

**STATE OF ILLINOIS  
PRAIRIELAND ENERGY, INC.**

**FINANCIAL AUDIT  
For the Year Ended June 30, 2007**

**Performed as Special Assistant Auditors  
for the Auditor General, State of Illinois**

**STATE OF ILLINOIS  
PRAIRIELAND ENERGY, INC.  
FINANCIAL AUDIT  
For the Year Ended June 30, 2007**

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**PRAIRIELAND ENERGY, INC.**  
**COMPANY OFFICIALS**  
**June 30, 2007**

President and Chief Executive Officer (thru 12/31/07)	Mr. Lyle D. Wachtel
President and Chief Executive Officer (12/31/07 thru 2/5/08)	Vacant
Interim President and Chief Executive Officer (2/6/08 thru current)	Mr. Walter K. Knorr
Vice President (thru 8/31/07)	Mr. Kenneth V. Buric
Vice President (9/1/07 thru 2/5/08)	Vacant
Vice President (2/6/08 thru current)	Mr. Mark K. Kruger
Secretary (thru 12/7/06)	Dr. Peter J. Czajkowski
Secretary (12/7/06 thru current)	Mr. Kevin L. Noland
Treasurer	Mr. Kevin L. Noland
Assistant Treasurer	Mr. Steven A. Gangloff
Assistant Treasurers (2/6/08 thru current)	Ms. Anita M. Million Mr. Grant E. Nohren Ms. Nicole M. Roberts Ms. Jill S. Wilberg
Board of Directors (thru 7/6/07)	Dr. Craig S. Bazzani Mr. Douglas E. Beckmann Mr. Stephen K. Rugg
Board of Directors (9/6/07 thru current)	Mr. Walter K. Knorr Mr. Thomas R. Bearrows
Board of Directors (9/21/07 thru current)	Mr. Niranjan S. Shah Mr. Robert F. Vickrey

The Prairieland Energy, Inc. offices are located at:

106 Town Center, Suite 304  
Champaign, Illinois 61820

**PRAIRIELAND ENERGY, INC.**  
**FINANCIAL STATEMENT REPORT SUMMARY**  
**June 30, 2007**

The audit of the accompanying financial statements of Prairieland Energy, Inc. was performed by Clifton Gunderson LLP.

Based on their audit, the auditors expressed an unqualified opinion on Prairieland Energy, Inc.'s financial statements.

**SUMMARY OF FINDINGS**

The auditors identified matters involving Prairieland Energy, Inc.'s internal control over financial reporting that they considered to be significant deficiencies. The significant deficiencies are described in the accompanying Schedule of Findings on pages 21 - 26 of this report, as finding 07-01, *Inadequate Operation of Accounting Controls*, 07-02, *Billing Errors and Contract Irregularities*, 07-03, *Inadequate System of Accounting for Sales and Related Accounts Receivable*, and 07-4, *Conflict of Interest and Fraud Prevention and Detection Policies*.

**EXIT CONFERENCE**

Prairieland Energy, Inc. waived holding an exit conference in an e-mail dated February 11, 2008.

The responses to the recommendations were provided by Mr. Walter K. Knorr in an e-mail dated February 11, 2008.

## Independent Auditor's Report

The Honorable William G. Holland  
Auditor General  
State of Illinois

and

Board of Directors  
PrairieLand Energy, Inc.

As Special Assistant Auditors for the Auditor General, we have audited the accompanying basic financial statements of PrairieLand Energy, Inc., a component unit of the University of Illinois, and a component unit of the State of Illinois as of and for the year ended June 30, 2007, as listed in the table of contents. These financial statements are the responsibility of the Company'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 PrairieLand Energy, Inc. as of June 30, 2007, 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 February 21, 2008 on our consideration of PrairieLand Energy, Inc.'s internal control over financial reporting and 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.

The accompanying management's discussion and analysis on pages 5 through 8 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

*Clifton Henderson LLP*

Peoria, Illinois  
February 21, 2008

**PRAIRIELAND ENERGY, INC.**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**June 30, 2007**

(Unaudited)

**INTRODUCTION**

The following discussion and analysis provides an overview of the financial position and activities of Prairieland Energy, Inc. for the year ended June 30, 2007, with selected comparative information for the year ended June 30, 2006. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section. These include the Statement of Net Assets; Statement of Revenues, Expenses and Changes in Net Assets; and Statement of Cash Flows.

By agreement with the Board of Trustees of the University of Illinois (University), Prairieland Energy, Inc. (Prairieland) exists for the sole purpose of reducing energy operating costs to the University.

**USING THE FINANCIAL STATEMENTS**

Prairieland's financial report includes three financial statements: Statement of Net Assets; Statement of Revenues, Expenses and Changes in Net Assets; and Statement of Cash Flows. These statements are prepared in accordance with the pronouncements of the Governmental Accounting Standards Board (GASB).

