



Bryan Texas Utilities

City Electric System

Annual Financial Statements

For the Years Ended September 30, 2009 and 2008

Bryan Texas Utilities
City Electric System
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For the Years Ended September 30, 2009 and 2008

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Bryan Texas Utilities

City Electric System

Introduction

For the Years Ended September 30, 2009 and 2008

Bryan Texas Utilities (BTU) is pleased to present its Annual Financial Report for the fiscal years ended September 30, 2009 and 2008. 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 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.



INDEPENDENT AUDITOR'S REPORT

To the City Council of City of Bryan, Texas
and the Board of Directors of Bryan Texas Utilities

We have audited the accompanying financial statements of the City Electric System of Bryan Texas Utilities (BTU) of the City of Bryan, Texas, as of and for the year ended September 30, 2009, 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 audit. The financial statements of the City Electric System of BTU as of and for the year ended September 30, 2008 were audited by other auditors whose report dated January 26, 2009 expressed an unqualified opinion on those financial statements.

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

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, 2009, and the changes in their financial position, or, cash flows for the year 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 of the City of Bryan, Texas, as of September 30, 2009, and the changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 4 through 7 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the City Electric System of BTU's basic financial statements. The information included in the Introduction is presented for the purpose of additional analysis and is not a required part of the basic financial statements. This information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

Weaver and Tidwell, L.L.P.

WEAVER AND TIDWELL, L.L.P.

Houston, Texas
January 21, 2010

Bryan Texas Utilities
City Electric System
Management's Discussion and Analysis
For the Years Ended September 30, 2009 and 2008
(Unaudited)

This discussion and analysis of the City Electric System financial performance provides an overview of financial activities for the years ended September 30, 2009 and 2008. 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 Revenues, Expenses and Changes in Net Assets presents 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, 2009 and 2008
(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, 2009 and 2008.

| <u>Condensed Statements of Net Assets</u> | <u>2009</u> | <u>2008</u> |
|--|-----------------------|-----------------------|
| Current assets | \$ 42,001,023 | \$ 43,835,353 |
| Capital assets, net | 197,239,937 | 168,720,478 |
| Restricted assets | 33,721,847 | 60,289,488 |
| Other | <u>11,274,356</u> | <u>12,278,827</u> |
| Total assets | <u>284,237,163</u> | <u>285,124,146</u> |
| Current liabilities | 10,562,788 | 12,000,832 |
| Current liabilities payable from restricted assets | 6,860,604 | 6,146,666 |
| Noncurrent liabilities | <u>88,272,030</u> | <u>90,839,919</u> |
| Total liabilities | <u>105,695,422</u> | <u>108,987,417</u> |
| Net assets: | | |
| Invested in capital assets, net of related debt | 111,139,619 | 102,408,085 |
| Restricted | 25,952,587 | 31,349,830 |
| Unrestricted | <u>41,449,534</u> | <u>42,378,814</u> |
| Total net assets | <u>\$ 178,541,741</u> | <u>\$ 176,136,729</u> |

Condensed Statements of Revenues, Expenses And Changes in Net Assets

| | | |
|---------------------------------|-----------------------|-----------------------|
| Operating revenues | \$ 149,544,637 | \$ 155,748,711 |
| Operating expenses | <u>137,282,903</u> | <u>148,475,010</u> |
| Operating income | 12,261,734 | 7,273,701 |
| Investment income | 1,378,874 | 2,522,016 |
| Interest expense | (4,379,165) | (2,872,086) |
| Transfers, net | <u>(6,856,431)</u> | <u>(5,723,297)</u> |
| Change in net assets | 2,405,012 | 1,200,334 |
| Net assets, beginning of period | <u>176,136,729</u> | <u>174,936,395</u> |
| Net assets, end of period | <u>\$ 178,541,741</u> | <u>\$ 176,136,729</u> |

Bryan Texas Utilities
City Electric System
Management's Discussion and Analysis - Continued
For the Years Ended September 30, 2009 and 2008
(Unaudited)

Financial Highlights

- The City Electric System customer base totaled 32,152 and 31,656 customers at September 30, 2009 and 2008, respectively, an increase of 1.6%.
- Operating revenues for the years ending September 30, 2009 and 2008 were \$149,544,637 and \$155,748,711, respectively. The decrease in revenues is primarily due to lower fuel related revenues.
- Operating expenses for the years ending September 30, 2009 and 2008 were \$137,282,903 and \$148,475,010, respectively. The decrease in expenses is primarily due to lower fuel related energy costs.
- Net assets for the years ended September 30, 2009 and 2008 were \$178,541,741 and \$176,136,729, respectively, of which \$41,449,535 and \$42,378,814 were available to meet BTU's ongoing obligations.
- The City Electric System increase in capital assets is due mostly to additions to generation assets related to Dansby 3 construction as well as 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 coupon rates ranging from 4.00% to 5.25%. The proceeds from the sale of these bonds are restricted to the construction of a new generating facility. No bonds were issued in the 2009 fiscal year. At September 30, 2009, there were \$90,165,000 of City Electric System revenue bonds outstanding payable from revenues of the City Electric System.

General Trends and Significant Events

Power Supply –

- BTU completed construction of Dansby 3, a 50MW gas turbine generator located adjacent to BTU's existing Dansby 1& 2 units in Brazos County, Texas. The unit, powered by a General Electric LM6000, was synchronized to the ERCOT grid on January 19, 2010 and is expected to commence commercial operations in the near future.
- 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, 2009 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.

