

BRYAN TEXAS UTILITIES

City Electric System

Financial Statements

For the Years Ended September 30, 2007 and 2006

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

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

Bryan Texas Utilities (BTU) is pleased to present its 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 internal and external accounting and reporting purposes. The accompanying financial statements present only the City Electric System and its blended component unit, BTU QSE Services, Inc. (“QSE”), a separate legal entity. These financial statements are not intended to fairly present the financial position or results of operations of the Rural Electric System or the City of Bryan, Texas.

The City 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 BTU 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 City 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 City Electric System (the "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 City Electric System of BTU and do not purport to, and do not, present fairly the financial position of the Rural 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 City 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.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise BTU's City 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.

Logan, Wallis & Company

Bryan, Texas

February 4, 2008

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

This discussion and analysis of the City 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 City Electric System and its blended component unit, BTU QSE Services, Inc. ("QSE"). The QSE exists to perform qualified scheduling services of electrical generation for BTU according to the Electric Reliability Council of Texas (ERCOT) protocols. Although the QSE is a separate legal entity, it is considered a blended component unit and is reported as if it were a part of the City Electric System.

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

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

The Statements of Activities present information showing how the City 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 City Electric System's recovery of 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 City Electric System accounting policies, significant account balances and activities, material risks, obligations, commitments, contingencies and subsequent events, if any.

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

Financial Analysis

The following selected condensed financial statements for BTU's City Electric System and its blended component unit, QSE, as defined in the introduction, 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	\$ 48,983,223	\$ 30,155,596
Capital assets, net	127,735,752	116,378,804
Restricted assets	80,520,647	66,097,672
Other	625,317	332,869
Total assets	257,864,939	212,964,941
Current liabilities	17,039,514	10,112,689
Current liabilities payable from restricted assets	5,376,122	4,079,987
Noncurrent liabilities	60,512,908	30,595,253
Total liabilities	82,928,544	44,787,929
Net assets:		
Invested in capital assets, net of related debt	100,992,721	99,822,651
Restricted	42,169,885	49,309,135
Unrestricted	31,773,789	19,045,226
Total net assets	\$ 174,936,395	\$ 168,177,012
<u>Condensed Statements of Activities</u>		
Program revenues		
Charges for services	\$ 143,073,607	\$ 183,563,117
General revenues		
Investment earnings	3,895,267	2,667,490
Total revenues	146,968,874	186,230,607
Program expenses	135,050,676	170,527,649
Excess before transfers	11,918,198	15,702,958
Transfers, net	(5,158,815)	(5,421,866)
Change in net assets	6,759,383	10,281,092
Net assets, beginning of period	168,177,012	157,895,920
Net assets, end of period	\$ 174,936,395	\$ 168,177,012

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

Financial Highlights

- The City Electric System customer base totaled 31,202 and 30,503 customers at September 30, 2007 and 2006, respectively, an increase of 2.3%.
- Operating revenues for the years ending September 30, 2007 and 2006 were \$143,073,607 and \$183,563,117, respectively. The decrease is primarily due to a reduction in the volume of wholesale transactions from 2006 to 2007.
- Operating expenses for the years ending September 30, 2007 and 2006 were \$127,100,116 and \$163,039,450, respectively. As with operating revenues the decrease is primarily due to a reduction in the volume of wholesale transactions from 2006 to 2007.
- Net assets for the years ended September 30, 2007 and 2006 were \$174,936,395 and \$168,177,012, respectively, of which \$31,773,789 and \$19,045,226 were available to meet BTU's ongoing obligations. The City Electric System increase in capital assets is due mostly to additions to transmission and distribution infrastructure for new customer growth.

