BRYAN TEXAS UTILITIES

THE ENERGY TO SERVE YOU SINCE 1919

Bryan Texas Utilities

City Electric System

Annual Financial Statements

For the Fiscal Years Ended September 30, 2012 and 2011

Bryan Texas Utilities
City Electric System
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For the Fiscal Years Ended September 30, 2012 and 2011

Introduction

Bryan Texas Utilities (BTU) is pleased to present its Annual Financial Report for the fiscal years ended September 30, 2012 and 2011. 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, 2012 and 2011, 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, 2012 and 2011, 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, 2012 and 2011, 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.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 4 through 8 be presented to supplement the financial statements. Such information, although not part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be a an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted principally of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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 financial statements. This information has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

Weaver and Tidwell, L.L.P.

WEAVER AND TIDWELL, L.L.P.

Houston, Texas
January 18, 2013

Management's Discussion and Analysis

This discussion and analysis of the City Electric System financial performance provides an overview of financial activities for the fiscal years ended September 30, 2012 and 2011. 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, 2012 and 2011.

Condensed Statements of Net Assets	**2012**	**2011**
Current assets	$ 78,079,907	$ 69,589,988
Capital assets, net	230,256,346	222,233,813
Restricted assets	74,383,721	34,079,434
Other	65,522,104	65,410,011
Total assets	448,242,078	391,313,246
Current liabilities	20,672,487	19,777,867
Current liabilities payable from restricted assets	27,692,682	24,727,673
Noncurrent liabilities	219,685,018	169,619,357
Total liabilities	268,050,187	214,124,897
Net assets:		
Invested in capital assets, net of related debt	109,288,009	120,097,924
Restricted	20,209,795	14,693,615
Unrestricted	50,694,087	42,396,810
Total net assets	$ 180,191,891	$ 177,188,349

Condensed Statements of Revenues, Expenses And Changes in Net Assets		
Operating revenues	$ 147,972,138	$ 153,517,110
Operating expenses	124,960,318	135,897,510
Operating income	23,011,820	17,619,600
Investment income	369,937	369,563
Interest expense	(8,046,301)	(7,440,176)
Excess before special items & transfers	15,335,456	10,548,987
Special items – loss on disposal of legacy meters	(4,759,212)	-
Transfers, net	(7,572,702)	(7,714,981)
Change in net assets	3,003,542	2,834,006
Net assets, beginning of period	177,188,349	174,354,343
Net assets, end of period	$ 180,191,891	$ 177,188,349

Financial Highlights

- The City Electric System customer base totaled 33,160 and 32,583 customers at September 30, 2012 and 2011, respectively, an increase of 1.8%.

- Operating revenues for the fiscal years ending September 30, 2012 and 2011 were $147,972,138 and $153,517,110, respectively, a decrease of 3.6%. The decrease in revenues is primarily due to lower wholesale and retail revenues caused by more normal weather conditions during the fiscal year ended September 30, 2012. The fiscal year ended September 30, 2011, experienced more weather extremes than typical.

- Operating expenses for the fiscal years ending September 30, 2012 and 2011 were $124,960,318 and $135,897,510, respectively, a decrease of 8.0%. The decrease in expenses is primarily due to lower fuel related energy costs caused by the reasons explained in the prior paragraph.

- Net assets for the years ended September 30, 2012 and 2011 were $180,191,891 and $177,188,349, respectively, of which $50,694,087 and $42,396,810 were available to meet the City Electric System's ongoing obligations. The change in net assets for the years ended September 30, 2012 and 2011 were $3,003,542 and $2,834,006, respectively. The positive increase is primarily the result of lower energy related 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

For the fiscal year ended September 30, 2012, the City Electric System issued revenue and refunding bonds dated April 4, 2012 ("2012 Bonds") totaling $65,675,000. The 2012 Bonds mature serially on July 1, 2012, through July 1, 2037, with coupon rates ranging from 3.00% to 5.00%. The proceeds from the sale of the 2012 Bonds are restricted to the construction of transmission system improvements, the acquisition and installation of automated metering, and refunding portions of outstanding bonds. At September 30, 2012, there was $202,610,000 of City Electric System revenue bonds outstanding payable from revenues of the City Electric System. No bonds were issued in the 2011 fiscal year.