**Bryan Texas Utilities
City Electric System**

Management's Discussion and Analysis - Continued
For the Years Ended September 30, 2009 and 2008
(Unaudited)

Other –

- For the fiscal year ended September 30, 2009, BTU transferred \$5,881,953 from the Rate Stabilization Fund reflected in Restricted Assets on the Balance Sheet to Unrestricted Assets. This transfer recognizes BTU's commitment to maintaining appropriate levels of unrestricted operating cash.

Subsequent Events

On December 3, 2009, the utility directors of the Texas Municipal Power Agency (TMPA) member Cities, and the general manager of TMPA, executed a Memorandum of Understanding, expressing the intent of each signatory, to recommend to the appropriate municipal governing boards, approval of a comprehensive settlement agreement addressing pending litigation between Bryan, TMPA and the other TMPA member Cities. By December 17, 2009, the Board of Directors of TMPA and all member Cities had approved the settlement agreement. The parties are in the process of accomplishing the remaining actions necessary to effect the settlement agreement. These actions include the financings described below and the submission of agreed orders to the various courts to dispose of the pending litigation.

Under the settlement agreement, TMPA will develop a transmission financing program under which debt for transmission system assets may be financed for the life of the assets, beyond September 1, 2018, but without extending the term of the Power Sales Contract. No new debt and all existing debt shall mature on or before September 1, 2018 unless an extension beyond this date is approved by all member Cities. Under the settlement, several planned TMPA financings, including one for a scrubber refurbishment project, will be accomplished through the issuance of debt by the member Cities. When finally implemented, the settlement agreement will resolve longstanding disputes between BTU and TMPA and member Cities currently pending before the Public Utility Commission of Texas, and the Travis County and Grimes County state district courts, relating to the allocation of prior transmission costs between the Cities and the ability of TMPA to extend debt beyond the term of the Power Sales Contract.

At September 30, 2008 and 2009 BTU maintained a restricted net asset of \$6,336,495 for potential losses associated with TMPA litigation.

Requests for Information

This financial report is designed to provide readers with a general overview of BTU's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to Bryan Texas Utilities, P.O. Box 8000, Bryan, Texas 77805.

BTU Group Managers:

Joe Hegwood
Gary Miller
Kean Register
Roy Trotter

BTU General Manager:

Dan Wilkerson

Bryan Texas Utilities
City Electric System
Statements of Net Assets
September 30, 2009 and 2008

| <u>Assets</u> | <u>2009</u> | <u>2008</u> |
|--|----------------|----------------|
| Current assets: | | |
| Cash and cash equivalents | \$ 17,915,563 | \$ 7,049,276 |
| Investments | 3,602,491 | - |
| Accounts receivable | 12,620,261 | 15,108,022 |
| Less allowance for uncollectible accounts | (983,533) | (889,645) |
| Accrued interest receivable | 118,895 | 170,745 |
| Inventory | 4,869,378 | 6,671,453 |
| Due from other funds | 2,277,108 | 3,012,901 |
| Prepaid purchased power option | 1,400,000 | 1,400,000 |
| Other assets | 180,860 | 143,136 |
| Under recovered fuel | - | 11,169,465 |
| | 42,001,023 | 43,835,353 |
| Total current assets | | |
| Non-current assets: | | |
| Restricted assets: | | |
| Cash and cash equivalents | - | 50,220,113 |
| Investments | 33,721,847 | 10,069,375 |
| Prepaid purchased power option | 10,150,000 | 11,550,000 |
| Capital assets | 318,969,881 | 282,932,436 |
| Less accumulated depreciation | (121,729,944) | (114,211,958) |
| Unamortized bond issuance expenses and other | 1,099,251 | 728,827 |
| Other post employment benefits | 25,105 | - |
| | 242,236,140 | 241,288,793 |
| Total noncurrent assets | | |
| Total assets | \$ 284,237,163 | \$ 285,124,146 |

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

Bryan Texas Utilities
City Electric System
Statements of Net Assets - Continued
September 30, 2009 and 2008

| <u>Liabilities</u> | <u>2009</u> | <u>2008</u> |
|---|--------------------|--------------------|
| Current liabilities: | | |
| Accounts payable | \$ 8,346,023 | \$ 10,386,414 |
| Accrued liabilities | 206,206 | 200,544 |
| Over-recovered fuel | 954,069 | - |
| Due to City of Bryan | 837,029 | 814,735 |
| Deferred credits and other current liabilities | 219,461 | 599,139 |
| | 10,562,788 | 12,000,832 |
| Total current liabilities | 10,562,788 | 12,000,832 |
| Current liabilities payable from restricted assets: | | |
| Accrued interest | 1,061,821 | 695,691 |
| Revenue bonds - current portion | 2,820,000 | 2,530,000 |
| General obligation bonds - current portion | - | 543 |
| Customer deposits | 2,978,783 | 2,920,432 |
| | 6,860,604 | 6,146,666 |
| Total current liabilities payable from restricted assets | 6,860,604 | 6,146,666 |
| Non-current liabilities: | | |
| Revenue bonds payable | 87,345,000 | 90,165,000 |
| Bond (discounts)/premium, net | (336,025) | (363,923) |
| Arbitrage rebate | 91,082 | 100,280 |
| Accrued vacation pay | 399,902 | 360,821 |
| Net pension obligation | 396,776 | - |
| Other post employment benefits | - | 20,183 |
| Deferred credits and other noncurrent liabilities | 375,295 | 557,558 |
| | 88,272,030 | 90,839,919 |
| Total noncurrent liabilities | 88,272,030 | 90,839,919 |
| Total liabilities | 105,695,422 | 108,987,417 |
| <u>Net Assets</u> | | |
| Net assets: | | |
| Invested in capital assets, net of related debt | 111,139,619 | 102,408,085 |
| Restricted for: | | |
| Debt reserve | 3,977,813 | 3,977,413 |
| Debt service | 704,999 | 494,135 |
| Rate stabilization | 14,933,280 | 20,541,787 |
| TMPA escrow | 6,336,495 | 6,336,495 |
| Unrestricted | 41,449,535 | 42,378,814 |
| | \$ 178,541,741 | \$ 176,136,729 |
| Total net assets | \$ 178,541,741 | \$ 176,136,729 |