The Statement of Net Assets is presented to show assets, liabilities, and net assets as of June 30, 2007. Following the Statement of Net Assets is the Statement of Revenues, Expenses and Changes in Net Assets, which provides operational information for Prairieland regarding changes in its financial position for the year ended June 30, 2007. The Statement of Cash Flows provides details on how cash was used during the year followed by a reconciliation of the operating income to the net cash provided by operating activities.

**FINANCIAL HIGHLIGHTS**

The Statement of Net Assets indicate an increase in current assets of \$2,876,426 from June 30, 2006 to June 30, 2007. The increase is due mostly to two significant events, both connected to the receipt of electric service from MISO; the cash deposit of \$1,239,042 for the purchase of electricity from Midwest Independent System Operator (MISO) organization and the increase of accounts receivable of \$1,449,014 which was primarily for electric service provided to the University. Prairieland's capital assets, net of depreciation, were \$60,809 as compared to \$22,680 as of June 30, 2006. Net assets increased by \$177,882, primarily the result of increased electric service revenue from non-University customers.

**PRAIRIELAND ENERGY, INC.**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**June 30, 2007**

(Unaudited)

**Condensed Statements of Net Assets**

	<u>2007</u>	<u>2006</u>
Current assets	\$3,972,422	\$1,095,996
Capital assets	<u>60,809</u>	<u>22,680</u>
<b>Total assets</b>	<b><u>\$4,033,231</u></b>	<b><u>\$1,118,676</u></b>
Current liabilities	\$2,987,137	\$ 384,054
Long-term liabilities	<u>140,462</u>	<u>6,872</u>
Total liabilities	<u>3,127,599</u>	<u>390,926</u>
Net assets:		
Invested in capital assets	60,809	22,680
Unrestricted	<u>844,823</u>	<u>705,070</u>
Total net assets	<u>905,632</u>	<u>727,750</u>
<b>Total liabilities and net assets</b>	<b><u>\$4,033,231</u></b>	<b><u>\$1,118,676</u></b>

The Statement of Revenues, Expenses and Changes in Net Assets presents Prairieland's results of operations. Operating revenues include revenue from the University for the sale of high temperature hot water, steam and chilled water. It also includes revenue for the sale of electricity, steam, and chilled water to the Urbana-Champaign campus beginning in January 2007 and to third parties adjacent to the Urbana-Champaign campus. The energy cost adjustment represents the amounts the University bills Prairieland for producing electricity, steam, hot water, and chilled water. The facilities rental expense reflects the rent Prairieland pays the University for the heat and chilled water production facilities Prairieland utilizes in the production of the steam, high temperature hot water and chilled water it sells to the University. This facility rental and the fuel cost adjustment process and procedure was modified as of January 2007 (see Note 1).

While service income has decreased by \$3,721,179, the cost of energy has also decreased by \$2,908,978 and the cost of facilities rents has decreased by \$1,452,030 due to the January changes in lease and sales with the University previously discussed, contributing to the majority of the change of operating income from a loss of \$221,267 to a profit of \$199,392.

**PRAIRIELAND ENERGY, INC.**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**June 30, 2007**

(Unaudited)

**Condensed Statements of Revenues, Expenses, and Changes in Net Assets**

	<u>2007</u>	<u>2006</u>
Operating revenue	\$ 9,956,136	\$ 13,677,315
Operating expenses:		
Energy costs	7,936,031	10,845,009
Facilities rental	1,451,850	2,903,880
Accounting fees	19,800	15,572
Salaries	116,499	46,593
Office rent	15,180	13,596
Depreciation	5,569	3,615
Telephone	1,497	1,223
Municipal and Excise Tax	72,998	45,563
Contracted services	132,095	-
Budget allocation University of Illinois	-	21,210
Other	5,225	2,321
Total operating expenses	<u>9,756,744</u>	<u>13,898,582</u>
Operating income (loss)	<u>199,392</u>	<u>(221,267)</u>
Nonoperating revenues (expenses):		
Interest	7,238	9,107
Other	(134)	(514)
Income and built-in gains taxes (expense)	<u>(28,614)</u>	<u>70,002</u>
Total nonoperating revenues (expenses)	<u>(21,510)</u>	<u>78,595</u>
Increase/Decrease in net assets	177,882	(142,672)
Net assets, beginning of year	<u>727,750</u>	<u>870,422</u>
<b>Net assets, end of year</b>	<u><b>\$ 905,632</b></u>	<u><b>\$ 727,750</b></u>

**Condensed Statements of Cash Flows**

	<u>2007</u>	<u>2006</u>
Net cash provided by operating activities	\$ 475,954	\$ 42,332
Net cash used in non-capital financing activities	(10,474)	(6,191)
Net cash used in capital and related financing activities	(43,698)	(4,232)
Net cash provided by investing activities	7,238	9,107
Increase in cash	<u>\$ 429,020</u>	<u>\$ 41,016</u>

**PRAIRIELAND ENERGY, INC.**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**June 30, 2007**

(Unaudited)

**Factors affecting the future**

Future events that could have an impact on revenues and expenses are the regulatory framework that Prairieland operates within and the market conditions that would permit the economic purchase and/or sale of electricity on the wholesale markets.