General Trends and Significant Events

Automated Metering Infrastructure –

- During 2012, BTU completed the installation phase of Automated Metering Infrastructure (AMI). Over 32,000 AMI meters were installed in the City Electric System's service territory allowing remote meter readings, service turn-ons and service turn-offs. Reflected in the Statement of Revenues, Expenses and Changes in Net Assets is the write off of the book values of legacy meters totaling $4,759,212.

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 Commission's Transmission Cost of Service Rates on August 24, 2011.

Rates –

- On October 1, 2011, BTU implemented phase one of a two phase electric rate adjustment for the City Electric System which includes City of Bryan retail customers and the Rural Electric System wholesale rate. Phase one produced a 7.0% increase in base rates which was more than offset by a reduction in fuel rates. Overall, the October 1, 2011 combined base and fuel rate reflected a 0.2% reduction from previous rates. The phase two increase is discussed below in Subsequent Events.

Other –

- On August 10, 2012, BTU experienced a summer peak load of 298MW. This represented the second highest electrical demand for one hour in BTU's history. BTU experienced a winter peak load of 216MW on December 7, 2011, which due to more normal winter temperatures, was lower than the record winter peak load of 259MW set on February 9, 2011.

- 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. No transfers from the Rate Stabilization Fund occurred for the fiscal year ended September 30, 2012.

Subsequent Events

On October 1, 2012, BTU implemented phase two of a two phase electric rate adjustment for the City Electric System which includes City of Bryan retail customers and the Rural Electric System wholesale rate. The phase two rates reflect a 13.0% increase in base rates which are almost entirely offset by a reduction in fuel rates. BTU had an over-recovered fuel balance of $11,024,462 at September 30, 2012. Overall, the new October 1, 2012 combined base and fuel rates reflect a 0.7% increase from phase one 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 Interim General Manager:
Randy Trimble David Werley	Gary Miller

City of Bryan:

Kean Register, City Manager
Joe Hegwood, Chief Financial Officer

Bryan Texas Utilities
City Electric System
Statements of Net Assets
At September 30, 2012 and 2011

	September 30, 2012	September 30, 2011
Assets		
Current assets:		
Cash and cash equivalents	$ 42,052,325	$ 28,671,298
Accounts receivable	15,078,964	17,461,729
Less allowance for uncollectible accounts	(959,585)	(1,079,752)
Accrued interest receivable	121,654	132,960
Inventory	5,025,489	4,801,191
Due from other funds	2,523,997	3,521,018
Prepaid energy costs	8,300,717	8,300,717
Other assets	617,621	328,144
Deferred cash flow hedges – unrealized loss on derivatives	5,318,725	7,452,683
Total current assets	78,079,907	69,589,988
Non-current assets:		
Restricted assets:		
Cash and cash equivalents	13,928,705	12,992,794
Investments	60,455,016	21,086,640
Prepaid energy costs	45,629,125	53,929,842
Capital assets	368,433,192	352,614,563
Less accumulated depreciation	(138,176,846)	(130,380,750)
Unamortized bond issuance expenses and other	2,863,155	2,602,079
Deferred cash flow hedges – unrealized loss on derivatives	17,029,824	8,878,090
Total noncurrent assets	370,162,171	321,723,258
Total assets	$ 448,242,078	$ 391,313,246

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, 2012 and 2011

	September 30, 2012	September 30, 2011
Liabilities		
Current liabilities:		
Accounts payable	$ 12,560,846	$ 10,485,253
Accrued liabilities	843,375	327,303
Due to other funds	1,370,413	1,085,949
Derivative financial instruments	5,318,725	7,452,683
Unamortized gain on refunded debt	191,814	-
Deferred credits and other current liabilities	387,314	426,679
Total current liabilities	20,672,487	19,777,867
Current liabilities payable from restricted assets:		
Accrued interest	2,336,738	1,903,867
Over-recovered fuel	11,024,462	8,574,684
Revenue bonds - current portion	10,575,000	10,915,000
Customer deposits	3,756,482	3,334,122
Total current liabilities payable from restricted assets	27,692,682	24,727,673
Non-current liabilities:		
Revenue bonds payable	192,035,000	154,235,000
Bond premium, net	7,886,944	4,467,836
Arbitrage rebate	-	77,832
Derivative financial instruments	17,029,824	8,878,090
Unamortized gain on refunded debt	383,627	-
Net pension obligation	1,748,460	1,459,629
Other post-employment benefits	294,812	194,619
Deferred credits and other noncurrent liabilities	306,351	306,351
Total noncurrent liabilities	219,685,018	169,619,357
Total liabilities	268,050,187	214,124,897
Net Assets		
Net Assets		
Invested in capital assets, net of related debt	109,288,009	120,097,924
Restricted for:		
Debt reserve	11,558,189	10,289,151
Debt service	2,643,746	2,727,848
Rate stabilization	1,678,841	1,676,616
Collateral deposits	4,329,019	-
Unrestricted	50,694,087	42,396,810
Total net assets	$ 180,191,891	$ 177,188,349