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, 2009 and 2008

| | <u>2009</u> | <u>2008</u> |
|---|-----------------------|-----------------------|
| Operating revenues: | | |
| Electrical system | \$ 147,926,010 | \$ 153,872,437 |
| Other | 1,618,627 | 1,876,274 |
| Total operating revenues | <u>149,544,637</u> | <u>155,748,711</u> |
| Operating Expenses: | | |
| Personnel services | 9,498,731 | 8,511,317 |
| Electric operations | 111,876,741 | 126,564,316 |
| Maintenance | 1,429,580 | 2,111,231 |
| Other services and charges | 2,118,967 | 1,527,847 |
| Other expenses | 578,614 | 579,252 |
| General and administrative | 4,101,588 | 2,674,975 |
| Total operating expenses before depreciation | <u>129,604,221</u> | <u>141,968,938</u> |
| Operating income before depreciation | 19,940,416 | 13,779,773 |
| Depreciation | <u>7,678,682</u> | <u>6,506,072</u> |
| Operating income | <u>12,261,734</u> | <u>7,273,701</u> |
| Non operating revenues (expenses): | | |
| Investment income | 1,378,874 | 2,522,016 |
| Interest expense | <u>(4,379,165)</u> | <u>(2,872,086)</u> |
| Total non operating revenues (expenses) | <u>(3,000,291)</u> | <u>(350,070)</u> |
| Income before operating transfers | 9,261,443 | 6,923,631 |
| Transfers: | | |
| City of Bryan administrative payment | 1,280,000 | 1,247,616 |
| “Right of Way” payment to City of Bryan | <u>(8,136,431)</u> | <u>(6,970,913)</u> |
| Transfers, net | <u>(6,856,431)</u> | <u>(5,723,297)</u> |
| Change in net assets | 2,405,012 | 1,200,334 |
| Net assets, beginning of period | <u>176,136,729</u> | <u>174,936,395</u> |
| Net assets, end of period | <u>\$ 178,541,741</u> | <u>\$ 176,136,729</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, 2009 and 2008

| <u>Cash flows from operating activities</u> | <u>2009</u> | <u>2008</u> |
|--|----------------------|----------------------|
| Receipts from customers | \$ 151,399,513 | \$ 157,419,483 |
| Payments to suppliers | (107,001,669) | (140,232,725) |
| Payments to employees | (9,191,367) | (8,521,566) |
| | <hr/> | <hr/> |
| Net cash provided by operating activities | 35,206,477 | 8,665,192 |
| <u>Cash flows from noncapital financing activities</u> | | |
| Operating subsidies and transfers from other funds | 1,280,000 | 1,247,616 |
| Operating subsidies and transfers to other funds | (8,136,431) | (6,970,913) |
| | <hr/> | <hr/> |
| Net cash used by non-capital financing activities | (6,856,431) | (5,723,297) |
| <u>Cash flows from capital and related financing activities</u> | | |
| Purchases of capital assets | (35,372,924) | (50,129,506) |
| Prepaid purchased power option | - | (11,550,000) |
| Proceeds from capital debt | 17,898 | 32,434,057 |
| Principal paid on capital debt | (2,519,130) | (1,878,765) |
| Interest paid on capital debt | (3,978,503) | (2,538,258) |
| | <hr/> | <hr/> |
| Net cash used by capital and related financing activities | (41,852,659) | (33,662,472) |
| <u>Cash flows from investing activities</u> | | |
| Proceeds from sales and maturities of investments | 57,515,599 | 47,550,000 |
| Purchases of investments | (84,273,894) | (23,073,550) |
| Interest and dividends received | 907,082 | 2,814,909 |
| | <hr/> | <hr/> |
| Net cash (used) provided by investing activities | (25,851,213) | 27,291,359 |
| Net decrease in cash and cash equivalents | (39,353,826) | (3,429,218) |
| Balance-beginning of the year | 57,269,389 | 60,698,607 |
| | <hr/> | <hr/> |
| Balance-end of the year | <u>\$ 17,915,563</u> | <u>\$ 57,269,389</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, 2009 and 2008

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

| | <u>2009</u> | <u>2008</u> |
|--|---------------|--------------|
| Operating income | \$ 12,261,734 | \$ 7,273,701 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | |
| Depreciation | 7,678,682 | 6,506,072 |
| Bad debts | 396,531 | 341,618 |
| Change in assets and liabilities: | | |
| Accounts receivable | 1,796,525 | (1,312,554) |
| Inventory | 1,802,075 | (832,636) |
| Prepaid assets | 1,337,171 | (1,335,198) |
| Due from other funds | 215,325 | 3,200,925 |
| Under-recovered fuel | 11,169,465 | (2,881,687) |
| Accounts payable | (2,669,939) | (1,989,680) |
| Accrued liabilities | 5,662 | (6,065) |
| Customer deposits | 58,351 | (217,599) |
| Net pension obligation | 262,621 | - |
| Over-recovered fuel | 954,069 | - |
| Due to other funds | 22,294 | (658,502) |
| Accrued vacation | 39,081 | (4,184) |
| Deferred credit and other | (123,170) | 580,981 |
| Net cash provided by operating activities | \$ 35,206,477 | \$ 8,665,192 |

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

**Bryan Texas Utilities
City Electric System**

Notes to Financial Statements - Continued
September 30, 2009 and 2008

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 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.