The Company and the University of Illinois are involved in ongoing discussions with Commonwealth Edison regarding a schedule of regulatory electrical rates for the Chicago campus.

Prairieland has been accepted for membership to the Midwest Independent Transmission System Operator and is currently in the application process for the PJM Interconnection LLC., the two independent system operators serving the two utilities; AmerenIP for the Urbana-Champaign campus and Commonwealth Edison for the Chicago campus. The memberships are central to the ability of Prairieland to access the wholesale electric markets to provide electric service to the University.

Having access to the wholesale markets will permit Prairieland to provide low cost electric service options to the University. The final evaluation of suppliers for the Chicago campus and options will occur well into fiscal year 2008 operations.

**PRAIRIELAND ENERGY, INC.**  
**STATEMENT OF NET ASSETS**  
**June 30, 2007**

**ASSETS**

**CURRENT ASSETS**

Cash	\$ 626,529	
Accounts receivable	2,105,601	
Escrow deposit	1,239,042	
Prepaid expense	<u>1,250</u>	\$ 3,972,422

**CAPITAL ASSETS**

60,809

**TOTAL ASSETS**

\$ 4,033,231

**LIABILITIES AND NET ASSETS**

**CURRENT LIABILITIES**

Accounts payable	\$ 975,172	
Accrued expenses	65,231	
Customer deposits	1,900	
Service deposit - University of Illinois	1,821,040	
Taxes payable	<u>123,794</u>	\$ 2,987,137

**LONG-TERM LIABILITIES**

Deferred taxes		<u>140,462</u>
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Total liabilities

3,127,599

**NET ASSETS**

Invested in capital assets	60,809	
Unrestricted	<u>844,823</u>	<u>905,632</u>

**TOTAL LIABILITIES AND NET ASSETS**

\$ 4,033,231

These financial statements should be read only in connection with  
the accompanying notes to financial statements.

**PRAIRIELAND ENERGY, INC.**  
**STATEMENT OF REVENUES, EXPENSES, AND CHANGES**  
**IN NET ASSETS**  
**Year Ended June 30, 2007**

**OPERATING REVENUES**

Steam sales	\$ 2,882,019	
Chilled water sales	1,541,329	
Hot water sales	1,442,324	
Electricity sales	<u>4,090,464</u>	\$ 9,956,136

**OPERATING EXPENSES**

Energy cost adjustment	7,936,031	
Facilities rental	1,451,850	
Accounting fees	19,800	
Salaries	116,499	
Office rent	15,180	
Depreciation	5,569	
Telephone	1,497	
Municipal & Excise Tax	72,998	
Contracted services	132,095	
Other	<u>5,225</u>	<u>9,756,744</u>

Operating income 199,392

**NONOPERATING REVENUES (EXPENSES)**

Interest revenue	7,238	
Other expense	(134)	
Income and built-in gains taxes	<u>(28,614)</u>	<u>(21,510)</u>

**INCREASE IN NET ASSETS** 177,882

**NET ASSETS, BEGINNING OF YEAR** 727,750

**NET ASSETS, END OF YEAR** \$ 905,632

These financial statements should be read only in connection with  
the accompanying notes to financial statements.

**PRAIRIELAND ENERGY, INC.**  
**STATEMENT OF CASH FLOWS**  
**Year Ended June 30, 2007**

**CASH FLOWS FROM OPERATING ACTIVITIES**

Payments from customers	\$ 10,328,702
Payments to suppliers	(9,737,863)
Payments to employees	<u>(114,885)</u>

Net cash provided by operating activities \$ 475,954

**CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES**

Other expenses	(134)
Payments for income taxes	<u>(10,340)</u>

Net cash used in noncapital financing activities (10,474)

**CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES**

Purchase of equipment	<u>(43,698)</u>
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Net cash used in capital and related financing activities (43,698)

**CASH FLOWS FROM INVESTING ACTIVITIES**

Interest income	<u>7,238</u>
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Net cash provided by investing activities 7,238

**INCREASE IN CASH** 429,020

**CASH, BEGINNING OF YEAR** 197,509

**CASH, END OF YEAR** \$ 626,529

**RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES**

Operating income	\$ 199,392
Adjustments to reconcile operating (loss) to net cash provided by operating activities:	
Depreciation	5,569
Effects of changes in operating assets and liabilities:	
Accounts receivable	(1,449,014)
Escrow deposit	(1,239,042)
Prepaid expense	240,650
Accounts payable	876,399
Customer and service deposits	1,821,580
Accrued expenses	<u>20,420</u>

**NET CASH PROVIDED BY OPERATING ACTIVITIES** \$ 475,954

These financial statements should be read only in connection with the accompanying notes to financial statements.