Long-Term Debt

In 2007, the City Electric System issued revenue bonds dated August 15, 2007, totaling \$32,295,000 and maturing serially on July 1, 2008, through July 1, 2032, with yields ranging from 3.68% to 5.05%. In 2006, the City Electric System issued revenue bonds dated August 15, 2006, totaling \$12,385,000 and maturing serially on July 1, 2007, through July 1, 2031, with yields ranging from 3.54% to 4.56%. Proceeds from the sale of the bonds are restricted for the construction of transmission and distribution facilities. At September 30, 2007, there were \$62,060,000 of City Electric System revenue bonds outstanding and \$1,069 of City of Bryan General Obligation bonds outstanding payable from revenues of the City Electric System.

Budgetary Highlights

The primary variances between the original budget and actual expenditures affecting Net Assets for the fiscal years 2007 and 2006 were higher wholesale capacity sales than budgeted. Wholesale capacity revenues contributed to a 3.0% and 4.8% positive variance from budgeted total operating revenues for the fiscal years 2007 and 2006, respectively.

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

General Trends and Significant Events

Transmission Constraints –

- Transmission of electricity into BTU's service territory has been constrained in recent years as customer growth has increased at a faster pace than the construction of transmission facilities. As a result, BTU, upon ERCOT's instruction, provided back-up generation from its Atkins and Dansby units in 2006, as described below. Prior to the summer of 2007, initial transmission construction projects were completed which helped relieve transmission constraints within BTU's service territory and eliminated most ERCOT instructed generation in 2007.
- During 2006, BTU was instructed by ERCOT to provide Out-Of-Merit-Capacity (OOMC) and Out-Of-Merit-Energy (OOME) from its Atkins and Dansby units. This capacity and energy was needed to ensure system reliability in the Brazos Valley. The additional cost to run these units was reimbursed to BTU by other ERCOT market participants. The additional fuel required to operate these units caused a significant increase in fuel and purchased power expense in 2006. OOMC and OOME operations declined significantly in 2007 as transmission projects within the Brazos Valley were completed.
- On November 1, 2006, BTU mothballed units 3, 4, 5, and 6 of its 55 year old Atkins Power Plant. In recent years, combined-cycle generation and new aero derivative gas turbines that are up to fifty percent more efficient have been built throughout Texas. With the increase in natural gas prices in recent years, the resultant energy costs from the Atkins units make them currently uneconomical to operate, like some 100 other units in the state that have been mothballed or retired in recent years. Atkins unit 7 remains operational as a peaking unit.

Rates –

- To remain competitive with other utilities in ERCOT, in December 2006, BTU implemented an overall 5% rate reduction by lowering base rates applicable to City Electric and Rural Electric customers. The overall annualized decrease in revenues is approximately \$4.3 million.
- Also, in May 2006, BTU implemented energy only rates for qualified commercial and industrial customers. This new rate structure provides simplified billing, as well as a decrease in customer's electricity cost. The overall annual decrease in revenues is less than \$1.5 million.

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

General Trends and Significant Events - continued

Other –

- For the fiscal year ended September 30, 2007, BTU transferred \$8,716,184 from the Rate Stabilization Fund reflected in Restricted Assets on the Balance Sheet to Unrestricted Assets. This transfer recognizes BTU's commitment to maintaining higher levels of unrestricted operating cash.
- For the fiscal year ending September 30, 2008, the budget for operating expenses is \$106,356,070 for electric operations, \$4,739,778 for debt service, \$7,303,742 for transfers to the City of Bryan, and \$34,195,978 for capital expenditures in response to customer growth and infrastructure additions to transmission and distribution.

