

BRYAN TEXAS UTILITIES
City Electric System
Financial Statements
For the Years Ended September 30, 2008 and 2007

Bryan Texas Utilities
City Electric System
Table of Contents
For the Years Ended September 30, 2008 and 2007

	<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, 2008 and 2007	
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 - 35

Bryan Texas Utilities
City Electric System
Introduction
For the Years Ended September 30, 2008 and 2007

Bryan Texas Utilities (BTU) is pleased to present its Annual Financial Report for the fiscal years ended September 30, 2008 and 2007. 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, 2008 and 2007, 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, 2008 and 2007, 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, 2008 and 2007, 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.

Ingram, Wallis & Company

Bryan, Texas
January 26, 2009

Bryan Texas Utilities
City Electric System
Management's Discussion and Analysis
For the Years Ended September 30, 2008 and 2007
(Unaudited)

This discussion and analysis of the City Electric System financial performance provides an overview of financial activities for the years ended September 30, 2008 and 2007. 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. 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 of each year.

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, 2008 and 2007. 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, financing 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, 2008 and 2007
(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, 2008 and 2007.

<u>Condensed Statements of Net Assets</u>	<u>2008</u>	<u>2007</u>
Current assets	\$ 43,835,353	\$ 48,983,223
Capital assets, net	168,720,478	127,735,752
Restricted assets	60,289,488	80,520,647
Other	12,278,827	625,317
Total assets	<u>285,124,146</u>	<u>257,864,939</u>
Current liabilities	12,000,832	17,039,514
Current liabilities payable from restricted assets	6,146,666	5,376,122
Noncurrent liabilities	90,839,919	60,512,908
Total liabilities	<u>108,987,417</u>	<u>82,928,544</u>
Net assets:		
Invested in capital assets, net of related debt	102,408,085	100,992,721
Restricted	31,349,830	42,169,885
Unrestricted	42,378,814	31,773,789
Total net assets	<u>\$ 176,136,729</u>	<u>\$ 174,936,395</u>
 <u>Condensed Statements of Activities</u>		
Program revenues		
Charges for services	\$ 155,748,711	\$ 143,073,607
General revenues		
Investment earnings	2,522,016	3,895,267
Total revenues	<u>158,270,727</u>	<u>146,968,874</u>
Program expenses	151,347,096	135,050,676
Excess before transfers	6,923,631	11,918,198
Transfers, net	(5,723,297)	(5,158,815)
Change in net assets	1,200,334	6,759,383
Net assets, beginning of period	<u>174,936,395</u>	<u>168,177,012</u>
Net assets, end of period	<u>\$ 176,136,729</u>	<u>\$ 174,936,395</u>

Bryan Texas Utilities
City Electric System
Management's Discussion and Analysis - Continued
For the Years Ended September 30, 2008 and 2007
(Unaudited)

Financial Highlights

- The City Electric System customer base totaled 31,656 and 31,202 customers at September 30, 2008 and 2007, respectively, an increase of 1.5%.
- Operating revenues for the years ending September 30, 2008 and 2007 were \$155,748,711 and \$143,073,607, respectively. The increase in revenues is primarily due to higher fuel related revenues.
- Operating expenses for the years ending September 30, 2008 and 2007 were \$141,968,938 and \$127,100,116, respectively. The increase in expenses is primarily due to higher fuel related energy costs.
- Net assets for the years ended September 30, 2008 and 2007 were \$176,136,729 and \$174,936,395, respectively, of which \$42,378,814 and \$31,773,789 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 2008, the City Electric System issued revenue bonds dated September 1, 2008, totaling \$32,530,000 and maturing serially on July 1, 2009, through July 1, 2033, with yields ranging from 2.10% to 5.29%. The proceeds from the sale of these bonds are restricted to the construction of a new generating facility. 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 3.72% to 5.06%. Proceeds from the sale of the bonds are restricted for the construction of transmission and distribution facilities. At September 30, 2008, there were \$92,695,000 of City Electric System revenue bonds outstanding and \$543 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 2008 and 2007 were higher wholesale capacity sales than budgeted. Wholesale capacity revenues contributed to a 1.9% and 3.0% positive variance from budgeted total operating revenues for the fiscal years 2008 and 2007, respectively.

Bryan Texas Utilities
City Electric System
Management's Discussion and Analysis - Continued
For the Years Ended September 30, 2008 and 2007
(Unaudited)

General Trends and Significant Events

Power Supply –

- 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 unviable to run, 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.
- On November 16, 2007, BTU entered into a 10 year purchased power agreement with a subsidiary of Shell Energy North America (U.S.), L.P.. The agreement, which extends from January 1, 2008 to December 31, 2017, allows BTU to schedule up to 50MW of energy on a day-ahead basis. As a part of the agreement, BTU prepaid \$14.0 million of generation capacity costs. The prepayment was funded from BTU's Rate Stabilization Fund.
- In December of 2007, BTU began the process of constructing Dansby 3, a 50MW gas turbine generator to be located adjacent to BTU's existing Dansby 1& 2 units in Brazos County, Texas. The unit, to be powered by a General Electric LM6000, is scheduled to go in service during the summer of 2009.

Other –

- For the fiscal year ending September 30, 2009, the budget for operating expenses is \$126,358,099 for electric operations, \$7,909,510 for debt service, \$8,234,798 for transfers to the City of Bryan, and \$43,603,693 for capital expenditures in response to customer growth and infrastructure additions to transmission and distribution.