**PRAIRIELAND ENERGY, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2007**

**NOTE 1 - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Nature of Operations**

PrairieLand Energy, Inc. (PrairieLand) is an Illinois corporation with an office located in Champaign, Illinois. PrairieLand was formed by and is a component unit of the University of Illinois (University), a body corporate and politic of the State of Illinois.

PrairieLand was formed November 19, 1996 for the purpose of producing, acquiring, and selling various forms of energy, including electricity, at both wholesale and retail prices.

PrairieLand intends to acquire economically priced electricity from available sources and to make such electricity available to the University and other customers at prices below what they are otherwise paying. In order to access such electricity for the University's Chicago campus, PrairieLand must obtain transmission service from Commonwealth Edison Company (ComEd). ComEd denied PrairieLand's initial requests for such transmission service.

In September 1998, PrairieLand made application to the Federal Energy Regulatory Commission (Commission) for an order directing ComEd to provide transmission service under ComEd's Open Access Transmission Tariff (OATT), which is available to certain electric utility companies. ComEd intervened in the matter, stating that PrairieLand did not qualify as an eligible customer under ComEd's OATT because PrairieLand is not an electric utility. In an order dated August 2, 1999, the Commission agreed with ComEd. The order stated that PrairieLand had not shown that it was an electric utility, and that it had failed to demonstrate that it sold electrical energy. On September 1, 1999, PrairieLand filed a request for re-hearing of the Commission's August 2, 1999 order. The Commission subsequently denied PrairieLand's September 1, 1999 request.

On June 13, 2000, PrairieLand filed a new petition with the Commission. The petition requested the Commission to disclaim jurisdiction over PrairieLand as a "public utility" under the Federal Power Act. More specifically, the petition stated that since both PrairieLand and the University are agencies or instrumentalities of the State of Illinois, neither entity should fall under the Commission's jurisdiction. In an order dated August 1, 2000, the Commission granted PrairieLand disclaimer of jurisdiction as a public utility. The order means that PrairieLand will not be subject to the Commission's regulations and other requirements. However, the order did not address PrairieLand's request for transmission access through Commonwealth Edison Company. Concurrent with these activities, the University was constructing additional generating facilities for the two heating plants in Chicago. The East plant on the Chicago campus was completed in 2000 while the West plant on the Chicago campus was completed in April 2002. The University has been in an electric service tariff dispute with Commonwealth Edison since the completion of these plants. Until this dispute is resolved at the University, PrairieLand will be unable to complete its transmission access plans. PrairieLand staff is actively involved in assisting the University in the resolution of this dispute.

**PRAIRIELAND ENERGY, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2007**

**NOTE 1 - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Nature of Operations (Continued)**

On April 1, 1999, Prairieland entered into an agreement to lease certain steam, hot water, and chilled water production and distribution facilities from the University and entered into an agreement to supply the steam, hot water, and chilled water requirements for the University's Chicago campus.

Starting in October 2004, Prairieland entered into agreements to purchase electricity, steam and chilled water from the University of Illinois, at its Urbana Champaign campus and to supply electricity, steam and chilled water to private individuals and companies at locations adjacent to the Urbana Champaign campus.

In the fall of 2006, Prairieland Energy, Inc. began the application process of becoming a market participant within the Midwest Independent System Operator (MISO) organization to access wholesale supplies of electric service for transportation through the Ameren local distribution system to supply the University's Urbana campus. All of the agreements required for this service from MISO and Ameren were completed, and service began on January 2, 2007. Prairieland intends to use this model to enter the Chicago market and provide electric services to the University's Chicago campus

In anticipation of the new electric service arrangements, Prairieland Energy, Inc. and the University amended their existing lease and purchase agreements effective for January 2007 to modify the business relationship between the University and Prairieland Energy, Inc. to reflect the value of assets and services the University provides Prairieland Energy, Inc. and the value of energy production and procurement Prairieland Energy, Inc. provides the University. The lease terms were modified to minimum values in return for reduced energy service charges for chilled water, high temperature hot water, steam, and electricity. Because the fuel components for chilled water, high temperature hot water and steam were largely purchased through the University, these amendments eliminate the fuel cost adjustment provisions for the University in conjunction with the reduced charges. The sales agreements have provisions for higher energy sales values to Prairieland Energy, Inc. customers who do not provide production facilities similar to the University. In addition, the agreements provide an annual payment to the University for various support functions to Prairieland Energy, Inc. such as legal and accounting services.