Group Managers:

Joe Hegwood
Gary Miller – Interim
Kean Register
Roy Trotter

General Manager:

Dan Wilkerson

Bryan Texas Utilities
City Electric System
Statements of Net Assets
September 30, 2007 and 2006

<u>Assets</u>	<u>2007</u>	<u>2006</u>
Current assets:		
Cash and cash equivalents	\$ 14,728,812	\$ 5,957,221
Accounts receivable	14,011,121	15,032,941
Less allowance for uncollectible accounts	(763,680)	(686,766)
Accrued interest receivable	458,611	459,449
Inventory	5,838,817	5,116,314
Due from other funds	6,213,826	2,763,106
Prepaid and other assets	207,938	157,713
Under recovery of fuel	8,287,778	1,355,618
	<hr/>	<hr/>
Total current assets	48,983,223	30,155,596
	<hr/>	<hr/>
Noncurrent assets:		
Restricted assets:		
Cash and cash equivalents	45,969,795	27,585,245
Investments	34,550,852	38,512,427
Capital assets	235,759,675	218,131,662
Less accumulated depreciation	(108,023,923)	(101,752,858)
Unamortized bond issuance expenses	625,317	332,869
	<hr/>	<hr/>
Total noncurrent assets	208,881,716	182,809,345
	<hr/>	<hr/>
Total assets	\$ 257,864,939	\$ 212,964,941
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The accompanying notes are an integral part of the financial statements.

Bryan Texas Utilities
City Electric System
Statements of Net Assets - Continued
September 30, 2007 and 2006

<u>Liabilities</u>	<u>2007</u>	<u>2006</u>
Current liabilities:		
Accounts payable	\$ 14,863,047	\$ 8,569,866
Accrued liabilities	206,609	674,680
Due to City of Bryan	1,473,237	496,078
Deferred credits and other current liabilities	496,621	372,065
	<hr/>	<hr/>
Total current liabilities	17,039,514	10,112,689
	<hr/>	<hr/>
Current liabilities payable from restricted assets:		
Accrued interest	342,565	247,075
Revenue bonds - current portion	1,895,000	1,210,000
General obligation bonds - current portion	526	508
Customer deposits	3,138,031	2,622,404
	<hr/>	<hr/>
Total current liabilities payable from restricted assets	5,376,122	4,079,987
	<hr/>	<hr/>
Noncurrent liabilities:		
Revenue bonds payable	60,165,000	29,765,000
General obligation bonds	543	1,069
Bond (discounts)/premiums, net	(447,872)	(501,366)
Arbitrage rebate	113,347	14,016
Accrued vacation pay	365,005	369,853
Deferred credits and other noncurrent liabilities	316,885	946,681
	<hr/>	<hr/>
Total noncurrent liabilities	60,512,908	30,595,253
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Total liabilities	82,928,544	44,787,929
	<hr/>	<hr/>
<u>Net Assets</u>		
Net assets:		
Invested in capital assets, net of related debt	100,992,721	99,822,651
Restricted for:		
Debt reserve	1,655,363	1,655,363
Debt service	309,159	282,704
Rate stabilization	33,868,868	41,034,573
TMPA	6,336,495	6,336,495
Unrestricted	31,773,789	19,045,226
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Total net assets	\$ 174,936,395	\$ 168,177,012
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The accompanying notes are an integral part of the financial statements.

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

			<u>2007</u> Net (Expense) Revenue and Changes in Net Assets	<u>2006</u> Net (Expense) Revenue and Changes in Net Assets
<u>Functions/Programs</u>	<u>Expenses</u>	<u>Program Revenues</u>	<u>Business-type Activities</u>	<u>Business-type Activities</u>
Business-type activities:				
Electric	\$ 135,050,676	\$ 143,073,607	\$ 8,022,931	\$ 13,035,468
Total	<u>\$ 135,050,676</u>	<u>\$ 143,073,607</u>	<u>8,022,931</u>	<u>13,035,468</u>
General revenues:				
Investment earnings			3,895,267	2,667,490
Transfers, net			<u>(5,158,815)</u>	<u>(5,421,866)</u>
Total general revenues and transfers			<u>(1,263,548)</u>	<u>(2,754,376)</u>
Change in net assets			6,759,383	10,281,092
Net assets at beginning of year			<u>168,177,012</u>	<u>157,895,920</u>
Net assets at end of year			<u>\$ 174,936,395</u>	<u>\$ 168,177,012</u>

