BRYAN TEXAS UTILITIES

BTU

THE ENERGY TO SERVE YOU SINCE 1919

Bryan Texas Utilities

City Electric System

Annual Financial Statements

For the Fiscal Years Ended September 30, 2011 and 2010

Bryan Texas Utilities
City Electric System
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Bryan Texas Utilities
City Electric System
Introduction
For the Fiscal Years Ended September 30, 2011 and 2010

Bryan Texas Utilities (BTU) is pleased to present its Annual Financial Report for the fiscal years ended September 30, 2011 and 2010. 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 management and control of BTU. The Bryan City Council retains authority for approval of the annual budget, rates for electric service, condemnations and 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.

weaver

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 years ended September 30, 2011 and 2010, 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 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 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, 2011 and 2010, and the changes in their financial position, or where applicable, their 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 BTU of the City of Bryan, Texas, as of September 30, 2011 and 2010, 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 is not a part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management about the methods of measurement and presentation of the required supplementary information. However, we did not audit the supplementary information and express no opinion on it.

AN INDEPENDENT
MEMBER OF BAKER TILLY
INTERNATIONAL

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Our audits were 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
December 21, 2011

Bryan Texas Utilities
City Electric System
Management's Discussion and Analysis
For the Fiscal Years Ended September 30, 2011 and 2010
(Unaudited)

This discussion and analysis of the City Electric System financial performance provides an overview of financial activities for the fiscal years ended September 30, 2011 and 2010. 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.

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 fiscal years ended September 30, 2011 and 2010.

Condensed Statements of Net Assets	2011	2010
Current assets	$ 69,589,988	$ 62,103,851
Capital assets, net	222,233,813	206,142,315
Restricted assets	34,079,434	50,826,042
Other	64,561,746	76,263,149
Total assets	390,464,981	395,335,357
Current liabilities	19,777,867	18,274,486
Current liabilities payable from restricted assets	24,727,673	19,829,456
Noncurrent liabilities	168,771,092	182,877,072
Total liabilities	213,276,632	220,981,014
Net assets:		
Invested in capital assets, net of related debt	120,097,924	114,561,067
Restricted	14,693,615	22,052,002
Unrestricted	42,396,810	37,741,274
Total net assets	$ 177,188,349	$ 174,354,343

Condensed Statements of Revenues, Expenses And Changes in Net Assets		
Operating revenues	$ 153,517,110	$ 136,621,287
Operating expenses	135,897,510	127,611,085
Operating income	17,619,600	9,010,202
Investment income	369,563	365,336
Interest expense	(7,440,176)	(6,357,981)
Transfers, net	(7,714,981)	(7,204,955)
Change in net assets	2,834,006	(4,187,398)
Net assets, beginning of period	174,354,343	178,541,741
Net assets, end of period	$ 177,188,349	$ 174,354,343

Financial Highlights

- The City Electric System customer base totaled 32,583 and 32,421 customers at September 30, 2011 and 2010, respectively, an increase of 0.5%.

- Operating revenues for the fiscal years ending September 30, 2011 and 2010 were $153,517,110 and $136,621,287, respectively. The increase in revenues is primarily due to higher wholesale revenues.

- Operating expenses for the fiscal years ending September 30, 2011 and 2010 were $135,897,510 and $127,611,085, respectively. The increase in expenses is primarily due to higher fuel related energy costs.

- Net assets for the years ended September 30, 2011 and 2010 were $177,188,349 and $174,354,343, respectively, of which $42,396,810 and $37,741,274 were available to meet BTU's ongoing obligations. The change in net assets for the years ended September 30, 2011 and 2010 were $2,834,006 and $(4,187,398), respectively. The positive increase is primarily the result of lower TMPA capacity costs.

- The City Electric System increase in capital assets is due mostly to transmission and distribution infrastructure for new customer growth and reliability.

Long-Term Debt

No bonds were issued in the 2011 fiscal year. For the fiscal year ended September 30, 2010, the City Electric System issued revenue bonds dated November 24, 2009 ("2009 Bonds") and March 30, 2010 ("2010 Bonds") totaling $25,070,000 and $64,190,000, respectively. The 2009 Bonds mature serially on July 1, 2010, through July 1, 2034, with coupon rates ranging from 4.00% to 5.00%. The proceeds from the sale of the 2009 Bonds are restricted to the construction of transmission and distribution facilities. The 2010 Bonds mature serially on July 1, 2011 through July 1, 2019, with coupon rates ranging from 2.00% to 5.00%. The proceeds from the sale of the 2010 Bonds were restricted to refund certain contractual obligations incurred pursuant to a power sales contract between BTU and the Texas Municipal Power Agency. For additional discussion of the 2010 Bonds refer to Note to Financial Statement 11 - Texas Municipal Power Agency. At September 30, 2011, there was $165,150,000 of City Electric System revenue bonds outstanding payable from revenues of the City Electric System.

General Trends and Significant Events

Power Supply –

- On October 14, 2010, BTU entered into a 15 year renewable energy power purchase agreement with Peñascal II Wind Power, LLC, a subsidiary of Iberdrola Renewables. Under the agreement, which extends from January 1, 2011 to December 31, 2025, BTU will purchase the output from wind turbines representing 30MW of generating capacity from Iberdrola Renewables' existing Peñascal 2 Wind Project in Kenedy County, Texas.

- On April 30, 2010, BTU entered into a 25 year renewable energy power purchase agreement with Fotowatio Renewable Ventures (FRV). FRV will own and operate a photovoltaic solar power plant to be constructed in West Texas. Under the agreement BTU will purchase the output from the 10MW facility starting as early as 2012.

- BTU completed construction of Dansby 3, a 48MW 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, commenced commercial operations on March 28, 2010.