**PRAIRIELAND ENERGY, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2007**

**NOTE 1 - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Summary of Significant Accounting Policies**

Basis of Presentation

Prairieland's financial statements are prepared as a business-type activity, as defined by Governmental Accounting Standards Board (GASB) Statement No. 34, using the economic resources measurement focus and the accrual basis of accounting. Business-type activities are those financed in whole, or in part, by fees charged to external parties for goods and services. Pursuant to GASB Statement No. 20, Prairieland 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, and do not conflict with or contradict GASB pronouncements. Prairieland has chosen not to follow FASB Statements and interpretations issued after November 30, 1989.

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 and expenses during the reporting period. Actual results could differ from those estimates.

Accounts Receivable

Accounts receivable are uncollateralized customer obligations which generally require payment within thirty days from the invoice date. Accounts receivable are stated at the invoice amount.

Account balances with invoices over ninety days old are considered delinquent. Payments of accounts receivable are applied to the specific invoices identified on the customer's remittance advice or, if unspecified, to the earliest unpaid invoices.

The carrying amount of accounts receivable is reduced by an allowance that reflects management's best estimate of amounts that will not be collected. The allowance for doubtful accounts is based on management's assessment of the collectibility of specific customer accounts and the aging of the accounts receivable. As of June 30, 2007 management does not believe an allowance is required and there were no write offs of uncollectible accounts during the year. If there is a deterioration of a major customer's credit worthiness or actual defaults are higher than the historical experience, management's estimates of the recoverability of amounts due the Company could be adversely affected. All accounts or portions thereof deemed to be uncollectible or that require excessive collection costs are written off to the allowance for doubtful accounts.

Capital Assets

Capital assets are stated at cost and depreciated over the estimated useful life of each asset which range from 3 to 10 years. Annual depreciation is computed using the straight-line method.

**PRAIRIELAND ENERGY, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2007**

**NOTE 1 - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Income Taxes

Beginning in fiscal year 2007, Prairieland filed and received permission from the Internal Revenue Service to change its corporate status from Subchapter C to Subchapter S. The income or loss of a Subchapter S corporation flows thru to the shareholders of the corporation, and no provision for income taxes is recognized by Prairieland.

The accrued and deferred taxes presented in the financial statements is Prairieland's liability for "built-in gains" tax related to its conversion from cash basis to accrual basis for income tax reporting and its Subchapter S election. Income taxes for the temporary differences between the amounts of assets and liabilities reported for financial statement purposes and their tax bases have been primarily recognized in previous years. The deferred tax liability will be payable in future years dependent upon Prairieland's profitability.

Revenue Recognition and Classification

Revenue from the sale of Prairieland's products is recognized when the products are delivered. Prairieland has classified its sales revenues as operating. All other revenues are classified as nonoperating.

**NOTE 2 - DEPOSITS**

Custodial credit risk is the risk that in the event of a bank failure, the Company's deposits may not be returned to the Company. Prairieland's policy is to request collateral for deposits exceeding Federal Deposit Insurance Corporation (FDIC) coverage. At June 30, 2007, all of Prairieland's deposits were collateralized by pledged securities or FDIC coverage.

**NOTE 3 - CAPITAL ASSETS**

Capital asset activity for the year ended June 30, 2007 was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Retirements</u>	<u>Ending Balance</u>
Office equipment	\$ 12,781	\$ 9,076	\$ -	\$ 21,857
Metering system	<u>27,432</u>	<u>34,622</u>	<u>-</u>	<u>62,054</u>
Total cost	40,213	43,698	-	83,911
Less accumulated depreciation	<u>(17,533)</u>	<u>(5,569)</u>	<u>-</u>	<u>(23,102)</u>
	<u>\$ 22,680</u>	<u>\$ 38,129</u>	<u>\$ -</u>	<u>\$ 60,809</u>

**PRAIRIELAND ENERGY, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2007**

**NOTE 4 - OPERATING LEASES**

Noncancelable operating leases with the University of Illinois for certain steam, hot water, and chilled water production and distribution facilities expire June 30, 2007. These leases automatically renew for successive periods of twelve calendar months beginning every July 1, absent of notification by either party to decline to renew. The leases were amended during the current year (see Note 1).

The Company leased office facilities during the year under a lease agreement with monthly lease payments of \$1,250. The initial term of the lease is through June 30, 2011. The monthly payment amount is \$1,250. Future minimum lease payments under this lease are as follows:

June 30, 2008	\$ 15,000
2009	15,000
2010	15,000
2011	<u>15,000</u>
Total	<u>\$ 60,000</u>

Rental expense for the year ended June 30, 2007 for all operating leases consisted of:

Facilities rental	\$ 1,451,850
Office rental	<u>15,180</u>
	<u>\$ 1,467,030</u>

**NOTE 5 - INCOME AND BUILT-IN GAINS TAXES**

As noted in Note 1, Prairieland elected Subchapter S status during the current year and was subject to built-in gains tax. Income taxes which had been provided for and deferred in previous fiscal years are no longer a liability to Prairieland. Prairieland also converted from cash basis to accrual basis for filing its income tax returns during the current year. The provision for taxes consists of the following components:

