

Notes to Financial Statements

June 30, 2014 and 2013

During fiscal year 2013, at the request of UNM, Lobo Energy began providing technical support for the smart-grid, renewable-energy project owned by Shimizu NA on the Mesa del Sol campus. Lobo Energy is compensated by Shimizu for its participation in this project. Lobo Energy's contract with Shimizu expired on March 31, 2014. The solar unit was given to UNM's Engineering Department by Shimizu and the maintenance is provided by UNM Physical Plant personnel.

(2) Summary of Significant Accounting Policies and Practices

(a) Basis of Accounting

As a proprietary fund, Lobo Energy's financial statements are reported using a flow of economic resources measurement focus and the full accrual basis of accounting. Accordingly, revenues are recognized when they are earned and expenses are recognized as soon as the liability is incurred. Operating revenues and expenses are those incurred that relate directly to energy and project management services. All other revenues and expenses are considered nonoperating.

The accompanying financial statements include only the accounts of Lobo Energy, which has no component units.

(b) Net Position

For accounting and reporting purposes, Lobo Energy reports its net position in the following net asset categories as applicable:

- Net investment in capital assets – capital assets, net of accumulated depreciation and debt incurred to finance the capital asset acquisition
- Unrestricted – net position that is not subject to externally imposed constraints

(c) Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the financial statements dates and the reported amounts of revenues and expenses during these reporting periods. Due to uncertainties inherent in the estimation process, actual results could differ from those estimates.

(d) Cash and Cash Equivalents

Lobo Energy considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. For purposes of the statement of cash, Lobo Energy considers cash and cash equivalents to be cash deposits and amounts held by its fiscal agent.

(e) Revenue Recognition

Lobo Energy provides two types of project management services: utilities management services and other management services. Note 2 describes these services in detail. Revenue is recognized for each type of service based on the terms of the MSA.

LOBO ENERGY, INCORPORATED
(A Component Unit of the University of New Mexico)

Notes to Financial Statements

June 30, 2014 and 2013

(f) *Equity Method Investment*

Lobo Energy initially recorded its equity method investment at cost. A decline in the fair value of the investment below cost that is deemed other-than-temporary results in an impairment to reduce the carrying value to fair value. In FY 2014, Lobo Energy recognized an impairment loss on its equity method investment. See note 9 to the consolidated financial statements.

(g) *Capital Assets*

Capital assets are stated at cost. Lobo Energy's policy is to capitalize all disbursements for equipment, software, and furnishings in excess of a \$5,000 unit price. Items with a cost of less than \$5,000 are expensed in the year of acquisition. Donated equipment is recorded at fair market value at the date of donation. Repairs and maintenance expenses are charged to operations when incurred and major improvements and replacements are capitalized.

(h) *Income Taxes*

Lobo Energy is exempt from federal income tax on income related to its exempt purposes under Section 501(a) of the Internal Revenue Code (Code) as an organization described in Section 501(c)(3) of the Code.

(i) *Recently Issued Accounting Standards*

Effective July 1, 2013, Lobo Energy adopted Governmental Accounting Standards Board Statement No. 65, *Items Previously Reported as Assets and Liabilities* (GASB 65), which amends or supersedes the accounting and financial reporting guidance for certain items that were previously required to be reported as assets or liabilities. The objective is to either properly classify certain items that were previously reported as assets or liabilities as deferred outflows of resources or deferred inflows of resources or recognize certain items that were previously reported as assets and liabilities as outflows of resources (expense) or inflows of resources (revenues). No changes in presentation have been made as a result of implementation.