Financial Statements - The 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 Statement of Revenues, Expenses and Changes in Net Assets presents 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 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.

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, 2009, GASB issued no pronouncements applicable to BTU financial reporting.

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.

**Bryan Texas Utilities
City Electric System**

Notes to Financial Statements - Continued
September 30, 2009 and 2008

- 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.

Accounting Pronouncements Issued But Not Yet Effective - In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. The statement requires derivative instruments covered in its scope to be recorded at fair value. The statement is effective for periods beginning after June 15, 2009. BTU purchases and sells certain financial instruments in order to manage the risk exposure of energy price changes. These financial instruments are considered derivative instruments under GASB Statement No. 53 and will be recorded at fair value. BTU is evaluating the impacts of Statement No. 53 on its financial statements.

Restricted Funds - Restricted funds consist of construction funds derived from debt issues, system revenues that have been designated for specific purposes by the BTU Board or other funds with legal or contractual constraints. When both restricted and unrestricted resources are available for use, it is BTU's policy to use restricted resources first, then unrestricted resources as they are needed.

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

Utility Revenues and Fuel Recovery - Customers are billed on the basis of monthly cycle billings. At year end, the 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 year ended September 30, 2009 the City Electric System reflected a current liability – Over recovered fuel of \$954,069 and for the year ended September 30, 2008, the City Electric System recorded a current asset – Under recovered fuel of \$11,169,465.

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. Except for certain assets that may become impaired, the cost of depreciable plant retired, plus removal cost and less salvage, is charged to accumulated depreciation. Per the financial reporting requirements of GASB Statement No. 42, *Accounting for Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, any losses associated with capital asset impairments will be charged to operations, not accumulated depreciation. 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.

**Bryan Texas Utilities
City Electric System**

Notes to Financial Statements - Continued
September 30, 2009 and 2008

Inventory - Inventory is valued at average cost and 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. Such reclassifications had no effect on the change in net assets as previously reported.

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 based on quoted market prices provided by the custodian.

Deposits

City Electric System demand deposits for the fiscal years ended September 30, 2009 and 2008 were held at Citibank, N.A. 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;

**Bryan Texas Utilities
City Electric System**

Notes to Financial Statements - Continued
September 30, 2009 and 2008

- e. Certificates of deposit issued by state and national banks domiciled in Texas that are secured by obligations qualified as acceptable collateral;
- f. Certificates of deposit issued by savings and loan associations domiciled in Texas that are secured by obligations qualified as acceptable collateral;
- g. Prime domestic bankers' acceptances;
- h. Commercial paper with a stated maturity of 180 days or less from the date of issuance that is rated not less than A-1, P-1 or its equivalent;
- i. Fully collateralized repurchase agreements that have a defined termination date of 90 days or less, secured by qualification obligations, pledged with a third party, and placed through a primary government securities dealer as defined by the Federal Reserve, or a bank domiciled in Texas;
- 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, 2009 and 2008 are summarized as follows:

| | <u>2009</u> | <u>2008</u> |
|------------------------------------|----------------------|----------------------|
| Demand deposits | \$ 17,915,563 | \$ 5,052,547 |
| Certificates of deposit | 10,131,525 | - |
| Investment in government pool | - | 52,216,842 |
| United States Agencies | 12,160,000 | 10,069,375 |
| Investments in treasury securities | 15,032,813 | - |
| Total | <u>\$ 55,239,901</u> | <u>\$ 67,338,764</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.

**Bryan Texas Utilities
City Electric System**
Notes to Financial Statements - Continued
September 30, 2009 and 2008

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.

As of September 30, 2009, BTU had the following investments:

| <u>Investment Types</u> | <u>Fair Value</u> | <u>Investment Maturity (in Years)</u> | | |
|------------------------------------|----------------------|---|---------------------|---------------------------|
| | | <u>Less Than 1</u> | <u>1 - 5</u> | <u>Greater Than 5</u> |
| Certificates of deposit | \$ 10,131,525 | \$ 10,131,525 | \$ - | \$ - |
| United States Agencies | 12,160,000 | 7,120,937 | 5,039,063 | - |
| Investments in treasury securities | 15,032,813 | 15,032,813 | - | - |
| Total fair value | <u>\$ 37,324,338</u> | <u>\$ 32,285,275</u> | <u>\$ 5,039,063</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, 2009 and 2008