Transmission Construction -

- During 2011, BTU completed construction of several major transmission projects. Additions include the Rayburn, Dowling and Thompson Creek substations and a 10 mile transmission line from the Dansby power plant to the new Thompson Creek substation. The new facilities increase system reliability and allow BTU to better serve system growth. These four transmission projects added $16.6 million to Plant In Service in 2011. The cost of the transmission additions were approved for recovery through the Texas Public Utility Commissions Transmission Cost of Service Rates on August 24, 2011.

Other –

- On August 3, 2011, BTU experienced a summer peak load of 306MW. This represented the highest electrical demand for one day in BTU's history. BTU also set a new winter peak load of 259MW on February 9, 2011. The new peaks were primarily the result of weather extremes experienced during the year.

- For the fiscal year ended September 30, 2011, BTU transferred $6,384,896 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.

- Effective December 17, 2009, the Texas Municipal Power Agency ("TMPA") and its Member Cities settled all pending legal disputes by entering into a Global Compromise Settlement Agreement (the "Agreement"). Pursuant to this Agreement, the following matters were implemented (<u>Note 11 – Texas Municipal Power Agency</u>):

    - All related lawsuits have been dismissed, and PUC cases have been ordered remanded.

    - The parties have agreed that TMPA will provide bundled transmission service to all Member Cities while the Contract remains in effect, and that TMPA will provide unbundled service thereafter.

    - The Member Cities have issued debt to provide for TMPA's scrubber refurbishment project and to refinance existing TMPA debt.

- TMPA and the Member Cities have, effective June 24, 2010, amended the Contract to permit the issuance by TMPA of transmission debt without extending the term of the Contract.

- TMPA and the Member Cities have agreed that, except for transmission debt, TMPA will not issue bonds without obtaining the consent of the Member Cities.

Subsequent Events

On October 1, 2011, BTU implemented new electric rates for the City Electric System which includes City of Bryan retail customers and the Rural Electric System wholesale rate. The new rates reflect a 7.0% increase in base rates which was more than offset by a reduction in fuel rates. BTU had an over-recovered fuel balance of $8,574,684 at September 30, 2011. Overall, the new October 1, 2011 combined base and fuel rates reflect a 0.2% reduction from previous rates.

Requests for Information

This financial report is designed to provide readers with a general overview of BTU's City Electric System 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:	BTU General Manager:
Joe Hegwood Gary Miller Randy Trimble	Dan Wilkerson

Bryan Texas Utilities
City Electric System
Statements of Net Assets
At September 30, 2011 and 2010

	September 30, 2011	September 30, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 28,671,298	$ 27,800,338
Accounts receivable	17,461,729	12,952,577
Less allowance for uncollectible accounts	(1,079,752)	(1,147,337)
Accrued interest receivable	132,960	198,708
Inventory	4,801,191	4,712,214
Due from other funds	3,521,018	2,132,544
Prepaid purchased power option	1,400,000	1,400,000
Prepaid energy costs – TMPA	6,900,717	6,900,717
Other assets	328,144	186,281
Deferred cash flow hedges – unrealized loss on derivatives	7,452,683	6,967,809
Total current assets	69,589,988	62,103,851
Non-current assets:		
Restricted assets:		
Cash and cash equivalents	12,992,794	20,773,042
Investments	21,086,640	30,053,000
Prepaid purchased power option	7,350,000	8,750,000
Prepaid energy costs - TMPA	46,579,842	53,480,559
Capital assets	352,614,563	328,978,150
Less accumulated depreciation	(130,380,750)	(122,835,835)
Unamortized bond issuance expenses and other	1,753,814	1,812,633
Deferred cash flow hedges – unrealized loss on derivatives	8,878,090	12,219,957
Total noncurrent assets	320,874,993	333,231,506
Total assets	$ 390,464,981	$ 395,335,357

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

Bryan Texas Utilities
City Electric System
Statements of Net Assets - continued
At September 30, 2011 and 2010

	September 30,	
	2011	**2010**
Liabilities		
Current liabilities:		
Accounts payable	$ 10,485,253	$ 9,676,892
Accrued liabilities	327,303	251,270
Due to other funds	1,085,949	961,204
Derivative financial instruments – current portion	7,452,683	6,967,809
Deferred credits and other current liabilities	426,679	417,311
Total current liabilities	19,777,867	18,274,486
Current liabilities payable from restricted assets:		
Accrued interest	1,903,867	1,974,513
Over-recovered fuel	8,574,684	3,848,556
Revenue bonds - current portion	10,915,000	10,685,000
Customer deposits	3,334,122	3,321,387
Total current liabilities payable from restricted assets	24,727,673	19,829,456
Non-current liabilities:		
Revenue bonds payable	154,235,000	165,150,000
Bond premium, net	3,619,571	4,105,145
Arbitrage rebate	77,832	83,328
Derivative financial instruments	8,878,090	12,219,957
Net pension obligation	1,459,629	935,121
Other post employment benefits	194,619	77,170
Deferred credits and other noncurrent liabilities	306,351	306,351
Total noncurrent liabilities	168,771,092	182,877,072
Total liabilities	213,276,632	220,981,014
Net Assets		
Net assets:		
Invested in capital assets, net of related debt	120,097,924	114,561,067
Restricted for:		
Debt reserve	10,289,151	10,289,151
Debt service	2,727,848	2,671,249
Rate stabilization	1,676,616	8,041,602
Collateral deposits	-	1,050,000
Unrestricted	42,396,810	37,741,274
Total net assets	$ 177,188,349	$ 174,354,343

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 Fiscal Years Ended September 30, 2011 and 2010