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, 2012 and 2011

	FY2012	**FY2011**
Operating revenues:		
Electrical system	$ 145,990,914	$ 151,634,735
Other	1,981,224	1,882,375
Total operating revenues	147,972,138	153,517,110
Operating expenses:		
Personnel services	9,909,790	10,158,885
Electric operations	89,101,968	99,794,601
Maintenance	3,240,570	2,973,076
Other services and charges	1,608,286	2,101,380
Other expenses	597,466	603,610
General and administrative	1,801,524	2,237,800
Depreciation and amortization	18,700,714	18,028,158
Total operating expenses	124,960,318	135,897,510
Operating income	23,011,820	17,619,600
Non-operating revenues (expenses):		
Investment income	369,937	369,563
Interest expense	(8,046,301)	(7,440,176)
Total non-operating revenues (expenses)	(7,676,364)	(7,070,613)
Income before operating transfers and special items	15,335,456	10,548,987
Special items – loss on disposal of legacy meters	(4,759,212)	-
Transfers:		
City of Bryan administrative payment	1,597,520	1,334,323
"Right of Way" payment to City of Bryan	(9,170,222)	(9,049,304)
Transfers, net	(7,572,702)	(7,714,981)
Change in net assets	3,003,542	2,834,006
Net assets, beginning of period	177,188,349	174,354,343
Net assets, end of period	$ 180,191,891	$ 177,188,349

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, 2012 and 2011

	FY2012	FY2011
Cash flows from operating activities		
Receipts from customers	$ 150,644,625	$ 148,531,182
Payments to suppliers	(92,642,779)	(102,025,764)
Payments to employees	(9,116,761)	(9,628,963)
Net cash provided by operating activities	48,885,085	36,876,455
Cash flows from non-capital financing activities		
Operating subsidies and transfers from other funds	1,597,520	1,334,323
Operating subsidies and transfers to other funds	(9,170,222)	(9,049,304)
Net cash used by non-capital financing activities	(7,572,702)	(7,714,981)
Cash flows from capital and related financing activities		
Purchases of capital assets	(21,310,430)	(26,870,914)
Proceeds from capital debt	69,717,872	-
Principal paid on capital debt	(11,155,000)	(10,685,000)
Interest paid on capital debt	(7,839,535)	(7,888,044)
Payments to escrow agent for debt refunding	(17,396,347)	-
Net cash provided (used) by capital and related financing activities	12,016,560	(45,443,958)
Cash flows from investing activities		
Proceeds from sales and maturities of investments	24,000,000	55,000,000
Purchases of investments	(59,281,153)	(46,513,782)
Collateral deposits to counterparties	(4,329,019)	-
Interest and dividends received	598,167	886,978
Net cash provided (used) by investing activities	(39,012,005)	9,373,196
Net increase (decrease) in cash and cash equivalents	14,316,938	(6,909,288)
Balance-beginning of the year	41,664,092	48,573,380
Balance-end of the year	$ 55,981,030	$ 41,664,092
Reconciliation of ending cash balance		
Cash and cash equivalents	$ 42,052,325	$ 28,671,298
Cash and cash equivalents – restricted	13,928,705	12,992,794
Balances-end of year	$ 55,981,030	$ 41,664,092

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, 2012 and 2011

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

	FY2012	FY2011
Operating income	$ 23,011,820	$ 17,619,600
Adjustments to reconcile operating income		
to net cash provided by operating activities:		
Depreciation and amortization	18,700,714	18,028,158
Bad debts	212,564	395,373
Change in assets and liabilities:		
Accounts receivable	2,250,127	(4,998,663)
Inventory	(224,298)	(88,977)
Prepaid assets	(289,477)	(141,863)
Due from other funds	420,623	(1,864,363)
Accounts payable	853,381	2,528,948
Accrued liabilities	516,072	80,745
Over-recovered fuel	2,449,778	4,726,128
Customer deposits	422,360	12,735
Net pension obligation and other post-employment benefits	276,957	453,889
Due to other funds	284,464	124,745
Net cash provided by operating activities	$ 48,885,085	$ 36,876,455