Restricted Cash and Investments

In 2009, cash and investments of \$55.2 million exceeded amounts required to be restricted by \$21.5 million. In 2009, BTU transferred \$5.9 million from the Rate stabilization fund reflected in Restricted assets on the Balance Sheet to Unrestricted assets. This transfer recognized BTU's commitment to maintaining appropriate levels of unrestricted operating cash. In 2008 cash and investments of \$67.3 million exceeded amounts required to be restricted by \$7.0 million. Amounts required to be restricted at September 30, 2009 and 2008 are as follows:

| | <u>2009</u> | <u>2008</u> |
|---------------------------------|----------------------|----------------------|
| Rate stabilization fund | \$ 14,933,280 | \$ 20,541,787 |
| Debt reserve | 3,977,813 | 3,977,413 |
| Debt service | 1,766,820 | 494,135 |
| TMPA escrow fund | 6,336,495 | 6,336,495 |
| Bond series 2007 reserve | 3,728,656 | 8,030,727 |
| Bond series 2008 reserve | - | 17,988,499 |
| Customer deposits | <u>2,978,783</u> | <u>2,920,432</u> |
| Restricted cash and investments | <u>\$ 33,721,847</u> | <u>\$ 60,289,488</u> |

3. Capital Assets

General Description – At September 30, 2009, production plant 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. The mothballed units were fully depreciated at September 30, 2007.

BTU completed construction of Dansby 3, a 50MW gas turbine generator located adjacent to BTU's existing Dansby 1& 2 units in Brazos County, Texas. The unit, powered by a General Electric LM6000, was synchronized to the ERCOT grid on January 19, 2010 and is expected to commence commercial operations in the near future. Other assets reflected in total capital assets include transmission, distribution and general plant facilities.

Impairments – BTU annually evaluates capital assets as required by 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. 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, 2009.

**Bryan Texas Utilities
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Notes to Financial Statements - Continued
September 30, 2009 and 2008

Capital asset activity for the year ended September 30, 2009 was as follows:

| | Beginning Balance | Increases | Decreases | Ending Balance |
|---|----------------------|---------------|--------------|-------------------|
| Capital assets, not being depreciated: | | | | |
| Land | \$ 3,589,249 | \$ 282,258 | \$ - | \$ 3,871,507 |
| Construction in progress | 19,319,237 | 36,176,314 | 9,886,138 | 45,609,413 |
| Total capital assets, not being depreciated | 22,908,486 | 36,458,572 | 9,886,138 | 49,480,920 |
| Capital assets, being depreciated: | | | | |
| Production plant | 80,444,643 | 851,111 | - | 81,295,754 |
| Transmission plant | 70,177,900 | 146,415 | - | 70,324,315 |
| Distribution plant | 88,434,781 | 4,948,942 | 41,927 | 93,341,796 |
| General plant | 20,966,626 | 3,679,758 | 119,288 | 24,527,096 |
| Total capital assets, being depreciated | 260,023,950 | 9,626,226 | 161,215 | 269,488,961 |
| Less accumulated depreciation for: | | | | |
| Production plant | 54,017,760 | 1,473,074 | - | 55,490,834 |
| Transmission plant | 12,852,266 | 2,107,325 | - | 14,959,591 |
| Distribution plant | 33,432,611 | 2,713,754 | 41,408 | 36,104,957 |
| General Plant | 13,909,321 | 1,384,529 | 119,288 | 15,174,562 |
| Total accumulated depreciation | 114,211,958 | 7,678,682 | 160,696 | 121,729,944 |
| Total capital assets, being depreciated, net | 145,811,992 | 1,947,544 | 519 | 147,759,017 |
| Total capital assets, net | \$168,720,478 | \$ 38,406,116 | \$ 9,886,657 | \$197,239,937 |

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 coupon rates ranging from 4.00% to 5.25%. In 2009, no revenue bonds were issued by the City Electric System. Proceeds of the 2008 bond issue were restricted to the construction of the Dansby 3 generating unit and to pay bond costs. At September 30, 2009, there was \$90,165,000 of City Electric System revenue bonds outstanding payable from revenues of the City Electric System. Changes to long term debt during 2009, including current portion are as follows:

| | Interest Rates (%) | Series Matures | Beginning Balance | Additions | Reductions | Ending Balance | Due in One Year |
|-------------|-----------------------|-------------------|----------------------|-----------|-------------|-------------------|--------------------|
| Series 2001 | 4.125 - 5.000 | 2019 | \$ 4,885,000 | \$ - | \$ 420,000 | \$4,465,000 | \$440,000 |
| Series 2005 | 3.500 - 4.500 | 2025 | 11,950,000 | - | 505,000 | 11,445,000 | 525,000 |
| Series 2006 | 4.000 - 5.000 | 2031 | 11,745,000 | - | 305,000 | 11,440,000 | 320,000 |
| Series 2007 | 4.000 - 5.250 | 2032 | 31,585,000 | - | 745,000 | 30,840,000 | 775,000 |
| Series 2008 | 4.000 - 5.250 | 2033 | 32,530,000 | - | 555,000 | 31,975,000 | 760,000 |
| GO Bonds | | | 543 | - | 543 | - | - |
| Total | | | \$92,695,543 | \$ - | \$2,530,543 | \$90,165,000 | \$2,820,000 |

**Bryan Texas Utilities
City Electric System**

Notes to Financial Statements - Continued
September 30, 2009 and 2008

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, 2009 and 2008.