	FY2011	FY2010
Operating revenues:		
Electrical system	$ 151,634,735	$ 134,670,691
Other	1,882,375	1,950,596
Total operating revenues	153,517,110	136,621,287
Operating expenses:		
Personnel services	10,158,885	10,259,593
Electric operations	108,095,318	101,828,655
Maintenance	2,973,076	1,824,198
Other services and charges	2,101,380	2,019,865
Other expenses	603,610	604,607
General and administrative	2,237,800	2,458,888
Total operating expenses before depreciation	126,170,069	118,995,806
Operating income before depreciation	27,347,041	17,625,481
Depreciation	9,727,441	8,615,279
Operating income	17,619,600	9,010,202
Non operating revenues (expenses):		
Investment income	369,563	365,336
Interest expense	(7,440,176)	(6,357,981)
Total non operating revenues (expenses)	(7,070,613)	(5,992,645)
Income before operating transfers	10,548,987	3,017,557
Transfers:		
City of Bryan administrative payment	1,334,323	1,308,160
“Right of Way” payment to City of Bryan	(9,049,304)	(8,513,115)
Transfers, net	(7,714,981)	(7,204,955)
Change in net assets	2,834,006	(4,187,398)
Net assets, beginning of period	174,354,343	178,541,741
Net assets, end of period	$ 177,188,349	$ 174,354,343

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

Bryan Texas Utilities
City Electric System
Statements of Cash Flows
For the Fiscal Years Ended September 30, 2011 and 2010

	FY2011	FY2010
Cash flows from operating activities		
Receipts from customers	$ 148,531,182	$ 136,412,486
Payments to suppliers	(102,025,764)	(101,372,095)
Payments to employees	(9,628,963)	(9,777,018)
Net cash provided by operating activities	36,876,455	25,263,373
Cash flows from noncapital financing activities		
Operating subsidies and transfers from other funds	1,334,323	1,308,160
Operating subsidies and transfers to other funds	(9,049,304)	(8,513,115)
Net cash used by non-capital financing activities	(7,714,981)	(7,204,955)
Cash flows from capital and related financing activities		
Purchases of capital assets	(26,870,914)	(15,587,422)
Prepaid energy cost - TMPA	-	(63,256,575)
Proceeds from capital debt	-	92,838,378
Principal paid on capital debt	(10,685,000)	(3,555,407)
Interest paid on capital debt	(7,888,044)	(5,370,922)
Net cash provided (used) by capital and related financing activities	(45,443,958)	5,068,052
Cash flows from investing activities		
Proceeds from sales and maturities of investments	55,000,000	45,176,904
Purchases of investments	(46,513,782)	(38,303,906)
Interest and dividends received	886,978	658,349
Net cash provided by investing activities	9,373,196	7,531,347
Net increase (decrease) in cash and cash equivalents	(6,909,288)	30,657,817
Balance-beginning of the year	48,573,380	17,915,563
Balance-end of the year	$ 41,664,092	$ 48,573,380

Reconciliation of Ending Cash Balance		
Cash and cash equivalents	$ 28,671,298	$ 27,800,338
Cash and cash equivalents – restricted	12,992,794	20,773,042
Balances-end of year	$ 41,664,092	$ 48,573,380

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

Bryan Texas Utilities
City Electric System
Statements of Cash Flows - continued
For the Fiscal Years Ended September 30, 2011 and 2010

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

	FY2011	FY2010
Operating income	$ 17,619,600	$ 9,010,202
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	9,727,441	8,615,279
Bad debts	395,373	441,102
Change in assets and liabilities:		
Accounts receivable	(4,998,663)	(551,405)
Inventory	(88,977)	157,164
Prepaid assets	8,158,854	4,294,983
Due from other funds	(1,864,363)	97,026
Accounts payable	2,528,948	(601,399)
Accrued liabilities	76,033	45,064
Customer deposits	12,735	342,604
Net pension obligation	453,889	435,303
Over-recovered fuel	4,726,128	2,894,487
Due to other funds	124,745	124,175
Deferred credits and other	4,712	(41,212)
Net cash provided by operating activities	$ 36,876,455	$ 25,263,373

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

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 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 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, 2011, GASB issued no pronouncements applicable to BTU financial reporting.

For the fiscal year ended September 30, 2010, BTU adopted the following GASB pronouncements:

GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets.* This Statement addresses the nature of intangible assets and requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. There was no impact on BTU's financial statements as a result of this implementation.

GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments.* This statement addresses the recognition, measurement, and disclosure of information regarding derivative instruments and generally requires derivative instruments covered in its scope to be recorded at fair value on the Statement of Net Assets. 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. Refer to Notes to Financial Statements 8 – Financial Hedging for disclosures related to GASB Statement No. 53.

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. At September 30, 2011 the City Electric System reported a current liability – over recovered fuel of $8,574,684 and at September 30, 2010, the City Electric System reported a current liability – over recovered fuel of $3,848,556.

Prepaid Energy Costs - TMPA's rates for the purchase of electricity billed to the City Electric System are designed to cover TMPA's annual system costs including debt service costs. As further discussed in Note 11 – Texas Municipal Power Agency, during the fiscal year ended September 30, 2010 the City Electric System, along with other TMPA member cities, issued debt in their own names to refund a portion of TMPA debt and to finance certain capital improvements of TMPA. Such amounts have been accounted for as a prepayment of future energy costs on the Statement of Net Assets and are amortized over the life of the associated debt.

Capital Assets - Capital assets are stated at the historical cost. 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.