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 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 the City Electric System (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 the City Electric System 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. The City Electric System 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, 2012, BTU adopted GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions—an amendment of GASB Statement No. 53.* This Statement clarifies whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty's credit support provider, and sets forth criteria that establish when hedge accounting should continue to be applied. There was no impact on the City Electric System's financial statements as a result of this implementation.

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, 2012 and 2011, the City Electric System reported a current liability – over recovered fuel of $11,024,462 and 8,574,684, respectively.

Prepaid Energy Costs - The Texas Municipal Power Agency's ("TMPA") 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 10 – 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 through 2018, the life of the associated debt. Additionally, as discussed in Note 12 – Commitments and Contingencies, in 2007, BTU entered into a purchase power agreement with a subsidiary of Shell Energy North America (U.S.), L.P. As a part of the agreement, BTU prepaid $14,000,000 of generation capacity costs. The prepayment is being amortized over the life of the agreement which extends through December 31, 2017. The amortization of prepaid energy costs is reported on the Statement of Revenues, Expenses and Changes in Net Assets in depreciation and amortization and totaled $8,300,717 for each of the fiscal years ended September 30, 2012 and 2011.

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.

Special Items – Special items are those transactions or events within the control of management that are either unusual in nature or infrequent in occurrence. The City Electric System recognized as a special item the loss on disposal of assets related to switching out legacy meters for the AMI project. For the fiscal year ended September 30, 2012, the City Electric System reported a one-time special item loss of $4,759,212, which represented the net book value of the existing meters removed from service, less any salvage proceeds.

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, 2012 and 2011 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.

The City Electric System's cash, cash equivalents and investments at September 30, 2012 and 2011 are summarized as follows:

	FY2012	FY2011
Demand deposits	$ 55,981,030	$ 41,664,092
Investment in government pool	3,002,974	-
Collateral deposits with counterparties	4,329,019	-
Investments in agency securities	41,034,313	-
Investments in treasury securities	12,088,710	21,086,640
Total	$ 116,436,046	$ 62,750,732

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 the City Electric System does not hold foreign investments, foreign currency risk is not discussed.

As of September 30, 2012, the City Electric System had the following investments:

		Investment Maturity (in Years)		
Investment Types	**Fair Value**	**Less Than 1**	**1 - 5**	**Greater Than 5**
Investment in agency securities	$ 41,034,313	$ 34,987,010	$ 6,047,303	$ -
Investment in treasury securities	12,088,710	6,069,023	6,019,687	-
Investment in government pool	3,002,974	3,002,974		
Collateral deposits with counterparties	4,329,019	4,329,019		
Total fair value	$ 60,455,016	$ 48,388,026	$ 12,066,990	$ -

The City Electric System's investment in government pools includes the 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. TexStar operates on a $1.00 net asset value basis and allows same day or next day redemptions and deposits. Interest is allocated daily based on portfolio earnings and participant account balances. The City Electric System's investment in TexStar is stated at amortized cost, which approximates fair value. The fair value of the City Electric System's investment is the same as the value of the pool shares. These pools are not managed by the City Electric System and the City Electric System does not possess securities that exist in either physical or book entry form.

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.

Restricted Cash and Investments

In 2012, cash and investments of $116.4 million exceeded amounts required to be restricted by $42.0 million. In 2011, cash and investments of $62.8 million exceeded amounts required to be restricted by $28.7 million. The City Electric System transferred $6,384,896 from the rate stabilization fund reflected in restricted assets on the Statement of Net Assets to unrestricted assets, in 2011. This transfer recognized the City Electric System's commitment to maintaining appropriate levels of unrestricted operating cash. The City Electric System did not transfer any rate stabilization funds to unrestricted assets in 2012.

