

BRYAN TEXAS UTILITIES

Rural Electric System

Financial Statements

For the Years Ended September 30, 2007 and 2006

Bryan Texas Utilities
Rural Electric System
Table of Contents
For the Years Ended September 30, 2007 and 2006

	<u>Page</u>
Introduction	1
Independent Auditors' Report	2 - 3
Management's Discussion and Analysis	4 - 7
Financial Statements for the Years Ended September 30, 2007 and 2006	
Statements of Net Assets	8 - 9
Statements of Activities	10
Statements of Revenues, Expenses and Changes in Net Assets	11
Statements of Cash Flows	12 - 13
Notes to Financial Statements	14 - 25

Bryan Texas Utilities
Rural Electric System
Introduction
For the Years Ended September 30, 2007 and 2006

Bryan Texas Utilities (BTU) is pleased to present the Annual Financial Report for the fiscal years ended September 30, 2007 and 2006. This report is published to provide the BTU Board, the City of Bryan, the Bondholders, representatives of financial institutions, and other interested parties detailed information concerning the financial condition of BTU.

BTU is an enterprise activity of the City of Bryan, Texas. BTU operates a “City” and “Rural” electric system, (the “City Electric System” and the “Rural Electric System”, respectively). Each system, while operated by a common staff, is maintained separately for accounting and reporting purposes. The accompanying financial statements present only the Rural Electric System and are not intended to present the financial position or results of operations of the City Electric System or the City of Bryan, Texas.

The Rural Electric System provides electric service to the immediate rural area outside the City of Bryan extending to most of Brazos County, all service adjacent to the City of College Station service area, and parts of Burleson, and Robertson counties in a radius of nearly 20 miles from the City of Bryan.

The Rural Electric System is managed by the BTU Board. The BTU Board, established on June 12, 2001, is appointed by the Bryan City Council and is empowered with the custody and management of BTU operations. The Bryan City Council retains authority for approval of the annual budget, rates for electric service, condemnations and approval of debt financing.

BTU management has prepared and is responsible for the financial statements and related information included in this report. Management believes that its policies and procedures provide guidance and reasonable assurance that the Rural Electric System operations are conducted according to management’s intentions and to a high standard of business ethics. In management’s opinion, the financial statements present fairly, in all material respects, the net assets, changes in net assets and cash flows of the Rural Electric System in conformity with accounting principles generally accepted in the United States of America.



Ingram, Wallis & Co., P.C.

CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

To the Audit Committee of City of Bryan, Texas
and Board of Directors of Bryan Texas Utilities

We have audited the accompanying financial statements of the Rural Electric System of Bryan Texas Utilities ("BTU") as of and for the years ended September 30, 2007 and 2006, as listed in the Table of Contents. These financial statements are the responsibility of BTU's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

As discussed in Note 1, the financial statements present only the Rural Electric System of BTU and do not purport to, and do not, present fairly the financial position of the City Electric System of BTU, or the City of Bryan, Texas, as of September 30, 2007 and 2006, and the changes in financial position, or cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Rural Electric System of Bryan Texas Utilities as of September 30, 2007 and 2006, and the changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

2

James D. Ingram, III | Thomas A. Wallis | James D. Ingram, IV | Richard L. Webb

Judith W. Childs • Jennifer A. Stillman • Melissa M. Suehs • Donald B. Browning • Diana K. Wagner • Rosanne P. Ely

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise BTU's Rural Electric System financial statements. The accompanying Introduction, as listed in the Table of Contents, is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the financial statements and, accordingly, we express no opinion on it.

Angam, Wallis Company

Bryan, Texas

February 4, 2008

Bryan Texas Utilities
Rural Electric System
Management's Discussion and Analysis
For the Years Ended September 30, 2007 and 2006
(Unaudited)

This discussion and analysis of the Rural Electric System financial performance provides an overview of financial activities for the years ended September 30, 2007 and 2006. Please read this information in conjunction with the accompanying financial analysis, the financial report, and the accompanying notes to financial statements.

Overview of Annual Financial Report

The financial statements report information about the Rural Electric System using accrual accounting methods as utilized by similar business activities in the private sector. The Rural Electric System annual reporting period ("fiscal year") ends September 30.

The Statements of Net Assets include the Rural Electric System assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to creditors (liabilities). It also provides the basis for the evaluation of capital structure, liquidity, and flexibility of the Rural Electric System.

The Statements of Activities present information showing how the Rural Electric System's net assets changed during the years ended September 30, 2007 and 2006. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows.

The Statements of Revenues, Expenses and Changes in Net Assets present the results of the business activities (revenues and expenses) over the course of the fiscal year and can provide information about the Rural Electric System recovery of its costs.

The Statements of Cash Flows present cash receipts, cash disbursements and net changes in cash resulting from operations, capital and related investing activities. This statement provides information such as where cash came from, what cash was used for and what the changes in cash balances were during the reporting period.