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. Bond payments are as follows:

| Year Ending September 30 | Principal | Interest | Total |
|-------------------------------------|----------------------|----------------------|-----------------------|
| 2010 | \$ 2,820,000 | \$ 4,247,281 | \$ 7,067,281 |
| 2011 | 2,930,000 | 4,133,356 | 7,063,356 |
| 2012 | 3,055,000 | 4,014,369 | 7,069,369 |
| 2013 | 3,180,000 | 3,888,269 | 7,068,269 |
| 2014 | 3,305,000 | 3,756,394 | 7,061,394 |
| 2015-2019 | 17,985,000 | 16,528,281 | 34,513,281 |
| 2020-2024 | 19,960,000 | 12,128,919 | 32,088,919 |
| 2025-2029 | 20,995,000 | 7,092,519 | 28,087,519 |
| 2030-2033 | 15,935,000 | 1,810,838 | 17,745,838 |
| Total | \$ 90,165,000 | \$ 57,600,225 | \$ 147,765,225 |

In the Statement of Revenues, Expenses and Changes in Net Assets for the years ended September 30, 2009 and 2008, interest expense in the amount of \$4,379,165 and \$2,872,086, respectively, is included as a non-operating 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. The following covers the City's retirement plan as a whole, unless indicated otherwise.

Plan Description

The City provides pension benefits for all of its full-time employees through a non-traditional, joint contributory, hybrid defined benefit plan in the state-wide Texas Municipal Retirement System (TMRS), an agent multiple-employer public employee retirement system. The plan provisions that have been adopted by the City are within the options available in the governing state statutes of TMRS.

**Bryan Texas Utilities
City Electric System**

Notes to Financial Statements - Continued
September 30, 2009 and 2008

The City of Bryan is one of 833 municipalities having their benefit plan administered by TMRS. Each of the 833 municipalities has an annual, individual actuarial valuation performed. TMRS issues a publicly available comprehensive annual financial report that includes financial statements and required supplementary information (RSI) for TMRS; the report also provides detailed explanations of the contributions, benefits and actuarial methods and assumptions used by the System. This report may be obtained by writing to TMRS, P.O. Box 149153, Austin, Texas 78714-9153 or by calling 800-924-8677; in addition, the report is available on TMRS' website at www.TMRS.com.

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.

The plan provisions are adopted by the governing body of the City, within the options available in the state statutes governing TMRS. Plan provisions for the City were as follows:

| | Plan Year 2008 | Plan Year 2009 |
|---|---------------------------|---------------------------|
| Employee deposit rate | 7.0% | 7.0% |
| Matching ratio (city to employee) | 2 to 1 | 2 to 1 |
| Years required for vesting | 5 | 5 |
| Service retirement eligibility (expressed as age / years of service) | 60/5, 0/20 | 60/5, 0/20 |
| Updated Service Credit | 100% Repeating, Transfers | 100% Repeating, Transfers |
| Annuity Increase (to retirees) | 70% of CPI Repeating | 70% of CPI Repeating |

**Bryan Texas Utilities
City Electric System**

Notes to Financial Statements - Continued
September 30, 2009 and 2008

Contributions

Under the state law governing TMRS, the contribution rate for each city is determined annually by the actuary, using the Projected Unit Credit actuarial cost method. This rate consists of the normal cost contribution rate and the prior service cost contribution rate, which is calculated to be a level percent of payroll from year to year. The normal cost contribution rate finances the portion of an active member's projected benefit allocated annually; the prior service contribution rate amortizes the unfunded (overfunded) actuarial liability (asset) over the applicable period for that city. Both the normal cost and prior service contribution rates include recognition of the projected impact of annually repeating benefits, such as Updated Service Credits and Annuity Increases.

The City contributes to the TMRS Plan at an actuarially determined 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 a basis for the rate and the calendar year when the rate goes into effect. The annual pension cost and net pension obligation/(asset) are as follows:

| | |
|--|----------------|
| Annual Required Contribution (ARC) | \$ 7,831,491 |
| Interest on Net Pension Obligation | - |
| Adjustment to the ARC | - |
| Annual Pension Cost (APC) | 7,831,491 |
| Contributions Made | (6,244,387) |
| Increase (decrease) in net pension obligation | 1,587,104 |
| Net Pension Obligation/(Asset), beginning of year | - |
| Net Pension Obligation/(Asset), end of year | \$ 1,587,104 |
| Net Pension Obligation/(Asset), end of year – BTU only | \$ 396,776 |

The portion of the net pension obligation allocated to BTU is determined by the ratio of BTU contributions to TMRS as a percentage of City-wide contributions to TMRS. That ratio was 25% for the year ended September 30, 2009.

City historical data is as follows:

| Fiscal Year | Annual Pension Cost (APC) | Percentage of APC Contributed | Net Pension Obligation at September 30 |
|----------------|---------------------------------|----------------------------------|--|
| 09/30/07 | \$ 4,791,580 | 100.00% | \$ - |
| 09/30/08 | 5,028,310 | 100.00% | - |
| 09/30/09 | 7,831,491 | 79.73% | 1,587,104 |

**Bryan Texas Utilities
City Electric System**

Notes to Financial Statements - Continued
September 30, 2009 and 2008

The required contribution rates for fiscal year 2009 were determined as part of the December 31, 2006 and 2007 actuarial valuations. Additional information as of the latest actuarial valuation, December 31, 2008, also follows:

| | | | |
|-------------------------------|--------------------------|--------------------------|--------------------------|
| Valuation date | <u>12/31/2006</u> | <u>12/31/2007</u> | <u>12/31/2008</u> |
| Actuarial cost method | Unit Credit | Projected Unit Credit | Projected Unit Credit |
| Amortization method | Level Percent of Payroll | Level Percent of Payroll | Level Percent of Payroll |
| Remaining amortization period | 25 years - open | 30 years - closed | 29 years - closed |
| Asset valuation method | Amortized Cost | Amortized Cost | Amortized Cost |
| Actuarial assumptions: | | | |
| Investment rate of return | 7.0% | 7.0% | 7.5% |
| Projected salary increases | 0.0% | Varies by age & service | Varies by age & service |
| Included inflation rate | 3.5% | 3.0% | 3.0% |
| Cost-of-living adjustments | 0.0% | 2.1% | 2.1% |