Group Managers:

Joe Hegwood
Gary Miller
Kean Register
Roy Trotter

General Manager:

Dan Wilkerson

Bryan Texas Utilities
City Electric System
Statements of Net Assets
September 30, 2008 and 2007

<u>Assets</u>	<u>2008</u>	<u>2007</u>
Current assets:		
Cash and cash equivalents	\$ 7,049,276	\$ 14,728,812
Accounts receivable	15,108,022	14,011,121
Less allowance for uncollectible accounts	(889,645)	(763,680)
Accrued interest receivable	170,745	458,611
Inventory	6,671,453	5,838,817
Due from other funds	3,012,901	6,213,826
Prepaid purchased power option	1,400,000	-
Other assets	143,136	207,938
Under recovery of fuel	11,169,465	8,287,778
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Total current assets	43,835,353	48,983,223
	<hr/>	<hr/>
Non-current assets:		
Restricted assets:		
Cash and cash equivalents	50,220,113	45,969,795
Investments	10,069,375	34,550,852
Prepaid purchased power option	11,550,000	-
Capital assets	282,932,436	235,759,675
Less accumulated depreciation	(114,211,958)	(108,023,923)
Unamortized bond issuance expenses	728,827	625,317
	<hr/>	<hr/>
Total noncurrent assets	241,288,793	208,881,716
	<hr/>	<hr/>
Total assets	\$ 285,124,146	\$ 257,864,939
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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, 2008 and 2007

<u>Liabilities</u>	<u>2008</u>	<u>2007</u>
Current liabilities:		
Accounts payable	\$ 10,386,414	\$ 14,863,047
Accrued liabilities	200,544	206,609
Due to City of Bryan	814,735	1,473,237
Deferred credits and other current liabilities	599,139	496,621
	<hr/>	<hr/>
Total current liabilities	12,000,832	17,039,514
	<hr/>	<hr/>
Current liabilities payable from restricted assets:		
Accrued interest	695,691	342,565
Revenue bonds - current portion	2,530,000	1,895,000
General obligation bonds - current portion	543	526
Customer deposits	2,920,432	3,138,031
	<hr/>	<hr/>
Total current liabilities payable from restricted assets	6,146,666	5,376,122
	<hr/>	<hr/>
Non-current liabilities:		
Revenue bonds payable	90,165,000	60,165,000
General obligation bonds	-	543
Bond (discounts)/premium, net	(363,923)	(447,872)
Arbitrage rebate	100,280	113,347
Accrued vacation pay	360,821	365,005
Other post employment benefits	20,183	-
Deferred credits and other noncurrent liabilities	557,558	316,885
	<hr/>	<hr/>
Total noncurrent liabilities	90,839,919	60,512,908
	<hr/>	<hr/>
Total liabilities	108,987,417	82,928,544
	<hr/>	<hr/>
<u>Net Assets</u>		
Net assets:		
Invested in capital assets, net of related debt	102,408,085	100,992,721
Restricted for:		
Debt reserve	3,977,413	1,655,363
Debt service	494,135	309,159
Rate stabilization	20,541,787	33,868,868
TMPA escrow	6,336,495	6,336,495
Unrestricted	42,378,814	31,773,789
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Total net assets	\$ 176,136,729	\$ 174,936,395
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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, 2008 and 2007

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Program Revenues</u>	<u>2008 Net (Expense) Revenue and Changes in Net Assets</u>	<u>2007 Net (Expense) Revenue and Changes in Net Assets</u>
<u>Charges for Services</u>	<u>Business-type Activities</u>	<u>Business-type Activities</u>	<u>Business-type Activities</u>	<u>Business-type Activities</u>
Business-type activities:				
Electric	\$ 151,347,096	\$ 155,748,711	\$ 4,401,615	\$ 8,022,931
Total	<u>\$ 151,347,096</u>	<u>\$ 155,748,711</u>	<u>4,401,615</u>	<u>8,022,931</u>
General revenues:				
Investment earnings			2,522,016	3,895,267
Transfers, net			<u>(5,723,297)</u>	<u>(5,158,815)</u>
Total general revenues and transfers			<u>(3,201,281)</u>	<u>(1,263,548)</u>
Change in net assets			1,200,334	6,759,383
Net assets at beginning of year			<u>174,936,395</u>	<u>168,177,012</u>
Net assets at end of year			<u><u>\$ 176,136,729</u></u>	<u><u>\$ 174,936,395</u></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, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Operating revenues:		
Electrical system	\$ 153,872,437	\$ 141,061,065
Other	1,876,274	2,012,542
Total operating revenues	155,748,711	143,073,607
Operating Expenses:		
Personnel services	8,511,317	8,863,499
Electric operations	126,564,316	110,768,779
Maintenance	2,111,231	2,765,346
Other services and charges	1,527,847	1,826,643
Other expenses	579,252	443,335
General and administrative	2,674,975	2,432,514
Total operating expenses before depreciation	141,968,938	127,100,116
Operating income before depreciation	13,779,773	15,973,491
Depreciation	6,506,072	6,603,789
Operating income	7,273,701	9,369,702
Nonoperating revenues (expenses):		
Investment income	2,522,016	3,895,267
Interest expense	(2,872,086)	(1,346,771)
Total nonoperating revenues (expenses)	(350,070)	2,548,496
Income before operating transfers	6,923,631	11,918,198
Transfers:		
City of Bryan administrative payment	1,247,616	1,216,000
“Right of Way” payment to City of Bryan	(6,970,913)	(6,374,815)
Transfers, net	(5,723,297)	(5,158,815)
Change in net assets	1,200,334	6,759,383
Net assets, beginning of period	174,936,395	168,177,012
Net assets, end of period	\$ 176,136,729	\$ 174,936,395