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

Bryan Texas Utilities
City 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	\$ 141,061,065	\$ 181,408,666
Other	2,012,542	2,154,451
Total operating revenues	<u>143,073,607</u>	<u>183,563,117</u>
Operating Expenses:		
Personnel services	8,863,499	9,407,337
Electric operations	110,768,779	146,462,958
Maintenance	2,765,346	2,053,435
Other services and charges	1,826,643	1,659,587
Other expenses	443,335	595,545
General and administrative	2,432,514	2,860,588
Total operating expenses before depreciation	<u>127,100,116</u>	<u>163,039,450</u>
Operating income before depreciation	15,973,491	20,523,667
Depreciation	<u>6,603,789</u>	<u>6,689,092</u>
Operating income	<u>9,369,702</u>	<u>13,834,575</u>
Nonoperating revenues (expenses):		
Investment income	3,895,267	2,667,490
Interest expense	(1,346,771)	(799,107)
Total nonoperating revenues (expenses)	<u>2,548,496</u>	<u>1,868,383</u>
Income before operating transfers	11,918,198	15,702,958
Transfers:		
City of Bryan administrative payment	1,216,000	930,000
"Right of Way" payment to City of Bryan	(6,374,815)	(6,351,866)
Transfers, net	<u>(5,158,815)</u>	<u>(5,421,866)</u>
Change in net assets	6,759,383	10,281,092
Net assets, beginning of period	<u>168,177,012</u>	<u>157,895,920</u>
Net assets, end of period	<u><u>\$ 174,936,395</u></u>	<u><u>\$ 168,177,012</u></u>

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

Bryan Texas Utilities
City 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	\$ 140,969,498	\$ 209,574,231
Payments to suppliers	(118,750,492)	(169,018,816)
Payments to employees	(9,336,418)	(9,158,038)
	<hr/>	<hr/>
Net cash provided by operating activities	12,882,588	31,397,377
 <u>Cash flows from noncapital financing activities</u>		
Operating subsidies and transfers from other funds	1,216,000	930,000
Operating subsidies and transfers to other funds	(6,374,815)	(6,351,866)
	<hr/>	<hr/>
Net cash used by noncapital financing activities	(5,158,815)	(5,421,866)
 <u>Cash flows from capital and related financing activities</u>		
Purchases of capital assets	(17,960,737)	(12,227,496)
Proceeds from capital debt	31,994,188	12,130,664
Principal paid on capital debt	(1,197,763)	(838,347)
Interest paid on capital debt	(1,261,000)	(759,667)
	<hr/>	<hr/>
Net cash provided (used) by capital and related financing activities	11,574,688	(1,694,846)
 <u>Cash flows from investing activities</u>		
Proceeds from sales and maturities of investments	12,050,001	30,701,062
Purchase of investments	(7,578,962)	(40,695,723)
Interest and dividends received	3,386,641	1,856,153
	<hr/>	<hr/>
Net cash provided (used) by investing activities	7,857,680	(8,138,508)
 Net increase in cash and cash equivalents	27,156,141	16,142,157
Balance-beginning of the year	33,542,466	17,400,309
	<hr/>	<hr/>
Balance-end of the year	<u>\$ 60,698,607</u>	<u>\$ 33,542,466</u>

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

Bryan Texas Utilities
City 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	\$ 9,369,702	\$ 13,834,575
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	6,603,789	6,689,092
Amortization	158,163	14,127
Bad debt	267,750	293,718
Change in assets and liabilities:		
Accounts receivable	830,984	20,510,506
Inventory	(722,503)	(563,358)
Prepaid assets	(50,225)	201,588
Due from other funds	(3,450,720)	2,819,168
Under recovered fuel	(6,932,160)	2,070,684
Accounts payable	6,293,181	(14,833,915)
Accrued liabilities	(468,071)	298,511
Customer deposits	515,627	317,038
Due to other funds	977,159	3,821
Accrued vacation	(4,848)	(49,212)
Deferred credits	(505,240)	(208,966)
Net cash provided by operating activities	<u>\$ 12,882,588</u>	<u>\$ 31,397,377</u>