Funding Status and Funding Progress

The funded status as of December 31, 2008, the most recent actuarial valuation date, is as follows:

| Actuarial Valuation Date | Actuarial Value of Assets | Actuarial Accrued Liability (AAL) | Funded Ratio | Unfunded AAL (UAAL) | Covered Payroll | UAAL as a Percentage of Covered Payroll |
|---------------------------------|----------------------------------|--|---------------------|----------------------------|------------------------|--|
| | (1) | (2) | (3) | (4) | (5) | (6) |
| | | | (1) / (2) | (2) - (1) | | (4) / (5) |
| 12/31/2008 | \$91,123,170 | \$153,116,068 | 59.5% | \$61,992,898 | \$41,808,463 | 148.3% |

**Bryan Texas Utilities
City Electric System**

Notes to Financial Statements - Continued
September 30, 2009 and 2008

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 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. This plan is a single employer defined benefit other post employment benefit plan. To qualify 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. Coverage can continue for life. Employees terminating before normal retirement conditions are not eligible for retiree health coverage. 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. 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. Surviving spouses and dependents of deceased retired employees may continue health care coverage for up to 36 months through COBRA. Once the retiree or spouse is enrolled in Medicare, the City's plan becomes the 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.

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 also offers a fully insured optional vision plan that retirees and their dependents may purchase. The City reserves the right to modify premium amounts, to modify eligibility requirements and to modify or discontinue retiree health benefits.

**Bryan Texas Utilities
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Notes to Financial Statements - Continued
September 30, 2009 and 2008

In the year ended September 30, 2009, retirees paid \$406,463 in premiums and \$1,231,793 in claims were paid for post-retirement health care and administrative charges. As of September 30, 2009, the City has 32 retirees, 27 retirees and spouses, 10 retirees and families and 6 retirees and child(ren) participating in the health plan, out of the 298 employees eligible to participate upon retirement. Expenses are recognized as retirees submit claims.

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 when submitted. COBRA participants are reimbursed at the same levels as active employees. Participants paid premiums of \$10,819 and incurred claims and administrative expenses of \$203,622 in the year ended September 30, 2009. As of September 30, 2009 the City has 4 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.

Currently, all retirees electing health plan coverage receive a health premium subsidy averaging 40%. Beginning January 1, 2010, the City will implement new eligibility requirements for subsidized retiree premiums. The new eligibility requirements will require retirees to meet the 'Rule of 80' (age at retirement plus years of service with the City = 80), in order to receive the subsidized retiree premium. Retirees not meeting the 'Rule of 80' may still elect the City's retiree health plan coverage, but will not receive a subsidy.

The Governmental Accounting Standards Board (GASB) issued GASB Statement No. 45, *Accounting and Financial Reporting for Employers for Postemployment Benefits Other than Pensions*, which establishes standards for the measurement, recognition and display of other postemployment benefit expenditures and related liabilities, and note disclosures in the financial report. Basically, public-sector employers must accrue the cost of other postemployment benefits (OPEB) over the active service life of benefiting employees. This statement was effective for the City for the fiscal year ending September 30, 2008.

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.

**Bryan Texas Utilities
City Electric System**

Notes to Financial Statements - Continued
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Annual OPEB costs for FY2009 and FY2008 are as follows:

| | FY2009 | FY2008 |
|--|-----------------|---------------|
| Annual required contribution | \$ 594,447 | \$ 596,441 |
| Interest on OPEB obligation | 4,207 | - |
| Adjustment to ARC | (2,213) | - |
| Annual OPEB cost (expense) end of year | 596,441 | 596,441 |
| Net estimated employer contributions | (825,330) | (502,960) |
| Increase in net OPEB obligation | \$ (228,889) | \$ 93,481 |
| Net OPEB obligation – as of beginning of the year | 93,481 | - |
| Net OPEB obligation (asset) – as of end of year | \$ (135,408) | \$ 93,481 |
| Net OPEB obligation (asset) – as of end of year – BTU Only | \$ (25,105) | \$ 20,183 |

The portion of the net OPEB asset allocated to BTU is determined by the ratio of BTU employees as a percentage of City-wide employees. That ratio was 18.54% for the year ended September 30, 2009.

Funding status and funding progress

The funded status of the City’s retiree health care plan, under GASB Statement No. 45 for fiscal year 2008 is as follows:

| | |
|-----------------------------------|--------------|
| Actuarial value of plan assets | \$ - |
| Actuarial accrued liability (AAL) | 7,898,192 |
| Unfunded AAL | \$ 7,898,192 |
| Funded Ratio | 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, 2009.

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.

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, 2009 and 2008, the City Electric System paid the City \$364,463 and \$336,402, respectively, for participation in the City’s risk management program.

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8. Financial Hedging

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.