Amounts required being restricted at September 30, 2012 and 2011 are as follows:

	FY2012	**FY2011**
Rate stabilization fund	$ 1,678,841	$ 1,676,616
Debt reserve	11,558,189	10,289,151
Debt service	4,980,484	4,631,714
Bond funds for construction	37,056,244	5,573,147
Over-recovered fuel expense	11,024,462	8,574,684
Customer deposits	3,756,482	3,334,122
Collateral deposits	4,329,019	-
Restricted cash and investments	$ 74,383,721	$ 34,079,434

3. Capital Assets

General Description – At September 30, 2012, production plant included Dansby and Atkins power plants located in Brazos County, which are 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 plants. 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 the City Electric System had no impaired capital assets at September 30, 2012.

Capital asset activity for the fiscal year ended September 30, 2012 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets, not being depreciated:				
Land	$ 4,405,728	$ 24,671	$ -	$ 4,430,399
Construction in progress	8,181,941	23,174,644	11,611,174	19,745,411
Total capital assets, not being depreciated	12,587,669	23,199,315	11,611,174	24,175,810
Capital assets, being depreciated:				
Production plant	123,550,366	54,009	-	123,604,375
Transmission plant	88,947,675	1,125,276	-	90,072,951
Distribution plant	108,802,084	9,681,149	7,369,253	111,113,980
General plant	18,726,769	750,739	11,432	19,466,076
Total capital assets, being depreciated	340,026,894	11,611,173	7,380,685	344,257,382
Less accumulated depreciation for:				
Production plant	59,953,754	2,546,311	-	62,500,065
Transmission plant	19,396,129	2,671,618	-	22,067,747
Distribution plant	40,564,082	3,310,632	2,592,470	41,282,244
General plant	10,466,785	1,871,437	11,432	12,326,790
Total accumulated depreciation	130,380,750	10,399,998	2,603,902	138,176,846
Total capital assets, being depreciated, net	209,646,144	1,211,175	4,776,783	206,080,536
Total capital assets, net	$ 222,233,813	$ 24,410,490	$ 16,387,957	$ 230,256,346

Depreciation and amortization totals $18.7 million, which includes $8.3 million related to amortization of prepaid energy.

4. Long-Term Debt

For the fiscal year ended September 30, 2012, the City Electric System issued revenue and refunding bonds dated April 4, 2012 ("2012 Bonds") totaling $65,675,000. The 2012 Bonds mature serially on July 1, 2012, through July 1, 2037, with coupon rates ranging from 3.00% to 5.00%. The proceeds from the sale of the 2012 Bonds are restricted to the construction of transmission system improvements, the acquisition and installation of automated metering, and refunding portions of outstanding bonds. No bonds were issued in the 2011 fiscal year.

A portion of the 2012 Bonds was allocated to repay outstanding principal of the City Electric System's 2001 Bonds and 2010 Bonds ($3,095,000 and $13,965,000, respectively). Gross and net savings realized in this refunding totaled $1,571,010 and $1,370,204, respectively. At the issuance date of the 2012 Bonds, the net carrying value of the refunded 2001 Bonds and 2010 Bonds exceeded the reacquisition price of the refunding portion of the new 2012 Bonds. The City Electric System recognized a gain on refunded debt in the liabilities section (current and noncurrent) in the Statement of Net Assets. The gain is amortized over 3.5 years, which is the weighted average life of the old refunded debt. At September 30, 2012, the unamortized gain on refunded debt was $575,441.

Changes to long term debt during 2012, 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	$3,575,000	$ -	$3,575,000	$ -	$ -
Series 2005	4.000 - 4.500	2025	10,375,000	-	565,000	9,810,000	585,000
Series 2006	4.000 - 5.000	2031	10,785,000	-	350,000	10,435,000	365,000
Series 2007	4.250 - 5.250	2032	29,255,000	-	840,000	28,415,000	880,000
Series 2008	4.000 - 5.250	2033	30,425,000	-	820,000	29,605,000	855,000
Series 2009	4.000 - 5.000	2034	23,695,000	-	630,000	23,065,000	655,000
Series 2010	3.000 - 5.000	2019	57,040,000	-	21,195,000	35,845,000	3,480,000
Series 2012	3.125 - 5.000	2037	-	65,675,000	240,000	65,435,000	3,755,000
Total			$165,150,000	$65,675,000	$28,215,000	$202,610,000	$10,575,000

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, 2012 and 2011.