The notes to the financial statements provide required disclosures and other information that are essential to a full understanding of material data provided in the statements. The notes present information about the Rural Electric System accounting policies, significant account balances and activities, material risks, obligations, commitments, contingencies and subsequent events, if any.

Bryan Texas Utilities
Rural Electric System
Management's Discussion and Analysis - Continued
For the Years Ended September 30, 2007 and 2006
(Unaudited)

Financial Analysis

The following condensed financial statements are for BTU's Rural Electric System, as described in the introduction, and provide key financial data as of and for the years ended September 30, 2007 and 2006.

<u>Condensed Statements of Net Assets</u>	<u>2007</u>	<u>2006</u>
Current assets	\$ 11,910,245	\$ 10,327,926
Capital assets, net	31,839,677	28,194,774
Restricted assets	<u>332,092</u>	<u>306,819</u>
Total assets	<u>44,082,014</u>	<u>38,829,519</u>
Current liabilities	7,380,566	3,423,951
Current liabilities payable from restricted assets	332,092	306,819
Noncurrent liabilities	<u>91,750</u>	<u>1,045,443</u>
Total liabilities	<u>7,804,408</u>	<u>4,776,213</u>
Net assets:		
Invested in capital assets	31,839,677	28,194,774
Unrestricted	<u>4,437,929</u>	<u>5,858,532</u>
Total net assets	<u>\$ 36,277,606</u>	<u>\$ 34,053,306</u>
 <u>Condensed Statements of Activities</u>		
Program Revenues		
Charges for services	\$ 24,991,627	\$ 26,825,404
General Revenues		
Investment earnings	<u>383,439</u>	<u>339,295</u>
Total revenues	25,375,066	27,164,699
Program expenses	<u>23,150,766</u>	<u>24,727,234</u>
Change in net assets	2,224,300	2,437,465
Net assets, beginning of period	<u>34,053,306</u>	<u>31,615,841</u>
Net assets, end of period	<u>\$ 36,277,606</u>	<u>\$ 34,053,306</u>

Bryan Texas Utilities
Rural Electric System
Management's Discussion and Analysis - Continued
For the Years Ended September 30, 2007 and 2006
(Unaudited)

Financial Highlights

- Rural Electric System retail energy sales were 275,764 MWH's and 278,914 MWH's during the fiscal years ended September 30, 2007 and 2006, respectively, a decrease of 1.1% due primarily to milder weather. The decrease was partially offset by a 3.3% increase to the retail customer base which totaled 13,923 and 13,477 customers at September 30, 2007 and 2006, respectively.
- Operating revenues for fiscal years ended September 30, 2007 and 2006 were \$24,991,627 and \$26,825,404, respectively, a decrease of 6.8%. The decrease is attributable to lower base revenues of \$960,265 due to base rate reductions as described below, and to lower fuel revenues of \$837,766 due to lower billed fuel rates.
- Operating expenses for the fiscal years ended September 30, 2007 and 2006 were \$21,889,442 and \$23,628,753, respectively, a decrease of 7.4%. The decrease was due to the deferral of billings to rural retail customers for fuel cost increases in 2007. Actual purchased power costs increased by \$1,118,986 from 2006 to 2007, or 5.2%.
- Net assets for the fiscal years ended September 30, 2007 and 2006 were \$36,277,606 and \$34,053,306, respectively. The increase of 6.5% was the result of continual customer growth and related expansion of the distribution system.

Capital Assets

The Rural Electric System net utility plant was \$31,839,677 and \$28,194,774 for the fiscal years ended September 30, 2007 and 2006, respectively, an increase of 12.9%. The increase in capital assets is primarily the result of construction expenditures for new customers.

Budgetary Highlights

The primary variances between the original budget and actual expenditures affecting Net Assets for the fiscal years 2007 and 2006 were 2% higher base revenues in 2007 due to the mix of customer sales, and for 2006, 49.2% lower distribution operation and maintenance expenses due to crews working on capital projects.

General Trends and Significant Events

- The economy in the local area continues to grow, and the service area supplied by the Rural Electric System is positioned for continued customer growth, especially in new subdivisions south of the City of College Station service area.

Bryan Texas Utilities
Rural Electric System
Management's Discussion and Analysis - Continued
For the Years Ended September 30, 2007 and 2006
(Unaudited)

General Trends and Significant Events - continued

- To remain competitive with other utilities in ERCOT, in December 2006, BTU implemented an overall 5% rate reduction by lowering base rates applicable to Rural Electric and City Electric customers.
- For the fiscal year ending September 30, 2008, the budget is \$24,116,537 for electric operations and maintenance expenses and \$4,660,000 for capital expenditures to continue the expansion of the distribution system in response to customer growth.