(3) *Project Management Services under The Revised Management Services Agreement*

Utilities Management Services

Lobo Energy may provide assistance to UNM, as requested, for the management and supervision of its contracts that provide for the:

- a. planning, design, engineering, contracting, energy conservation, and commissioning services for assigned projects
- b. procurement of equipment and services in the course of implementing the projects
- c. management of UNM's energy procurement strategies
- d. recommendations for obtaining cost-effective energy commodities and services from energy suppliers

LOBO ENERGY, INCORPORATED
(A Component Unit of the University of New Mexico)

Notes to Financial Statements

June 30, 2014 and 2013

- e. management of UNM's energy-related regulatory issues
- f. recommendations for appropriate actions and strategies in response to regulatory opportunities or events
- g. administrative tools capable of providing utility operational budgeting, capital project budgeting, major maintenance budgeting, cash flow tracking, and energy savings tracking
- h. assistance with developing the energy and administrative capabilities described in items a through g above.

Under the terms of the revised MSA, effective November 1, 2010, UNM compensates Lobo Energy for these services at the rate of \$40,000 per month, continuing for five years.

Other Management Services

- a. Development planning services
- b. Additional infrastructure development plans
- c. Other planning services as assigned

Under the revised MSA, as of November 1, 2010, UNM pays Lobo Energy a mutually agreed-upon monthly fee for the duration of each project.

(4) Cash

Lobo Energy's cash balances include cash on deposit with its fiscal agent and an operating account. Lobo Energy has no statutory or policy requirements; however, it has a policy to deposit funds only in FDIC-insured accounts. UNM serves as the fiscal agent for Lobo Energy through which Lobo Energy participates in a pooled bank account maintained by UNM. At June 30, 2014 and 2013, Lobo Energy had a balance in that pooled account of \$1,299,617 and \$1,679,759, respectively. As fiscal agent, UNM requires the financial institution holding these pooled funds to maintain minimum collateral amounts. Interest is allocated monthly to Lobo Energy's account based on its balance in the pooled bank account at the end of the preceding month. Lobo Energy realized a gain of \$14,425 via year-end adjustments to the interest account by UNM.

Custodial Credit Risk – Custodial credit risk is the risk that in the event of a bank failure, the entity's deposits may not be returned to it. At June 30, 2014 and 2013, the book balance in Lobo Energy's separate checking account was \$7,652 and \$10,593, respectively. Of the bank balance, the entire amount is insured by the FDIC. At June 30, 2014, Lobo Energy's Bank of Albuquerque account was depleted when the final expenses were paid in connection with the completion of the installation of the second co-generation unit on the campus of UNM.

LOBO ENERGY, INCORPORATED
(A Component Unit of the University of New Mexico)

Notes to Financial Statements

June 30, 2014 and 2013

(5) Capital Assets and Long-Term Debt

Co-generation Unit

In July 2012, Lobo Energy entered into a \$10,000,000 commitment to finance the construction of a new co-generation unit to be installed on the UNM main campus in Ford Utilities Center. The Master Equipment Lease/Purchase Agreement with Banc of America Leasing and Capital, LLC (Banc of America) was entered into and is to be repaid over a period of 10 years. Monthly payments in the amount of \$94,922 commenced on August 25, 2012. The final lease payment is anticipated to be made on July 25, 2022. The escrow account was held at Bank of Albuquerque. The installation of an additional co-generation unit in the future was part of the plan when the utility infrastructure was upgraded in a project concluding in 2006. The additional unit was placed into service in January 2014. During the years ended June 30, 2014 and 2013, Lobo Energy capitalized \$2,900,820 and \$7,719,096, respectively. Lobo Energy now has a fixed asset valued at \$10,619,916.

Depreciation

Lobo Energy depreciates the co-generation unit using the straight-line method based upon a useful life of 25 years. Lobo Energy estimates useful life based upon internal information and similar assets at UNM. The unit was placed into service and Lobo Energy began depreciating the asset in January 2014. Lobo Energy recorded \$212,398 and \$0 of accumulated depreciation at June 30, 2014 and 2013, respectively.