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, 2011 and 2010 were held at Citibank, N.A. These deposits were entirely covered by federal depository insurance or by collateral equal to at least 105% 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 City of Bryan 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. Investments authorized under the policy include the following:

a. Direct obligations of the United States government;

b. Debentures or discount notes issued by, guaranteed by, or for which the credit of any Federal Agencies and Instrumentalities is pledged for payment;

c. Bonds or other interest bearing obligations for which the principal and interest are guaranteed by the full faith and credit of the United States government;

d. Time Certificates of Deposit, insured by the Federal Deposit Insurance Corporation (FDIC) or its successor, in state or national banks or state or federally chartered savings and loan associations located within the State of Texas;

e. Repurchase Agreements with a defined termination date of 90 days or less based upon U.S. Treasury securities collateralized at a minimum of 102%;

f. Reverse repurchase agreements with a defined termination date of 90 days or less;

g. Bankers Acceptances eligible for discounting with the Federal Reserve maturing within 90 days;

h. Commercial Paper maturing within 180 days carrying a rating of A-1, P-1 or F-1;

i. Money Market Mutual Funds that are registered with and regulated by the Securities and Exchange Commission, are no load with a maximum stated maturity of 13 months and dollar-weighted average stated maturity of no more than 90 days;

j. AAA-rated local government investment pools;

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

The City Electric System's cash, cash equivalents and investments at September 30, 2011 and 2010 are summarized as follows:

	FY2011	FY2010
Demand deposits	$ 41,664,092	$ 47,523,380
Collateral deposits with counterparty	-	1,050,000
Investments in treasury securities	21,086,640	30,053,000
Total	$ 62,750,732	$ 78,626,380

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, 2011, BTU had the following investments:

		Investment Maturity (in Years)		
Investment Types	**Fair Value**	**Less Than 1**	**1 - 5**	**Greater Than 5**
Investments in treasury securities	$ 21,086,640	$ 21,086,640	$ -	$ -
Total fair value	$ 21,086,640	$ 21,086,640	$ -	$ -

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.

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

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

<u>Restricted Cash and Investments</u>

In 2011, cash and investments of $62.8 million exceeded amounts required to be restricted by $28.7 million. In 2011, BTU transferred $6,384,896 from the rate stabilization fund reflected in Restricted assets on the Statement of Net Assets to Unrestricted assets. This transfer recognized BTU's commitment to maintaining appropriate levels of unrestricted operating cash. On November 8, 2010, the BTU Board of Directors approved a motion to reclassify the TMPA reserve of $6,336,495 to "Cash and cash equivalents" in current assets on the Statement of Net Assets. This amount represented potential losses associated with TMPA litigation. All litigation has been settled, and BTU is no longer required to segregate these funds. In 2010 cash and investments of $78.6 million exceeded amounts required to be restricted by $27.8 million.

Amounts required being restricted at September 30, 2011 and 2010 are as follows:

	FY2011	FY2010
Rate stabilization fund	$ 1,676,616	$ 8,041,602
Debt reserve	10,289,151	10,289,151
Debt service	4,631,714	4,645,761
Bond funds for construction	5,573,147	19,629,585
Over-recovered fuel expense	8,574,684	3,848,556
Customer deposits	3,334,122	3,321,387
Collateral deposits	-	1,050,000
Restricted cash and investments	$ 34,079,434	$ 50,826,042

3. Capital Assets

General Description – At September 30, 2011, production plant included Dansby and Atkins power plants located in Brazos County, which were solely owned and operated by BTU. In 2010, BTU completed construction of Dansby 3, a 48 megawatt gas turbine generator located adjacent to BTU's existing Dansby 1 and 2 units. The unit, powered by a General Electric LM6000, commenced commercial operations on March 28, 2010. In total BTU production plants include eight gas-fired generating units representing 337 megawatts of generating capacity. Four of the oldest Atkins power plant units representing 111 megawatts of capacity are in mothball status, leaving 226 megawatts of available capacity from owned production plant. 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, 2011.

Capital asset activity for the fiscal year ended September 30, 2011 was as follows:

	Beginning Balance	**Increases**	**Decreases**	**Ending Balance**
Capital assets, not being depreciated:				
Land	$ 3,914,184	$ 491,544	$ -	$ 4,405,728
Construction in progress	16,892,177	26,132,845	34,843,081	8,181,941
Total capital assets, not being depreciated	20,806,361	26,624,389	34,843,081	12,587,669
Capital assets, being depreciated:				
Production plant	120,730,025	2,820,341	-	123,550,366
Transmission plant	71,564,365	17,395,333	12,023	88,947,675
Distribution plant	97,470,222	12,582,013	1,250,151	108,802,084
General plant	18,407,177	1,157,459	837,867	18,726,769
Total capital assets, being depreciated	308,171,789	33,955,146	2,100,041	340,026,894
Less accumulated depreciation for:				
Production plant	57,471,972	2,481,782	-	59,953,754
Transmission plant	17,069,921	2,338,231	12,023	19,396,129
Distribution plant	38,840,067	3,056,652	1,332,637	40,564,082
General Plant	9,453,875	1,850,776	837,866	10,466,785
Total accumulated depreciation	122,835,835	9,727,441	2,182,526	130,380,750
Total capital assets, being depreciated, net	185,335,954	24,227,705	(82,485)	209,646,144
Total capital assets, net	$ 206,142,315	$ 50,852,094	$ 34,760,596	$ 222,233,813