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 2005, 2008, 2009, 2010, and 2012 Bonds are satisfied with restricted funds which are reported on the 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**
2013	$ 10,575,000	$ 9,346,938	$ 19,921,938
2014	10,555,000	8,956,538	19,511,538
2015	11,730,000	8,532,050	20,262,050
2016	12,165,000	7,968,200	20,133,200
2017	11,470,000	7,437,800	18,907,800
2018-2022	55,490,000	28,252,675	83,742,675
2023-2027	34,120,000	18,275,681	52,395,681
2028-2032	38,915,000	9,643,206	48,558,206
2033-2037	17,590,000	1,904,419	19,494,419
Total	$202,610,000	$100,317,507	$302,927,507

In the Statement of Revenues, Expenses and Changes in Net Assets for the fiscal years ended September 30, 2012 and 2011, interest expense in the amount of $8,046,301 and $7,440,176, 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 847 municipalities having their benefit plan administered by TMRS. Each of the 847 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 from 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 2011	**Plan Year 2012**
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
COLA Increase (to retirees)	70% of CPI Repeating	70% of CPI Repeating

In 2012, the City reduced future retiree annual Cost-of-Living Adjustments (COLAs) to 50% of the Consumer Price Index (CPI) effective January 1, 2013.

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)	$ 8,359,770
Interest on Net Pension Obligation	388,974
Adjustment to the ARC	(334,363)
Annual Pension Cost (APC)	8,414,381
Contributions Made	(7,403,380)
Increase (decrease) in net pension obligation	1,011,001
Net Pension Obligation, beginning of year	5,556,778
Net Pension Obligation, end of year	$ 6,567,779
Net Pension Obligation, end of year – City Electric System only	$ 1,748,460

The portion of the net pension obligation allocated to the City Electric System is determined by the ratio of the City Electric System contributions to TMRS as a percentage of City-wide contributions to TMRS. That ratio was 27% for the year ended September 30, 2012.

City historical data is as follows:

Fiscal Year	Annual Pension Cost (APC)	Annual Contribution	Percentage of APC Contributed	Net Pension Obligation at September 30
09/30/10	$ 8,718,507	$ 6,621,877	75.96%	$ 3,683,734
09/30/11	8,939,676	7,066,633	79.05%	5,556,778
09/30/12	8,414,382	7,403,380	87.98%	6,567,779

The required contribution rates for fiscal year 2012 were determined as part of the December 31, 2010 actuarial valuation. Additional information as of the latest actuarial valuation, December 31, 2011, also follows:

Valuation date	**12/31/2009**	**12/31/2010**	**12/31/2011**
Actuarial cost method	Projected Unit Credit	Projected Unit Credit	Projected Unit Credit
Amortization method	Level Percent of Payroll	Level Percent of Payroll	Level Percent of Payroll
GASB 25 Equivalent Single Amortization Period	28.2 years; closed period	27.2 years; closed period	26.2 years; closed period
Amortization Period for new Gains/Losses	30 years	30 years	30 years
Asset valuation method	10-year Smoothed Market	10-year Smoothed Market	10-year Smoothed Market
Actuarial assumptions:			
Investment rate of return	7.5%	7.0%	7.0%
Projected salary increases	Varies by age & service	Varies by age & service	Varies by age & service
Included inflation rate	3.0%	3.0%	3.0%
Cost-of-living adjustments	2.1%	2.1%	2.1%

Funding Status and Funding Progress

The funded status as of December 31, 2011, the most recent actuarial valuation date, and as of December 31, 2010, and December 31, 2009, 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)
12/31/2011	$181,556,932	$239,737,958	75.7%	$58,181,026	$44,508,267	130.7%
12/31/2010	$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%

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future.

Actuarial calculations are based on the benefits provided under the terms of the substantive plan in effect at the time of each valuation, and reflect a long-term perspective. Consistent with that perspective, actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets.

6. Other Post-Employment Benefits

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 26 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 (health benefits as required by the Federal Government under the Consolidated Omnibus Budget Reconciliation Act of 1985).

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 ("AD&D") 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, 2012, retirees paid $459,502 in premiums and $748,742 in claims were paid for post-retirement health care and administrative charges. As of September 30, 2012, the City has 80 retirees, 31 retirees and spouses, 35 retirees and families and 4 retirees and child(ren) participating in the health plan, out of the 346 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 $51,813 and incurred claims and administrative expenses of $163,155 in the year ended September 30, 2012. As of September 30, 2012 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.

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.

<u>Funding Policy and Annual OPEB Cost</u>

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, 2011 as required by GASB.