	<u>Balance at July 1, 2013</u>	<u>Additions</u>	<u>Retirements/ disposals</u>	<u>Balance at June 30, 2014</u>
Plant in service	\$ —	\$ 10,619,916	\$ —	\$ 10,619,916
Accumulated depreciation	—	(212,398)	—	(212,398)
Net property, plant and equipment	<u>\$ —</u>	<u>\$ 10,407,518</u>	<u>\$ —</u>	<u>\$ 10,407,518</u>

Lease Payments

Payments are due monthly to Banc of America and the lease charges interest at 2.64% and matures on July 25, 2022. The outstanding principal balance at June 30, 2014 and 2013 was \$8,282,133 and \$9,189,252, respectively. The following is a summary of lease liability transactions, including the current portion:

	<u>Balance at July 1</u>	<u>Proceeds</u>	<u>Payments</u>	<u>Balance at June 30</u>	<u>Due within one year</u>
Lease liability, FY 2013	\$ —	10,000,000	(810,748)	9,189,252	907,119
Lease liability, FY 2014	\$ 9,189,252	—	(907,119)	8,282,133	931,388

LOBO ENERGY, INCORPORATED
(A Component Unit of the University of New Mexico)

Notes to Financial Statements

June 30, 2014 and 2013

Future minimum lease payments is as follows:

	Principal	Interest	Total
Fiscal year ending June 30:			
2015	\$ 931,388	\$ 207,677	\$ 1,139,065
2016	956,306	182,759	1,139,065
2017	981,891	157,174	1,139,065
2018	1,008,160	130,905	1,139,065
2019	1,035,132	103,933	1,139,065
2020 to 2022	3,369,256	142,861	3,512,117
	\$ 8,282,133	\$ 925,309	\$ 9,207,442

Internally generated software

Lobo Energy is in the process of developing internally generated software. The software is intended to gather and retain information related to the efficient management of energy consumption. It was developed for use by UNM and potentially other educational institutions as well as emergency responders and other facility managers who could benefit from having a database that collects institutional knowledge about their assets. At June 30, 2014 and 2013, Lobo Energy has capitalized \$545,834 and \$189,008, respectively, and is included in the construction in progress line item on the balance sheet.

In addition, Lobo Energy bought a commercially available software package on March 20, 2014, for \$76,745 and is in the process of modifying it using more than minimal incremental effort, and it is expected to be placed into operation in fiscal year 2015, and is also included in the construction in progress line item on the balance sheet.

(6) Major Contracts

UNM requested that Lobo Energy implement an energy conservation program on the campus during 2008. Effective December 7, 2007, Lobo Energy entered into a contract with EEI (now known as Cenergistic), a corporation that specializes in the reduction of consumption of electricity, gas, propane, fuel oil, water, and sewer. There was a strategic planning and implementation period that extended through March of 2008. A six-month fast track followed (April–September 2008) in which Lobo Energy hired energy conservation specialists (ECSs) to work on UNM’s Albuquerque campus. Four performance years, during which Lobo Energy pays EEI \$1,924,800 per year, or a total of \$7,699,200, commenced on October 1, 2008. EEI estimated a cumulative net cost avoidance of \$10,838,672 during the four performance years. The four-year contract expired on September 30, 2012. Net avoided costs realized at that time were \$10,956,660 (unaudited).

During fiscal years 2008 and 2009, energy-conservation programs were started on UNM’s Valencia, Gallup, Los Alamos, and Taos Campuses. The program on each of those campuses is administered by an employee who was already employed on each campus. The programs are ongoing during fiscal years 2013 and 2014.

LOBO ENERGY, INCORPORATED
(A Component Unit of the University of New Mexico)