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

Bryan Texas Utilities
City 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 (the “City”). BTU operates a city and rural electric system. Each system, while operated by a common staff, is maintained separately for accounting and reporting purposes. BTU’s City Electric System (the “City Electric System”) is the reporting entity and includes BTU’s Qualified Servicing Entity (QSE), a separate legal entity considered a blended component unit because its primary purpose is to provide a service to BTU. The financial statements present only the City Electric System of BTU and are not intended to present fairly the financial position of the BTU’s Rural Electric System, or the City and 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 City Electric System and its component unit.

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
City Electric System
Notes to Financial Statements - continued
September 30, 2007 and 2006

1. Summary of Significant Accounting Policies – continued

Basis of Accounting - The City 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.

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

1. Summary of Significant Accounting Policies - Continued

Utility Revenues and Fuel Recovery - Customers are billed on the basis of monthly cycle billings. At year end, the City Electric System accrues estimated unbilled revenues for the period ended September 30. The difference between fuel revenue 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, whichever is appropriate. For the years ended September 30, 2007 and 2006, the City Electric System recorded accounts receivable – under recovered fuel of \$8,287,778 and \$1,355,618, respectively.

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 City 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 renewals and 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 City 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.

Bond Issuance Expenses - Bond issuance expenses are amortized on a straight-line basis over the period of the related maturities, which approximates the interest 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 City Electric System accrues vacation pay when the liability is incurred.

2. Cash and Investments

City Electric System cash managed by BTU is deposited into separate revenue and operating accounts in the name of the BTU City Electric System. All City 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.

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

2. Cash and Investments - continued

Deposits

City 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.

Investments

The BTU investment program is guided by Texas state laws, by various City ordinances, and by BTU's investment policy which prescribes how the City 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 and the Texas Public Funds Collateral Act. 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 AA 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;

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

2. Cash and Investments – continued

Investments - continued

- 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;
- 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. AAA-rated local government 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 City Electric System’s cash, cash equivalents and investments at September 30, 2007 and 2006 are summarized as follows:

	<u>2007</u>	<u>2006</u>
Demand deposits	\$ 59,586,316	\$ 33,440,817
Commercial paper	-	4,966,940
United States agencies	34,550,852	33,545,487
Investment in short term treasury securities	1,112,291	101,649
Total	<u>\$ 95,249,459</u>	<u>\$ 72,054,893</u>

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.

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

2. Cash and Investments – continued

Investments - continued

As of September 30, 2007, BTU had the following investments:

<u>Investment Types</u>	<u>Fair Value</u>	<u>Investment Maturity</u> <u>(in Years)</u>		
		<u>Less</u> <u>Than 1</u>	<u>1 - 5</u>	<u>Greater</u> <u>Than 5</u>
United States agencies	\$ 34,550,852	\$ 18,566,780	\$ 9,973,438	\$ 6,010,634
Total fair value	\$ 34,550,852	\$ 18,566,780	\$ 9,973,438	\$ 6,010,634

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 and commercial paper holding the top ratings issued by nationally recognized statistical rating organizations (NRSROs).

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.

Concentration of Credit Risk – BTU’s investment policy places some limits on the amount that may be invested in any one issuer. Investments in any single money market fund or investment pool shall never exceed ten percent of the total assets of the money market fund or pool.

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

2. Cash and Investments – continued

Restricted Cash and Investments

In 2007, cash and investments of \$95.2 million exceeded amounts required to be restricted by \$14.7 million. In 2007, BTU transferred \$8.7 from the Rate Stabilization Fund reflected in Restricted Assets on the Balance Sheet to Unrestricted Assets. This transfer recognized BTU's commitment to maintaining higher levels of unrestricted operating cash. In 2006, cash and investments of \$72.1 million exceeded amounts required to be restricted by \$6.0 million.