Annual OPEB costs for the fiscal year ending September 30, 2012, and prior two fiscal years ended are as follows:

	FY2012	**FY2011**	**FY2010**
Annual required contribution	$ 947,563	$ 733,190	$ 711,835
Interest on OPEB obligation	43,381	17,653	(6,093)
Adjustment to ARC	(40,192)	(9,977)	3,206
Annual OPEB cost (expense) end of year	950,752	740,866	708,948
Net estimated employer contributions	(289,840)	(169,126)	(181,259)
Increase in net OPEB obligation	$ 660,912	$ 571,740	$ 527,689
Net OPEB obligation (asset) – as of beginning of year	964,021	392,281	(135,408)
Net OPEB obligation (asset) – as of end of year	$1,624,933	$ 964,021	$ 392,281
Net OPEB obligation (asset) – as of end of year – City Electric System only	$ 294,812	$ 194,619	$ 77,170

The portion of the net OPEB asset allocated to the City Electric System is determined by the ratio of the City Electric System employees as a percentage of City-wide employees. That ratio was 18.1% for the year ended September 30, 2012.

The City's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation for fiscal year ending September 30, 2012 and the preceding two fiscal years were as follows:

Fiscal Year	Annual OPEB Cost	Employer Amount Contributed	Percentage Contributed	Net OPEB Obligation	City Electric System OPEB Obligation
2010	$ 708,948	$ 181,259	25.6%	$ 392,281	$ 77,170
2011	740,866	169,126	22.8%	964,021	194,619
2012	950,752	289,840	30.5%	1,624,933	294,812

Funding status and funding progress

The City had actuarial valuations performed as of December 31, 2011, December 31, 2009 and May 31, 2008. The funded status of the City's retiree health care plan, under GASB Statement No. 45, is as follows:

	FY2012	**FY2011**	**FY2010**
Actuarial value of plan assets	$ -	$ -	$ -
Actuarial accrued liability (AAL)	11,860,133	7,694,907	7,694,907
Unfunded AAL (UAAL)	(11,860,133)	(7,694,907)	(7,694,907)
Funded Ratio	0%	0%	0%
Covered Payroll	$44,294,557	$44,610,716	$45,844,873
UAAL as a % of Covered Payroll	27%	17%	17%

Under the reporting parameters, the City's retiree health care plan is 0% funded with an estimated actuarial accrued liability exceeding actuarial assets by $11,860,133 at September 30, 2012.

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 entry age normal method then provides for a systematic recognition of the cost of 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:	
Inflation rate	3.00% per annum
Investment rate of return	4.50%, net of expenses
Actuarial cost method	Projected unit credit cost method
Amortization method	Level as a percentage of employee payroll
Amortization period	30-year, open amortization
Payroll growth rate	3.00% per annum
Healthcare cost trend rate	Initial rate of 8.50% declining to an ultimate rate of 4.50% after 8 years

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

7. Risk Management

The City Electric System is covered for risk of losses related to general liability and workers' compensation through the City's risk management program. The City has established an "Insurance Fund" whereby the costs of providing claims servicing and claims payment are funded by charging a "premium" based upon a percentage of estimated current year payroll and management's estimate of projected current costs. For the years ended September 30, 2012 and 2011, the City Electric System paid the City $385,210 and $400,872, 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, the City Electric System 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, 2012, 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 2012. The correlation coefficient of (0.8387) 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 0.9513 indicates that the changes in cash flows of the hedge substantially offset the changes in cash flows of the hedgeable item. The City Electric System also utilizes HSC indexed gas commodity swaps to hedge its open exposure after a NYMEX-based swap contract month settles. The City Electric System entered into Platts 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, 2012 and 2011, the total fair value of outstanding hedging derivative instruments was a net liability of $22,348,549 and $16,330,773, 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 $5,318,725 and $7,452,683 at September 30, 2012 and 2011, 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 $17,029,824 and $8,878,090 at September 30, 2012 and 2011, 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, 2012, the fair value of the City Electric System's hedging derivative instruments - the option collars, NYMEX-based commodity swaps, and HSC-based commodity swaps - increased by $308,724, decreased by $7,020,321, and increased by $693,821, respectively. The City Electric System did not have HSC based commodity swap obligations at September 30, 2012. The $6,017,776 total decrease in fair value of the City Electric System's hedging derivative instruments during the fiscal year ended September 30, 2012, 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, 2012 and 2011, the current deferred outflows related to hedging derivatives were $5,318,725 and $7,452,683, respectively. These amounts are reported on the Statement of Net Assets as current assets. The noncurrent deferred outflows related to hedging derivatives were $17,029,824 and $8,878,090, at September 30, 2012 and 2011, respectively. These amounts are reported on the Statement of Net Assets as noncurrent assets.