Notes to Financial Statements

June 30, 2014 and 2013

During fiscal year 2012, at the request of UNM, Lobo Energy entered into a contract with Shimizu NA whereby Lobo Energy began providing technical support for the smart-grid solar energy project owned by Shimizu NA on the Mesa del Sol campus. Lobo Energy was compensated by Shimizu for labor and materials per terms of the contract. The contracts for the periods April 15–June 14, 2012, and June 15–August 14, 2012, provided for billing of a fixed fee of \$12,500 per month for 40 hours of labor per week, plus overtime billed at \$50/hr. Lobo Energy realized revenue in the amount of \$27,443 during fiscal year 2013. The contract for the period of August 15, 2012 through March 31, 2014 provides for services to be provided on a limited, as-needed basis. Services are limited to 25 hours per month to be billed at \$60/hr. Overtime hours are limited to 32 hours per month at a rate of \$100/hr. Lobo Energy recognized revenue in the amount of \$21,026 during fiscal year 2014. In July 2012, Lobo Energy entered into a Memorandum of Understanding with UNM’s Physical Plant Department to define the responsibilities of both parties with respect to provision of and payment for materials and services to be provided by UNM Physical Plant on the Shimizu project on the Mesa del Sol campus. This project was completed in March 30, 2014.

(7) Defined-Contribution Plan

Lobo Energy entered into, and administers, a 403(b) defined-contribution plan effective February 1, 2000 and amended January 1, 2009. As a defined-contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. The plan may be amended by a board of directors’ resolution. All employees of Lobo Energy are eligible to participate and are considered to be immediately vested. The plan allows for variable employee contributions up to the IRS maximum allowed amount. The employer contributes a 100% match up to 6% of each participating employee’s gross salary per compensation period. Contributions to the plan for the fiscal years ended June 30, 2014 and 2013 were \$64,406 and \$54,167, respectively, which consisted of \$34,851 and \$33,017 contributed by employees and \$29,554 and \$28,220 contributed by Lobo Energy, respectively.

(8) Related-Party Transactions

Effective December 1, 1998, UNM and Lobo Energy entered into a Memorandum of Agreement (MOA) containing the expectations and performance obligations that UNM was seeking from Lobo Energy at that time. The MOA articulates UNM’s and Lobo Energy’s mutual obligations in planning, developing, and implementing the utility facilities and services required by UNM.

Pursuant to the MOA, UNM provides to Lobo Energy, at no cost to Lobo Energy, facilities support and general business office and associated workspace. The MOA also establishes UNM as the fiscal agent for Lobo Energy, with UNM providing cash and investment management activities for Lobo Energy, at no cost to Lobo Energy.

The MOA may be terminated by UNM and, upon termination, all property of Lobo Energy will be transferred to UNM or other successor organizations designated by a resolution of UNM’s Board of Regents.

LOBO ENERGY, INCORPORATED
(A Component Unit of the University of New Mexico)

Notes to Financial Statements

June 30, 2014 and 2013

In FY 2014, Lobo Energy paid a total of \$365,077 to Facility Facts, Inc. a company owned by an employee of Lobo Energy, and in which Lobo Energy has a 10% common stock interest in order to help get the company established in order to market and sell the Facility Facts software internally generated by Lobo Energy. Lobo Energy accounts for its investment in Facility Facts, Inc. using the equity method of investment.

Pursuant to the licensing agreement made with Facility Facts Inc., Lobo Energy retains the patent rights, permanent royalty-free rights to use the Facility Facts software, and will receive royalties representing 50% of gross receipts of sublicenses granted during each calendar year for the life of the filed patents.

(9) Equity Method Investments

Investments accounted for under the equity method consist of 10% of the common stock of Facility Facts, Inc. Lobo Energy received 7% of common stock upon execution of the licensing agreement discussed in note 8 to the financial statements. The remaining 3% of common stock was issued to Lobo Energy as consideration for \$365,077 of funding provided during FY 2014. Under this method, there was no recorded goodwill; however, the investment was analyzed for impairment. As a result of impairment testing during FY 2014, Lobo Energy recognized a loss related to its investment in the amount of \$350,077.

(10) Risk Management

Lobo Energy, through UNM, participates in the State of New Mexico Risk Management Program (Risk Management) that provides general liability, auto liability, physical damage, and workers' compensation insurance. The Risk Management program liability insurance coverage includes most employee liability claims; those claims falling outside this state program are in limited amounts and are covered by UNM from its operating budget. UNM's exposure is limited to \$1,000 per any first-party incurred property loss, with the exception of theft, which has a \$5,000 deductible.