4. Long-Term Debt

No bonds were issued in the 2011 fiscal year. During the fiscal year ended September 30, 2010, the City Electric System issued revenue bonds dated November 24, 2009 ("2009 Bonds") and March 30, 2010 ("2010 Bonds") totaling $25,070,000 and $64,190,000, respectively. The 2009 Bonds mature serially on July 1, 2010 through July 1, 2034, with coupon rates ranging from 4.00% to 5.00%. The proceeds from the sale of the 2009 Bonds are restricted to the construction of transmission and distribution facilities. The 2010 Bonds mature serially on July 1, 2011 through July 1, 2019, with coupon rates ranging from 2.00% to 5.00%. The proceeds from the sale of the 2010 Bonds were restricted to refund certain contractual obligations incurred pursuant to a power sales contract between BTU and the Texas Municipal Power Agency. For additional discussion of the 2010 Bonds refer to Note to Financial Statement 11 - Texas Municipal Power Agency. At September 30, 2011, there was $165,150,000 of City Electric System revenue bonds outstanding payable from revenues of the City Electric System. Changes to long term debt during 2011, including current portion are as follows:

	Interest Rates (%)	**Series Matures**	**Beginning Balance**	**Additions**	**Reductions**	**Ending Balance**	**Due in One Year**
Series 2001	4.375 - 5.000	2019	$ 4,025,000	$ -	$ 450,000	$ 3,575,000	$ 480,000
Series 2005	4.000 - 4.500	2025	10,920,000	-	545,000	10,375,000	565,000
Series 2006	4.000 - 5.000	2031	11,120,000	-	335,000	10,785,000	350,000
Series 2007	4.250 - 5.250	2032	30,065,000	-	810,000	29,255,000	840,000
Series 2008	4.000 - 5.250	2033	31,215,000	-	790,000	30,425,000	820,000
Series 2009	4.000 – 5.000	2034	24,300,000	-	605,000	23,695,000	630,000
Series 2010	3.000 – 5.000	2019	64,190,000	-	7,150,000	57,040,000	7,230,000
Total			$175,835,000	$ -	$10,685,000	$165,150,000	$10,915,000

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, 2011 and 2010.

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, 2008, 2009, and 2010 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
2012	$ 10,915,000	$ 7,611,856	$ 18,526,856
2013	9,480,000	7,243,656	16,723,656
2014	9,400,000	6,916,231	16,316,231
2015	9,995,000	6,534,725	16,529,725
2016	10,320,000	6,080,163	16,400,163
2017-2021	49,425,000	22,685,931	72,110,931
2022-2026	26,040,000	13,596,369	39,636,369
2027-2031	28,455,000	7,165,894	35,620,894
2032-2034	11,120,000	914,388	12,034,388
Total	$165,150,000	$ 78,749,213	$ 243,899,213

In the Statement of Revenues, Expenses and Changes in Net Assets for the fiscal years ended September 30, 2011 and 2010, interest expense in the amount of $7,440,176 and $6,357,981, 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.

The City of Bryan is one of 842 municipalities having their benefit plan administered by TMRS. Each of the 842 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.

Plan provisions for the City were as follows:

	Plan Year 2010	**Plan Year 2011**
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

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 for the fiscal year ended September 30, 2011, and net pension obligation at September 30, 2011 are as follows:

Annual Required Contribution (ARC)	$ 8,891,562
Interest on Net Pension Obligation	276,280
Adjustment to the ARC	(228,166)
Annual Pension Cost (APC)	8,939,676
Contributions Made	(7,066,633)
Increase (decrease) in net pension obligation	1,873,043
Net Pension Obligation, beginning of year	3,683,734
Net Pension Obligation, end of year	$ 5,556,777
Net Pension Obligation, end of year – BTU only	$ 1,459,629

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 26.3% for the year ended September 30, 2011.

City historical data is as follows:

Fiscal Year	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation at September 30
09/30/09	7,831,491	79.73%	1,587,104
09/30/10	8,718,507	75.96%	3,683,734
09/30/11	8,939,676	79.05%	5,556,777

The required contribution rates for fiscal year 2011 were determined as part of the December 31, 2009 actuarial valuation. Additional information as of the latest actuarial valuation, December 31, 2010, also follows:

Valuation date	12/31/2008	12/31/2009	12/31/2010 Prior to Restructuring	12/31/2010 Restructured
Actuarial cost method	Projected Unit Credit	Projected Unit Credit	Projected Unit Credit	Projected Unit Credit
Amortization method	Level Percent of Payroll	Level Percent of Payroll	Level Percent of Payroll	Level Percent of Payroll
GASB 25 Equivalent Single Amortization Period	29 years; closed period	28 years; closed period	27.2 years; closed period	27.2 years; closed period
Amortization Period for new Gains/Losses	30 years	30 years	30 years	30 years
Asset valuation method	Amortized Cost	10-year Smoothed Market	10-year Smoothed Market	10-year Smoothed Market
Actuarial assumptions:				
Investment rate of return	7.5%	7.5%	7.5%	7.0%
Projected salary increases	Varies by age & service	Varies by age & service	Varies by age & service	Varies by age & service
Included inflation rate	3.0%	3.0%	3.0%	3.0%
Cost-of-living adjustments	2.1%	2.1%	2.1%	2.1%

In June, 2011, SB 350 was enacted by the Texas Legislature, resulting in a restructure of the TMRS funds. This legislation provided for the actuarial valuation to be completed, as if restructuring had occurred on December 31, 2010. In addition, the actuarial assumptions were updated for the new fund structure, based on an actuarial experience study that was adopted by the TMRS Board at their May, 2011 meeting (the review compared actual to expected experience for the four-year period of January 1, 2006 through December 31, 2009). For a complete description of the combined impact of the legislation and new actuarial assumptions, including the effects on TMRS city rates and funding ratios, please see the December 31, 2010 TMRS Comprehensive Annual Financial Report (CAFR).