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, 2008 and 2007

<u>Cash flows from operating activities</u>	<u>2008</u>	<u>2007</u>
Receipts from customers	\$ 157,419,483	\$ 140,969,498
Payments to suppliers	(140,232,725)	(120,944,959)
Payments to employees	(8,521,566)	(9,336,418)
	<hr/>	<hr/>
Net cash provided by operating activities	8,665,192	10,688,121
<u>Cash flows from noncapital financing activities</u>		
Operating subsidies and transfers from other funds	1,247,616	1,216,000
Operating subsidies and transfers to other funds	(6,970,913)	(6,374,815)
	<hr/>	<hr/>
Net cash used by non-capital financing activities	(5,723,297)	(5,158,815)
<u>Cash flows from capital and related financing activities</u>		
Purchases of capital assets	(50,129,506)	(15,766,270)
Prepaid purchased power option	(11,550,000)	-
Proceeds from capital debt	32,434,057	31,994,188
Principal paid on capital debt	(1,878,765)	(1,197,763)
Interest paid on capital debt	(2,538,258)	(1,261,000)
	<hr/>	<hr/>
Net cash (used) provided by capital and related financing activities	(33,662,472)	13,769,155
<u>Cash flows from investing activities</u>		
Proceeds from sales and maturities of investments	47,550,000	12,050,001
Purchase of investments	(23,073,550)	(7,578,962)
Interest and dividends received	2,814,909	3,386,641
	<hr/>	<hr/>
Net cash provided by investing activities	27,291,359	7,857,680
Net (decrease) increase in cash and cash equivalents	(3,429,218)	27,156,141
Balance-beginning of the year	60,698,607	33,542,466
	<hr/>	<hr/>
Balance-end of the year	\$ 57,269,389	\$ 60,698,607
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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, 2008 and 2007

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

	<u>2008</u>	<u>2007</u>
Operating income	\$ 7,273,701	\$ 9,369,702
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	6,506,072	6,603,789
Amortization	65,852	158,163
Bad debts	341,618	267,750
Change in assets and liabilities:		
Accounts receivable	(1,312,554)	830,984
Inventory	(832,636)	(722,503)
Prepaid assets	(1,335,198)	(50,225)
Due from other funds	3,200,925	(3,450,720)
Unrecovered fuel	(2,881,687)	(6,932,160)
Accounts payable	(1,989,680)	3,542,794
Accrued liabilities	(6,065)	(468,071)
Customer deposits	(217,599)	515,627
Due to other funds	(658,502)	977,159
Accrued vacation	(4,184)	(4,848)
Deferred credit	515,129	50,680
Net cash provided by operating activities	\$ 8,665,192	\$ 10,688,121

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

Bryan Texas Utilities
City Electric System
Notes to Financial Statements
September 30, 2008 and 2007

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 non-operating 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 non-operating revenues and expenses.

Bryan Texas Utilities
City Electric System
Notes to Financial Statements - continued
September 30, 2008 and 2007

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. BTU has elected not to follow FASB guidance issued subsequent to this date.

Implementation of New Accounting Principles - For the fiscal year ended September 30, 2008, BTU adopted the following GASB pronouncements:

- GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*. This statement establishes additional guidance for the financial reporting of other postemployment benefits (“OPEB”) plans. It provides standards for the recognition, measurement, display of OPEB costs and the related balance sheet items. Disclosure requirements have been incorporated into Note 6 – Post Employment Benefits Other Than Pension Benefits.
- GASB Statement No. 50, *Pension Disclosures—an amendment of GASB Statements No. 25 and No. 27*. This statement establishes more extensive disclosure requirements for pension plans. Employer disclosure requirements have been incorporated into Note 5 – Retirement Plan. There was no additional impact to the financial statements as a result of this GASB statement.

For the fiscal year ended September 30, 2007, GASB issued no pronouncements applicable to BTU financial reporting.

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, 2008 and 2007

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, 2008 and 2007, the City Electric System recorded accounts receivable – under recovered fuel of \$11,169,465 and \$8,287,778, 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 value. 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.

Reclassifications – Certain reclassifications have been made to the prior period's financial statements in order to conform them to the classification used in the current year.

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, 2008 and 2007

2. Cash and Investments - continued

Deposits

City Electric System demand deposits for the fiscal years ended 2008 were held at Citibank, N.A. and in 2007 deposits were held at First National Bank of Bryan/College Station. These deposits were entirely covered by federal depository insurance or by collateral equal to at least 102% of the 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;
- 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;

Bryan Texas Utilities
City Electric System
Notes to Financial Statements - Continued
September 30, 2008 and 2007

2. Cash and Investments – continued

Investments - continued

- 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.
- l. Hedging contracts and related security insurance agreements in relation to BTU fuel and energy supplies to protect against loss due to price fluctuations.