Group Managers:

Joe Hegwood
Gary Miller- Interim
Kean Register
Roy Trotter

General Manager:

Dan Wilkerson

Bryan Texas Utilities
Rural Electric System
Statements of Net Assets
For the Years Ended September 30, 2007 and 2006

<u>Assets</u>	<u>2007</u>	<u>2006</u>
Current assets:		
Cash and cash equivalents	\$ 1,973,572	\$ 1,651,046
Investments	4,999,160	5,000,935
Account receivable	3,065,681	3,208,730
Less allowance for uncollectible accounts	(155,786)	(135,724)
Under recovery of fuel	2,027,618	602,939
Total current assets	11,910,245	10,327,926
Noncurrent assets:		
Restricted cash and cash equivalents	332,092	306,819
Capital assets	47,175,659	42,297,931
Less accumulated depreciation	(15,335,982)	(14,103,157)
Total noncurrent assets	32,171,769	28,501,593
Total assets	\$ 44,082,014	\$ 38,829,519

The accompanying notes are an integral part of the financial statements.

Bryan Texas Utilities
Rural Electric System
Statements of Net Assets - Continued
For the Years Ended September 30, 2007 and 2006

<u>Liabilities</u>	<u>2007</u>	<u>2006</u>
Current liabilities:		
Accounts payable	\$ 361,916	\$ 150,508
Accrued liabilities	57,912	45,481
Due to other funds	6,141,652	2,726,872
Deferred credits and other liabilities	819,086	501,090
Total current liabilities	<u>7,380,566</u>	<u>3,423,951</u>
Current liabilities payable from restricted assets:		
Customer deposits	<u>332,092</u>	<u>306,819</u>
Total current liabilities payable from restricted assets	<u>332,092</u>	<u>306,819</u>
Noncurrent liabilities:		
Accrued vacation pay	37,310	48,493
Deferred credits and other liabilities	54,440	996,950
Total noncurrent liabilities	<u>91,750</u>	<u>1,045,443</u>
Total liabilities	<u>7,804,408</u>	<u>4,776,213</u>
 <u>Net Assets</u> 		
Net Assets:		
Invested in capital assets, net of related debt	31,839,677	28,194,774
Unrestricted	4,437,929	5,858,532
Total net assets	<u>\$ 36,277,606</u>	<u>\$ 34,053,306</u>

The accompanying notes are an integral part of the financial statements.

Bryan Texas Utilities
Rural Electric System
Statements of Activities
For the Years Ended September 30, 2007 and 2006

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Program Revenues</u>	<u>2007 Net (Expense) Revenue and Changes in Net Assets</u>	<u>2006 Net (Expense) Revenue and Changes in Net Assets</u>
		<u>Charges for Services</u>	<u>Business-type Activities</u>	<u>Business-type Activities</u>
Business-type activities:				
Electric	\$ 23,150,766	\$ 24,991,627	\$ 1,840,861	\$ 2,098,170
Total	<u>\$ 23,150,766</u>	<u>\$ 24,991,627</u>	<u>1,840,861</u>	<u>2,098,170</u>
General revenues:				
Unrestricted investment earnings			<u>383,439</u>	<u>339,295</u>
Total general revenues and transfers			<u>383,439</u>	<u>339,295</u>
Change in net assets			2,224,300	2,437,465
Net assets at beginning of year			<u>34,053,306</u>	<u>31,615,841</u>
Net assets at end of year			<u>\$ 36,277,606</u>	<u>\$ 34,053,306</u>

The accompanying notes are an integral part of the financial statements.

Bryan Texas Utilities
Rural Electric System
Statements of Revenues, Expenses
And Changes in Net Assets
For the Years Ended September 30, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Operating revenues:		
Electrical system	\$ 24,991,627	\$ 26,825,404
Total operating revenues	<u>24,991,627</u>	<u>26,825,404</u>
Operating expenses:		
Personnel services	310,698	365,506
Electric operations	21,120,275	22,791,399
Maintenance	314,367	311,312
General and administrative	144,102	160,536
Total operating expenses before depreciation	<u>21,889,442</u>	<u>23,628,753</u>
Operating income before depreciation	3,102,185	3,196,651
Depreciation	<u>1,261,324</u>	<u>1,098,481</u>
Operating income	<u>1,840,861</u>	<u>2,098,170</u>
Nonoperating revenues:		
Investment income	<u>383,439</u>	<u>339,295</u>
Total nonoperating revenues	<u>383,439</u>	<u>339,295</u>
Increase in net assets	2,224,300	2,437,465
Net assets, beginning of period	<u>34,053,306</u>	<u>31,615,841</u>
Net assets, end of period	<u>\$ 36,277,606</u>	<u>\$ 34,053,306</u>

The accompanying notes are an integral part of the financial statements.