Amounts required to be restricted at September 30, 2007 and 2006 are as follows:

	<u>2007</u>	<u>2006</u>
Rate Stabilization Fund	\$ 33,868,868	\$ 41,034,573
Debt Reserve	1,655,363	1,655,363
Debt Service	651,724	529,779
TMPA Fund	6,336,495	6,336,495
Bond Series 2005 Reserve	-	1,534,058
Bond Series 2006 Reserve	2,575,166	12,385,000
Bond Series 2007 Reserve	32,295,000	-
Customer Deposits	3,138,031	2,622,404
Restricted Cash and Investments	<u>\$ 80,520,647</u>	<u>\$ 66,097,672</u>

3. Capital Assets

General Description – At September 30, 2007, plant-in-service included Dansby and Atkins power plants located in Brazos County, which were solely owned and operated by BTU. In total, the plants had seven gas-fired generating units representing 284 megawatts of generating capacity. On November 1, 2006, BTU mothballed four of its oldest Atkins power plant units representing 119 megawatts of generating capacity. With the increase in natural gas prices in recent years, the resultant energy costs from the Atkins units made them currently uneconomical to operate. The mothballed units were fully depreciated at September 31, 2007.

Other assets reflected in plant-in-service include transmission and 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.

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

3. Capital Assets - continued

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	\$ 2,685,065	\$ 445,576	\$ -	\$ 3,130,641
Construction in progress	5,743,463	15,776,160	10,742,788	10,776,835
Total capital assets, not being depreciated	8,428,528	16,221,736	10,742,788	13,907,476
Capital assets, being depreciated:				
Production plant	79,483,235	735,201	-	80,218,436
Transmission plant	36,779,795	5,525,156	75,000	42,229,951
Distribution plant	75,157,348	5,119,998	142,099	80,135,247
General plant	18,282,756	985,809	-	19,268,565
Total capital assets, being depreciated	209,703,134	12,366,164	217,099	221,852,199
Less accumulated depreciation for:				
Production plant	50,559,945	1,992,648	-	52,552,593
Transmission plant	10,628,926	1,162,049	224,193	11,566,782
Distribution plant	28,910,220	2,230,794	108,531	31,032,483
General plant	11,653,767	1,218,298	-	12,872,065
Total accumulated depreciation	101,752,858	6,603,789	332,724	108,023,923
Total capital assets, being depreciated, net	107,950,276	5,762,375	(115,625)	113,828,276
Total capital assets, net	\$116,378,804	\$21,984,111	\$ 10,627,163	\$ 127,735,752

4. Long-Term Debt

In response to the deregulation of the electric energy market in Texas, the City of Bryan separated its combined pledge of water revenues, wastewater revenues and municipal electric revenues into two separate pledges. The City's outstanding bonds having combined pledges were defeased and new bonds were issued dated November 15, 2001, totaling \$7,540,000 for the City Electric System which is solely responsible for their repayment from City Electric System revenues. In 2005, the City Electric System issued revenue bonds dated March 15, 2005, totaling \$13,375,000 and in 2006, the City Electric System issued revenue bonds dated August 15, 2006, totaling \$12,385,000. In 2007, the City Electric System issued revenue bonds dated August 15, 2007, totaling \$32,295,000 and maturing serially on July 1, 2008, through July 1, 2032, with yields ranging from 3.68% to 5.05%. Proceeds for the sale of the Series 2005, 2006 and 2007 Bonds are restricted for the construction of transmission and distribution facilities and to pay the costs associated with the issuance of the Bonds. At September 30, 2007, there were \$62,060,000 of City Electric System revenue bonds outstanding and \$1,069 of City of Bryan General Obligation bonds outstanding payable from revenues of the City Electric System.