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, 2008 and 2007 are summarized as follows:

	<u>2008</u>	<u>2007</u>
Demand deposits	\$ 5,052,547	\$ 59,586,316
Investment in government pool	52,216,842	-
United States agencies	10,069,375	34,550,852
Investment in short term treasury securities	-	1,112,291
Total	<u>\$ 67,338,764</u>	<u>\$ 95,249,459</u>

The City Electric System’s investment in a government pool reflects deposits in TexSTAR. TexSTAR is a local government investment pool created and jointly managed by First Southwest Asset Management, Inc. and JPMorgan Chase Bank to invest funds on behalf of Texas political subdivisions. The pool is not managed by the City Electric System and the investment in the pool is stated at cost which approximates fair value.

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, 2008 and 2007

2. Cash and Investments – continued

Investments - continued

As of September 30, 2008, 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>
Government pool	\$ 52,216,842	\$ 52,216,842	\$ -	\$ -
United States agencies	10,069,375	3,004,688	7,064,687	-
Total fair value	<u>\$ 62,286,217</u>	<u>\$ 55,221,530</u>	<u>\$ 7,064,687</u>	<u>\$ -</u>

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 102% 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, 2008 and 2007

2. Cash and Investments – continued

Restricted Cash and Investments

In 2008, cash and investments of \$67.3 million exceeded amounts required to be restricted by \$7.0 million. In 2008, BTU transferred \$14.0 million from the Rate stabilization fund to prepay capacity costs on a purchased power agreement. In 2007, cash and investments of \$95.2 million exceeded amounts required to be restricted by \$14.7 million.

Amounts required to be restricted at September 30, 2008 and 2007 are as follows:

	<u>2008</u>	<u>2007</u>
Rate stabilization fund	\$ 20,541,787	\$ 33,868,868
Debt reserve	3,977,413	1,655,363
Debt service	494,135	651,724
TMPA escrow fund	6,336,495	6,336,495
Bond series 2006 reserve	-	2,575,166
Bond series 2007 reserve	8,030,727	32,295,000
Bond series 2008 reserve	17,988,499	-
Customer deposits	2,920,432	3,138,031
Restricted cash and investments	<u>\$ 60,289,488</u>	<u>\$ 80,520,647</u>

3. Capital Assets

General Description – At September 30, 2008, 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 not viable to run. The mothballed units were fully depreciated at September 30, 2007.

In December of 2007, BTU began the process of constructing Dansby 3, a 50MW gas turbine generator to be located adjacent to BTU's existing Dansby 1 & 2 units in Brazos County, Texas. The unit, to be powered by a General Electric LM6000, is scheduled to go in service during the summer of 2009. The balance of construction in progress related to this project is \$14,541,501. 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, 2008.

Bryan Texas Utilities
City Electric System
Notes to Financial Statements - Continued
September 30, 2008 and 2007

3. Capital Assets - continued

Capital asset activity for the year ended September 30, 2008 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets, not being depreciated:				
Land	\$ 3,130,641	\$ 458,608	\$ -	\$ 3,589,249
Construction in progress	10,776,835	47,161,653	38,619,251	19,319,237
Total capital assets, not being depreciated	13,907,476	47,620,261	38,619,251	22,908,486
Capital assets, being depreciated:				
Production plant	80,218,436	226,207	-	80,444,643
Transmission plant	42,229,951	28,014,898	66,949	70,177,900
Distribution plant	80,135,247	8,351,364	51,830	88,434,781
General plant	19,268,565	1,739,420	41,359	20,966,626
Total capital assets, being depreciated	221,852,199	38,331,889	160,138	260,023,950
Less accumulated depreciation for:				
Production plant	52,552,593	1,465,167	-	54,017,760
Transmission plant	11,566,782	1,476,964	191,480	12,852,266
Distribution plant	31,032,483	2,487,880	87,752	33,432,611
General Plant	12,872,065	1,076,061	38,805	13,909,321
Total accumulated depreciation	108,023,923	6,506,072	318,037	114,211,958
Total capital assets, being depreciated, net	113,828,276	31,825,817	(157,899)	145,811,992
Total capital assets, net	<u>\$ 127,735,752</u>	<u>\$ 79,446,078</u>	<u>\$ 38,461,352</u>	<u>\$ 168,720,478</u>

4. Long-Term Debt

In 2008, the City Electric System issued revenue bonds dated September 1, 2008, totaling \$32,530,000 and maturing serially on July 1, 2009, through July 1, 2033, with yields ranging from 2.10% to 5.29%. 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 3.72% to 5.06%. Proceeds of the 2008 bond issue are restricted to the construction of a new generating unit and to pay bond costs. Proceeds for the sale of the Series 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, 2008, there were \$92,695,000 of City Electric System revenue bonds outstanding and \$543 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, 2008 and 2007