Bryan Texas Utilities
Rural Electric System
Statements of Cash Flows
For the Years Ended September 30, 2007 and 2006

<u>Cash flows from operating activities</u>	<u>2007</u>	<u>2006</u>
Receipts from customers	\$ 25,127,633	\$ 28,651,621
Payments to suppliers	(19,949,371)	(26,670,392)
Payments to employees	(309,450)	(351,607)
	<u>4,868,812</u>	<u>1,629,622</u>
Net cash provided by operating activities		
<u>Cash flows from capital and related financing activities</u>		
Purchases of capital assets	<u>(4,906,227)</u>	<u>(4,281,078)</u>
Net cash used by capital and related financing activities	<u>(4,906,227)</u>	<u>(4,281,078)</u>
<u>Cash flows from investing activities</u>		
Purchase of investments	-	(5,000,935)
Investment earnings	385,214	339,295
	<u>385,214</u>	<u>(4,661,640)</u>
Net cash provided(used) by investing activities		
Net increase(decrease) in cash and cash equivalents	347,799	(7,313,096)
Balances-beginning of the year	<u>1,957,865</u>	<u>9,270,961</u>
Balances-end of the year	<u>\$ 2,305,664</u>	<u>\$ 1,957,865</u>

The accompanying notes are an integral part of the financial statements.

Bryan Texas Utilities
Rural Electric System
Statements of Cash Flows - continued
For the Years Ended September 30, 2007 and 2006

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

	<u>2007</u>	<u>2006</u>
Operating income	\$ 1,840,861	\$ 2,098,170
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	1,261,324	1,098,481
Bad debt	52,378	46,054
Change in assets and liabilities:		
Accounts receivable	110,733	409,880
Under recovered fuel	(1,424,679)	1,370,283
Accounts payable	211,408	32,718
Accrued liabilities	12,431	16,891
Customer deposits	25,273	(26,183)
Due to other funds	3,414,780	(2,831,086)
Accrued vacation	(11,183)	(2,992)
Deferred credits	(624,514)	(582,594)
Net cash provided by operating activities	\$ 4,868,812	\$ 1,629,622

The accompanying notes are an integral part of the financial statements.

Bryan Texas Utilities
Rural Electric System
Notes to Financial Statements
September 30, 2007 and 2006

1. Summary of Significant Accounting Policies

Reporting Entity - Bryan Texas Utilities (“BTU”) is a municipally owned utility system that operates as an enterprise activity of the City of Bryan, Texas. BTU operates a city and rural electric system, (the “City Electric System” and the “Rural Electric System”, respectively). Each system, while operated by a common staff, is maintained separately for accounting and reporting purposes. The Rural Electric System is the reporting entity. These financial statements present only the Rural Electric System and are not intended to present the financial position of BTU’s City Electric System or the City of Bryan, Texas (the “City”) nor the results of their operations and cash flows in conformity with generally accepted accounting principles.

Government-wide and Fund Financial Statements - Government-wide financial statements consist of the statement of net assets and the statement of activities. These statements report all of the non-fiduciary activities of BTU’s Rural Electric System.

The government-wide financial statements and the fund financial statements for BTU (a proprietary fund) are reported using the economic resources measurement focus and the accrual basis of accounting. All assets and liabilities (whether current or noncurrent) are included on the statement of net assets. The operating statements present increases (revenues) and decreases (expenses) in net total assets. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

The statement of activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include charges to customers who purchase, use, or directly benefit from goods, services, or privileges provided by a given function.

The statement of revenues, expenses and changes in net assets distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund’s principal ongoing operations. Operating expenses for BTU include the cost of sales and services, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Bryan Texas Utilities
Rural Electric System
Notes to Financial Statements - continued
September 30, 2007 and 2006

1. Summary of Significant Accounting Policies - continued

Basis of Accounting - The Rural Electric System is accounted for on the flow of economic resources measurement focus and uses the accrual basis of accounting. Accounting records are maintained in accordance with accounting principles generally accepted in the United States of America. BTU prepares its financial statements as a business-type activity in conformity with applicable pronouncements of the Governmental Accounting Standards Board (GASB). Pursuant to GASB Statement No. 20, BTU has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) that were issued on or before November 30, 1989, to the extent they do not conflict with or contradict GASB pronouncements.

Implementation of New Accounting Principles - For the fiscal year ended September 30, 2007, GASB issued no pronouncements applicable to BTU financial reporting. For the fiscal year ended September 30, 2006, BTU implemented:

- GASB Statement No. 40, *Deposit and Investment Risk Disclosures*. The result of this implementation is to provide for additional risk related reporting disclosures. See Note 2 - Cash and Investments.
- GASB Statement No. 42, *Accounting for Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. The statement provides guidance for determining if any assets have been impaired and for calculating the appropriate write-downs in value for any assets found to be impaired. The statement also provides guidance for accounting for any insurance proceeds for impaired capital assets. For additional information, see Note 3 - Capital Assets.

When both restricted and unrestricted resources are available for use, it is BTU's policy to use restricted resources first, then unrestricted resources as they are needed.

Use of Estimates - In preparing financial statements in conformity with generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. Actual results could differ from these estimates.