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

4. Long-Term Debt - continued

The City Electric System revenue bonds outstanding are summarized as follows:

Series 2001 Bonds

<u>Year Ending</u> <u>September 30</u>	<u>Principal</u> <u>Amount</u>	<u>Interest</u> <u>Amount</u>	<u>Rate</u>
2008	\$ 400,000	\$ 239,494	4.000%
2009	420,000	223,494	4.000%
2010	440,000	206,694	4.125%
2011	450,000	188,544	4.250%
2012	480,000	169,418	4.375%
2013-2017	2,195,000	527,150	4.500% - 5.000%
2018-2019	<u>900,000</u>	<u>68,000</u>	5.000%
	\$ <u>5,285,000</u>	\$ <u>1,622,794</u>	

Series 2005 Bonds

<u>Year Ending</u> <u>September 30</u>	<u>Principal</u> <u>Amount</u>	<u>Interest</u> <u>Amount</u>	<u>Rate</u>
2008	\$ 490,000	\$ 512,919	3.250%
2009	505,000	496,994	3.500%
2010	525,000	479,319	3.500%
2011	545,000	460,944	3.750%
2012	565,000	440,506	4.000%
2013-2017	3,175,000	1,845,531	4.000% - 4.125%
2018-2022	3,875,000	1,136,831	4.125% - 4.375%
2023-2025	<u>2,760,000</u>	<u>252,000</u>	4.500%
	\$ <u>12,440,000</u>	\$ <u>5,625,044</u>	

Series 2006 Bonds

<u>Year Ending</u> <u>September 30</u>	<u>Principal</u> <u>Amount</u>	<u>Interest</u> <u>Amount</u>	<u>Rate</u>
2008	\$ 295,000	\$ 531,538	4.000%
2009	305,000	519,738	5.000%
2010	320,000	504,488	5.000%
2011	335,000	488,488	4.000%
2012	350,000	475,088	4.000%
2013-2017	1,985,000	2,145,340	4.000% - 5.000%
2018-2022	2,455,000	1,669,050	4.125% - 4.375%
2023-2027	3,035,000	1,085,506	4.375% - 4.500%
2028-2031	<u>2,960,000</u>	<u>340,425</u>	4.500%
	\$ <u>12,040,000</u>	\$ <u>7,759,661</u>	

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

4. Long-Term Debt - continued

Series 2007 Bonds

<u>Year Ending</u> <u>September 30</u>	<u>Principal</u> <u>Amount</u>	<u>Interest</u> <u>Amount</u>	<u>Rate</u>
2008	\$ 710,000	\$ 1,186,572	4.000%
2009	745,000	1,524,931	4.000%
2010	775,000	1,495,131	4.000%
2011	810,000	1,464,131	4.250%
2012	840,000	1,429,706	4.250%
2013-2017	4,800,000	6,558,269	4.250% - 5.000%
2018-2022	6,065,000	5,292,338	4.500% - 5.250%
2023-2027	7,710,000	3,654,000	5.000%
2028-2032	<u>9,840,000</u>	<u>1,524,000</u>	5.000%
	<u>\$ 32,295,000</u>	<u>\$ 24,129,078</u>	

General Obligation bonds outstanding not refunded with the debt separation revenue refunding bonds payable from City Electric System revenues with rates from 3.95% to 4.00% are summarized as follows:

<u>Year Ending</u> <u>September 30</u>	<u>Principal</u> <u>Amount</u>	<u>Interest</u> <u>Amount</u>
2008	\$ 526	\$ 32
2009	543	11
Total	<u>\$ 1,069</u>	<u>\$ 43</u>

All net revenues of the City Electric System are pledged for the payment of debt service of the revenue bonds. Net revenues, as defined by the bond resolution include all of the revenues and expenses of the City Electric System other than certain interest income and expense and depreciation and amortization. The bond resolutions further require that the net revenues, as defined, equal at least 1.10 times the average annual debt service on all revenue bonds. The City Electric System is in compliance with these requirements at September 30, 2007 and 2006.