Funding Status and Funding Progress

The funded status as of December 31, 2010, the most recent actuarial valuation date, and as of December 31, 2009, and December 31, 2008, are 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)
12/31/2010 (1)	$105,463,843	$175,122,241	60.2%	$69,658,398	$44,486,837	156.6%
12/31/2010 (2)	$167,407,171	$226,635,273	73.9%	$59,228,102	$44,486,837	133.1%
12/31/2009	$95,477,625	$164,435,101	58.1%	$68,957,476	$45,844,873	150.4%
12/31/2008	$91,123,170	$153,116,068	59.5%	$61,992,898	$41,808,463	148.3%

(1) Actuarial valuation performed under the original fund structure.
(2) Actuarial valuation performed under the new fund structure.

6. Other Post-Employment Benefits

BTU is an integral part of the City, and as such, provides post employment benefits for all its full-time employees through the City benefit plan. 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. A separate, audited GAAP-basis post employment benefit plan report is not available.

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 date the surviving spouse becomes eligible for federal Medicare benefits. Surviving dependent minor children are entitled to continue health insurance coverage until the dependent reaches the age of 18 years. A surviving dependent who is not a minor child is entitled to continue health insurance coverage until the earlier of: (1) the date the dependent becomes eligible for group health insurance through another employer or (2) the date the dependent becomes eligible for federal Medicare benefits. Eligible survivors are entitled to purchase the continued coverage at the group rate for that coverage that exists at the time of payment. Surviving covered 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.

In the year ended September 30, 2011, retirees paid $462,096 in premiums and $631,222 in claims were paid for post-retirement health care and administrative charges. As of September 30, 2011, the City has 35 retirees, 30 retirees and spouses, 9 retirees and families and 6 retirees and child(ren) participating in the health plan, out of the 328 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 $53,515 and incurred claims and administrative expenses of $47,425 in the year ended September 30, 2011. As of September 30, 2011 the City has 5 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.

Prior to January 1, 2010, all retirees electing health plan coverage received a health premium subsidy averaging 40%. Beginning January 1, 2010, the City implemented new eligibility requirements for subsidized retiree premiums. The new eligibility requirements require retirees to meet the 'Rule of 80' (sum of age plus years of service at retirement must equal to at least 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 most recent OPEB valuation performed as of December 31, 2009 as required by GASB.

Annual OPEB costs for the fiscal years ended 2011 and 2010 are as follows:

	FY2011	**FY2010**	**FY2009**
Annual required contribution	$ 733,190	$ 711,835	$ 594,447
Interest on OPEB obligation	17,653	(6,093)	4,207
Adjustment to ARC	(9,977)	3,206	(2,213)
Annual OPEB cost (expense) end of year	740,866	708,948	596,441
Net estimated employer contributions	(169,126)	(181,259)	(825,330)
Increase in net OPEB obligation	$ 571,740	$ 527,689	$ (228,889)
Net OPEB obligation (asset) – as of beginning of year	392,281	(135,408)	93,481
Net OPEB obligation (asset) – as of end of year	$ 964,021	$ 392,281	$ (135,408)
Net OPEB obligation (asset) – as of end of year –BTU only	$ 194,619	$ 77,170	$ (25,105)

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 20.19% for the year ended September 30, 2011.

Funding status and funding progress

The funded status as of December 31, 2009, the most recent valuation date, is as follows:

	FY2011	**FY2010**	**FY2009**
Actuarial value of plan assets	$ -	$ -	$ -
Actuarial accrued liability (AAL)	7,694,907	7,694,907	7,898,192
Unfunded AAL (UAAL)	(7,694,907)	(7,694,907)	(7,898,192)
Funded Ratio	0%	0%	0%
Covered Payroll	$44,610,716	$45,844,873	$41,808,463
UAAL as a % of Covered Payroll	0%	0%	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 $7,694,907 at September 30, 2011.

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.

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:

Actuarial valuation date	December 31, 2009
Investment rate of return	4.5%, net of expenses
Actuarial cost method	Projected unit credit cost method
Amortization method	Level as a percentage of payroll
Remaining amortization period	28 years – Open Period
Payroll growth rate	3.00% per annum

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. The required schedule of funding progress presented as required supplementary information provides multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

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 ended September 30, 2011 and 2010, the City Electric System paid the City $400,872 and $383,631, respectively, for participation in the City's risk management program.

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.

For the fiscal year ended September 30, 2010, BTU implemented GASB Statement No. 53 – *Accounting and Financial Reporting for Derivative Instruments* ("GASB 53"), which addresses the recognition, measurement, and disclosures related to derivative instruments. BTU utilizes natural gas commodity swaps and options to hedge its exposure to fluctuating fuel prices. Since these derivatives are entered into for risk mitigation purposes, the instruments are considered potential hedging derivative instruments under GASB 53.

In accordance with the requirements of GASB 53, BTU reports all fuel hedges on the Statement of Net Assets at fair value. The fair value of option contracts are determined using New York Mercantile Exchange ("NYMEX") or Houston Ship Channel ("HSC") closing settlement prices as appropriate to the instrument. For swap transactions, the value is calculated as the difference between the closing futures price at the end of the reporting period, and the futures price at the time the positions were established, less applicable commissions.

BTU evaluated all potential hedging derivative instruments for effectiveness as of September 30, 2011, and determined the derivatives to be effective in substantially offsetting the changes in cash flows of the hedgeable items. BTU's hedgeable items are expected HSC natural gas purchases to serve budgeted load. BTU projects total natural gas needs as part of a 10-year forecast. This forecast is the basis for the procurement amount of the hedgeable item. BTU's potential hedging derivatives are NYMEX and HSC indexed commodity swaps and options. These derivatives act as cash flow hedges.