Utility Revenues and Fuel Recovery - Customers are billed on the basis of monthly cycle billings. At year end, the Rural Electric System accrues estimated unbilled revenues (excluding fuel). The Rural Electric System is allowed to recover fuel and purchased power cost through fuel revenue rates. The difference between fuel revenues billed and fuel expense incurred is recorded as an addition or a reduction to fuel and purchased power expense, with a corresponding entry to accounts payable - over recovered fuel or accounts receivable - under recovered fuel, which ever is appropriate. For the fiscal years ended September 30, 2007 and 2006, the Rural Electric System accrued \$2,027,618 and \$602,939 respectively for under recovered fuel expense.

Bryan Texas Utilities
Rural Electric System
Notes to Financial Statements - continued
September 30, 2007 and 2006

1. Summary of Significant Accounting Policies – continued

Capital Assets - Capital assets are stated at the historical cost, net of contributions from third parties (principally developers). Also, to the extent the construction is performed by the Rural Electric System, the cost includes payroll and related costs and certain general and administrative expenses. Interest is not capitalized in these accounts because interest is recovered concurrently in the utility rate structure. Maintenance, repairs and minor replacements are charged to operating expense, while major property replacements are capitalized. Depreciation is recorded on a straight-line basis over estimated service lives ranging from 5 to 40 years.

Cash and Cash Equivalents – For purposes of cash flows, the Rural Electric System considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. Cash and cash equivalents from restricted assets are also included.

Inventory – Inventory is valued at average cost, which approximates market. Inventory is accounted for using the consumption method.

Accrued Vacation Pay - Employees earn vacation pay at rates of 10 to 25 days per year and may accumulate up to a maximum of 10 to 25 days, depending on their length of employment. Upon termination, the respective employees are paid for any unused accumulated vacation pay. The Rural Electric System accrues vacation pay when the liability is incurred.

2. Cash and Investments

Rural Electric System cash is managed by BTU and deposited into separate revenue and operating accounts at the City's depository bank in the name of the BTU, Rural Electric System. All Rural Electric System cash is deposited in accounts that receive interest credit or is invested in permissible securities pursuant to BTU's investment policy. Investments are stated at fair value.

Deposits

The Rural Electric System demand deposits for the fiscal years ended 2007 and 2006 were held at First National Bank of Bryan/College Station and were entirely covered by federal depository insurance or by collateral equal to at least 105% of deposits. For deposits that were collateralized, the securities were in accordance with the Texas Public Funds Collateral Act.

Bryan Texas Utilities
Rural Electric System
Notes to Financial Statements - continued
September 30, 2007 and 2006

2. Cash and Investments - continued

Investments

The BTU investment program is guided by State laws, by various City ordinances, by the City's investment policy, and BTU's investment policy which amplifies those guidelines and prescribes how the Rural Electric System will operate its investment program in accordance with applicable laws and regulations. This policy further sets forth (1) the basic principles governing the investment of funds; (2) the objectives of the investment program; and (3) the authority, responsibilities, limitations, documentation, and requirements to be used in the administration and operation of the investment program.

Investments authorized by the investment policy are those approved by the revised State of Texas Public Funds Investment Act of 1997 and the Texas Public Funds Collateral Act of 1989. These investments include the following:

- a. Obligations of the United States or its agencies and instrumentalities;
- b. Direct obligations of the State of Texas or its agencies;
- c. Other obligations, the principal of and interest on which is unconditionally guaranteed or insured by the State of Texas or the United States or its agencies or instrumentalities;
- d. Obligations of states, agencies, counties, cities and other political subdivisions of any state having been rated as to investment quality by a nationally recognized investment rating firm and having received a rating of not less than A or its equivalent;
- e. Certificates of deposit issued by state and national banks domiciled in Texas that are secured by obligations qualified as acceptable collateral;
- f. Certificates of deposit issued by savings and loan associations domiciled in Texas that are secured by obligations qualified as acceptable collateral;
- g. Prime domestic bankers' acceptances;
- h. Commercial paper with a stated maturity of 180 days or less from the date of issuance that is rated not less than A-1, P-1 or its equivalent;
- i. Fully collateralized repurchase agreements that have a defined termination date of 90 days or less, secured by qualification obligations, pledged with a third party, and placed through a primary government securities dealer as defined by the Federal Reserve, or a bank domiciled in Texas;

Bryan Texas Utilities
Rural Electric System
Notes to Financial Statements - continued
September 30, 2007 and 2006

2. Cash and Investments - continued

Investments - continued

j. Money-market mutual funds that are SEC registered no-load funds with a maximum stated maturity of 13 months and dollar-weighted average stated maturity of no more than 90 days;

k. Public funds investment pools.

Collateralized Mortgage Obligations (“CMO’s”) and other derivatives such as inverse floaters and other mortgage-backed securities that pay only interest or principal portion of the mortgage payment are not authorized BTU investments.