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

4. Long-Term Debt - continued

Under the terms of the bond covenants, City Electric System is required to maintain minimum reserve fund requirements equal to approximately one year of debt service requirements. The reserve fund requirements may be satisfied by cash, a letter of credit or an insurance policy. The reserve fund requirements for the Series 2001 and 2005 Bonds are satisfied with restricted funds which are reported on City Electric System's Statement of Net Assets as Debt reserve. The reserve fund requirements for the Series 2006 and Series 2007 Bonds are satisfied with insurance policies.

Long-term debt activity for the year ended September 30, 2007 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Revenue Bonds - Series 2001	\$ 5,675,000	\$ -	\$ 390,000	\$ 5,285,000	\$ 400,000
Revenue Bonds - Series 2005	12,915,000	-	475,000	12,440,000	490,000
Revenue Bonds - Series 2006	12,385,000		345,000	12,040,000	295,000
Revenue Bonds - Series 2007	-	32,295,000	-	32,295,000	710,000
General Obligation Bonds	1,577	-	508	1,069	526
Total	<u>\$30,976,577</u>	<u>\$32,295,000</u>	<u>\$ 1,210,508</u>	<u>\$62,061,069</u>	<u>\$1,895,526</u>

In the Statement of Activities for the years ended September 30, 2007 and 2006, interest expense in the amount of \$1,346,771 and \$799,107, respectively, is included as a direct function expense.

5. 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.

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

5. Retirement Plan – continued

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.

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).

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

5. Retirement Plan – continued

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%

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%	-

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

5. Retirement Plan – continued

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 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.

6. Risk Management

The City Electric System is covered for risk of losses related to general liability and workers' 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 years ending September 30, 2007 and 2006, the City Electric System paid the City \$462,119 and \$499,250, respectively, for participation in the City's risk management program.

7. Litigation

There are several lawsuits pending in which the City Electric System is involved. In the event of an unfavorable outcome in any suit, in management's opinion, a claim against the City Electric System would be covered by insurance, or has been provided for in the financial statements, and would not materially affect the financial statements of the City Electric System.

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

8. Deferred Compensation Plan

The City 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.

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	<u>\$ 975,422</u>	<u>\$ 736,809</u>
Amounts due in one year	\$ 975,422	\$ 736,809

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

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.

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.

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

11. Texas Municipal Power Agency

The Texas Municipal Power Agency (TMPA) was created in July 1975 by concurrent ordinances of the Texas cities of Bryan, Denton, Garland, and Greenville (the "Cities"). In September 1976, TMPA entered into identical Power Sales Contracts, as amended in November 1997, (the "Contract") with each of the Cities for the purpose of obtaining the economic advantages of jointly financing, constructing and operating large electric generating units and related facilities to supply the Cities' future energy needs. Under the Contract each City is obligated to take or pay for a specified percentage of electricity from TMPA's generating facility.

For the years ended September 30, 2007 and 2006, City Electric System paid TMPA a net \$23,928,961 and \$24,475,604 in capacity charges and \$13,862,454 and \$12,626,143, respectively, for generation under this contract. These amounts are included in electric operations.

12. 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. In 2007 and 2006, these sales totaled \$22,486,555 and \$21,367,570, respectively. These amounts are included in City Electric System operating revenues.

In addition to the \$6,374,815 and \$6,351,866 transferred to the City of Bryan for right of way in 2007 and 2006, respectively, City Electric System paid the City \$423,000 and \$595,000 for administrative functions performed by city personnel in 2007 and 2006, respectively. These amounts are included in the other expenses in the accompanying financial statements.

The City of Bryan transferred to City Electric System \$1,216,000 and \$930,000 in 2007 and 2006, respectively, for billing services performed by City Electric System.