(11) Subsequent Events

Lobo Energy has evaluated subsequent events from the balance sheet date through October 17, 2014, the date at which the financial statements were available to be issued.

Lobo Energy experienced a turnover of administrative staff and corporate officers, which began with the sudden, unfortunate passing of Steven R. Beffort (President/CEO) on June 29, 2014. Mary Vosevich (Vice President of Lobo Energy and UNM's Physical Plant Director) left UNM at the end of August. Jewel Glavey (Secretary/Treasurer) retired on September 30, 2014.

The Board of Directors held a special meeting on August 5, 2014, and appointed Jason Strauss to the position of President/CEO. At the August 21, 2014 Lobo Energy Board of Directors annual meeting, Strauss announced that he had appointed J. A. "Jeff" Zumwalt to the position of Vice President and Wanita Kirkman to the position of Secretary/Treasurer effective August 14, 2014. Jeff Zumwalt has just been appointed Interim Physical Plant Director at UNM, replacing Mary Vosevich in that position, too. He is a UNM employee. Wanita Kirkman retired from UNM at the end of April and was hired as Lobo Energy's Chief Financial Officer on August 18, 2014.



KPMG LLP
Two Park Square, Suite 700
6565 Americas Parkway, N.E.
Albuquerque, NM 87110-8179

**Independent Auditors' Report on Internal Control over Financial Reporting
and on Compliance and Other Matters Based on an Audit of Financial
Statements Performed in Accordance with *Government Auditing Standards***

The Board of Directors
Lobo Energy, Incorporated
and
Mr. Hector Balderas, New Mexico State Auditor:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Lobo Energy, Incorporated (Lobo Energy), a component unit of the University of New Mexico, which comprise the balance sheet as of June 30, 2014, and the related statements of revenues, expenses, and changes in net position and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated October 17, 2014.

Internal Control over Financial Reporting

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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



Compliance and Other Matters

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

We noted a certain matter that is required to be reported per Section 12-6-5 NMSA 1978 that we have described in the accompanying schedule of findings as item 2014-001.

Purpose of this Report

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

KPMG LLP

Albuquerque, New Mexico
October 17, 2014

LOBO ENERGY, INCORPORATED
(A Component Unit of the University of New Mexico)

Schedule of Findings and Responses

Year ended June 30, 2014

Findings – Financial Statements Audit

Finding Number: 2014-001 Other Matter

Finding Title: Expenses

Type of Finding: Other Matter

Condition and Criteria

In establishing a system of internal controls, specific to expenditures, one effective internal control is to have the proper level of authority sign and approve checks. Per company policy, checks in any amount up to \$10,000 require only one signature (that of either the President/CEO or Vice President). Checks for amounts in excess of \$10,000 require two signatures; the second signature must be that of the UNM Executive Vice President on the Lobo Energy Board of Directors.

Of the 19 items tested requiring 2 signatures, 4 items did not possess the requisite two signatures.

Effect

Weaknesses in internal controls could result in inappropriate or unapproved expenditures being incurred.

Cause

Established policies and procedures for review and approval of expenditures were not consistently being followed.

Auditor's Recommendation

We recommend that Lobo Energy improve the expenditures process to ensure that payments are submitted for review and authorization in a timely fashion in accordance with the company's policy.

Corrective Action Plan (CAP)

Expense invoices and other supporting documents will be submitted to either the President or Vice President for proper review and signature.

LOBO ENERGY, INCORPORATED
(A Component Unit of the University of New Mexico)

Exit Conference

Year ended June 30, 2014

An exit conference was conducted on October 9, 2014. During this meeting, the contents of this report were discussed with the following individuals:

Lobo Energy, Incorporated

Jason Strauss, President/CEO

Jewel M. Glavey, Retired Business Manager and Board Secretary/Treasurer

Wanita Kirkman, CFO and Corporate Secretary/Treasurer

KPMG LLP

John T. Kennedy, Partner

Caroline M. Garcia, Partner