Built-in gains tax	\$ 264,256
Federal income tax reversal	(178,870)
State income tax reversal	<u>(56,772)</u>
<b>Tax expense</b>	<u>\$ 28,614</u>

**PRAIRIELAND ENERGY, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2007**

**NOTE 5 - INCOME AND BUILT-IN GAINS TAXES (CONTINUED)**

PrairieLand Energy, Inc., with the consent of its shareholder, elected S corporation status effective July 1, 2006. In lieu of corporation income taxes, the shareholder will be taxed on all future income. However, as a result of the S election and conversion to the accrual method for filing income tax returns, the corporation was subject to a built-in gains tax of \$264,256. For the tax year ended June 30, 2007, the taxes due were limited to the taxes computed as if it were a C corporation. The taxes payable and the deferred taxes were computed as follows:

Total built-in gains tax as of July 1, 2006	\$ 264,256
Taxes payable for year ended June 30, 2007	<u>123,794</u>
<b>Deferred tax liability</b>	<b><u>\$ 140,462</u></b>

**NOTE 6 - RELATED PARTY TRANSACTIONS**

The University provides various services to PrairieLand including management (president's salary), clerical services, the cost of operation and maintenance of the facilities leased to PrairieLand (see Note 4), and certain administrative costs as provided in the agreement.

PrairieLand has an agreement with the University to provide the steam, hot water, and chilled water requirements of the University's Chicago campus. The agreement operates on a year-to-year basis and can be terminated by either party with two month's prior written notice. These services through December 2006 were billed to the University monthly at rates specified in the agreement. Through December 2006, the University pays for the cost of the fuel to produce the services, and amounts billed by PrairieLand are net of a fuel cost adjustment. Gross operating revenue from steam, hot water, and chilled water sales in 2007 was \$5,865,672, and energy costs paid to the University were \$4,404,757. Electricity sales to the University were \$3,380,099. Included in accounts receivable is \$1,985,581 due from the University. Included in accounts payable is \$131,412 due to the University.

The agreements for lease payments and energy costs were modified for services beginning in January 2007 (see Note 1) reflecting the success of PrairieLand's market participation in the MISO market. The majority of the PrairieLand's financial activity from January 2007 forward will center mostly on the acquisition and supply of electric service to the University and outside customers. During the year ended June 30, 2007, PrairieLand paid the University \$75,000 for support services such as legal and accounting services. To provide an appropriate escrow for electric services purchased on behalf of the University, the University paid PrairieLand Energy, Inc. \$1,821,040 as a service deposit. In accordance with the agreement with the University, this service deposit will increase to \$2,000,000 in fiscal year 2008.

**PRAIRIELAND ENERGY, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2007**

**NOTE 7 - SUBSEQUENT EVENT**

The Board of Trustees of the University of Illinois has reconstituted Prairieland's Board of Directors. The new Prairieland Board of Directors now consists of the Chief Financial Officer of the University, the University Counsel, and two members of the University's Board of Trustees. The new Board convened its first meeting on February 6, 2008.

This information is an integral part of the accompanying financial statements.



**Clifton  
Gunderson LLP**

Certified Public Accountants & Consultants

**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***

Honorable William G. Holland  
Auditor General  
State of Illinois

and

The Board of Directors  
PrairieLand Energy, Inc.

As Special Assistant Auditors for the Auditor General, we have audited the basic financial statements of PrairieLand Energy, Inc. as of and for the year ended June 30, 2007, and have issued our report thereon dated February 21, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered PrairieLand Energy, Inc.'s internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not for the purpose of expressing an opinion on the effectiveness of PrairieLand Energy, Inc.'s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the PrairieLand Energy, Inc.'s internal control over financial reporting.

Our consideration of the internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a certain deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the following deficiencies described in the accompanying schedule of findings to be significant deficiencies in internal control over financial reporting, findings 07-01, 07-02, 07-03, and 07-04.

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

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that finding 07-01, 07-2, and 07-03 are material weaknesses.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Prairieland Energy, Inc.'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*.

Prairieland Energy, Inc.'s responses to the findings identified in our audit are described in the accompanying schedule of findings. We did not audit Prairieland Energy, Inc.'s responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, agency management, and the Board of Directors and is not intended to be and should not be used by anyone other than these specified parties.

*Clifton Anderson LLP*

Peoria, Illinois  
February 21, 2008

**PRAIRIELAND ENERGY, INC.**  
**SCHEDULE OF FINDINGS**  
**Current Findings – Government Auditing Standards**  
**June 30, 2007**

**07-01 - Finding: Inadequate Operation of Accounting Controls**

PrairieLand Energy, Inc. (PrairieLand) maintained its accounting records during the year on the cash basis and recorded accrual adjustments at the end of the year in order to report financial results in accordance with accounting principles generally accepted in the United States of America (GAAP). However, PrairieLand failed to identify and properly record certain accrual adjustments.