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>Yield</u>
2009	\$ 420,000	\$ 223,494	4.100%
2010	440,000	206,694	4.200%
2011	450,000	188,544	4.310%
2012	480,000	169,418	4.700%
2013	495,000	148,419	4.590%
2014-2018	2,140,000	423,731	4.710% - 5.080%
2019	<u>460,000</u>	<u>23,000</u>	5.140%
	<u>\$ 4,885,000</u>	<u>\$ 1,383,300</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>Yield</u>
2009	505,000	496,994	3.1700%
2010	525,000	479,319	3.700%
2011	545,000	460,944	3.560%
2012	565,000	440,506	3.700%
2013	585,000	417,906	3.820%
2014-2018	3,305,000	1,717,674	3.940% - 4.440%
2019-2023	4,040,000	970,981	4.480% - 4.620%
2024-2025	<u>1,880,000</u>	<u>127,800</u>	4.650% - 4.680%
	<u>\$ 11,950,000</u>	<u>\$ 5,112,124</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>Yield</u>
2009	305,000	519,738	3.610%
2010	320,000	504,488	3.620%
2011	335,000	488,488	3.690%
2012	350,000	475,088	3.730%
2013	365,000	461,088	3.790%
2014-2018	2,070,000	2,057,690	3.870% - 4.210%
2019-2023	2,560,000	1,563,969	4.260% - 4.500%
2024-2028	3,170,000	950,350	4.520% - 4.630%
2029-2031	<u>2,270,000</u>	<u>207,225</u>	4.630%
	<u>\$ 11,745,000</u>	<u>\$ 7,228,124</u>	

Bryan Texas Utilities
City Electric System
Notes to Financial Statements - Continued
September 30, 2008 and 2007

4. Long-Term Debt - continued

Series 2007 Bonds

Year Ending <u>September 30</u>	Principal <u>Amount</u>	Interest <u>Amount</u>	<u>Yield</u>
2009	745,000	1,524,931	3.720%
2010	775,000	1,495,131	3.750%
2011	810,000	1,464,131	3.800%
2012	840,000	1,429,706	3.880%
2013	880,000	1,394,006	3.970%
2014-2018	5,025,000	6,331,732	4.050% - 4.470%
2019-2023	6,355,000	5,002,370	4.680% - 4.850%
2024-2028	8,095,000	3,268,500	4.880% - 5.000%
2029-2032	<u>8,060,000</u>	<u>1,032,000</u>	5.040% - 5.060%
	<u>\$ 31,585,000</u>	<u>\$ 22,942,507</u>	

Series 2008 Bonds

Year Ending <u>September 30</u>	Principal <u>Amount</u>	Interest <u>Amount</u>	<u>Yield</u>
2009	555,000	1,192,288	2.100%
2010	760,000	1,561,650	2.400%
2011	790,000	1,531,250	2.750%
2012	820,000	1,499,650	3.000%
2013	855,000	1,466,850	3.220%
2014-2018	4,820,000	6,783,850	3.460% - 4.210%
2019-2023	6,095,000	5,500,063	4.420% - 4.810%
2024-2028	7,830,000	3,766,500	4.860% - 5.100%
2029-2032	<u>10,005,000</u>	<u>1,589,518</u>	5.290%
	<u>\$ 32,530,000</u>	<u>\$ 24,891,619</u>	

General Obligation bonds outstanding not refunded with the debt separation revenue refunding bonds payable from City Electric System revenues with rates of 4% are summarized as follows:

Year Ending <u>September 30</u>	Principal <u>Amount</u>	Interest <u>Amount</u>
2009	<u>543</u>	<u>11</u>
Total	<u>\$ 543</u>	<u>\$ 11</u>

Bryan Texas Utilities
City Electric System
Notes to Financial Statements - Continued
September 30, 2008 and 2007

4. Long-Term Debt - continued

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, 2008 and 2007.

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, 2005 and 2008 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, 2008 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Revenue Bonds - Series 2001	\$ 5,285,000	\$	\$ 400,000	\$ 4,885,000	\$ 420,000
Revenue Bonds - Series 2005	12,440,000		490,000	11,950,000	505,000
Revenue Bonds - Series 2006	12,040,000		295,000	11,745,000	305,000
Revenue Bonds - Series 2007	32,295,000		710,000	31,585,000	745,000
Revenue Bonds - Series 2008	-	32,530,000	-	32,530,000	555,000
General Obligation Bonds	1,069		526	543	543
	<u>\$62,061,069</u>	<u>\$32,530,000</u>	<u>\$ 1,895,526</u>	<u>\$ 92,695,543</u>	<u>\$ 2,530,543</u>

In the Statement of Activities for the years ended September 30, 2008 and 2007, interest expense in the amount of \$2,872,086 and \$1,346,771, 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 827 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, 2008 and 2007

5. Retirement Plan - continued

Plan Description – 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 (over funded) actuarial liability (asset) over the remainder of the plan's 30-year amortization period. The projected 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, 2007 valuation is effective for rates beginning January 2009).

Bryan Texas Utilities
City Electric System
Notes to Financial Statements - Continued
September 30, 2008 and 2007

5. Retirement Plan - continued

Actuarial assumptions are as follows:

Actuarial valuation date	12/31/2005	12/31/2006	12/31/2007
Actuarial cost method	----- Unit Credit -----		Projected Unit Credit
Amortization method	----- Level Percentage of Payroll -----		
Remaining amortization period	----- 25 years – open -----		30 years - closed
Asset valuation method	----- Amortized cost -----		
Actuarial assumptions:			
Investment return	7.0%	7.0%	7.0%
Projected salary increased	0.0%	0.0%	Varies by age & service
Included inflation rate	3.5%	3.5%	3.0%
Cost-of-living adjustments	0.0%	0.0%	2.1% (3.0% CPI)