The Rural Electric System’s cash, cash equivalents and investments are summarized as follows:

	<u>2007</u>	<u>2006</u>
Demand Deposits	\$ 2,305,664	\$ 1,957,865
United States Agencies	4,999,160	5,000,935
Total	\$ 7,304,824	\$ 6,958,800

In accordance with GASB Statement No. 40, additional disclosures are provided below that address investment exposure to interest rate risk and credit risk including custodial credit risk and concentrations of credit risk. Because BTU does not hold foreign investments, foreign currency risk is not discussed.

Interest rate risk – As a means of limiting its exposure to fair value losses arising from rising interest rates, BTU’s investment policy limits investments in securities of more than five years, unless matched by a specific cash flow. Additionally, in accordance with its investment policy BTU manages its exposure to interest rate risk by limiting its investment to those held to maturity.

Credit Risk – As described above, it is BTU’s policy to limit its investment to high grade instruments including obligations of the United States or its agencies.

Custodial Credit Risk – For deposits, custodial credit risk is the risk that in an event of a bank failure, the government’s deposits may not be returned to it. Demand deposits held in BTU’s name are required to be collateralized with securities equal to at least 105% of deposits held in a custodian bank, or be covered by federal depository insurance. For investments, this is the risk that in the event of the failure of the counterparty, the government will not be able to recover the value of its investments or collateral securities that are in possession of an outside party. BTU’s investment policy requires that all security transactions be conducted on a delivery versus payment basis and that all securities be held by a third party custodian and evidenced by safekeeping receipts.

Bryan Texas Utilities
Rural Electric System
Notes to Financial Statements - continued
September 30, 2007 and 2006

3. Capital Assets

General Description – Assets reflected in plant-in-service include distribution facilities.

Impairments – As discussed in Note 1, BTU adopted GASB Statement No. 42, *Accounting for Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries* in 2006. The statement provides guidance for determining if any assets have been impaired and for calculating the appropriate write-downs in value for any assets found to be impaired. An internal company-wide review of capital assets, in accordance with GASB Statement No. 42, concluded that BTU had no impaired capital assets at September 30, 2007.

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

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets, not being depreciated:				
Land	\$ 111,099	\$ 384	\$ -	\$ 111,483
Construction in progress	728,609	4,911,552	3,546,124	2,094,037
Total capital assets, not being depreciated	839,708	4,911,936	3,546,124	2,205,520
Capital assets, being depreciated:				
Distribution plant	40,643,269	3,371,617	46,232	43,968,654
General plant	814,954	186,531	-	1,001,485
Total capital assets, being depreciated	41,458,223	3,558,148	46,232	44,970,139
Less accumulated depreciation for:				
Distribution plant	13,320,200	1,252,668	28,499	14,544,369
General plant	782,957	8,656	-	791,613
Total accumulated depreciation	14,103,157	1,261,324	28,499	15,335,982
Total capital assets, being depreciated, net	27,355,066	2,296,824	17,733	29,634,157
Total capital assets, net	\$ 28,194,774	\$ 7,208,760	\$ 3,563,857	\$ 31,839,677

4. Long-Term Debt

During the period ending September 30, 2004 Rural Electric System's final serial bond matured and payment was processed. There presently is no long-term debt outstanding for the Rural Electric System. The City reserves the right at any time to merge the City Electric System and Rural Electric System into a single operating electric utility system. The merger of the Rural Electric System would not have an adverse impact on the bondholders.

Bryan Texas Utilities
Rural Electric System
Notes to Financial Statements - continued
September 30, 2007 and 2006

5. Transactions with BTU Electric System

The Rural Electric System receives all of its purchased power from BTU's City Electric System. The City Electric System also provides all administrative support to the Rural Electric System.

6. Retirement Plan

BTU is an integral part of the City, and as such, provides pension benefits for all its full-time employees through the City retirement plan. Separate information regarding BTU is not available. The following covers the City's retirement plan as a whole.

Plan Description

The City provides pension benefits for all of its full-time employees through a nontraditional, joint contributory, hybrid defined benefit plan in the statewide Texas Municipal Retirement System (TMRS), one of 821 currently administered by TMRS, an agent multiple-employer public employee retirement system.

Benefits depend upon the sum of the employee's contributions to the plan, with interest, and the City-financed monetary credits, with interest. At the date the plan began, the City granted monetary credits for service rendered before the plan began of a theoretical amount equal to two times what would have been contributed by the employee, with interest, prior to establishment of the plan. Monetary credits for service since the plan began are a percent (100%, 150%, or 200%) of the employee's accumulated contributions. In addition, the City can grant, as often as annually, another type of monetary credit referred to as an updated service credit which is a theoretical amount which, when added to the employee's accumulated contributions and the monetary credits for service since the plan began, would be the total monetary credits and employee contributions accumulated with interest if the current employee contribution rate and City matching percentage had always been in existence and if the employee's salary had always been the average of his salary in the last three years that are one year before the effective date. At retirement, the benefit is calculated as if the sum of the employee's accumulated contributions with interest and the employer-financed monetary credits with interest were used to purchase an annuity.