During our testing, we identified the following adjustments which had not been previously recorded by PrairieLand:

- We identified two liabilities which had not been recorded in accounts payable. The first liability (\$43,164) was found early in the audit process and was recorded by PrairieLand after bringing it to their attention. The second liability (\$30,299), was found while updating our liabilities search near audit completion. A proposed entry was not recorded by PrairieLand.
- We identified a deposit slip dated June 30, 2007 for \$36,408 which cleared the bank on July 2, 2007 (July 1 was a Sunday) that was not included as a deposit in transit and the customers' accounts receivable had not been credited for the payments.
- PrairieLand had not recorded a liability for the built-in gains tax related to their conversion from cash to accrual for filing income taxes and Subchapter S election. The built-in gains tax liability related to these totaled \$264,256.

Good business practices and internal controls require management to implement an adequate system of controls to ensure that the financial statements are presented in accordance with GAAP.

PrairieLand personnel stated that historically, cash basis accounting had been used throughout the year and then adjusted to accrual at year end. The two liabilities were not identified during the year end adjustment process. The accounting for the deposit in transit was a clerical error. The built-in gains tax liability would be booked on completion of the audit and preparation of the tax return.

Failure to properly identify liabilities and record transactions in accordance with GAAP may lead to materially misstated financial statements. (Finding Code No. 07-01)

Recommendation:

We recommend that PrairieLand improve its procedures and related controls for identifying liabilities and recording transactions in accordance with GAAP.

PrairieLand Response:

Accepted. PrairieLand management has initiated a review of accounting procedures and internal controls. Procedures and controls will be revised as necessary to improve GAAP compliance.

**PRAIRIELAND ENERGY, INC.**  
**SCHEDULE OF FINDINGS**  
**Current Findings – Government Auditing Standards**  
**June 30, 2007**

**07-02 - Finding: Billing Errors and Contract Irregularities**

Prairieland Energy, Inc. (Prairieland) did not properly bill its electric service customers in accordance with its written service agreements.

We sampled 10 residential and tested 100% of the larger commercial (non-University) electric service customer billings during the year and noted the following:

- Seven of the 10 residential customers were not billed in accordance with the written service agreements. We found 5 underbillings (\$6.80 underbilled) and 2 overbillings (\$9.67 overbilled).
- We also examined 96 commercial electric service invoices and noted 42 with errors that exceeded \$1. The 42 errors resulted in a net underbilling of \$2,678.

The projected net error from our billing testing was a net underbilling of \$3,463.

In addition, we noted the following:

- Prairieland could not locate a written service agreement for steam and chilled water services for a commercial customer.
- An amended service agreement between Prairieland and the University dated December 7, 2006 was not signed until January 31, 2007 and several schedules to the agreement which defined service rates were signed only by the President of Prairieland.
- Multiple service agreements with differing rates were noted for three commercial electric service customers.

Prairieland indicated that it maintains written service agreements with each of its customers. The written electric service agreements provide for higher summer rates from June through September and lower rates from October through May. Our residential customer testing indicated that the lower rates were often used for billing during the entire year. The residential service agreements also call for a reduced rate for all kilowatt hours used in excess of 290 per month. Our testing indicated that these reduced rates were not used for any residential billings where the kilowatts exceeded 290. The commercial customers have varying service agreements dependent on the expected customer usage. The commercial billing errors noted were primarily miscalculations of usage due to meter multipliers or incorrect application of the rates.

Prairieland personnel stated that there were clerical errors in billing of certain residential and commercial customers.

Failure to properly bill customers in accordance with written service agreements is a violation of those agreements and may result in liability to the customers and lost revenue to Prairieland. Failure to properly maintain written service agreements may jeopardize Prairieland's position if billing disputes arise. (Finding Code No. 07-02)

**PRAIRIELAND ENERGY, INC.**  
**SCHEDULE OF FINDINGS**  
**Current Findings – Government Auditing Standards**  
**June 30, 2007**

**07-02 - Finding: Billing Errors and Contract Irregularities (continued)**

Recommendation:

We recommend that Prairieland bill its customers in accordance with its written service agreements, rectify the noted billings errors, and properly maintain all service agreements.

Prairieland Response:

Prairieland management has initiated a review of staffing, processes and procedures. Customer billing software and processes will be revised to provide accurate and reliable customer billing and collection. The management of service agreements will also be reviewed and improved procedures will be implemented.

**PRAIRIELAND ENERGY, INC.**  
**SCHEDULE OF FINDINGS**  
**Current Findings – Government Auditing Standards**  
**June 30, 2007**

**07-03 - Finding: Inadequate System of Accounting for Sales and Related Accounts Receivable**

Prairieland Energy, Inc. (Prairieland) does not maintain an integrated accounting system for recording its sales and accounts receivable and some billings are not done timely.