BTU follows GASB Technical Bulletin No. 2003-1, *Disclosure Requirements for Derivatives Not Reported at Fair Value*. Accordingly, hedge transactions are reported at cost on the Statement of Net Assets. Gains and losses related to hedge instrument transactions are netted to fuel expense in the period realized. The following information is provided regarding BTU's outstanding financial hedge instruments at September 30, 2009:

Natural Gas Derivative Transactions at September 30, 2009

| Type of Transaction | Duration | Volume in MMBtu's |
|---|---------------------|----------------------|
| 3 Way Collar (Long Call/Short Call/Short Put) | May 2010 - Sep 2011 | 1,406,000 |
| Long Swap | Jan 2010 - Sep 2012 | 2,975,000 |

The net proceeds associated with establishing hedge instruments outstanding at September 30, 2009, was \$43,420. The fair value of the hedges at September 30, 2009 was (\$ 2,162,671). The fair value of option contracts are determined using New York Mercantile Exchange (NYMEX) or Houston Ship Channel closing settlement prices as appropriate to the instrument. For swap transactions, the value is calculated as the difference between the closing futures price at September 30, 2009 and the futures price at the time the positions were established, less applicable commissions. 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. At September 30, 2008, the fair value of outstanding hedge instruments was (\$261,160). 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.

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The City established the Employee Benefits Trust Fund effective October 1, 1986, covering health benefits for eligible employees. At that time the 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 \$6,547,005 for the twelve month period which began January 1, 2009 and ends December 31, 2009. 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 City claims liabilities for the year:

| | <u>2009</u> | <u>2008</u> |
|-----------------------------------|--------------------|--------------------|
| Beginning balance - unpaid claims | \$ 855,612 | \$ 975,422 |
| Incurred claims | 7,037,199 | 5,664,099 |
| Claim payments | <u>(6,901,166)</u> | <u>(5,783,909)</u> |
| Ending balance – unpaid claims | <u>\$ 991,645</u> | <u>\$ 855,612</u> |
| Amounts due in one year | \$ 991,645 | \$ 855,612 |

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. At September 30, 2009, BTU’s portion of TMPA bonds outstanding was approximately \$188.4 million.

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.

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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.

On December 3, 2009, the utility directors of the Texas Municipal Power Agency (TMPA) member Cities, and the general manager of TMPA, executed a Memorandum of Understanding, expressing the intent of each signatory, to recommend to the appropriate municipal governing boards, approval of a comprehensive settlement agreement addressing pending litigation between Bryan, TMPA and the other TMPA member Cities. By December 17, 2009, the Board of Directors of TMPA and all member Cities had approved the settlement agreement. The parties are in the process of accomplishing the remaining actions necessary to effect the settlement agreement. These actions include the financings described below and the submission of agreed orders to the various courts to dispose of the pending litigation.

Under the settlement agreement, TMPA will develop a transmission financing program under which debt for transmission system assets may be financed for the life of the assets, beyond September 1, 2018, but without extending the term of the Power Sales Contract. No new debt and all existing debt shall mature on or before September 1, 2018 unless an extension beyond this date is approved by all member Cities. Under the settlement, several planned TMPA financings, including one for a scrubber refurbishment project, will be accomplished through the issuance of debt by the member Cities. When finally implemented, the settlement agreement will resolve longstanding disputes between BTU and TMPA and member Cities currently pending before the Public Utility Commission of Texas, and the Travis County and Grimes County state district courts, relating to the allocation of prior transmission costs between the Cities and the ability of TMPA to extend debt beyond the term of the Power Sales Contract.

At September 30, 2008 and 2009 BTU maintained a restricted net asset of \$6,336,495 for potential losses associated with TMPA litigation.

During the years ended September 30, 2009 and 2008 the City Electric System paid TMPA \$42,901,696 and \$52,470,345, respectively for power purchases and related activity under the contract. As of September 30, 2009 and 2008 the City Electric System had payables to TMPA amounting to \$1,287,791 and \$2,765,992, respectively.

The TMPA’s Comprehensive Annual Financial Report for the year ended September 30, 2009 reported the following:

| | |
|--|------------------|
| | 2009 |
| Total Assets | \$ 1,183,993,000 |
| Total Liabilities | 1,143,666,000 |
| Total Accumulated Excess Revenues | \$ 40,327,000 |
| Change in Accumulated Excess Revenues for year ended September 30, 2009 | \$ 4,518,000 |

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

**Bryan Texas Utilities
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Notes to Financial Statements - Continued
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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. BTU's Rural Electric System purchases all of its energy from the City Electric System. BTU's common staff is employed by the City Electric System and is either direct billed to the Rural Electric System or is billed through the City Electric System's purchased power rates. Generally, all power supply, customer service and administrative services are billed through purchased power rates, while distribution services are direct billed. Rural purchased power rates are established through City ordinance. Non-fuel Rural purchased power rates were last adjusted in December 2006. Fuel rates are adjusted monthly to reflect actual cost. In 2009 and 2008, Rural purchased power totaled \$22,841,070 and \$26,101,980, respectively.

In addition to the \$8,136,431 and \$6,970,913 transferred to the City of Bryan for right of way in 2009 and 2008, respectively, City Electric System paid the City of Bryan \$405,339 and \$423,000 for administrative functions performed by city personnel in 2009 and 2008, respectively. These amounts are included in the other expenses in the accompanying financial statements.

The City of Bryan transferred to City Electric System \$1,280,000 and \$1,247,616 in 2009 and 2008, respectively, for billing services performed by City Electric System.

13. Commitments and Contingencies

BTU purchase and construction commitments approximate \$81.5 million at September 30, 2009. This amount primarily includes provisions for fuel and energy purchases through December 2017.

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 \$81.5 million of purchase and construction commitments.

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.