Members can retire at ages 60 and above with 5 or more years of service or with 20 years of service regardless of age. A member is vested after 5 years. The plan provisions are adopted by the governing body of the City, within the options available in the state statutes governing TMRS and within the actuarial constraints also in the statutes.

Bryan Texas Utilities
Rural Electric System
Notes to Financial Statements - continued
September 30, 2007 and 2006

6. Retirement Plan – continued

Contributions

The contribution rate for the employees is 7%, and the City matching percent is currently 2 to 1, both as adopted by the governing body of the City. Under the state law governing TMRS, the actuary annually determines the City contribution rate. This rate consists of the normal cost contribution rate and the prior service cost contribution rate, both of which are calculated to be a level percent of payroll from year to year. The normal cost contribution rate finances the currently accruing monetary credits due to the City matching percent, which are the obligation of the City as of an employee's retirement date, not at the time the employee's contributions are made. The normal cost contribution rate is the actuarially determined percent of payroll necessary to satisfy the obligation of the City to each employee at the time his/her retirement becomes effective. The prior service contribution rate amortizes the unfunded (overfunded) actuarial liability (asset) over the remainder of the plan's 25-year amortization period. The unit credit actuarial cost method is used for determining the City contribution rate. Both the employees and the City make contributions monthly. Since the City needs to know its contribution rate in advance for budgetary purposes, there is a one-year delay between the actuarial valuation that serves as the basis for the rate and the calendar year when the rate goes into effect (i.e. December 31, 2006 valuation is effective for rates beginning January 2008).

Actuarial assumptions are as follows:

Actuarial valuation date	12/31/2004	12/31/2005	12/31/2006
Actuarial cost method	----- Unit Credit -----		
Amortization method	----- Level Percentage of Payroll -----		
Remaining amortization period	----- 25 years – open -----		
Asset valuation method	----- Amortized cost -----		

Actuarial assumptions:

Investment return	7.0%	7.0%	7.0%
Projected salary increases	0.0%	0.0%	0.0%
Included inflation rate	3.5%	3.5%	3.5%
Cost-of-living adjustments	0.0%	0.0%	0.0%

Bryan Texas Utilities
Rural Electric System
Notes to Financial Statements - continued
September 30, 2007 and 2006

6. Retirement Plan – continued

Schedule of Actuarial Liabilities and Funding Progress

Actuarial Valuation Date, Dec. 31	<u>2004</u>	<u>2005</u>	<u>2006</u>
Actuarial Value of Assets	\$ 80,630,073	\$ 85,259,236	\$ 87,895,438
Actuarial Accrued Liability	107,409,013	113,740,747	118,752,796
Percentage Funded	75.1%	75.0%	74.0%
Unfunded Actuarial Accrued Liability (UAAL)	26,778,940	28,481,511	30,857,358
Annual Covered Payroll	32,047,255	33,650,168	35,240,358
UAAL as a Percentage of Covered Payroll	83.6%	84.6%	87.6%

Historical data is as follows:

Fiscal Year	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligations at September 30
9/30/2005	\$ 4,497,286	100%	-
9/30/2006	\$ 4,787,919	100%	-
9/30/2007	\$ 4,791,580	100%	-

The City of Bryan is one of 821 municipalities having the benefit plan administered by TMRS. Each of the 821 municipalities has an annual, individual actuarial valuation performed. All assumptions for the December 31, 2006 valuations are contained in the 2006 TMRS Comprehensive Annual Financial Report, a copy of which may be obtained by writing to P.O. Box 149153, Austin, Texas 78714-9153.

Future Funding Requirements

In early December 2007 the TMRS Board of Trustees met and adopted actuarial changes that include a change from the Unit Credit actuarial cost method to the Projected Unit Credit actuarial cost method for all TMRS city plans as well as a closed amortization period of 30 years. The effect of these changes will result in an increase in city contribution rates for most Texas cities. Cities will have the option to increase their contributions over an eight-year phase-in period. All cities will receive their 2009 contribution rate letter in May 2008 that will specify exactly how these changes will affect the future annual required contribution rate upon completion of an actuarial valuation to be performed as of 12/31/07. These changes are

Bryan Texas Utilities
Rural Electric System
Notes to Financial Statements - continued
September 30, 2007 and 2006

6. Retirement Plan – continued

Future Funding Requirements - continued

intended to help the TMRS system remain well-funded, to preserve members' benefits, and to give cities a more complete picture of the cost of benefits currently adopted. While the impact of TMRS changes is not presently known, the City's contribution rate is expected to increase significantly. Tentative estimates of the City's future contribution rate show an increase from 13.56% to 25.00%. Management believes that while these possible increases will present additional challenges to the City during the budget process the City will be able to make necessary changes to mitigate any adverse financial impact to the City.