BTU utilized regression analysis to test effectiveness of its NYMEX hedges. Testing was based on the extent of correlation between historical NYMEX index and HSC natural gas prices for the prompt months of January 2003, to September 2011. The correlation coefficient of -.8171 exceeds the minimum standard established by GASB 53 and indicates a strong linear relationship between the NYMEX and HSC prices. The calculated R^2 value of .9422 indicates that the changes in cash flows of the hedge substantially offset the changes in cash flows of the hedgeable item. BTU also utilizes HSC indexed gas commodity swaps to hedge its open exposure after a NYMEX-based swap contract month settles. BTU entered into HSC gas-daily-daily swaps to hedge this exposure. These HSC indexed swaps are hedging the physical purchases of natural gas also based on the HSC index and are effective cash flow hedges under the consistent critical terms method as defined by GASB 53. The swap is for the purchase of virtually the same quantity of the hedgeable item, has zero fair value at inception, and the reference rate of the swap and the hedgeable item are the same (HSC index).

For the fiscal years ended September 30, 2011 and 2010, the total fair value of outstanding hedging derivative instruments was a net liability of $16,330,773 and $19,187,766, respectively. The fair value of those instruments maturing within one year are reported on the Statement of Net Assets in current liabilities as derivative financial instruments and were $7,452,683 and $6,967,809 at September 30, 2011 and 2010, respectively. The fair value of those instruments with maturities exceeding one year are reported on the Statement of Net Assets in noncurrent liabilities as derivative financial instruments and were $8,878,090 and $12,219,857 at September 30, 2011 and 2010, respectively.

Hedge accounting treatment outlined in GASB 53 requires changes in the fair value of derivative instruments deemed effective in offsetting changes in cash flows of hedged items be reported as deferred (inflows) outflows of resources on the Statement of Net Assets. During the fiscal year ended September 30, 2011, the fair value of BTU's hedging derivative instruments - the option collars, NYMEX-based commodity swaps, and HSC-based commodity swaps - increased by $980,388, decreased by $363,809, and increased by $2,240,414, respectively. The $2,856,993 total increase in fair value of BTU's hedging derivative instruments during the fiscal year ended September 30, 2011, is reported in the Statement of Net Assets as current and non-current deferred cash outflows. The deferred outflows are reported until respective contract expirations occur in conjunction with hedged expected physical fuel purchases. When fuel purchase transactions occur, the deferred balance associated with the expired fuel hedging contract is recorded as an adjustment to fuel expense. At September 30, 2011 and 2010, the current deferred outflows related to hedging derivatives were $7,452,683 and $6,967,809, respectively. These amounts are reported on the Statement of Net Assets as current assets. The noncurrent deferred outflows related to hedging derivatives were $8,878,090 and $12,219,857, at September 30, 2011 and 2010, respectively. These amounts are reported on the Statement of Net Assets as noncurrent assets.

The following information details BTU's hedging derivative instruments as of September 30, 2011:

Type	Terms	Volume Hedged (MMBtu)	Effective Dates	Maturity Dates	Reference Index	Fair Value
3 Way Option Collars	$5.000 – 8.00 Strike Prices	1,800,000	Jan – Dec 2012	Jan – Dec 2012	NYMEX	$ (580,300)
Commodity Swaps	BTU pays prices of $5.485 – 7.570	14,721,500	Oct 2011 – Dec 2018	Oct 2011 – Dec 2018	NYMEX	(15,056,652)
Commodity Swaps	BTU pays prices of $7.500	184,000	Oct – Dec 2011	Nov 2011 – Jan 2012	HSC	(693,821)
		16,705,500				$(16,330,773)

The following information details BTU's hedging derivative instruments as of September 30, 2010:

Type	Terms	Volume Hedged (MMBtu)	Effective Dates	Maturity Dates	Reference Index	Fair Value
3 Way Option Collars	$5.000 – 8.750 Strike Prices	1,212,000	May 2011 – Jan 2012	Sep 2011 – Dec 2012	NYMEX/HSC	$ (1,560,688)
Commodity Swaps	BTU pays prices of $5.845 - 7.570	16,196,500	Oct 2010 – Dec 2018	Oct 2010 – Dec 2018	NYMEX	(14,692,843)
Commodity Swaps	BTU pays prices of $7.320 – 7.500	914,000	Oct 2010 – Dec 2011	Oct 2010 – Dec 2011	HSC	(2,934,235)
		18,322,500				$(19,187,766)

Should purchased options be allowed to expire, premiums paid for such options will be lost. BTU receives a premium for those options it sells and creates an obligation to honor the contract terms if those options are exercised by the purchasing counterparty. Fuel swap contracts represent a financial obligation to buy or sell the underlying settlement point price. 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.

Credit Risk - BTU's hedging derivative instruments generate exposure to a certain amount of risk that could give rise to financial loss. Since current hedges have a net liability position, BTU is not exposed to counterparty credit risk. However, it is BTU's policy to require full collateralization of the fair value of derivative instruments in assets positions should the counterparty's credit ratings fall below investment grade.

Basis Risk - BTU is exposed to basis risk because the expected gas purchases being hedged will settle based on a pricing point (HSC) different than the pricing point of the hedge transactions (NYMEX). For September 2011, prompt month prices were $3.857/MMBtu and $3.868/MMBtu, for NYMEX and HSC, respectively.

Termination Risk - Exposure to termination risk occurs because BTU or its counterparties may terminate a derivative instrument if the other party fails to perform under the terms of the contract. BTU's fuel hedges are exchange-traded instruments, and consequently, termination risk is mitigated by the rules and guidelines established by NYMEX, which is governed by the Commodity Futures Trade Commission.