Schedule of Actuarial Liabilities and Funding Progress

Actuarial Valuation Date, Dec. 31	<u>2005</u>	<u>2006</u>	<u>2007</u>
1. Prior Service Liability			
a. Present Members			\$ 31,369,479
b. Annuitants			24,623,906
2. Current Service Liability			<u>92,303,970</u>
3. Total Actuarial Value of Liabilities	\$ 113,740,747	\$ 118,752,796	\$ 148,297,355
4. Actuarial Value of Assets	<u>85,259,236</u>	<u>87,895,438</u>	<u>90,418,211</u>
5. Unfunded actuarial accrued liability: (3) – (4)	\$ 28,481,511	\$ 30,857,358	\$ 57,879,144
6. Funded ratio: (4) / (3)	75.0%	74.0%	61.0%
Annual Covered Payroll	33,650,168	35,240,358	37,229,136
UAAL as a Percentage of Covered Payroll	84.6%	87.6%	155.5%

Bryan Texas Utilities
City Electric System
Notes to Financial Statements - Continued
September 30, 2008 and 2007

5. Retirement Plan - continued

Historical data is as follows:

Fiscal Year	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligations at September 30
9/30/2006	\$ 4,787,919	100%	-
9/30/2007	\$ 4,791,580	100%	-
9/30/2008	\$ 5,028,310	100%	-

The City of Bryan is one of 827 municipalities having the benefit plan administered by TMRS. Each of the 827 municipalities has an annual, individual actuarial valuation performed. All assumptions for the December 31, 2007, valuations are contained in the 2007 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. 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 14.53% to 19.25%. 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. Post Employment Benefits Other Than Pension 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. The following covers the City's post employment benefit plan as a whole, unless noted otherwise.

Effective January 1, 1991, by action of the Bryan City Council, the City began offering post-retirement health care benefits to employees under the City of Bryan Retiree Health Care Plan. 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

Bryan Texas Utilities
City Electric System
Notes to Financial Statements - Continued
September 30, 2008 and 2007

6. Post Employment Benefits Other Than Pension Benefits - continued

retirement under the City's retirement plan, and must elect to continue coverage under this other post employment benefit(OPEB) plan immediately upon retirement. This plan is a single employer defined benefit OPEB plan whose operations are included in the financial results of the City of Bryan Texas. A copy of this report may be obtained by writing to City of Bryan, 300 South Texas Ave., Bryan, Texas 77803.

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 years ended September 30, 2008 and 2007, retirees paid \$370,493 and \$291,461 in premiums and \$873,453 and \$985,492 in claims were paid for post-retirement health care and administrative charges, respectively. As of September 30, 2008, the City has 28 retirees, 25 retirees and spouses, 10 retirees and families and 9 retirees and child(ren) participating in the health plan, out of the 284 employees eligible to participate upon retirement. As of September 30, 2007, the City had 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. In the years ended September 30, 2008 and 2007 participants paid premiums of \$17,998 and \$22,121, and incurred claims and administrative expenses of \$113,394 and \$170,345, respectively. As of September 30, 2008 and 2007, the City had four COBRA participants.

Plan Description

The City's health care plan includes medical, dental, and prescription coverage. Retiree health plan coverage is the same as coverage provided to active City employees in accordance with the terms and conditions of the current City of Bryan Health Plan.

The City offers a fully insured optional vision plan that retirees and their dependents may purchase. To be eligible for healthcare an employee must be at least 60 years of age and have five years of TMRS service credit or have at least 20 years of service credit. In order to be eligible, employees must elect to retire at time of separation, must elect in writing to continue health benefits coverage at the time of separation, and must pay the appropriate premium. Employees terminating before normal retirement conditions are not eligible for retiree health coverage.

Bryan Texas Utilities
City Electric System
Notes to Financial Statements - Continued
September 30, 2008 and 2007

6. Post Employment Benefits Other Than Pension Benefits – continued

Employees who terminate employment are not eligible for retiree health coverage. Retiring employees, who do not elect in writing to continue health benefits coverage at the time of separation, are not eligible for retiree health coverage.

Survivors of employees who die while actively employed are not eligible for retiree health coverage. However, surviving spouses and dependents of Texas law enforcement officers killed in the line of duty are entitled to purchase continued health insurance benefits. The surviving spouse is entitled to continue to purchase health insurance coverage until the earlier of: (1) the date the surviving spouse remarries; (2) the date the surviving spouse becomes eligible for group health insurance through another employer; or (3) the date the surviving spouse becomes eligible for federal Medicare benefits. Surviving dependent minor children are entitled to continue health insurance coverage until the dependent (1) reaches the age of 21 years; or (2) becomes eligible for group health insurance through another employer. Eligible survivors are entitled to purchase the continued coverage at the group rate for that coverage that exists at the time of payment.

Employees who retire under a disability retirement are not eligible for retiree health coverage. Eligible retirees may continue health insurance benefits for eligible spouses and dependents covered at the time of retirement. A dependent not covered under the plan at this time is not eligible for coverage. If the retiree elects to continue coverage for any dependent and on any subsequent date elects to discontinue coverage, the dependent is no longer eligible for coverage. Surviving spouses and dependents of deceased retired employees may continue health care coverage for up to 36 months through COBRA.