7. Risk Management

The Rural Electric System is covered for risk of losses related to general liability and worker's compensation through the City's risk management program. The City has established an "Insurance Fund" whereby the costs of providing claims servicing and claims payment are funded by charging a "premium" based upon a percentage of estimated current year payroll and management's estimate of projected current costs. For the fiscal years ended September 30, 2007 and 2006, the Rural Electric System paid the City \$74,499 and \$75,129 respectively for participation in the City's risk management program.

8. Deferred Compensation Plan

The Rural Electric System employees participate in the City's deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, as amended, is available to all employees and permits them to defer a portion of the salary until future years. The plan funds are not available to employees until termination, retirement, death or emergency.

9. Employee Benefits

BTU is an integral part of the City, and as such, provides employee health benefits for all its full-time employees through the City health benefit plan. Separate information regarding BTU is not available. The following covers the City's health benefit plan as a whole.

The City established the Employee Benefits Trust Fund effective October 1, 1986, covering health benefits for eligible employees. At that time the Bryan City Council approved a formal trust agreement establishing the Fund. Employee premium costs are shared by the City and the employee, while dependent coverage is paid by the employee. The City's contract with its third party administrator and reinsurer sets a stop loss level per participant in the amount of \$125,000 and a maximum aggregate stop loss deductible of \$4,861,156 for the twelve month period which began January 1, 2007 and ends December 31, 2007. There were no significant reductions in insurance coverage in the current year from coverage in the prior year, nor have there been any settlements that have exceeded insurance coverage for each of the past three fiscal years.

Bryan Texas Utilities
Rural Electric System
Notes to Financial Statements - continued
September 30, 2007 and 2006

9. Employee Benefits - continued

The schedule below represents the changes in claims liabilities for the year:

	<u>2007</u>	<u>2006</u>
Beginning balance - unpaid claims	\$ 736,809	\$ 569,732
Incurred claims	7,250,583	5,107,526
Claim payments	(7,011,970)	(4,940,449)
Ending balance – unpaid claims	\$ 975,422	\$ 736,809
 Amounts due in one year	 \$ 975,422	 \$ 736,809

10. Post Employment Benefits

BTU is an integral part of the City, and as such, provides post employment benefits for all its full-time employees through the City benefit plan. Separate information regarding BTU is not available. The following covers the City’s post employment benefit plan as a whole.

Effective January 1, 1991, by action of the Bryan City Council, the City began offering post-retirement health care benefits to employees. Effective January 1, 1993, retiree spouses were granted eligibility for benefits. Dependents were granted eligibility effective January 1, 1994. The retiree is responsible for paying the premiums, and coverage can continue for life. Retirees must qualify for service retirement under the City’s retirement plan, and must elect to continue coverage immediately upon retirement.

The City reserves the right to modify premium amounts, to modify eligibility requirements and to modify or discontinue retiree health benefits. Expenses are recognized as retirees submit claims. Retirees are reimbursed at the same levels as active employees. In the year ended September 30, 2007, retirees paid \$291,461 in premiums and \$985,492 in claims were paid for post-retirement health care and administrative charges. As of September 30, 2007, the City has 25 retirees, 18 retirees and spouses, 8 retirees and families and 7 retirees and child(ren) participating in the health plan, out of the 255 employees eligible to participate upon retirement.

The City also provides health benefits as required by the Federal Government under the Consolidated Omnibus Budget Reconciliation Act of 1985 (“COBRA”). COBRA requires employers that sponsor group health plans to provide continuation of group coverage to employees and their dependents under certain circumstances where coverage would otherwise end. Terminated employees who qualify under COBRA pay premium costs for themselves and dependents.

Bryan Texas Utilities
Rural Electric System
Notes to Financial Statements - continued
September 30, 2007 and 2006

10. Post Employment Benefits - continued

Expenses are recognized as claims are submitted. COBRA participants are reimbursed at the same levels as active employees. Participants paid premiums of \$22,121 and incurred claims and administrative expenses of \$170,345 in the year ended September 30, 2007. As of September 30, 2007, the City has four COBRA participants.

Future year estimated claims for all health plan participants are actuarially determined by the reinsurer. All assets of the Employee Benefits Trust Fund are available for future claim payments for health plan participants.

11. Related Party Transactions

BTU operates the Rural Electric System which provides electric service to the immediate rural area outside the City of Bryan, extending to most of Brazos County, adjacent to the City of College Station service area, and parts of Burleson, and Robertson counties in a radius of nearly 20 miles from the City of Bryan. The Rural Electric System purchases all of its power from BTU City Electric System. In 2007 and 2006, these purchases totaled \$22,486,555 and \$21,367,570, respectively. These amounts are included in Electric operations expense in the accompanying financial statements.