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 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 $150,000 and a maximum aggregate stop loss deductible of $7,065,175 for the twelve month period which began January 1, 2011 and ends December 31, 2011. 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 following schedule represents the changes in claims liabilities for the fiscal year:

	FY2011	FY2010
Beginning balance - unpaid claims	$ 1,011,803	$ 991,645
Incurred claims	7,339,596	6,663,242
Claim payments	(7,400,908)	(6,643,084)
Ending balance – unpaid claims	$ 950,491	$ 1,011,803
Amounts due in one year	$ 950,491	$ 1,011,803

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 and commercial paper. At September 30, 2011, BTU's portion of outstanding TMPA bonds and commercial paper was approximately $139.7 million and $45.6 million, respectively.

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.

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.

In 1998, a dispute arose between TMPA and the City of Bryan over the inclusion by TMPA, in TMPA's budget and rates, of transmission charges associated with the delivery of Gibbons Creek power to the Member Cities. This dispute resulted in a series of administrative proceedings at the Public Utility Commission of Texas (the "PUC Cases") that were ultimately appealed to the courts in a lawsuit between TMPA and Bryan in Grimes County District Court (the "Grimes County Suit"). In 2008, a dispute arose between TMPA and Bryan over TMPA's attempt to restructure its debt through passage of a bond resolution, which would have extended the term of the Contract. This dispute resulted in a bond validation suit in Travis County Texas (the "Bond Validation Suit"). The Member Cities of Denton, Garland, and Greenville supported TMPA's position in the Grimes County Suit and in the Bond Validation Suit.

Effective December 17, 2009, TMPA and the Member Cities settled all of the above disputes by entering into a Global Compromise Settlement Agreement. Pursuant to the Global Compromise Settlement Agreement, the following matters were implemented:

- The Bond Validation Suit and the Grimes County Suit were dismissed. The PUC Cases were ordered remanded to the PUC for reissuance of agreed orders that are neutral on the issue that had been in dispute.

- The parties agreed that TMPA will provide bundled transmission service to all Member Cities while the Contract remains in effect, and that TMPA will provide unbundled service thereafter.

- The Member Cities issued debt (i) to provide $98,500,000 for TMPA's scrubber refurbishment project and (ii) to refinance $56,935,000 of TMPA's Series 2003 Subordinate Lien Bonds, $77,335,000 of TMPA's Series 2004 Subordinate Lien Bonds, and $61,385,000 of TMPA's Series 2004A Subordinate Lien Bonds.

- TMPA and the Member Cities, effective June 24, 2010, amended the Contract to permit the issuance by TMPA of transmission debt without extending the term of the Contract. On that same date, TMPA's Board of Directors adopted a bond resolution for the issuance of TMPA's first series of transmission debt, the Series 2010, Subordinate Lien Revenue/Transmission Revenue Converting Security Refunding Bonds. The Series 2010 Bonds, which mature on September 1, 2040 and which were in the par amount of $122,375,000, were delivered on August 30, 2010. Following the date all non-transmission debt is paid and the Contract expires, currently anticipated to be September 1, 2018, the Series 2010 will be payable solely from revenues of TMPA's transmission system.

- TMPA and the Member Cities agreed that, except for transmission debt, TMPA will not issue bonds without obtaining the consent of the Member Cities.

During the years ended September 30, 2011 and 2010 the City Electric System paid TMPA $30,051,020 and $45,799,847, respectively for power purchases and related activity under the contract. As of September 30, 2011 and 2010 the City Electric System had payables to TMPA amounting to $1,391,738 and $1,569,849, respectively.

The TMPA's Comprehensive Annual Financial Report for the year ended September 30, 2011 reported the following:

		FY2011
Total Assets	$	1,189,165,000
Total Liabilities		1,137,686,000
Total Accumulated Excess Revenues		51,479,000
Change in Accumulated Excess Revenues for year ended September 30, 2011	$	(6,164,000)

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 and including portions of the City of College Station, 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 2011 and 2010, Rural purchased power totaled $24,526,558 and $23,971,508, respectively.

In addition to the $9,049,304 and $8,513,115 transferred to the City of Bryan for right of way in 2011 and 2010, respectively, City Electric System paid the City of Bryan $450,546 and $449,267 for administrative functions performed by city personnel in 2011 and 2010, respectively. These amounts are included in the other expenses in the accompanying financial statements.

The City of Bryan transferred to City Electric System $1,334,323 and $1,308,160 in 2011 and 2010, respectively, for billing services performed by City Electric System.

13. Commitments and Contingencies

BTU purchase and construction commitments approximate $227.5 million at September 30, 2011. This amount primarily includes provisions for future fuel and energy purchases.

On October 14, 2010, BTU entered into a 15 year renewable energy power purchase agreement with Peñascal II Wind Power, LLC, a subsidiary of Iberdrola Renewables. Under the agreement, which extends from January 1, 2011 to December 31, 2025, BTU will purchase the output from wind turbines representing 30MW of generating capacity from Iberdrola Renewables' existing Peñascal 2 Wind Project in Kenedy County, Texas.

On April 30, 2010, BTU entered into a 25 year renewable energy power purchase agreement with Fotowatio Renewable Ventures (FRV). FRV will own and operate a photovoltaic solar power plant to be constructed in West Texas. Under the agreement BTU will purchase the output from the 10MW facility starting as early as 2012.

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 $227.5 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.

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.

14. Subsequent Events

On October 1, 2011, BTU implemented new electric rates for the City Electric System which includes City of Bryan retail customers and the Rural Electric System wholesale rate. The new rates reflect a 7.0% increase in base rates which was more than offset by a reduction in fuel rates. BTU had an over-recovered fuel balance of $8,574,684 at September 30, 2011. Overall, the new October 1, 2011 combined base and fuel rates reflect a 0.2% reduction from previous rates.