Once retiree or spouse is enrolled in Medicare, City's plan is secondary payer. Retiree is responsible for payment of any Medicare premiums. The City does not provide any cash payment in lieu of electing the City's health care plan. Retirees who do not elect to continue coverage at time of separation are not eligible to opt back in.

The City does not offer life insurance coverage for retirees or their dependents. Employees who retire are eligible to convert their group life insurance coverage to a Whole Life Policy without accidental death and dismemberment until the employee reaches age 100 or a Group Term Life with AD&D until the employee reaches age 70.

Funding Policy and Annual OPEB Cost

The City's annual other post employment benefits (OPEB) cost is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameter of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The City had its first OPEB actuarial valuation performed for the fiscal year beginning October 1, 2007 as required by GASB. BTU's portion of the City's annual OPEB cost for the current year is as follows:

Bryan Texas Utilities
City Electric System
Notes to Financial Statements - Continued
September 30, 2008 and 2007

6. Post Employment Benefits Other Than Pension Benefits – continued

Funding Policy and Annual OPEB Cost – continued

Annual required contribution	\$	128,777
Interest on OPEB obligation		-
Adjustment to ARC		-
Annual OPEB cost (expense) end of year		128,777
Net estimated employer contributions		(108,594)
Increase in net OPEB obligation		\$ 20,183
Net OPEB obligation – as of beginning of the year		-
Net OPEB obligation (asset) – as of end of year		\$ 20,183

Funding Status and Funding Progress

The funded status of the City’s retiree health care plan, under GASB Statement No. 45 as of September 30, 2007 is as follows:

Actuarial Valuation Date as of September 30	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)
2007	-	\$7,898,192	\$7,898,192	0%

Under the reporting parameters, the City’s retiree health care plan is 0% funded with an estimated actuarial accrued liability exceeding actuarial assets by \$7,898,192 at September 30, 2007.

Actuarial methods and assumptions

The Projected Unit Credit actuarial cost method is used to calculate the GASB ARC for the City’s retiree health care plan. Using the plan benefits, the present health premiums and a set of actuarial assumptions, the anticipated future payments are projected. The projected unit credit method then provides for a systematic funding for these anticipated payments. The yearly ARC is computed to cover the cost of benefits being earned by covered members as well as to amortize a portion of the unfunded accrued liability.

Bryan Texas Utilities
City Electric System
Notes to Financial Statements - Continued
September 30, 2008 and 2007

6. Post Employment Benefits Other Than Pension Benefits - continued

Projections of health benefits are based on the plan as understood by the City and include the types of benefits in force at the valuation date and the pattern of sharing benefit costs between the City and the City's employees to that point. Actuarial calculations reflect a long-term perspective and employ methods and assumptions that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets. Significant methods and assumptions were as follows:

Actuarial Methods and Assumptions

Investment rate of return	4.5%, net of expenses
Medical cost increases	10.0% for 2008, decreasing to 4.5% after 2018
Actuarial cost method	Projected Unit Credit Cost Method
Amortization method	Level as a percentage of pay

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events in the future. Amounts determined regarding the funded status and the annual required contributions of the City's retiree health care plan are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future.

7. 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, 2008 and 2007, the City Electric System paid the City \$336,402 and \$462,119 respectively for participation in the City's risk management program.

8. Financial Hedging

The 1999 Texas utility deregulation legislation, Senate Bill 7, contains provisions modifying the Public Finance Investment Act to allow municipal utilities the ability to purchase and sell energy-related financial instruments in order to hedge or mitigate the effect of market price fluctuations of natural gas, fuel oil and electric energy.

On March 10, 2008, the BTU Board of Directors modified BTU's Energy Risk Policy to allow for the purchase and sale of certain financial instruments defined as hedge instruments. The essential goal of the Energy Risk Policy is to provide a framework for the operation of a fuel and energy purchasing and hedging program to better manage BTU's risk exposures in order to stabilize pricing and costs for the benefit of BTU's customers.

Bryan Texas Utilities
City Electric System
Notes to Financial Statements - Continued
September 30, 2008 and 2007

8. Financial Hedging - continued

BTU follows GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools* for put and call option hedge instruments and accordingly records changes in the fair value of such investments to fuel expense on the Statement of Revenues, Expenses and Changes in Net Assets.

BTU follows GASB Technical Bulletin No. 2003-1, *Disclosure Requirements for Derivatives Not Reported at Fair Value* for swap hedge transactions. Accordingly, swap transactions are reported at cost on the Statement of Net Assets. At September 30, 2008 BTU had outstanding swaps hedging 480,000 MMBtu's of gas purchases, indexed to Houston Ship Channel daily gas prices, covering the period from October 2008 to September 2009. The swaps transacted at no cost. As of September 30, 2008, the fair value of outstanding swap hedge instruments was (\$261,160). Fair value is determined based on the New York Mercantile Exchange (NYMEX) closing settlement prices at September 30, 2008, adjusted for the basis difference between Henry Hub and the Houston Ship Channel.

Swap contracts represent a financial obligation to buy or sell the underlying delivery point basis. If held to expiration, as is BTU's policy, the financial difference determined by mark-to-market valuation must be settled on a cash basis.

The hedging contracts expose BTU to a minimal amount of credit risk. In the event of default or nonperformance by a hedge counterparty the operations of BTU could be materially affected. However, BTU ensures minimum credit standards for hedge transactions and does not anticipate the counterparties to fail to meet their obligations.