The following information details the City Electric System's hedging derivative instruments as of September 30, 2012:

Type	Terms	Volume Hedged (MMBtu)	Effective Dates	Maturity Dates	Reference Index	Fair Value
3 Way Option Collars	$5.000 – 8.000 Strike Prices	500,000	Oct – Dec 2012	Oct – Dec 2012	NYMEX	$ (271,575)
Commodity Swaps	BTU pays prices of $5.485 – 7.570	13,431,500	Oct 2012 – Dec 2018	Oct 2012 – Dec 2018	NYMEX	(22,076,974)
		13,931,500				$(22,348,549)

The following information details the City Electric System'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 – 8.000 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)

Should purchased options be allowed to expire, premiums paid for such options will be expensed. 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 2012, prompt month prices were $2.634/MMBtu and $2.827/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. Employee Benefits

The City Electric System 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 $7,306,722 for the twelve month period which began January 1, 2012 and ends December 31, 2012. 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:

	FY2012	FY2011
Beginning balance - unpaid claims	$ 950,491	$ 1,011,803
Incurred claims	7,897,565	7,339,596
Claim payments	(7,833,672)	(7,400,908)
Ending balance – unpaid claims	$ 1,014,384	$ 950,491
Amounts due in one year	$ 1,014,384	$ 950,491

10. 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 recover 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, 2012, BTU's portion of outstanding TMPA bonds and commercial paper was approximately $138.8 million and $46.2 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. 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, 2012 and 2011 the City Electric System paid TMPA $24,841,070 and $30,051,020, respectively for power purchases and related activity under the contract. As of September 30, 2012 and 2011 the City Electric System had payables to TMPA amounting to $2,811,628 and $1,391,738, respectively.

As of September 30, 2012, TMPA was involved in a transportation rate dispute with one of its coal suppliers. Both parties were engaged in commercial negotiations that are expected to result in a resolution of all outstanding issues. The City Electric System accrued its portion of the projected liability resulting from this dispute; which was approximately $1.3 million, as of September 30, 2012.

The TMPA's Comprehensive Annual Financial Report for the year ended September 30, 2012 reported the following:

	FY2012
Total Assets	$ 1,157,572,000
Total Liabilities	1,105,714,000
Total Accumulated Excess Revenues	51,858,000
Change in Accumulated Excess Revenues for year ended September 30, 2012	$ 379,000

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

11. Related Party Transactions

BTU operates the Rural Electric System which provides electric service to the immediate rural area outside the City of Bryan, extending to most of Brazos County, adjacent to 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. Fuel rates are adjusted monthly to reflect actual cost. In 2012 and 2011, Rural purchased power totaled $25,311,824 and $24,526,558, respectively.

In addition to the $9,170,222 and $9,049,304 transferred to the City of Bryan for right of way in 2012 and 2011, respectively, City Electric System paid the City of Bryan $486,285 and $450,546 for administrative functions performed by city personnel in 2012 and 2011, respectively. These amounts are included in the other expenses in the accompanying financial statements.

The City of Bryan transferred to City Electric System $1,597,520 and $1,334,323 in 2012 and 2011, respectively, for billing services performed by the City Electric System for water, wastewater and solid waste services.

12. Commitments and Contingencies

BTU purchase and construction commitments approximate $252.0 million at September 30, 2012. 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 2013.

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 $252.0 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. (Credit Suisse) 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. This agreement was transferred by Credit Suisse to J.P. Morgan Ventures Energy Corporation in January 2012.

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.

13. Subsequent Events

On October 1, 2012, BTU implemented phase two of a two phase electric rate adjustment for the City Electric System which includes City of Bryan retail customers and the Rural Electric System wholesale rate. The phase two rates reflect a 13.0% increase in base rates which are almost entirely offset by a reduction in fuel rates. BTU had an over-recovered fuel balance of $11,024,462 at September 30, 2012. Overall, the new October 1, 2012 combined base and fuel rates reflect a 0.7% increase from phase one rates.