Prairieland maintains its accounting records on a cash basis during the year and records accrual adjustments at the end of the year. Prairieland uses an excel spreadsheet to track the monthly billing and payments of non-University electricity customers and to record accounts receivable at year end, but it is not used for recording monthly sales and billings. Energy sales were recorded during the year based on deposits reflected on the bank statements and not based on a detailed sales journal. We also noted that billings to a commercial customer of steam and chilled water in Champaign were not done timely. These bills were for one to six months of usage at a time and did not follow any type of billing pattern.

Good business practices and internal controls dictate that an accounts receivable ledger, sales journal and cash receipts journal be maintained. Good business practices also require the timely billing of customers.

Prairieland personnel stated that the change from cash basis accounting to the accrual basis would dictate a significant upgrade in the sales and accounts receivable system.

Failure to maintain proper ledgers and related journals, could result in loss of sales revenue for energy provided to private customers. Untimely and irregular billing may result in lost revenue to Prairieland. (Finding Code Nos. 07-03, 06-01, 05-01)

Recommendation:

We recommend Prairieland maintain its accounting records on the accrual basis, record sales and accounts receivable when they are earned, and implement a regular billing cycle for steam and chilled water customers in Champaign.

Prairieland Response:

Accepted. Prairieland management has initiated a review of staffing, processes and procedures. Sales and accounts receivable software and procedures will be revised to provide accurate and reliable reporting.

**PRAIRIELAND ENERGY, INC.**  
**SCHEDULE OF FINDINGS**  
**Current Findings – Government Auditing Standards**  
**June 30, 2007**

**07-04 - Finding: Conflict of Interest and Fraud Prevention and Detection Policies**

Prairieland Energy, Inc. (Prairieland) has not implemented a conflict of interest policy for its operations nor adopted a formal policy regarding the periodic evaluation of fraud risks.

Prairieland's Board of Directors and management are all University or Foundation employees, and in the past have completed conflict of interest statements relative to their position within the University or Foundation. However, no conflict of interest statements have ever been utilized relative to Prairieland's operations. Prairieland's Board of Directors did adopt a conflict of interest policy at its January 29, 2007 Board meeting, but the policy only addresses "salaried staff members" of Prairieland and has yet to be implemented.

Accounting industry trends have increased organizations' awareness of the prevalence of fraud. Many organizations rely in part on their auditors to uncover any internal fraud, but audits, even those of the highest quality, are not a substitute for management establishing good internal controls along with a formal policy regarding the evaluation of fraud risk.

It is management's responsibility to prevent and detect fraud. Therefore, the Prairieland should implement a formal policy regarding evaluation of fraud risk and a system of controls to help prevent and detect fraudulent activity within its organization. Preparing a written policy will serve to document the Prairieland's awareness and responsibility for fraud prevention and detection.

Sound business practice and good internal controls require that a conflict of interest policy be formally adopted. Each Board Member and management (as well as employees) have a duty to place the interest of Prairieland foremost in any dealings with Prairieland and must conduct their personal affairs in such a manner as to avoid any actual or perceived interest in an action that results in, or has the appearance of resulting in, personal, organizational, or professional gain. Members of the Board and management should be required to submit conflict of interest disclosure statements at least annually.

Prairieland officials stated the importance of a conflict of interest policy is understood.

Implementing an appropriate conflict of interest policy would establish a clear definition of situations or circumstances when a conflict of interest can occur, and would assist in identifying situations where a Board Member or member of management could use his or her position, or the knowledge gained therefrom, in such a manner that conflicts with the interests of Prairieland. Receiving the conflict of interest disclosure statement from all Board Members and members of management would aid in identifying potential conflicts of interest and would establish a consistent approach to managing conflict of interest matters as they arise. In addition, weaknesses in internal control, which may lead to fraud, may go unnoticed due to a formal fraud prevention and detection program not being implemented. (Finding Code No. 07-04).

**PRAIRIELAND ENERGY, INC.**  
**SCHEDULE OF FINDINGS**  
**Current Findings – Government Auditing Standards**  
**June 30, 2007**

**07-04 - Finding: Conflict of Interest and Fraud Prevention and Detection Policies  
(continued)**

Recommendation:

We recommend Prairieland review the content of its newly adopted conflict of interest policy and implement an appropriate program to identify and avoid conflicts of interest specific to Prairieland. We further recommend Prairieland management establish a continuous fraud prevention, deterrence and detection plan. This should include evaluating whether appropriate Internal controls have been implemented in any areas identified as posing a higher risk of fraudulent activity, as well as controls over the financial reporting process. In addition, the Board of Directors should evaluate management's identification of fraud risks and implementation of anti-fraud measures.

Prairieland Response:

Accepted. Prairieland will review its conflict of interest policy and will consider implementation of a fraud deterrence and detection plan. Prairieland management will also discuss both issues with the Board of Directors.