9. 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.

10. 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 \$6,478,308 and

Bryan Texas Utilities
City Electric System
Notes to Financial Statements - Continued
September 30, 2008 and 2007

10. Employee Benefits – continued

\$4,861,156 for the twelve month periods ending December 31, 2008 and 2007, respectively. 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>2008</u>	<u>2007</u>
Beginning balance - unpaid claims	\$ 975,422	\$ 736,809
Incurred claims	5,664,099	7,250,583
Claim payments	(5,783,909)	(7,011,970)
Ending balance – unpaid claims	\$ 855,612	\$ 975,422
Amounts due in one year	\$ 855,612	\$ 975,422

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 (“Cities”) pursuant to Acts 1995 64th Leg. Ch 143, sec 1 (the “Act”). Under the provisions of the Act, TMPA is a separate municipal corporation. TMPA is exempt from federal income tax under section 115 of the Internal Revenue code.

In September 1976, TMPA entered into identical Power Sales Contracts (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, the Cities are required to pay, for the benefits received or to be received by them from such activities, an amount sufficient to pay TMPA’s operating and maintenance expenses and the Bond Fund, Reserve Fund and Contingency Fund requirements of the Revenue Bond Resolutions. In addition, the Cities are obligated to guarantee the payment of TMPA’s bonds.

As originally written in September 1976, the Contract was a requirements contract, which obligated the Cities, with certain exceptions, to purchase their wholesale electricity requirements from TMPA. On November 5, 1997, the Contract was amended. Under the amendment, the Contract was converted from a requirements contract to a take-or-pay contract, under which each City is obligated to take or pay for a specified percentage of electricity from TMPA’s generating facility. Currently, those percentages are Bryan 21.7%; Denton 21.3%; Garland 47%; and Greenville 10%. The amendment confirmed the Cities’ obligations, explained above, to pay all costs of TMPA. The Debt Service Guarantee, contained in the Contract since September 1976, was not changed by the amendment. Concurrently with the execution of the amendment on November 5, 1997, a Travis County District Court validated the Contract as amended and confirmed the authority of TMPA to enter into the amendment.

Bryan Texas Utilities
City Electric System
Notes to Financial Statements - Continued
September 30, 2008 and 2007

11. Texas Municipal Power Agency - continued

TMPA operates the Gibbons Creek Steam Electric Station (“Gibbons Creek”), a coal-fired generating plant located in Grimes County, Texas with a net generating capability of 462 MW. The plant began commercial operation October 1, 1983.

During the years ended September 30, 2008 and 2007 the City Electric System paid TMPA \$52,470,345 and \$46,107,806, respectively for power purchases and related activity under the contract. As of September 30, 2008 and 2007 the City Electric System had payables to TMPA amounting to \$2,765,992 and \$1,352,703, respectively.

The TMPA’s Comprehensive Annual Financial Report for the year ended September 30, 2008 reported the following:

	2008 (Amounts in Thousands)
Total Assets	\$ 1,198,095
Total Liabilities	\$ 1,162,286
Total Accumulated Excess Revenues	\$ 35,809
Change in Accumulated Excess Revenues for year ended September 30, 2008	\$ (1,621)

TMPA’s audited financial statements may be obtained by writing TMPA, P.O. Box 7000, Bryan, TX 77805.

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 2008 and 2007, these sales totaled \$26,101,980 and \$22,486,555, respectively. These amounts are included in City Electric System operating revenues.

In addition to the \$6,970,913 and \$6,374,815 transferred to the City of Bryan for right of way in 2008 and 2007, respectively, City Electric System paid the City \$423,000 for administrative functions performed by city personnel in 2008 and 2007. These amounts are included in the other expenses in the accompanying financial statements.

The City of Bryan transferred to City Electric System \$1,247,616 and \$1,216,000 in 2008 and 2007, respectively, for billing services performed by City Electric System.

Bryan Texas Utilities
City Electric System
Notes to Financial Statements - Continued
September 30, 2008 and 2007

13. Commitments and Contingencies

BTU purchase and construction commitments approximate \$101.8 million at September 30, 2008. This amount includes provisions for fuel and energy purchases through December 2017 as well as the construction of a generating unit to be funded through revenue bonds issued in 2008.

On November 16, 2007, BTU entered into a 10 year purchased power agreement with a subsidiary of Shell Energy North America (U.S.), L.P.. The agreement, which extends from January 1, 2008 to December 31, 2017, allows BTU to schedule up to 50MW of energy on a day-ahead basis. Under the agreement, BTU must make specified minimum monthly non-fuel payments which are included in the \$101.8 million of purchase and construction commitments.

In December of 2007, BTU began the process of constructing Dansby 3, a 50MW gas turbine generator to be located adjacent to BTU's existing Dansby 1 & 2 units in Brazos County, Texas. The unit, to be powered by a General Electric LM6000, is scheduled to go in service during the summer of 2009.

On August 29, 2007, BTU entered into a 10 year fixed price purchased power agreement with Credit Suisse Energy, L.L.C. to supply energy to a wholesale customer under a corresponding 10 year fixed price full requirements sale agreement extending from January 1, 2008 to December 31, 2017.

BTU has entered into various other shorter term fuel and energy purchase agreements to ensure energy supplies through December 2009.

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 and would not materially affect the financial statements of the City Electric System.